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U. S. SECURITIES AND
EXCHANGE COMMISSION
Washington, D. C. 20549

ADVISORY COMMITTEE ON TENDER OFFERS

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REPORT OF RECOMMENDATIONS

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADVISORY COMMITTEE ON TENDER OFFERS

REPORT OF RECOMMENDATIONS

July 8, 1983

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John S.R. Shad
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Shad:

We are enclosing the final report of the Commission's Advisory Committee on Tender Offers which was established on February 25, 1983. The eighteen members of this Advisory Committee met six times in full session. Countless meetings of six sub-committees were held to prepare recommendations to the full body. We had the benefit of extensive experience of our individual members in completing our assignment within our original time frame.

The summary report emphasizes that we concentrated our work and recommendations on shareholders' interests. We are cognizant, however, of interest in takeovers on broader governmental, societal, jurisdictional planes and have touched on these issues in our work. We specifically address some questions put to us through the Commission that express Congressional concerns.

Our recommendations are detailed, technical and comprehensive. We expect the Commission to put them in place by rule making or by recommending legislation, or regulation, as may be required, as they stand. They are designed to be an integral and cohesive body.

I would like to point out the fundamental bases upon which our recommendations rest. There are other technical solutions which are consistent with our fundamental policy objectives. Throughout the meetings of the Committee we encouraged diversity of opinion and dissent. One of our functions was to bring out a number of ideas which might otherwise have become buried in a carefully negotiated majority view. We hope the Commission will draw upon this diversity of views in reaching your ultimate decisions.

The Committee respects the free market forces in the operation of the U.S. securities markets. Academic evidence is widespread that the takeover process is at least not demonstrably harmful to shareholders and some evidence points to its systematic benefits. We would be reluctant to restrict a process which seems to work reasonably well with the possibility that we might incur some unintended harm. The Committee is humble in its ability to anticipate all of the takeover innovations that are likely to occur: good and bad. Our instincts led us to rely upon competitive markets as the ultimate regulator for the unforeseen specifics that may affect security holders. Our recommendations should promote private investment systems rather than hamper capital flows by heavy reliance upon rule making. We are attracted to solutions which are characterized by flexibility, simplicity and lower costs.

A theme running through our recommendations is to promote the disclosure of meaningful information to all investors. The tender offer process seems the best way available to us of insuring that terms, price and conditions are made available equally to all shareholders in a timely fashion. We suggest that purchases above 20% ownership be offered to all shareholders through the tender process.

We resist the temptation to bar substantial partial positions in companies. In most instances, we would expect that the acquisition of control would be accompanied by the purchase of all shares. There are circumstances in this country, as in international markets, where partial participation establishes business relationships which encourage cooperation and productive sharing of skills. We would not wish to alter these affiliations. We do, however, recommend that the partial positions receive somewhat less favored treatment than purchases which are contemplated to be for an entire company.

We are introducing an improvement in shareholder democracy in the form of advisory votes. We do believe that shareholders should have a mechanism to express their periodic will on charter provisions which may limit conditions under which their stock may be sold. Company directors, on the other hand, should not be bound to act against their business judgment in the shareholder interest. We do believe that the advisory vote concept will become a useful device in measuring shareholder sentiments.

We encourage procedures which will equate the offering of cash and securities. A number of purchases are accomplished initially for cash because Commission procedures are simplified for cash, and then are converted later into securities. Should cash and securities be administratively equated in the first instance, the latter potentially cumbersome and expensive step can be eliminated.

Throughout our discussions we have argued for simplicity in the procedures which may be required. This simplification may in some measure counteract the almost natural attraction to an elegance of rule making to guard against a number of perceived evils, especially those of recent anecdotal evidence.

Documentation by academic sources, business reports and the Commission staff were very helpful in our deliberations. We benefited from a review of takeover practices in other countries which included generous personal visits by United Kingdom and Canadian representatives.

The committee would have been unable to complete its work without the competence, diligence and hard work of the staff assigned to it. David Martin, Secretary to the Committee, did excellent work in keeping us administratively on track. Linda Quinn, Associate Director, diplomatically functioned in a continuing and important role.

Finally, we hope that the Commission and its staff will draw upon the Committee members for their advice and counsel in the future as you wish. Although we are disbanded with this report, our interest has not lessened and our willingness to serve remains keen.

Sincerely,

Dean LeBaron
Chairman
Securities and Exchange Commission
Advisory Committee on Tender Offers

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EXECUTIVE SUMMARY

Since the Williams Act was adopted in 1968, acquisition practices have undergone fundamental changes, many in response to significant developments in the environment - financial, technological, social and legal - in which such acquisitions have taken place. These changes have been highlighted in recent years as the introduction of the "billion dollar takeover bid", complex and creative bidding strategies, and equally inventive defensive responses, have made tender offers front page news.

In light of these developments and the fundamental issues they have raised, the Commission has undertaken a reexamination of the takeover process and a reevaluation of the laws that govern it. As the first step, the Chairman of the Commission established the Advisory Committee on February 25, 1983 to review the techniques for acquisition of control of public companies and the laws applicable to such transactions. The 18 individuals appointed to the Advisory Committee included prominent members of the business and financial community, academia and the legal and accounting professions, who have been actively involved in numerous tender offers as institutional investors, bidders, targets, arbitrageurs, investment and commercial bankers, attorneys, accountants and recognized authorities. The Committee's mandate was to consider the process in terms of the best interests of all shareholders, i.e. shareholders of all corporations, whether potential acquirors, target companies or bystanders, and to propose specific legislative and regulatory improvements for the benefit of all shareholders.

There follows a brief summary of the principal conclusions and recommendations of the Committee.

Economics of Takeovers and their Regulation

After considerable study, discussion and consideration of commentators' views, the Committee finds that there is insufficient basis for concluding that takeovers are either per se beneficial or detrimental to the economy or the securities markets in general, or to issuers or their shareholders, specifically. While in certain cases takeovers may have served as a discipline on inefficient management, in other cases there is little to suggest that the quality of management of the target company was at issue. Similarly, while the threat of takeover may cause certain managements to emphasize short term profits over long term growth, there is little evidence that this is generally true. Nor has the Committee found a basis for concluding that the method of acquisition is a major factor in determining whether an acquisition proves successful. As with other capital transactions, the fact that some takeovers prove beneficial while other prove disappointing is attributable less to the method of acquisition than it is to the business judgment reflected in combining the specific enterprises involved. Therefore, the Committee concluded that the regulatory scheme should be designed neither to promote nor to deter takeovers. Such transactions and related activities are a valid method of capital allocation, so long as they are conducted in accordance with the laws deemed necessary to protect the interests of shareholders and the integrity and efficiency of the capital markets.

As part of its study of the economic consequences of takeovers, the Committee specifically addressed the issue of the effect of the takeover process on the availability of credit and its allocation in the market. On the basis of its deliberations, including discussion with Federal Reserve Board Chairman Paul Volcker and members of his staff, the Committee believes that there is no material distortion in the credit markets resulting from acquisition of control transactions, and that no regulatory initiative should be undertaken to limit or to allocate the availability of credit in such transactions.

Objectives of Federal Regulation of Takeovers

The Committee recommends the following premises as the bases for the regulation of takeovers:

> Neutrality and Protection of Shareholders. Takeover regulation should not favor either the acquiror or the target company, but should aim to achieve a reasonable balance while at the same time protecting the interests of shareholders and the integrity and efficiency of the markets.
>
> National Market. Regulation of takeovers should recognize that such transactions take place in a national securities market.
>
> Elimination of the Present Bias Against Exchange Offers. Cash and securities tender offers should be placed on an equal regulatory footing so that bidders, the market and shareholders, and not regulation, decide between the two.
>
> Innovation. Regulation of takeovers should not unduly restrict innovations in techniques. These techniques should be able to evolve in relationship to changes in the market and the economy.
>
> Scope of Regulation. Even though regulation may restrict innovations in takeover techniques, it is desirable to have sufficient regulation to insure the integrity of the markets and to protect shareholders and market participants against fraud, non-disclosure of material information and the creation of situations in which a significant number of reasonably diligent small shareholders may be at a disadvantage to market professionals.

Restriction of Periodic Abuses. The evolution of the market and innovation in takeover techniques may from time to time produce abuses. The regulatory framework should be flexible enough to allow the Commission to deal with such abuses as soon as they appear.

Relationship to Other Legislative Objectives.

a. State Takeover Law. State regulation of takeovers should be confined to local companies.

b. State Corporation Law. Except to the extent necessary to eliminate abuses or interference with the intended functioning of federal takeover regulation, federal takeover regulation should not preempt or override state corporation law. Essentially the business judgment rule should continue to govern most such activity.

c. State Regulation of Public Interest Businesses. Federal takeover regulation should not preempt substantive state regulation of banks, utilities, insurance companies and similar businesses, where the change of control provisions of such state regulation are justified in relation to the overall objectives of the industry being regulated, do not conflict with the procedural provisions of federal takeover regulation and relate to a significant portion of the issuer's business.

d. Federal Regulation. Federal takeover regulation should not override the regulation of particular industries such as banks, broadcast licensees, railroads, ship operators, nuclear licensees, etc.

e. Relationship with Other Federal Laws. Federal takeover regulation should not be used to achieve antitrust, labor, tax, use of credit and similar objectives. Those objectives should be achieved by separate legislation or regulation.

Regulation of Acquirors of Corporate Control

The Committee identified four major concerns with respect to the current regulation of acquirors of corporate control: (1) the substantial disincentives to undertake an exchange offer; (2) the use of open market accumulation programs and other methods to acquire control of issuers that deny all shareholders the opportunity to share in the premium paid for control of an issuer; (3) the potentially coercive effects on shareholders of a partial or two-tier offer; and (4) the need to provide equal opportunity to participate in an offer.

1. Exchange Offers. Because of the need to register securities to be offered in exchange for those of another company and the delay inherent in preparing the registration statement and having it processed by the Commission, the Committee found that the regulations applicable to exchange offers under the Securities Act of 1933 are a major disincentive to using securities as consideration in a tender offer. The Committee believes that such regulatory disincentives can be remedied without affecting investor protection and that the deterrence of exchange offers is not in the best interests of shareholders. If such regulatory disincentives were minimized, the Committee expects there would be greater use of securities in single step transactions. Therefore, the Committee recommends that the concept of integration of disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934, previously effected by the Commission in securities offerings for cash, be extended to exchange offers. The Committee also recommends that exchange offers be permitted to commence upon the filing of the registration statement relating to the exchange offer, rather than upon effectiveness of such registration statement.

2. Limitations on Acquisition of Securities.

a. Schedule 13D. The Committee found that the current rules under section 13(d) of the Exchange Act, which require reporting of the acquisition of more than 5% of certain classes of an issuer's securities, have failed to give adequate notice to shareholders and the market of potential acquisitions of control. Currently, the acquiror may continue to purchase securities after passing the reporting threshold and prior to the date the report is required to be filed, i.e. the tenth day after reaching the threshold. This ten-day window presents substantial opportunity for abuse as the acquiror "dashes" to buy as many shares as it can before disclosure of its investment and its intentions. The Committee therefore recommends that the ten-day window be closed by prohibiting any acquisition that would result in a person's having beneficial ownership of more than 5% of the specified classes of securities prior to the expiration of 48 hours from filing of a Schedule 13D with the Commission.

b. Shareholders' Access to Control Premium. Concluding that "control" is essentially a corporate asset and that shareholders should have equal opportunity to share in any premium paid for such asset, the Committee recommends that the law prohibit any acquisition of voting securities of an issuer, if immediately following such acquisition, such person would own more than 20% of the voting power of the issuer. Excepted from such prohibition would be acquisitions made (1) from the issuer, or (2) pursuant to a tender offer. To deal with situations not within the purpose of this provision, the Committee recommends that the Commission retain broad exemptive power with respect to this prohibition.

3. Partial Offers and Two-Tier Bids. The Committee is concerned with the potentially coercive nature of partial and two-tier bids. However, given that partial offers can serve valid business purposes and that two-tier bids generally have proved more favorable to shareholders than partial offers with no second step, the Committee is not prepared to recommend that such bids be prohibited. The Committee recommends instead, as a

regulatory disincentive for partial and two-tier offers, the adoption of a minimum offering period for the partial bid that is approximately two weeks longer than that required for a full bid.

4. Equal Opportunity. A fundamental premise of the Committee's recommendations is that all target company shareholders should have an equal opportunity to participate in a tender offer. Essential to providing such opportunity is a minimum offering period sufficient to permit a reasonably diligent shareholder (individual or institution) to receive the offering materials and to make an informed investment decision. The Committee concluded that the appropriate period for an initial bid for a particular target is 30 calendar days. Given the "alerting" of the market and target shareholders by the initial bid, the Committee believes that the minimum offering period for subsequent competing bids need only be 20 calendar days, except that generally a subsequent competing bid would not be permitted to expire prior to the initial bid. As noted above, in either case, if the bid is a partial offer, the minimum offering period will be increased by approximately two weeks. The Committee also recommends that the minimum offering period and prorationing period remain open for five calendar days from the announcement of an increase in price or number of shares sought.

A major change in the timing provisions applicable to tender offers recommended by the Committee is the elimination of the extension of withdrawal rights upon the commencement of another bid. The Committee believes that the ability of another bidder to effect changes in the terms of an existing bidder's offer results in confusion and "game playing", presents opportunities for abuse and tips the balance in favor of the second bidder.

Regulation of Opposition to Acquisitions of Control

While the activities of bidders are largely regulated by federal law, the response of the target company generally has been governed by state law, statutory and common. A principal issue identified by the Committee is the extent to which federal regulation should intrude into this area. Resolution of this issue requires a balancing of two basic objectives defined by the Committee: first, recognition that tender offers take place in a national securities market, and second, minimal preemption of state corporate law.

1. Antitakeover Provisions. While the Committee supports a system of state corporation laws, the Committee concluded that provisions generally restricting the transfer of control of an issuer, whether contained in state statutes or in an issuer's charter or by-laws, improperly interfere with the conduct of takeovers in a national market place and generally should be prohibited. Until such provisions are prohibited, the Committee recommends that certain supermajority provisions be required to be adopted and periodically ratified by an equivalent supermajority vote. Other change of control related policies would be treated as advisory vote matters as discussed in the following section. The Committee recognizes that such federal preemption may not be necessary or appropriate in certain cases such as transactions

involving local companies or companies with a long history of public regulation where change of control is regulated separately by state or federal law.

2. Advisory Votes. In the Committee's judgment, certain other actions taken by management with respect to takeovers, while not appearing to interfere substantially with the national markets, call for additional disclosure to shareholders and the opportunity for them to express their opinion on the desirability of such actions. The Committee recommends that change of control related policies and compensation be required to be disclosed annually in an issuer's proxy statement and submitted to an advisory vote of shareholders. Items to be included for such disclosure and advisory votes are provisions (other than cumulative voting) that abandon the one-share, one-vote rule based on the concentration of ownership in a class, long-term standstill agreements, change of control related compensation provisions, and, if not prohibited or otherwise restricted, supermajority provisions.

3. Prohibition of Change of Control Compensation after Tender Offer Commenced. In addition to requiring annual disclosure of, and an annual advisory vote on, change of control compensation, the Committee recommends that no such arrangements be permitted to be adopted once a takeover has commenced.

4. Shareholder Approval of Share Issuances and Block Repurchases. The Committee also recommends that shareholder approval be required for the issuance of shares during a tender offer that represent more than 15% of the fully diluted shares to be outstanding after issuance. It believes shareholder approval also should be required before an issuer's repurchase at a premium of a block of shares held for less than two years.

5. <u>Business Judgment</u>. With respect to various transactions undertaken by management in the context of a tender offer, such as a self-tender, a counter tender offer, the sale of assets or stock to a preferred acquiror or the sale of significant assets to a third party, the Committee concluded that there are legitimate business purposes for undertaking such transactions and that such actions can benefit shareholders. Where such transactions would constitute a breach of the directors' fiduciary duties to their shareholders, state corporate law should and does prohibit such transactions.

<u>Regulation of Market Participants</u>

The recommendations of the Committee regarding the activities of market participants are directed principally to strengthening Rule 10b-4's prohibition of short tendering and to including specifically within its prohibitions hedged tendering and multiple tendering. Such practices, in the Committee's judgment, give market professionals such an advantage in the takeover process as to jeopardize public confidence in the fairness and integrity of the capital markets.

Based on similar concerns and the potential for over-tenders, the Committee also recommends that the Commission revise its interpretation of Rule 10b-4 so that, for purposes of determining whether a person has a "net long position" in a security subject to the tender offer, call options on such security that a person has sold and should know are highly likely to be exercised prior to expiration of the offer shall be deemed to constitute sales of the security underlying such options and therefore netted against such person's position in that security.

Finally, the Committee endorses the Commission's proposal to require bidders' tender agents to establish during tender offers an account with qualified registered securities depositories to permit financial institutions participating in such depository systems to use the services of the depository to tender shares if desired.

INTRODUCTION

A. Establishment of the Committee

Chairman John S.R. Shad, with the concurrence of the other members of the Securities and Exchange Commission ("Commission"), established the Securities and Exchange Commission Advisory Committee on Tender Offers ("Advisory Committee" or "Committee") on February 25, 1983 to examine the tender offer process and other techniques for acquiring control of public issuers and to recommend to the Commission legislative and/or regulatory changes the Committee considered necessary or appropriate. 1/

In establishing the Committee, Chairman Shad noted that since the Williams Act was adopted in 1968, 2/ acquisition practice has undergone fundamental changes, many in response to significant changes in the environment - financial, technological, social and legal - in which such acquisitions have taken place. This has been particularly evident, he pointed out, in the past five years during which there have been a record number of tender offers commenced and the initiation of the "billion

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1/ *See* Release No. 34-19528 (February 25, 1983) (48 FR 9111) (Appendix A). The Committee was established in accordance with the provisions of the Federal Advisory Committee Act, as amended, 5 U.S.C. App. 1 (1976 & Supp. V 1981).

2/ 15 U.S.C. §§ 78m(d), 78m(e), 78n(d)-(f). Until 1968 tender offers were essentially unregulated. The Williams Act amended the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. §§ 78a-78kk (1976 & Supp. V 1981), *as amended by* Act of June 6, 1983, Pub. L. No. 98-38) to provide for federal regulation of tender offers.

dollar takeover bid." These activities have raised a number of issues as to the regulation of takeovers and have renewed public concern with respect to such issues. The questions include (1) whether there should be neutrality in the regulation between bidder and target company as currently mandated by the Williams Act, and if so, whether such neutrality exists today, (2) whether there should be limitations on the defensive responses of management of the target company, and (3) whether there should be a requirement of fundamental fairness and/or equality applicable to a bidder's offer. In view of the substantial evolution in tender offer practices and the issues raised, the Commission believed it was appropriate to undertake a major reexamination of the tender offer process and a reassessment of the appropriate regulation of such activity.

The Commission's decision to establish an advisory committee to study tender offers and other acquisition of control transactions was commended by various members of the Senate Committee on Banking, Housing and Urban Affairs ("Senate Banking Committee"). By letter dated February 1, 1983, to Chairman Shad, 12 members of the Senate Banking Commitee expressed interest in the work of the Advisory Committee and requested that the Committee's final report be forwarded by July 31, 1983. The Senate letter, which is attached to the Committee's Agenda of Issues at Appendix B, set forth a number of questions for consideration by the Committee.

B. The Work Of The Advisory Committee

1. March 18 Meeting

At its first meeting on March 18, 1983, the Committee debated and reached agreement on the appropriate scope of its review. The general consensus was that a narrow focus on the tender offer alone would not be sufficient. On the other hand, with less than four months in which to produce a final report, the Committee resisted the temptation to appraise in detail all methods for and regulation of acquisition of control. By way of defining the activities to be reviewed, the Committee stated as follows:

> The Committee has determined that, given the interrelationship of various techniques to acquire control and the consequences of regulating one method of acquisition without taking into account the effect of such regulation on the relative advantages and disadvantages of other acquisition methods, it is necessary to consider the whole spectrum of acquisition techniques. The Committee recognizes, however, that given the anticipated date of its report to the Commission, it may not address in detail the full range of regulations, state and federal, applicable to proxy solicitations and mergers, but rather may focus on those issues that are common to such transactions and acquisitions of control through purchases of equity from investors. 3/

Having defined the parameters for its work, the Committee then identified specific points of stress in the regulatory framework. These are set forth in the Agenda of Issues that the Committee adopted at its

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3/ See Section I of the Advisory Committee's Agenda of Issues, attached as Appendix B.

first meeting and are divided into six basic categories: economics of takeovers and their regulation; basic objectives of the federal securities laws applicable to takeovers; regulation of acquisition of corporate control; regulation of opposition to acquisition of corporate control; regulation of market participants; and interrelationships with other regulatory schemes. The Committee also agreed to review and to respond to those questions posed in the Senate Banking Committee letter of February 1 and thus incorporated that letter into its Agenda of Issues. See Appendix B.

In order to facilitate the necessary review of these issues, the Committee formed six working groups or sub-committees. It was the purpose of these working groups to report back to the full Committee at subsequent meetings with an analysis of the issues and proposals for their resolution.

Finally, at the March 18 meeting the Committee underscored its interest in receiving views from all members of the public and solicited comment on the issues it would consider. 4/ As a result of this solicitation, the Committee received letters from 44 commentators, including 14 current articles and papers, that gave critical treatment to many of the issues that the Committee considered. 5/

4/ See Release No. 34-19635 (March 30, 1983) (48 FR 13537) attached as Appendix C; SEC News Release 83-10 (March 22, 1983) attached as Appendix D.

5/ A list of commentators is attached as Appendix E.

2. April 15 and May 13 Meetings

The Committee held its second and third meetings on April 15 and May 13 in New York City. At these meetings each of the working groups reported and took back to their efforts the reactions and thinking of the full Committee. In preparation for these meetings, the working groups not only exchanged papers and research but also met with representatives of various government agencies, including the Treasury Department, the Federal Trade Commission, and the Federal Reserve, to explore a number of issues.

At its meeting on May 13, the Committee discussed at length the tender offer experience and regulatory response in Great Britain. John M. Hignett and Peter Lee, Director-General and Deputy Director-General of the London Panel on Take-overs and Mergers, who previously had provided the Committee a Note on the British system, were in attendance and participated in the Committee's discussions.

3. June 2 Meeting

On June 2, the Committee held a meeting in New York City for the purpose of receiving presentations from certain commentators and other interested parties. Thirty-two people participated in the day long session. The agenda for this meeting, including a list of the participants, is attached as Appendix F.

4. June 10 Meeting

The Committee held its fifth and next to last meeting on June 10 at the Commission's main offices in Washington, D.C. At this meeting the Committee considered and reached final agreement on approximately 50 recommendations to be included in its final report.

5. July 8 Meeting

The Committee presented this report to the Commission at its last meeting on July 8 in Washington, D.C. The report follows the format of the Committee's Agenda of Issues and intersperses its discussion of those issues with specific recommendations.

CHAPTER I

ECONOMICS OF TAKEOVERS AND THEIR REGULATION

A. Economic Consequences

There is a broad range of opinion among Committee members as to the economic consequences of takeovers. Some members believe that takeovers create real value for both bidders' and target companies' shareholders and should be encouraged. The economic benefit identified is measured in terms of increases in the market value of the shares of tender offer participants at the time of such transactions. 6/ In addition to encouraging takeover transactions through deregulation, these members would reduce the costs of such transactions by limiting the defensive measures of target companies. 7/ Such members are concerned that as the costs of acquisition increase, all corporations that are potential targets trade for less in the market because their values as future acquisitions are less.

At the opposite end of the spectrum of views on the economic consequences of takeovers are those that believe that hostile takeovers, particularly partial acquisitions, are socially and economically

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6/ Certain studies indicate that in the 60 to 120 days during which a takeover transaction is considered the target company's shares rise an average of 30% while the bidder's shares increase an average of 3-4%. The Committee understands that there is not available substantial data measuring the impact of the takeover process on market prices over a longer period of time, nor is it aware of substantial study of the economic consequences of acquisitions on the financial condition or results of operations of the combined enterprises.

7/ These members distinguish between defensive charter or by-law provisions and actions taken in response to a specific bid. They would limit the latter, but not necessarily the former, as the market would already have valued the target company's shares in the former case.

detrimental. Certain Committee members are concerned that the mere threat of a hostile takeover draws the attention of management away from long range planning and good business judgment. Further, these members believe that there are unseen social and economic implications to hostile takeovers.

A substantial majority of the Committee, however, is of the view that the economic data is problematic. They are unable to agree that substantial economic benefits or detriments of takeover activities have been conclusively established. Some question whether short term market price increases are the appropriate basis for concluding that takeovers provide economic benefits of such substance as to justify regulation adopted to promote such transactions. These members suggest that the principal basis for determining the macro-economic issue of whether takeovers are beneficial involves a long term evaluation of the economic soundness of the acquisition, as measured by the operations, conditions and productivity of the combined enterprises. 8/ Others take issue with the general harm perceived by those opposed to hostile offers; these members question the proposition that the method of acquisition affects its merits.

The Committee found that while in certain cases takeovers have served as a discipline on inefficient management, in other cases there is little to suggest that inefficiency of target company management

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8/ In addition to those taking issue with the basic premise that a short term increase in market price demonstrates economic benefits, others have challenged the analysis of the available data or methodology of research. Some suggest that the data have been overstated. Others argue that there likewise have been increases in market price for shares of target companies that have successfully defended against hostile bids.

is a factor. Similarly, while the threat of takeover may cause certain managements to emphasize short-term results at the expense of long-term growth, the Committee found little evidence that this is generally true. As with other capital transactions, the Committee believes the fact that some takeovers prove beneficial while others prove disappointing is less attributable to the method of acquisition and more to the business judgment reflected in combining the specific enterprises involved.

On the strength of the evidence presented, the Committee does not believe that there is sufficient basis for determining that takeovers are per se either beneficial or detrimental to the economy or the securities markets in general, or to issuers or their shareholders, specifically.

The Committee therefore recommends the following:

<u>Recommendation 1</u>

> The purpose of the regulatory scheme should be neither to promote nor to deter takeovers; such transactions and related activities are a valid method of capital allocation, so long as they are conducted in accordance with the laws deemed necessary to protect the interests of shareholders and the integrity and efficiency of the capital markets.

B. <u>Factors Affecting Takeover Activity</u>

The Committee has not reached any conclusions concerning the relative effect of the following factors on the number and size of control transactions:

1. credit availability and policies;
2. tax policies;
3. antitrust policies;
4. market conditions;
5. general economic conditions;
6. laws applicable to changes in control of regulated industries;
7. accounting requirements;
8. state takeover laws;
9. federal securities laws;
10. state corporate laws; and
11. antitakeover and fair price provisions.

The sense of the Committee, however, is that the first five of the listed factors are those that over time are the principal determinants of the level of acquisition activity and the structure of the acquisition transaction. As to the other factors, the Committee has observations on two: federal securities laws and antitakeover and fair price provisions.

The historical impact of federal securities law regulation warrants note perhaps less for its impact on the number or size of transactions and more for its effect on the structure of the control acquisition. 9/ As exchange offers generally have had to be registered under the Securities Act of 1933 (the "Securities Act") 10/ and thus

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9/ Note should be made that certain members of the Committee have expressed the view that regulation of tender offers is a major factor in determining the number of tender offers. They believe that since the adoption of the Williams Act, the number of tender offers that would have commenced would be significantly higher but for the regulation.

Fiscal Year	Number of Tender Offers *	Fiscal Year	Number of Tender Offers *
1965	105 **	1974	105
1966	77 **	1975	113
1967	113 ***	1976	100
1968	115 ***	1977	162 ****
1969	70	1978	179
1970	34	1979	147
1971	43	1980	104
1972	50	1981	205
1973	75	1982	117

* Data for fiscal year 1969 and following have been obtained from the Commission and represent tender offers commenced.

** These figures were obtained from a study on "Tactics of Cash Takeovers Bids" prepared by Professors Samuel L. Hayes, III and Russell A. Taussig, 45 Harv. Bus. Rev. 135 (1967), which was submitted in 1967 to the Senate and House committees holding hearings on the bill that became the Williams Act. The figures are based on a calendar rather than fiscal year. See Hearings on H.R. 14475, S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 90th Cong., 2d Sess. 21 (1968).

*** These figures were obtained from W.T. Grimm & Co. They are based on a calendar year and represent tender offers commenced. Grimm has indicated that it obtained this information from newsstories in the financial press and that the figures include tender offers for companies not subject to section 12 under the Exchange Act, but do not include tender offers for securities other than common stock.

**** In 1977, the federal government changed its fiscal year. Accordingly, this figure is based on an extended fiscal year from July 1, 1976 to September 30, 1977.

10/ 15 U.S.C. §§ 77a-77aa (1976 & Supp. V 1981), as amended by Bus Regulatory Reform Act of 1982, Pub. L. No. 97-261, § 19(d), 96 Stat. 1121 (1982).

required the usual processing and effectiveness of the registration statement prior to commencement of the tender offer, the attractiveness of exchange offers as compared to cash offers has suffered. 11/ The Committee has recommended that regulatory disincentives to the use of exchange offers be removed to the extent consistent with the Securities Act. 12/ On the other hand, open market accumulation programs are virtually unregulated and therefore have gained favor over other more regulated methods of acquiring control. The Committee has recommended certain regulation of open market accumulation programs, which regulation incidentally may lessen the regulatory incentives to resort to this mechanism for acquisition of control. 13/ It also appears that the limited proration rights permitted by the federal securities laws before the Commission's adoption of Rule 14d-8 under the Exchange Act may have been a primary factor in the development of the "front-end loaded" or "two-tier" bid. 14/

The reemergence of supermajority, fair price and other antitakeover provisions in the past year may have significant affect on the number and kinds of transactions undertaken in the future. The Committee believes, therefore, that such provisions may become an increasingly significant factor.

11/ An exchange offer is a tender offer where the bidder offers its securities to target company shareholders in lieu of or in addition to cash.

12/ See Recommendations 11-12.

13/ See Recommendations 13-14.

14/ A "front-end loaded" or "two-tier" bid as used in this report refers to an acquisition where the per share consideration is higher for a portion of the shares to be acquired; it does not include a tender offer that provides for multiple forms of consideration to be paid pro rata to those electing the particular form of consideration.

C. Auctions

The Committee also has considered the effects of an auction market for control. While no conclusive evidence was presented as to the actual effect of the potential for an auction on the number or size of takeovers, the Committee recognizes that an auction of the target company increases a bidder's acquisition costs, and thus may deter initial bids. This deterrent effect is an intangible that the Committee finds has not been measured satisfactorily. The sense of the Committee is that if the regulatory system were revised to eliminate perceived incentives for second bidders not necessary for the protection of shareholders, it would be unnecessary to pursue further the measurement of the intangible effects of the potential for an auction. Further, there is substantial sentiment on the Committee that an auction market is an element of the free market. While the Committee, on balance, is not prepared to recommend the opportunity for an auction market as a basic objective of the regulatory scheme, it believes that a system providing for a minimum offering period will have as an acceptable by-product the auction potential.

D. Credit Availability

Finally, both the Committee and the Senate Banking Committee identified as a major issue the effect of the takeover process on the availability of credit and its allocation in the economy. On the basis of its experience and study, including a meeting with Federal Reserve Board Chairman Paul Volcker and members of his staff, the

Committee has concluded that transactions involving acquisitions of control do not result in a material distortion in the credit markets, do not divert investment from new plants, do not limit consumers' ability to obtain credit and do not otherwise deplete available credit. Acquisition financing generally can be expected to have little lasting impact on the cost and availability of credit to other potential borrowers. Takeover transactions fundamentally involve a transfer of assets, not the absorption of new savings, and because the sellers of stock to an acquiring firm reinvest the proceeds, the capital is made available to others.

Recommendation 2

> There is no material distortion in the credit markets resulting from control acquisition transactions, and no regulatory initiative should be undertaken to limit the availability of credit in such transactions, or to allocate credit among such transactions.

CHAPTER II

OBJECTIVES OF FEDERAL REGULATION OF TAKEOVERS

In arriving at a consensus on the appropriate objectives for the federal regulation of takeovers, the Committee looked first to the legislative purpose of the current scheme. The Williams Act was designed principally to protect investors by ensuring full disclosure. However, Congress took

> extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The bill [was] designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case. 15/

The Committee concurs with the Congressional goal of neutrality between acquirors and target companies.

Recommendation 3

> Takeover regulation should not favor either the acquiror or the target company, but should aim to achieve a reasonable balance while at the same time protecting the interests of shareholders and the integrity and efficiency of the markets.

Secondly, the Committee believes that the regulatory scheme should be sensitive to the environment in which it operates, in this case the national securities market.

Recommendation 4

> Regulation of takeovers should recognize that such transactions take place in a national securities market.

15/ S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967).

The Committee found that there are significant regulatory impediments to undertaking an exchange offer rather than a cash tender offer, which impediments are not necessary for the protection of shareholders. 16/ The Committee believes that regulation should not be a principal factor in determining the method of acquisition.

Recommendation 5

> Cash and securities tender offers should be placed on an equal regulatory footing so that bidders, the market and shareholders, and not regulation, decide between the two.

The Committee considered at some length various techniques to acquire or to oppose the acquisition of corporate control. Some, as they have evolved, have caused concern as to whether the existing regulatory scheme was equipped to evaluate or moderate such techniques. Others, because they are complex, have been misunderstood or misrepresented. On balance, the Committee believes regulation should be tempered to allow the proper development of new techniques, measured to restrict known or perceived excesses, and flexible to react promptly to new abuses. The Committee incorporated these goals in a series of three objectives.

Recommendation 6

> Regulation of takeovers should not unduly restrict innovations in takeover techniques. These techniques should be able to evolve in relationship to changes in the market and the economy.

16/ The securities offered in an exchange offer are subject to the registration provisions of the Securities Act.

Recommendation 7

Even though regulation may restrict innovations in takeover techniques, it is desirable to have sufficient regulation to insure the integrity of the markets and to protect shareholders and market participants against fraud, non-disclosure of material information and the creation of situations in which a significant number of reasonably diligent small shareholders may be at a disadvantage to market professionals.

Recommendation 8

The evolution of the market and innovation in takeover techniques may from time to time produce abuses. The regulatory framework should be flexible enough to allow the Commission to deal with such abuses as soon as they appear.

The Committee reviewed the relationships between federal takeover regulation and other federal and state laws. These relationships have often been the source of litigation and confusion. The friction between the various systems has been both substantive and procedural. The Committee believes that it is important in structuring federal takeover regulation to articulate the appropriate balance between the overlapping regulatory structures.

Recommendation 9

a. State Takeover Law. State regulation of takeovers should be confined to local companies. 17/

17/ The Committee considered various formulations for a definition of a "local" company. One definition included companies with more than 50% of the voting shares held within the state of incorporation, no listing on a national securities exchange, aggregate market value of voting stock held by non-affiliated stockholders of $20 million or less, and annual trading volume of such stock less than one million shares. Although the Committee ultimately elected to leave the definitional task to the Commission, it suggests that in developing the concept the Commission focus on the factors referred to in this footnote.

b. State Corporation Law. Except to the extent necessary to eliminate abuses or interference with the intended functioning of federal takeover regulation, federal takeover regulation should not preempt or override state corporation law. Essentially the business judgment rule should continue to govern most such activity.

c. State Regulation of Public Interest Businesses. Federal takeover regulation should not preempt substantive state regulation of banks, utilities, insurance companies and similar businesses, where the change of control provisions of such state regulation are justified in relation to the overall objectives of the industry being regulated, do not conflict with the procedural provisions of federal takeover regulation and relate to a significant portion of the issuer's business.

d. Federal Regulation. Federal takeover regulation should not override the regulation of particular industries such as banks, broadcast licensees, railroads, ship operators, nuclear licensees, etc.

e. Relationships with Other Federal Laws. Federal takeover regulation should not be used to achieve antitrust, labor, tax, use of credit and similar objectives. Those objectives should be achieved by separate legislation or regulation.

CHAPTER III

REGULATION OF ACQUIRORS OF CORPORATE CONTROL

The Committee found that the various techniques to acquire control are so intertwined that to regulate one method of acquisition without taking into account the effect of such regulation on other methods of acquisition of control is likely to prove at best ineffective, and at worst harmful to investors and distortive of the capital markets. While the Committee has not undertaken to address in detail all the different regulatory provisions (both state and federal) applicable to the various means of acquiring control of a public company, it focused on those issues common to the entire spectrum of control acquisitions and measured the effect of each of its recommendations on the entire spectrum of control acquisition methods.

<u>Recommendation 10</u>

> Any regulation of one or more change of control transactions by either the Congress or the Commission should address the effects of such regulation in the context of all control acquisition techniques.

The Committee identified four major concerns regarding the regulation of bidders: 1) the substantial disincentives, both regulatory and otherwise, to undertake an exchange offer; 2) the use of open market accumulation programs and other methods to acquire control of issuers that deny all shareholders the opportunity to share in the control premium; 3) the potentially coercive effects on shareholders of partial or two-tier offers; 18/ and 4) the need to provide equal opportunity to participate in an offer. In addition, a number of recommendations are included to remedy certain technical aspects of the current federal regulations.

A. Equivalency of Cash and Exchange Offers

Because of the need to register securities to be offered in exchange for those of another company and the delay inherent in the preparation and processing of the registration statement, the Committee found that the regulations applicable to exchange offers under the Securities Act are a major disincentive to using securities as consideration in a tender offer. Exchange offer registration statements are complex and long, frequently over 50 pages, and can take a substantial effort to prepare and process. Moreover, under current Commission rules, the exchange offer may not commence until the Commission has declared the registration statement effective. The Committee believes that such regulatory disincentives are not needed for investor protection and that the deterrence of exchange offers is not in the best interests of shareholders. If the regulatory disincentives to undertaking an exchange offer are reduced and exchange offers are able to compete effectively with cash offers, the Committee expects there will be greater use of securities in single

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18/ *See* note 14.

step transactions. The following recommendations are intended to place exchange offers on the same expedited timetable as cash offers.

Recommendation 11

The concept of integration of disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934, previously effected by the Commission in securities offerings for cash, should be extended to exchange offers.

Recommendation 12

Bidders should be permitted to commence their bids upon filing of a registration statement and receive tenders prior to the effective date of the registration statement. Prior to effectiveness, all tendered shares would be withdrawable. Effectiveness of the registration statement would be a condition to the exchange offer. If the final prospectus were materially different from the preliminary prospectus, the bidder would be required to maintain, by extension, a 10-day period between mailing of the amended prospectus and expiration, withdrawal and proration dates. This period would assure adequate dissemination of information to shareholders and the opportunity to react prior to incurring any irrevocable duties.

B. Notice to the Market of Potential Acquirors and Access to Control Premium

1. Reporting under Section 13(d) of the Exchange Act

The Committee found that the requirements to report the acquisition of more than 5% of an outstanding class of an issuer's equity securities 19/ adopted under section 13(d) of the Exchange Act have failed to give

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19/ Section 13(d) is applicable to any equity security of a class that is registered under section 12 of the Exchange Act or that is exempt from registration by virtue of section 12(g)(2)(G) pertaining to insurance companies or that is issued by a closed-end investment company registered under the Investment Company Act of 1940.

adequate notice to shareholders and the market at large of potential changes in control of an issuer. The 10-day window between the acquisition of more than a 5% interest and the required filing of a Schedule 13D was found to present a substantial opportunity for abuse, as the acquiror "dashes" to buy as many shares as possible between the time it crosses the 5% threshold and the required filing date. To provide adequate notice of the shareholder's investment and intentions regarding the issuer and time for the market to assimilate such information, the Committee recommends that the ten-day window be closed.

Recommendation 13

> No person may acquire directly or indirectly beneficial ownership of more than 5% of an outstanding class of equity securities unless such person has filed a Schedule 13D and that schedule has been on file with the Commission for at least 48 hours. Such person may rely on the latest Exchange Act report filed by the target company that reports the number of shares outstanding. The acquiror would have to report subsequent purchases promptly as provided by current law.

The general sense of the Committee is that the disclosure currently required in the Schedule 13D is material to shareholders, and it has not recommended any revision to such requirements.

2. Purchases of Control

The issue presented by open market accumulation programs and other limited purchases of control is one that engendered extended debate among Committee members, as well as among the commentators who submitted letters to the Committee or participated at its June 2 meeting. Those favoring some limitation on these methods of acquisition argued that "control" is essentially a corporate asset and that shareholders should have equal opportunity to share in any premium paid for such asset. To assure such opportunity, they contended that the target company shareholders should be provided the protections of the tender offer process. Among those supporting this view, there is, however, strong disagreement as to the threshold level at which effective control could pass. While a number of Committee members proposed a 15% level and others argued for 10%, the majority of the Committee found 20% to be the appropriate threshold.

The countervailing argument urged by other members of the Committee and several commentators is that a requirement for an acquiror to proceed by way of tender offer at the 15% or 20% level, because of time, risk and costs, would substantially deter toe-hold acquisitions. In so doing, such a requirement would limit dissident shareholders' ability to take issue with incumbent management and would reduce the number of acquisitions undertaken. After substantial debate and consideration, the Committee adopted the following recommendation.

Recommendation 14

> No person may acquire voting securities of an issuer, if, immediately following such acquisition, such person would own more than 20% of the voting power of the outstanding voting securities of that issuer unless such purchase were made (i) from the issuer, or (ii) pursuant to a tender offer. The Commission should retain broad exemptive power with respect to this provision.

3. Definition of "Group"

In connection with the required Schedule 13D report and the accumulation program limitation, the Committee expressed concern that the concept of a "group" has been diluted. It suggests that the Commission strengthen its interpretations and enforcement of the "group" concept.

Recommendation 15

The Committee encourages the Commission to study means to strengthen the concept and definition of "group" or concerted activity.

B. Partial Offers and Two-Tier Bids

Current regulations under the Williams Act make little distinction between full offers and partial offers. The relatively recent phenomenon of the two-tier or front-end loaded bid likewise has not been subject to different regulation. 20/ The Committee considered at length whether partial offers and/or two-tier bids should be distinguished under the regulations from offers to purchase all shares, and, if so, whether the partial offer and/or the two-tier bid should be prohibited or simply disadvantaged under the regulations.

There is substantial sentiment on the Committee that, so long as there is equal opportunity for all shareholders to participate in all phases of each bid, the laws should not distinguish among various types of bids. Those favoring no change in the current system argue that the preservation of partial tender offers is important to the working of the economy and that there are many valuable roles for partial offers and partial ownership, including:

(1) allowing companies to invest in one or more industries with more limited financial exposure than if the ownership were 100%;

20/ Radol v. Thomas, 534 F Supp. 1302 (S.D. Ohio 1982) (holding that the two-tier pricing of the U.S. Steel acquisition of Marathon Oil was not fraudulent or manipulative under the Williams Act or the general anti-fraud provisions of the Exchange Act). See also Martin Marietta Corp. v. The Bendix Corporation, 549 F. Supp. 623 (D. Md. 1982).

(2) facilitating technology exchange relationships;

(3) permitting change of control and reducing management entrenchment in large companies;

(4) facilitating private direct investment, such as venture capital;

(5) acknowledging the common practices of suppliers of foreign capital in the United States; and

(6) allowing acquirors to get to know a potential acquiree over time with a view to moving to 100% ownership.

These members posit that if partial bids therefore are permitted, two-tier bids should not be precluded, since as a practical matter such bids are more favorable to target company shareholders than partial offers with no second step. In such two-tier bids, a second step at a lower price than the first step normally is at a premium to the unaffected secondary market absent any second step.

The majority of the Committee, however, did not believe that the reasons advanced for equal treatment of full, partial and two-tier bids completely outweighed a concern with respect to coercive elements of partial and two-tier bids and the potential such bids provide for abusive tactics and practices. While some would have prohibited such bids altogether, the Committee determined to recommend a regulatory disincentive for partial offers and two-tier bids. 21/ Such disincentive would be provided by requiring a longer minimum offering period for partial bids than that required for full bids.

21/ Combination, package, two-step and similar offers where the consideration offered each shareholder is substantially equivalent need not be considered partial bids for these purposes.

Recommendation 16

The minimum offering period for a tender offer for less than all the outstanding shares of a class of voting securities should be approximately two weeks longer than that prescribed for other tender offers.

The Committee gave considerable thought to adoption of requirements similar to those provided in the British City Code on Take-overs and Mergers, i.e. restrictions on open market purchases above 15% and the general obligation to make an offer for all shares if the amount owned or sought exceeds 30% of the outstanding shares. 22/ Adoption of such a system in effect would preclude a number of significant partial offers and generally would require share purchases above a defined amount to be accomplished through a tender offer for all shares - for cash or securities or a mix thereof - at the same or different values. An essential corollary would be the elimination of supermajority and fair value charter provisions, and the adoption of a "non-fustration" doctrine to govern the actions of target management. While the British system has considerable attractions, the Committee determined that a more evolutionary development was appropriate, particularly in view of its conclusions concerning partial offers. In the event that the recommendations of the Committee do not have the desired effects, however, the Committee suggests that the Commission reconsider incorporation of some features of the British system.

22/ The Committee understands that partial offers are permitted only with the consent of the Panel on Take-overs and Mergers. Consent will normally be granted where the offer will result in the bidder holding less than 30% of the voting rights of the target. If the offer will result in the bidder holding 30% or more of the target company's voting rights, consent will not normally be granted if the bidder, or persons acting in concert with it, has acquired, selectively or in significant numbers, shares in the target company during the preceding 12 months. Any partial offer resulting in the bidder holding more than 30% of the target company's voting rights must be conditioned on approval by the target company's shareholders.

C. Equal Opportunity to Participate

A fundamental premise of the Committee's proposals is that the target company shareholders have equal opportunity to participate in the offer. Essential to providing such access is a minimum offering period that is sufficient to permit a reasonably diligent shareholder (individual or institution) to receive offering materials and to make an informed investment decision. The minimum withdrawal and prorationing period should be the same as the minimum offering period so as not to undercut the protection provided by the minimum offering period. The Committee determined that the appropriate period for an initial bid for a particular target is 30 calendar days. Given the notice to the market and target shareholders by the initial bid, the Committee found that shareholders will have sufficient time to receive the materials and to make an informed investment decision if the minimum offering period for a subsequent competing bid is 20 calendar days. 23/ As a general rule, however, a subsequent competing bid should not be permitted to expire prior to the initial bid. 24/ A beneficial by-product of this shorter minimum offering period for subsequent bids may be to reduce somewhat the risk of delay inherent in the subsequent bid.

23/ Note that under Recommendation 16 the minimum offering period for a subsequent competing bid that is a partial offer would be two weeks longer.

24/ There would be an exception to this general rule where the initial bid was a partial offer and the subsequent bid was a full offer.

Recommendation 17

> The minimum offering period for an initial bid should be 30 calendar days; for subsequent bids the minimum offering period should be 20 calendar days, provided that the subsequent bid shall not terminate before the 30th calendar day of the initial bid. In each case, the minimum offering period will be subject to increase, if the bid is a partial offer. 25/ The period during which tendering shareholders will have proration and withdrawal rights should be the same length as the minimum offering period.

In addition, to further the goal of equal opportunity to participate in the offer the Committee recommends extension of the minimum offering period and prorationing rights in the event of an announcement of an increase in the number of or price for the shares. The Committee determined that the withdrawal period did not need to be extended in such cases. Withdrawal rights would only be extended if there were a negative change in the terms of an offer that would disadvantage a shareholder who had tendered before such change.

Recommendation 18

> The minimum offering period and prorationing period should not terminate for five calendar days from the announcement of an increase in price or number of shares sought.

The Committee considered and rejected the extension of withdrawal rights upon commencement of a competing bid as is currently provided by Rule 14d-7(a)(2) under the Exchange Act. 26/ The Committee believes that the ability of another bidder to effect changes in the terms of an existing

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25/ *See* Recommendation 16.

26/ Rule 14d-7(a)(2) provides additional withdrawal rights in competing tender offer situations under which shares can be withdrawn on the date and for ten business days following the commencement date of a competing tender offer.

bidder's offer results in confusion and "game playing", presents opportunities for abuse and tips the balance in favor of the second bidder. A basic premise of the Committee's proposals is that each bidder should control its own bid. The Committee has recommended that the withdrawal period run the full length of the minimum offering period, rather than only three quarters of the period as under the current rules. The Committee believes such extension of the withdrawal period to the expiration of the minimum offering period provides shareholders protections comparable to those under the current system.

D. Other Provisions

1. Disclosure

Aside from recommending adoption of the integrated disclosure provisions in exchange offer documents, the Committee is not recommending substantial changes in the current disclosure requirements. The sense of the Committee, however, is that current disclosures of projections and valuations given to a bidder by the target company are essentially meaningless and can be misleading without disclosure of the underlying assumptions.

Recommendation 19

> Where the bidder discloses projections or asset valuations to target company shareholders, it must include disclosure of the principal supporting assumptions provided to the bidder by the target.

Moreover, the Committee expressed concern that tender offer disclosure documents are degenerating into needlessly complex and lengthy boilerplate, which serves to obscure the information concerning material terms and conditions of the offer and to confuse shareholders.

Recommendation 20

> The Commission should review its disclosure rules and the current disclosure practices of tender offer participants to eliminate unnecessary or duplicative requirements, as well as inordinately complex or confusing disclosures. The Commission's rules should require a clear and concise statement of the price, terms and key conditions of the offer. In addition, the Commission should amend its rules to permit inclusion of the key conditions in a summary advertisement used to commence an offer. 27/

The Committee considered prohibiting a target company management from refusing to provide one bidder with internal documentation and analysis where that same information had been made available to another bidder. Based on its own experience, however, the Committee does not believe that it is feasible to construct a regulatory system that would result in equal disclosure and thus is not recommending such a requirement.

2. Communications with Shareholders

Recommendation 21

> The Commission should continue its efforts to facilitate direct communications with shareholders whose shares are held in street name. 28/

27/ Rule 14d-4(a)(2) permits the commencement of a tender offer by a summary advertisement. Such advertisement must contain and be limited to certain information set forth in Rule 14d-6(e)(2). *See* Rule 14d-6(a)(2). The specified information does not include key conditions to the offer.

28/ *See* Report of the Advisory Committee on Shareholder Communications, *Improving Communications Between Issuers and Beneficial Owners of Nominee Held Securities*, June 1982; Release No. 34-19291 (December 2, 1982) (47 FR 55491) proposing for comment amendments to implement that Advisory Committee's recommendations.

The Committee believes that the current rules requiring a target company either to turn over the shareholder list or to mail for the acquiror 29/ have failed to assure that shareholders have speedy and complete dissemination of the acquiror's disclosure documents. The discretion given to the target company to mail for the acquiror severely restricts the ability of the acquiror to have free and easy access to shareholders. Morover, the potential for abuse through slow mailings is substantial. The Committee recommends that the Commission require that the target company provide its stockholder list to the acquiror upon request.

Recommendation 22

The Commission should require under its proxy and tender offer rules that a target company make available to an acquiror, at the acquiror's expense, shareholder lists and clearinghouse security position listings within five calendar days of a bona fide request by an acquiror who has announced a proxy contest or a tender offer. The Commission should consider prescribing standard forms (written or electronic) for the delivery of such information.

The Committee also found that communications with shareholders during a tender offer would be facilitated if reply forms were standardized.

Recommendation 23

Tender offer reply forms should be standardized to the extent possible to facilitate handling by brokerage firms, banks and depositaries.

29/ Rule 14d-5 under the Exchange Act establishes an obligation for the target company either, at its own election, to mail the bidder's materials, at the bidder's expense, or to provide the bidder with the target company's stockholder list and security position listings of clearing agencies. Rule 14a-7 sets forth a similar obligation under the Commission's proxy regulations.

3. Price and Related Terms

The Committee recommends that there be essentially no change in the current law with respect to the price and related terms of the tender offer.

Recommendation 24

Except to the extent there already exists such a requirement in a particular context, the price paid by an acquiror unaffiliated with the target company should not be required to be "fair" nor should federal law provide for state law-type appraisal rights.

Recommendation 25

All shareholders whose shares are purchased in a tender offer should be entitled to the highest per share price paid in the offer.

Recommendation 26

Current prohibitions of the purchase by a bidder of target company shares other than under the offer should be continued. 30/

4. Timing

Recommendation 27

All time periods should be defined in terms of calendar days.

Recommendation 28

"Commencement" of a tender offer should continue to be determined by present rules, and time periods should continue to run from that date.

30/ Rule 10b-13 under the Exchange Act prohibits a person who makes a cash or exchange tender offer for any equity security from purchasing that security (or any other security immediately convertible into or exchangeable for that security) otherwise than pursuant to the cash or exchange tender offer from the time the offer is publicly announced or otherwise made known until the expiration of the offering period.

Recommendation 29

Offering documents that are required to be mailed should be mailed within seven calendar days of commencement by announcement.

Recommendation 30

Voluntary extensions may be made by the offeror with any type of offer at any time before the commencement of the first trading day after the expiration date of the offer.

5. Approval of Acquiring Company's Shareholders

The Committee believes that, as a general rule, the use of an issuer's assets and securities should be and is a matter governed by state corporate law. For this reason, and because there is little to distinguish acquisitions ot control from other major capital transactions, the Committee would not require, as a matter of federal regulation, approval by shareholders of the bidder with respect to a control acquisition.

Recommendation 31

Approval by shareholders of a bidder with respect to an acquisition should continue to be an internal matter between shareholders and management, subject only to applicable state law.

6. General

Recommendation 32

The takeover process should not be permitted to become so complex that it is understood only by investment professionals.

CHAPTER IV

REGULATION OF OPPOSITION TO ACQUISITIONS OF CONTROL

A. General Policy Regarding State and Federal Regulation of Takeovers

While the activities of bidders are largely regulated by federal law, the response of the target company generally has been governed by state law, statutory and common. A principal issue defined by the Committee is the extent to which federal regulation should intrude into this area. Resolution of the issue requires a balancing of two competing interests: minimal preemption of traditional state corporate law and maintenance of the integrity of the national securities market in which tender offers take place. As to the first interest, the Committee concludes as follows:

Recommendation 33

> The Committee supports a system of state corporation laws and the business judgment rule. No reform should undermine that system. Broadly speaking, the Committee believes that the business judgment rule should be the principal governor of decisions made by corporate management including decisions that may alter the likelihood of a takeover.

While the Committee supports a system of state corporation law, however, it concluded that provisions generally restricting the transfer of control of an issuer, whether contained in state statutes 31/ or included in an issuer's charter or by-laws, improperly interfere with the conduct of takeovers in the national market place. Courts have invalidated state tender offer statutes that interfere

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31/ The Committee is concerned with any form of state statute, whether antitakeover, corporation, or broad policy legislation, that restricts transfer of control.

with the bidder's conduct of a tender offer under federal rules and burden tender offers in interstate commerce. 32/ Newly developed state statutes which, through regulation of target companies, have substantially similar effects on the ability to conduct a tender offer should not be permitted regardless of the form in which they are drafted. This category would include not only provisions incorporated into state corporation law but also broad policy enactments such as environmental quality legislation. 33/ Similarly, the Committee does not believe a company should be permitted to adopt charter or by-law provisions that erect high barriers to change of control and accomplish the very results that the Committee recommends be prohibited under state statutes. Based on these conclusions, the Committee recommends as follows:

Recommendation 34

> State laws and regulations, regardless of their form, that restrict the ability of a company to make a tender offer should not be permitted because they constitute an undue burden on interstate commerce. Included in this category should be statutes that prohibit completion of a tender offer without target company shareholder approval and broad policy legislation written so as to impair the ability to transfer corporate control in a manner and time frame consistent with the federal tender offer process.
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> An exception to this basic prohibition may be appropriate where a significant portion of the target company is in a

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32/ See, e.g., Edgar v. MITE Corp., 102 S. Ct. 2629 (1982).

33/ The Committee recognizes that exceptions to this position are appropriate in certain cases involving local companies or companies with a long history of public regulation where change of control is regulated separately by state or other federal law.

regulated industry and where special change of control provisions are vital to the achievement of ends for which the industry is regulated. Where such change of control provisions cannot be justified in relation to the overall objectives of the industry regulations or where only a small portion of the target company is in the regulated industry, there should not be an automatic impediment to the completion of a tender offer. Rather, the tender offer should be completed with the regulated business placed in trust during any post-acquisition approval period. Further, no such regulation should interfere with the procedural provisions under the Williams Act.

Recommendation 35

Congress and the Commission should adopt appropriate legislation and/or regulations to prohibit the use of charter and by-law provisions that erect high barriers to change of control and thus operate against the interests of shareholders and the national marketplace.

B. Specific Defensive Measures and Federal Regulation

1. Charter and By-law Provisions

Until such provisions are prohibited, the Committee recommends that companies be required to adopt supermajority provisions by the same vote percentage as that contained in the provisions and to have the provisions ratified periodically.

Recommendation 36

To the extent not prohibited or otherwise restricted, companies should be permitted to adopt provisions requiring supermajority approval for change of control transactions only where the ability to achieve such a level of support is demonstrable.

a. Any company seeking approval of a charter or by-law provision that requires, or could under certain circumstances require, the affirmative vote of more than the minimum specified by state law should be required to obtain that same level of approval in passing the provision initially. Ratification should be required every three years.

b. Where a charter or by-law provision provides a formula for the required level of approval, which level cannot be determined until the circumstances of the merger are known, the formula shall be limited by law so as to require a vote no higher than the percentage of votes actually ratifying the charter or by-law provision. Ratification should be required every three years.

c. For a nationally traded company that has adopted a supermajority provision prior to the date of enactment of this recommendation, and for a local company with a supermajority provision which becomes nationally traded at a later date, shareholders must ratify the supermajority provision within three years after such date, and continue to ratify such provision every three years thereafter.

Some Committee members believe that certain antitakeover provisions are justified responses to the threat of partial and two-tier offers. Other members agree that protective charter amendments are inappropriate when adopted after the announcement of a takeover, but argue against their restriction if adopted prior to commencement of a tender offer. In the latter case, these members argue, the market can assimilate the information into the price of the company's stock and will act to discipline management as to its selection of provisions; investors then generally will have investment opportunities ranging from full protection against takeovers to no protection.

2. Advisory Votes

The Committee found that there were other actions taken by management with respect to takeovers that, while not appearing to interfere substantially with the national securities market, called for additional disclosure to shareholders and the opportunity for shareholders to express their opinions on the appropriateness of such actions. The

Committee thus recommends that change of control related policies and compensation be required to be disclosed annually in an issuer's proxy statement and submitted to an advisory vote.

Recommendation 37

> The Commission should designate certain change of control related policies of corporations as "advisory vote matters" for review at each annual stockholders' meeting for the election of directors and for disclosure in the proxy statement.
>
> a. Matters Covered. Advisory vote matters should include:
>
> i. Supermajority provisions. To the extent not prohibited or otherwise restricted, charter provisions requiring more than the statutorily imposed minimum vote requirement to accomplish a merger, including provisions requiring supermajority approval under special conditions (*e.g.*, "fair value" and "majority of the disinterested shareholders" provisions);
>
> ii. Disenfranchisement. Charter provisions (other than cumulative voting and class voting) that abandon the one-share, one-vote rule based on the concentration of ownership within a class (*e.g.*, formulas diluting voting strength of 10% shareholders, and "majority of the disinterested shareholders" approval requirements);
>
> iii. Standstill agreements. Current agreements with remaining lives longer than one year that restrict or prohibit purchases or sales of the company's stock by a party to the agreement; and
>
> iv. Change of control compensation. Arrangements that provide change of control related compensation to company managers or employees. (*See* Recommendation 38).
>
> b. Proxy Statement Disclosure. Companies should be required to disclose all advisory vote matters in a "Change of Control" section of the proxy statement.

c. Vote. Shareholders should be requested to vote on an advisory basis as to whether they are or continue to be in favor of the company's policy with respect to the advisory vote matters disclosed in the proxy statement. The board would not be bound by the results of the advisory vote but could, in its own judgment, decide whether company policy should be changed on the advisory vote matters. The outcome of an advisory vote would have no legal effect on an existing agreement.

The recommendation for advisory votes was one that evoked substantial debate. A number of Committee members strongly objected to the process of advisory votes as a substantial and unwarranted interference in the internal affairs of a corporation better left to state corporation law. Questions also were raised as to the need for anything more than disclosure of control-related matters in the proxy statement. Some thought was expressed that advisory voting did not go far enough and that target company management should obtain shareholder approval before adopting any change of control policy.

3. Change of Control Compensation

Based on private surveys as well as filings with the Commission, it appears that contracts with change of control compensation are increasingly prevalent. Justifications articulated for contracts that become operative only in the event of a change of control are based on the issuer's interests in attracting and retaining high quality management, in keeping management's attention on running the business, and in aligning management's interests more closely with those of shareholders when an offer for the company is at hand. In general, the Committee does not believe that arrangements for change of control compensation in fact deter takeovers, as they are a small fraction of an acquisition price. Nevertheless, the Committee shares the public concern that such forms of compensation, particularly when adopted following the commencement of a tender offer, can present the appearance of self-dealing on the part of management at a moment of corporate vulnerability and a failure to place the interests of shareholders foremost. The Committee believes this perception is significant enough to warrant regulation.

The Committee's proposal is designed to strike a balance between the competing views on the issues raised by change of control compensation. On the one hand, the Committee recommendation avoids a direct restriction of free bargaining of management employment agreements by federal regulation. On the other hand, it eliminates an element of the practice that raises doubts as to the propriety of the takeover process and provides annual disclosure and the opportunity for shareholders to express their views on such arrangements.

<u>Recommendation 38</u>

a. <u>Change of Control Compensation During a Tender Offer.</u> The board of directors shall not adopt contracts or other arrangements with change of control compensation once a tender offer for the company has commenced.

b. <u>Change of Control Compensation Prior to a Tender Offer.</u>

   i. <u>Disclosure.</u> The issuer should disclose the terms and parties to contracts or other arrangements that provide for change of control compensation in the Change of Control section of the annual proxy statement.

ii. Advisory Vote. At each annual meeting, shareholders should be requested to vote, on an advisory basis, as to whether the company should continue to provide change of control compensation to its management and employees. The board would not be obligated by the results of the vote to take any specific steps, and the outcome of the vote would have no legal effect on any existing employment agreement.

4. Self-Tenders

Although there may be a perception that a self-tender will decapitalize the target company, the Committee does not view the practice as one that is substantively invalid. The self-tender may provide means of getting more value to shareholders. In some cases a self-tender can provide a favorable alternative to the second step of a front-end loaded deal. In view of the legitimate business purposes that can be served by a self-tender, the Committee believes that regulation of the mechanism generally should be governed by the business judgment rule and, if abused, principles of fiduciary duty under state law.

There is, however, a procedural problem with a self-tender that can work to the disadvantage of shareholders and requires correction. The proration period for a self-tender is 10 business days 34/ whereas the applicable proration period for the third party bidder must extend throughout the length of the offer (or, in the case of the Committee's recommendations, for a period equal to the minimum offering

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34/ See Rule 13(e)(4)(f)(3) under the Exchange Act.

period). 35/ As a result, target company shareholders in a partial self-tender lose the protections afforded by the minimum offering period required of third party tender offers. Such timing differences provide target companies significant advantages over competing tenders. The target company can create substantial uncertainty with respect to the values that will remain in the target company for shareholders who do not tender to the target company. The Committee recommends regulatory revision to limit the timing advantages of a self-tender over a competing third party bid.

Recommendation 39

a. In general, target company self-tenders should not be prohibited during the course of a tender offer by another bidder for the target company.

b. Once a third party tender offer has commenced, the target company should not be permitted to initiate a self-tender with a proration date earlier than that of any tender offer commenced prior to the self-tender.

5. Counter Tender Offers

The use of a counter tender offer as a defensive measure, the so-called "Pac-Man" defense, has evoked significant criticism. Given the circumstances where a counter tender offer can be used for the benefit of target company shareholders, the Committee is reluctant to recommend a total prohibition of such transactions, except in the instance

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35/ *See* Rule 14(d)(8) under the Exchange Act and Recommendation 17.

where the bidder company has made a cash tender offer for 100% of the target company.

The counter tender offer is a defensive action whereby the target company makes a tender offer for the shares of the bidding company. In mounting such a defense, the target company implicitly acknowledges the appropriateness of a combination between itself and the bidder, but may contest the ultimate management control and capital structure of the combined enterprise, as well as the terms of the exchange. The counter tender offer may be necessary to protect the interests of target company shareholders who will remain shareholders in the combined enterprise. Where, however, the bidder is offering cash for 100% of the target company, the counter tender offer is not appropriate because there will be no remaining shareholders on whose behalf target company management is acting.

The Committee believes principles of business judgment and fiduciary obligations under state law generally should provide adequate protection to shareholders against abuse of the technique.

Recommendation 40

There should be no general restrictions on the counter tender offer as a defense. The employment of the counter tender offer should be prohibited, however, where a bidder has made a cash tender offer for 100% of a target company.

6. Stock and Asset Transactions with Friendly Acquirors

Arrangements or options to sell stock or assets to a preferred acquiror (generally referred to as "leg-ups" or "lock-ups") have been criticized as providing an unfair advantage to one bidder over another and as possibly reducing the value received by shareholders by stifling competition. In the Committee's experience, however, such arrangements frequently are necessary to induce a second bidder into a takeover contest. Rather than stifling competition, such action may enhance the potential for an auction.

Nonetheless, above a certain level, the contract to issue stock becomes less supportable in that it may foreclose competition altogether. Therefore, the Committee recommends that the issuance of stock representing more than 15% of the fully diluted shares outstanding after issuance should be approved by shareholders. This recommendation extends the basic concept of the New York Stock Exchange rule that requires shareholder approval for the issuance of more than 18.5% of a company's shares where such shares are to be listed. 36/

Recommendation 41

> Contracts for the sale of stock or assets to preferred acquirors should continue to be tested against the business judgment rule. During a tender offer, however, the issuance of stock representing more than 15% of the fully diluted shares that would be outstanding after issuance should be subject to shareholder approval.

36/ See NYSE Company Manual A-284.

7. Third Party Asset Sales

Although the sale of significant assets ("crown jewels") by a target company during the course of a tender offer may appear to alter the value of a company to its shareholders should the bidder retract its offer, the Committee believes that asset dispositions may be a legitimate part of a plan to realize value for shareholders in excess of a proposed bid. When tested against the business judgment rule, the company must be satisfied that full value is being received for the assets disposed. Transactions of this sort should be allowed because, in many cases, value for a company can only be maximized by selling different components in different markets. There may, in fact, be no preferred acquiror for the entire company.

Recommendation 42

> The sale of significant assets, even when undertaken during the course of a tender offer, should continue to be tested against the business judgment rule.

8. Use of Employee Benefit Plans

A target company may attempt to use an employee benefit plan to defend against a takeover bid in two ways. First, the company may instruct the retirement plan managers not to tender company shares held by the plan to an unapproved bidder. Second, the target company may instruct the plan managers to purchase company stock with a view to defeating a hostile tender offer. It may be that in either case such instructions constitute economically unsound investment practice and result in substantial risks to plan beneficiaries. The Committee believes, nevertheless, that the substantial issues raised by the use of employee benefit plans during a tender offer are, and should be, governed by regulations other than under the federal securities laws. Traditional principles of fiduciary duty as well as existing pension regulations appear to prohibit observance of "no sale" instructions or instructions to purchase company stock for the purpose of defeating a tender offer.

9. Block Repurchases at a Premium

The Committee is particularly concerned with a target company's repurchase of its stock at a premium to market from a dissident shareholder. Under current law, the ability of a company to repurchase shares from dissident shareholders at a premium has created incentives for investors to accumulate blocks with the intention to sell them back to the issuer at a profit. Not only does such a transaction generally serve little business purpose outside the takeover context but also it constitutes a practice whereby a control premium may be distributed selectively and not shared equally by all shareholders. Moreover, the Committee is concerned about the doubt that such a transaction casts on the integrity of the takeover process. The Committee recommends prohibiting the repurchase at a premium of a block of stock held for less than two years without shareholder approval.

Recommendation 43

> Repurchase of a company's shares at a premium 37/ to market from a particular holder or group that has held such shares for less than two years should require shareholder approval. This rule would not apply to offers made to all holders of a class of securities.

37/ In formulating appropriate regulation, the meaning of "premium" should not be so broad as to interfere with normal recapitalization transactions (e.g., debt for stock).

CHAPTER V

REGULATION OF MARKET PARTICIPANTS

The recommendations of the Committee with respect to the activities of market participants are directed principally to the issue of the continued desirability and efficacy of Rule 10b-4 under the Exchange Act 38/ and the need for revisions to the rule to effect more fully its purpose.

Notwithstanding contentions that short and hedged tendering operate to increase the efficiency of the market and to reduce the spread between the market price and tender price, thereby benefiting individuals who sell into the market rather than tender, the Committee strongly endorses continuation of Rule 10b-4's prohibition of short tendering and recommends that the rule be strengthened to prohibit specifically hedged tendering. 39/ Because short and hedged tendering opportunities are available almost exclusively to market professionals, 40/ they appear to provide a substantial,

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38/ Rule 10b-4 makes it a manipulative or deceptive device or contrivance for purposes of section 10(b) of the Exchange Act for any person to tender a security unless he owns it or owns a security convertible into or exchangeable for the tendered security. An owner is defined as one who has title to the security, or has purchased the security or has converted, exchanged, or exercised another security that entitles him to obtain the security. A person is deemed to own the security, however, only to the extent that he has a "net long position" in the security.

39/ Short tendering is the tendering of shares that the tenderor does not own. Hedged tendering is the tender of shares that are owned, followed by a sale of a portion of those shares in the market.

40/ Market professionals are able to guarantee their tenders and have ready access to borrowable stock. By short tendering or selling short after tendering, the professional can significantly reduce its real proration risk, while increasing the proration risk of all those who cannot short or hedge tender, because the short or hedged tendering increases the number of shares tendered.

unfair advantage to market professionals. As a result, the Committee found that these techniques created too great a risk of undermining public confidence in the integrity of the markets.

Recommendation 44

> The Commission should continue the current prohibition on short tendering set forth in Rule 10b-4. To ensure the effectiveness of that provision, the Commission also specifically should prohibit hedged tendering.

As an additional measure to make short and hedged tendering less attractive, the Committee recommends that the Commission act to require delivery of the full number of shares tendered by guarantee, rather than only the actual number of shares to be accepted for purchase as the result of prorationing.

Recommendation 45

> In furtherance of the policy goals of Rule 10b-4, the Commission generally should require in a partial offer that all shares tendered pursuant to a guarantee be physically delivered, rather than permitting delivery only of the certificates for those shares to be actually purchased by the bidder.

Likewise, the Committee believes that Rule 10b-4 specifically should prohibit multiple tendering, i.e. the tendering of the same shares to more than one offer. In some situations, incentives exist to tender the same shares to competing bidders, particularly where only one of the competing offers can prevail, e.g., where each offer has a minimum condition that a majority of the shares be received. In the Committee's view, multiple tendering is simply a variant of short tendering and has a similar potential to undermine public confidence in the markets.

Moreover, to the extent that multiple tendering is prevalent in a competing situation, it is possible that both offers would appear successful, resulting in massive confusion in the market.

Recommendation 46

> Rule 10b-4 should be amended to include a specific prohibition of multiple tendering.

The Committee anticipates that the foregoing revisions to Rule 10b-4 would reduce substantially the potential for over-tenders and recommends that as a policy the Commission generally rely on market remedies rather than additional revisions of Rule 10b-4 to deal with other specific opportunities for over-tenders. 41/ However, one particular source of potential over-tenders may warrant regulation.

The Committee recognizes that the option market makes over-tenders more likely because there is no theoretical limit on the number of call option contracts (open interest). Under Rule 10b-4, a person may tender the securities underlying a call option immediately upon exercise. When the option is exercised near the expiration of a tender offer, the writer of the option may not receive the exercise assignment notice until the offer has expired, and, prior to such receipt, may tender the underlying stock. The Committee believes it would be appropriate that the option writer should not consider himself as owning securities subject to a

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41/ An over-tender is the tender of more securities of a particular class or series than are outstanding.

tender offer in determining his "net long position," if he has written a call option on those securities in circumstances where he should know that the call option is highly likely to be exercised prior to expiration of the offer. The Commission also may wish to consider the effect on the options market of changing Rule 10b-4 to require that exercisers of call options be treated as not owning the securities subject to the option until the underlying security is delivered.

Recommendation 47

> The Commission should revise its interpretation of Rule 10b-4 so that for the purposes of determining whether a person has a "net long position" in a security subject to the tender offer, call options on such security which a person has sold and which a person should know are highly likely to be exercised prior to expiration of the offer shall be deemed to constitute sales of the security underlying such options and therefore netted against such person's position in that security.

The Committee has reviewed the Commission's Release No. 34-19678 42/ relating to the processing of tender offers within the National Clearance and Settlement System. The Committee supports the use of book-entry delivery of tendered securities to the extent practicable and in concept favors (without commenting on the technical aspects of the proposal) proposed Rule 17Ad-14 that would require bidders' tender agents to

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42/ (48 FR 17603).

establish during tender offers an account with qualified registered securities depositories to permit financial institutions participating in such depository systems to use the services of the depository to tender shares if desired. The Committee expects that the use of such a system would reduce greatly the number of "items" which the tender agent must process and would facilitate continued trading in the securities subject to the tender offer with the benefits of efficiencies, cost savings and reduced confusion and delay. The Committee also anticipates that such a system would indirectly benefit shareholders who do not have access to the depository system, in that, due to the benefits noted, the tender agent should be able to process tenders more expeditiously and thus make payments more quickly than is now the case. Requiring the use of the facilities of registered securities depositories rather than relying on voluntary use of their services is warranted, in the Committee's view, given the substantial efficiencies to be derived from the new procedures and the factors that apparently have impeded voluntary resort to the procedures, i.e. press of time, unfamiliarity with the depository system and, possibly, incentives for bidders and their agents to avoid more expeditious payment procedures.

Recommendation 48

> Without commenting on the technical aspects of the proposal, the Committee recommends adoption of the Commission's proposed Rule 17Ad-14 under the Exchange Act.

The Committee also considered whether the advantages that market professionals have in the tender offer context warrant additional regulation. These advantages include the access of professionals to market information, the opportunity to monitor customers' tendering decisions, the ability to borrow securities, and their eligibility for soliciting dealers fees. The Committee determined that there is no need for additional regulation at this time.

Specifically, with respect to the advantage provided arbitrageurs by access to market information and opportunity to monitor customers' tendering decisions, the Committee found that arbitrageurs did not have an unfair advantage over other market professionals, and that the market professionals have general advantages that commonly derive from professional involvement in any area. To attempt to restrict such advantages by regulation could result in barring activities that contribute substantially to the market's efficiency. Interference with such activities, with the consequent jeopardy to market efficiency, should only be undertaken when the activity threatens to undermine public confidence in the fairness of the markets, which the Committee did not find to be the case in connection with access in this area.

As to the ability to borrow securities, the Committee believes that market professionals always have an inherent advantage. Especially considering its recommendations concerning Rule 10b-4, however, the Committee does not believe the advantage is an unfair one, even during a tender offer when borrowable stock is scarce.

Finally, with respect to the opportunity to receive soliciting dealer's fees, the Committee notes that such fees are no longer widely offered by bidders. Where included in an offer, the terms of the offer so limit the availability of the fee as to render it, for all practical purposes, an immaterial amount. 43/

43/ For example, some offers provide that no fee will be paid to the beneficial owner of the shares, thus precluding a fee on shares tendered by the arbitrageur as principal. Some offers also include a significant limitation on the aggregate fee payable with respect to the shares of any one beneficial owner.

CHAPTER VI

INTERRELATIONSHIPS OF VARIOUS REGULATORY SCHEMES

A. Scope of Review

Although the essential focus of its review was directed to federal securities regulation, the Committee was cognizant from the outset that other regulatory systems affect transactions in which corporate control passes hands. The Committee divided those schemes into two general categories: state securities and corporation law, and all other systems, both state and federal, such as tax, banking, labor, antitrust, insurance, and other regulated industries. In determining the scope of its review in the area of state securities and corporation law, the Committee concluded that it would evaluate broad questions of substantive interrelationship with federal securities law and formulate recommendations based on that review. Questions of procedural coordination between federal securities regulation and state securities and corporate law would then be governed by those policy formulations. The Committee did not attempt to analyze and make recommendations with respect to procedural coordination between federal securities regulation and each or any particular state corporate statute.

In measuring the scope of its review of the interrelationship between federal securities regulation and other systems of regulation, the Committee concluded that it would not severally consider substantive issues in other systems. Rather, the Committee determined that its review would be limited to considering whether other regulatory systems required coordination with federal securities laws governing takeovers.

B. State Securities and Corporate Law

The Committee adopted as basic objectives of the regulation of corporate control acquisitions certain broad policies that should govern the interrelationship of federal securities laws and state securities and corporate law. 44/ First, the Committee agreed that the regulation of control acquisitions should recognize that the transactions take place in, and are frequently only possible because of, a national market in securities. Second, for this reason, state regulation of control acquisitions, whether under the auspices of state securities or state corporate law, should be confined to local companies. Third, except to the extent necessary to eliminate abuses or interference with its intended functioning, federal securities regulation of tender offers should not preempt or override state corporation law.

C. Other Regulatory Systems

1. Antitrust Law

a. Policy Considerations.

Antitrust regulations and federal securities regulation of takeovers overlap as a result of the system of prior review of certain tender offers by antitrust authorities established by the premerger notification provisions of Title II of the Hart-Scott-Rodino Antitrust Improvements Act. 45/ Under that system, a proposed business combination meeting certain threshold minimums must be prenotified by filing a report with

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44/ See Chapter II.

45/ 15 U.S.C. § 18a (1976 & Supp. V 1981).

both the Federal Trade Commission ("FTC") and the Antitrust Division of the Justice Department. Parties to the proposed transaction must sit out a 30-day, or 15-day in the case of cash tender offers, waiting period before the transaction can be consummated. The FTC or the Antitrust Division can request additional information and thereby extend the waiting period for an additional 20 days, or 10 days for cash tender offers, after the information has been furnished. The agencies may grant early termination of a waiting period.

The Committee strongly supports the system of prior review of tender offers by antitrust authorities so that potentially anti-competitive acquisitions may be halted before they take place.

Recommendation 49

> Federal securities regulation of acquisition of corporate control should not impede or otherwise handicap the necessary and appropriate workings of federal antitrust regulations designed to review transactions for antitrust implications prior to their consummation.

b. Waiting Period vs. Minimum Offering Period.

The Committee nonetheless recognizes a tension between prior antitrust review and the system of tender offer regulation as contemplated by the Committee. That tension, which is created by differences in the antitrust waiting period and the minimum tender offer period, is avoidable. The Committee is proposing a general 30-day minimum offering period for cash and securities bids alike 46/. The Hart-Scott-Rodino Act, on the other

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46/ Minimum offering periods may vary from 20 to 44 days. See Recommendations 16 and 17.

hand, distinguishes cash from securities offers, imposing a 15-day waiting period on the former and a 30-day waiting period on the latter. Discussions with the FTC and with the Antitrust Division led the Committee to conclude that this distinction between cash and non-cash offers is not important to antitrust policy, and that changes in the administration of the Hart-Scott-Rodino Act by legislation or rulemaking, would harmonize the systems.

Recommendation 50

> Premerger notification waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act should be modified so as to take account of the required minimum offering period prescribed under the Williams Act and to avoid, to the extent practicable, delay in completion of a tender offer due to antitrust review.

c. Harmonizing the End of the Periods.

Under the Hart-Scott-Rodino Act, the bidder cannot purchase the shares until the expiration of the statutory waiting period. If there is a second request, the period may extend beyond the minimum offering period, unless earlier terminated, thus disabling one or more bidders from acquiring the shares at the end of the minimum offering period.

The purpose of the Hart-Scott-Rodino Act waiting period is to ensure that a merger does not take place before the enforcement agencies have fully evaluated the merits. Once the merger occurs, it is hard to unscramble the eggs. Members of the Committee explored the possibility of harmonizing the antitrust interest in prior review and the tender offer interest in permitting the completion of transactions upon expiration of the offer. This could be accomplished by permitting bidders to take down shares at the end of the minimum offering period, no matter what the status of the antitrust review, at their own risk, and subject to a hold-separate order. Once the review period expired, the bidder could acquire control of the stock, subject to the risk of suit by the antitrust enforcement agency, which may seek an interim judicial hold-separate order and ultimate divestiture. Assistant Attorney General William Baxter strongly advised against such proposal at the Committee's June 2 meeting. The Committee has not adopted a specific recommendation with respect to such proposal, but believes it is worthy of further study.

2. <u>Taxation</u>

The Committee considered two areas in which taxation of control acquisitions may impinge on the system of tender offer regulation envisioned by the Committee. The first involves the difference in the taxation of an acquisition in exchange for cash and one in exchange for non-cash. The former typically involves a recognized gain while the latter can be structured so as to carry forward the basis of the assets being acquired and defer the gain. The other area involves the taxation of the cash portion of mixed cash-securities tender offer packages. Both areas involve unequal treatment of cash tender offers and exchange offers, and also may, where the tender offer is hostile, impose on target company shareholders unfavorable tax treatment beyond their control.

As to the former area, the Committee determined, based in part on its discussions with representatives of the Treasury Department, that there are longstanding, substantive tax policies accounting for the treatment of cash and non-cash acquisitions. It appears unreasonable and inappropriate to recommend any change in the current tax system.

In the other area, the Committee focused on the tax treatment of a tender offer where securities and cash are issued pro rata to tendering shareholders. Under current tax policy, there is a risk that the cash will be treated as a dividend and taxed as ordinary income. The Committee considered the formulation of an election procedure whereby a tendering shareholder could opt for the particular form of payment that would best suit the individual's tax situation. Based on discussions with representatives of the Treasury Department who did not support such a change of tax treatment and the fact that the election procedure would require technical and complex tax legislation, this seemed in the final analysis to be an area in which the Committee had neither the time nor the expertise necessary to draft meaningful recommendations.

3. Regulation of Banking and Credit

There are two possible overlaps between banking and tender offer regulation. The first involves the issue of whether banks should have duties of confidentiality, notice, or abstention in connection with bids for their customers. The second raises the question of whether tender offers interfere with credit markets of capital formation in a way that calls for credit regulation. The Committee is strongly of the view that neither is an appropriate subject for regulation at this time.

a. Banks and their Customers.

The Committee believes the subject is adequately covered by contract law and applicable principles of fiduciary duties, a body of law with which federal takeover regulation does not appear incompatible. Consequently, the Committee has no recommendation on this subject.

b. Credit.

See Chapters I and VII.

4. Investment Managers

The Committee considered the relation between federal regulation of tender offers and the regulation of pension managers. It concluded that there is no need for it to make recommendations on this subject. The pension area is extensively governed both by ERISA and by principles of fiduciary duty applicable to funds' managers. Further, there appears to be little conflict between the workings of pension and tender offer regulation.

5. Regulated Industries

The Committee believes federal takeover regulation should not preempt substantive state regulation of banks, utilities, insurance companies and similar businesses, where the change of control provisions of such state regulation are justified in relation to the overall objectives of the industry being regulated and relate to a significant portion of the issuer's business. Regulation of these businesses should, however, be procedurally compatible with the Williams Act. For instance, requirement of a hearing prior to commencement of a tender offer would be deemed incompatible with the Williams Act.

CHAPTER VII

SENATE BANKING COMMITTEE LETTER

Members of the Senate Banking Committee have directed a number of questions to the Committee by letter dated February 1, 1983 (see Appendix B). The Committee has responded to many of these questions implicitly in its recommendations. In order to highlight these implicit responses and also to set forth answers to questions for which the Committee did not formulate a specific recommendation, this section reviews the Committee's views as to each of the Senate Banking Committee's questions.

1. What should be the role of the government in hostile takeovers?

In formulating what it believes should be the basic objectives for the federal regulation of takeovers, the Committee set forth its views on the role of government in hostile takeovers. The Committee has reaffirmed the basic policies of the Williams Act to protect shareholders and to maintain a regulatory balance and neutrality among all participants to a takeover. The Committee does not believe that economic research or data supports a finding that takeovers, negotiated or hostile, necessarily create real economic value or, on the other hand, are economically or socially detrimental. Rather, the Committee believes takeovers are a valid method of allocating capital which, so long as shareholders and the integrity of the capital markets are protected, should be allowed to take place. For this reason, the Committee does not believe the government should act to encourage or to discourage or to evaluate the merits of takeovers.

2. What are a corporation's obligations to its shareholders, its employees, consumers, and the community in a takeover situation?

At the broadest level a corporation's duties in a takeover situation should be no different than the duties which it must fulfill generally. A takeover is but one of a broad range of capital allocation decisions that a corporation must undertake in the course of its business activities, such as acquisitions, relocations or dispositions of plants and equipment and introduction or expansion of products. The Committee recognizes, however, that the takeover is a particularly difficult and complex transaction both from a substantive and procedural standpoint. Through its recommendations for regulation of bidders and target companies, the Committee has attempted to clarify what it believes are the appropriate obligations for corporations in the context of the takeover.

3. What abuses have occurred under current tender offer laws?

The Committee's recommendations for the regulation of acquirors of corporate control, of opposition to acquisition of corporate control, and of market participants during a tender offer reflect the opportunities for abuse that the Committee believes should be rectified. These include, among others, recommendations regarding notice to the market regarding potential acquirors (Recommendation 13), open market accumulation programs (Recommendation 14), partial offers (Recommendation 16), antitakeover provisions and change control compensation (Recommendations 35-38), and certain sales and repurchases of stock (Recommendations 41 and 43).

4. Chairman Paul A. Volcker of the Federal Reserve has expressed concern "about take-overs distorting banking judgments or the credit markets." How might such distortions be prevented?

As discussed in Chapter I, on the basis of its study, including discussions with Chairman Volcker and members of his staff, the Committee concluded that transactions involving acquisitions of control do not result in material distortion in the credit markets. Consequently, the Committee does not believe that any regulatory initiative should be undertaken to limit or allocate the availability of credit in such transactions.

5. What should be the involvement of states in regulating corporate takeovers?

The Committee addressed this question in formulating basic objectives for the regulatory system and in making recommendations as to the regulation of opposition to acquisition of corporate control and as to the interrelationships between federal takeover regulation and other regulatory schemes. See Chapters II, IV and VI.

6. Should shareholders of a corporation be given the right to vote on proposed tender offers within a specific period of time of the offer, and should a shareholder majority be required to approve acquisitions and takeovers?

Under the current scheme of regulation, state corporate law and, in some cases, stock exchange rules require shareholder approval for certain transactions that may be part of a takeover, e.g., certain issuances of securities, mergers, acquisitions, sales of certain assets and charter or by-law amendments. The Committee makes recommendations regarding shareholder voting in certain additional situations, e.g., antitakeover policies and compensation (see Recommendations 36-38), the issuance of more than 15% of stock and a block repurchase at a premium (see Recommendations 41 and 43). Beyond these recommendations, the Committee does not believe there should be further requirements for shareholder approval except as required by state law. The Committee did consider at some length the regulation of takeovers under the British system, a system which has broader shareholder approval requirements. It is the consensus of the Committee that such broad requirements would, in the U.S. market, impose substantial costs and delays on both bidders and target companies alike. These costs and delays would impact adversely on shareholders and, because the Committee was unable to identify a countervailing need that would outweigh such impact, it has determined not to recommend a system of shareholder approval that is as broad as the British system.

The Committee recommends that there be no federal requirement for approval by shareholders of the acquiror of major acquisitions. The appropriate use of an issuer's assets and securities is a matter of state law. Because there is little to distinguish acquisitions of control from other major capital transactions, the Committee does not believe federal law should mandate specific shareholder approval requirements for control acquisitions. <u>See</u> Recommendation 31.

7. Are "golden parachute" provisions guaranteeing executives salaries and other compensation after any change of control of a company in the best interests of shareholders of that company? Should federal securities law require shareholder approval of golden parachutes or that their provisions be spelled out in detail in companies' proxy materials?

The Committee recommends that companies not be permitted to adopt change of control compensation arrangements after the commencement of a tender offer. Further, the Committee recommends that any change of control compensation adopted before the commencement of a tender offer be disclosed and be the subject of an advisory vote of shareholders on an annual basis. <u>See</u> Recommendations 37 and 38.

8. Should interest or money borrowed specifically to buy the common stock of another corporation in a takeover situation be tax deductible?

The Committee does not believe that the use of credit in a takeover context has caused any significant distortion in the credit markets or any significant harm to shareholders or the participants to a tender offer. For this reason, the Committee does not recommend regulation that would treat the taxation of interest on borrowed funds differently in the takeover context than in any other business transaction.

9. Should retained earnings used to acquire other companies be subject to a minimum merger tax?

A minimum merger tax would constitute a form of penalty tax. Because the Committee does not believe there is any data to support a government policy of discouraging mergers, negotiated or not, the Committee does not recommend that such transactions be subject to tax policies that differ from those applicable to other business transactions.

10. Should additional time for competing bids be provided under a rule of auctioneering?

The Committee believes that its recommendations regarding the minimum offering period and withdrawal and prorationing rights provide a reasonable opportunity for competing bids to be successfully undertaken. (See Recommendations 16-18.) The Committee believes that care must be taken that delay and other impediments do not so increase the perceived entry costs for first bidders as to deter substantially such bids. The Committee does not believe it is appropriate to create a system that favors subsequent bidders any more than it is to design regulations that give the upper hand to the first bidder. The recommendations of the Committee have attempted to draw the appropriate balance.

11. Should a federally imposed period of advance notice be established requiring a bidder to file registration materials with both the SEC and subject company management prior to the implementation of a tender offer?

The Committee does not believe pre-commencement review, notice or filing is necessary. The Committee believes the recommended minimum offering period provides for timely disclosure.

12. Are individual shareholders currently receiving adequate and timely notice and information about takeovers (including competing offers)?

In general, the Committee believes shareholders receive adequate and timely notice and information about takeovers, including competing offers. On the other hand, there are certain improvements that the Committee believes would be useful. See Recommendations 19-22.

13. Do target corporations currently have sufficiently adequate access to all their individual shareholders to conduct a responsible and reasonable defense against a hostile takeover?

Although the Committee believes that target companies generally have sufficiently direct access to shareholders to conduct defenses to takeovers, the Committee also thinks there is need for improvement in the process by which issuers communicate with the beneficial owners of securities registered in the name of a broker-dealer ("street name"), bank or other nominee. These improvements are necessary in the context of all corporate communications and not just the takeover area. The Commission currently is engaged in an effort to facilitate communications with shareholders whose shares are held in street name, this in response to the recommendations of the Commission's Advisory Committee on Shareholder Communications which delivered its final report to the Commission in June 1982. This Committee encourages the Commission to continue its efforts to facilitate direct communications with shareholders. <u>See</u> Recommendation 21.

14. It has been suggested that tender offers serve as an effective mechanism to discipline incompetent management and to permit the transfer of productive assets to the control of more efficient management. On the other hand, it has been agreed that the fear of hostile takeovers tends to focus management's efforts on short-run profits while giving less attention to longer term investments needed for economic growth. What role, if any should federal regulation play in striking the proper balance between those conflicting concerns?

As discussed in Chapter VI, while takeovers may have served as a discipline of inefficient management in some cases, and may have caused some management's to emphasize short-term results at the expense of long-term growth, the Committee does not believe that one or the other of these effects is exclusively or predominantly true, so as to require a specific regulatory response. The Committee believes that the role of the federal government in maintaining a balance between these concerns is incorporated in its recommendation that the purpose of the regulatory scheme should be neither to promote nor to deter takeovers, so long as they are conducted in accordance with the laws deemed necessary to protect the interests of shareholders and the integrity and efficiency of the capital markets.

15. The Chairman and Chief Executive Officer of a company which was a major and successful player in a recent multibillion dollar acquisition contest has embraced the view that "Maybe there's something wrong with our system when . . . companies line up large amounts of money in order to purchase stock, when it doesn't help build one new factory, buy one more piece of equipment, or provide even one more job." How, if at all, should federal regulation address this widespread frustration?

The Committee believes that certain misapprehensions concerning the takeover process have been created by a relatively few celebrated contests. These cases may have served to identify points of stress in the existing regulations, but the Committee does not believe that they have provided an accurate view as to how the takeover process works in the vast number of unpublicized transactions. The Committee recognizes, however, that to the extent that these cases have created a negative public perception, there may be concerns as to the fairness of the tender offer process and the equality of treatment of shareholders. The Committee has proposed recommendations which it believes address those concerns.

16. On July 13, 1979, the Banking Committee requested the Commission to review seven specific questions concerning coverage of the Williams Act. The Commission provided its response on February 15, 1980. It would also be helpful if the Advisory Panel could review the questions and answers and provide any updating which the Panel may deem necessary.

As requested in the Senate Banking Committee letter, the Committee also considered the questions raised by the Senate Banking Committee by letter to Chairman Williams dated July 13, 1979. The Committee's views with respect to question 1 - Role of Banks in Tender Offers - are addressed in Chapters I (Section D) and VI (Section C3); question 2 - Issuer Repurchases - in Chapter IV (Section B4); question 3 - Coverage of the Williams Act - in Chapter III; question 4 - Filing Requirements - in Chapter III (Section A1); question 5 - Best Price Rule - in Recommendation 25; and question 6 - Relationship Between State and Federal Tender Offer Laws - in Chapters II, IV and VI (Section B). The Committee did not reach any conclusions on the issues raised with respect to the _Rondeau_ and _Piper_ cases.

SEPARATE STATEMENT OF FRANK H. EASTERBROOK AND GREGG A. JARRELL

The recommendations of the Advisory Committee are in some ways a substantial contribution to the analysis of tender offers and their regulation. We agree with many of the fundamental suppositions of the Advisory Committee and many of its recommendations. We agree, for example, that tender offers are generally beneficial for shareholders and that there is a problem, to which attention must be paid, in regulations that may discourage the making of offers. The suggestion that stock offers be made more readily available is an important step in the right direction, as are the suggestions for simplified disclosure, for allowing the first bidder to acquire tendered stock without extensions of time triggered by subsequent bids, and for reconciliation of the Williams and Hart-Scott-Rodino Acts. We endorse the Advisory Committee's principle of repeated review of anti-takeover changes in firms' articles and bylaws and its rejection of substantive regulation of two-price or two-tier offers.

Yet despite the good features of the Advisory Committee's report, it is essentially a plea for more regulation. Even moderately more regulation is a change in the wrong direction. The proposals, if adopted, would make tender offers — and especially the acquisition of substantial minority positions — more costly, more complicated, and thus more scarce. Shareholders in bidders, targets, and bystanders alike would be the losers. The economy as a whole would suffer.

This separate statement sets out the reasons why we reach these conclusions. Part I is an introduction, which also summarizes the rest of the analysis. Those who seek partial relief from the torrent of words produced by the Advisory Committee and its members may stop there. Part II discusses how costs and benefits of regulations might be assessed and why we disagree with the Advisory Committee's treatment. Part III offers our approach to the design of appropriate regulation. Part IV then addresses the more important of the Advisory Committee's recommendations. Part V is a conclusion.

Finally, the Appendix is an overview of the evidence about the consequences of tender offers, and tender offer regulation, for investors.

I

We were assembled to give the Congress and the SEC the benefit of our experience and our study of tender offers. We make no rules. Thus the Committee's approach to tender offers — why they exist, how they operate and to whose benefit and harm — is much more important than the detailed recommendations we make.

The most striking thing about the Advisory Committee's report is that the Committee offers <u>no</u> explanation of tender offers, no treatment of costs and benefits, indeed not even a definition of "abuse", which is the cornerstone of the recommendations for "reform." How can we identify, let alone rectify, "abuses" without some ideas about why tender offers exist, what costs and benefits are associated with them, and what effect our "reforms" would have on the number of offers? Should we analyze tender offers by assuming that they exist and then asking how to distibute the gains? Or should we be more concerned with the causes of offers and their economic functions? What counts as abusive? Can potential victims of abuse protect themselves, or can other institutions protect them, at lower costs than protection by means of new federal regulation? We cannot answer these questions in a vacuum, as the Advisory Committee implicitly does.

We start from the position, backed up by evidence detailed in the Appendix, that tender offers benefit shareholders of both bidders and targets. The premiums paid to targets do not just come out of the hide of bidders' stockholders; there is a gain when the bidders and targets are evaluated as a unit. Moreover, the evidence also shows that both the regulation of bids and the targets' defensive tactics make initial tender offers more costly to mount, and thus there will be fewer of them. As the price of anything goes up, the number purchased decreases. Regulation increases the cost (including the cost of uncertainty and risk) in making offers. Fewer offers mean fewer occasions when shareholders collect premiums, which also means that all corporations trade for less in the market because their value as future acquisitions is less.

The premiums reflect real gains to society as well as to investors. Stock prices reflect the anticipated future dividends of the stock (including profits distributed in any "final" dividend, such as the payment accompanying a merger). Profits and dividends, in turn, increase when a firm becomes more efficient or better at producing what consumers want to buy. Higher stock prices thus are based on social as well as private gains. Perhaps the gains observed in tender offers come from the fact that bidders' managers make more efficient use of the targets' resources than the targets' managers do. Resurrecting a declining business is no less productive than building a new one. The threat of tender offers also induces managers to take more care in their work, so that there are fewer declining businesses to resurrect. Perhaps the gains come from the combination of the bidders' and targets' assets, including their production, sales, and distribution networks, into more efficient units. The exact source of the gain does not matter much, so long as it is real. The market evidence tells us it is real and large. Unless the market systematically (not just occasionally) is irrational, this evidence is compelling. Thus when tender offers are not made because of regulation or defense, real value is lost.

The gains from tender offers are important for new businesses as well as existing ones. The prospective investors in a new firm want some assurance that people will be looking over the managers' shoulders, ready to step in if the managers falter badly or if there is a better use for the firm's assets. When shareholdings are diversified, it is important to find ways, such as the employment market, the tender offer, and the proxy contest, to control the agency costs of management, which scattered shareholders cannot do for themselves. (Agency costs are the full costs, in both monitoring and lost profits, that investors incur in inducing managers to act completely in the investors' interests rather than the managers' own. Agency costs are apt to rise as managers' stake in the firms' profits falls, for the smaller the managers' stake, the less they will sacrifice at the margin to obtain gains that accrue to other people.) Investors pay more for new stock with better safeguards against agency costs built in. Another way to put this is that new investments are more attractive (and hence society will invest more, increasing productivity) when tender offers are available.

Much of this seems accepted by the Committee, although the report does not say so explicitly. The common attacks on tender offers one reads in the popular press are so much hogwash. True, some offers appear to be unproductive and may reflect more the self-aggrandizement of the bidders' managers than new producitvity, but some new products and plants are also bad ideas. Bidders that err in making offers will suffer penalties automatically as profits drop, stock prices fall, and managers' salaries and employment prospects decline. They may even get taken over. There is no more reason for concern about unwise tender offers than about unneeded products and plants. The Advisory Committee does not give this point full credit, though: its belief that we should neither encourage nor discourage tender offers because some tender offers are not beneficial (Report at 8-9) would be equally applicable to every other economic transaction. (We discuss this further in Parts II.A and II.E of the Appendix to this Statement.)

The other common attack on tender offers, that they "use up credit" and divert resources from productive investment, is based on misunderstanding of how capital markets and the banking system work. The Advisory Committee properly gives this argument a rough sendoff (Report at 13 and Recommendation 2), pointing out that money disbursed by bidders is received and reinvested by targets' shareholders. Tender offers are no different from other capital transactions, such as the purchase of 80-100 million shares on the New York Stock Exchange every business day. People just shift from one investment to another. No real resources are used up, and if changes of control enable the new owners to make better use of the assets than the old owners and managers there are substantial benefits for the economy.[1]

Yet once we take the position that tender offers are beneficial as a rule, and that the prospect of tender offers is useful in our capital markets, we should be very sure of our ground before we propose new regulations or even the continuation of old regulations. The economic literature on regulation suggests that the costs of regulation often exceed the benefits, that the real gainers of regulation are the regulated firms rather than the people regulation is supposed to protect.2 We have seen substantial deregulation of airline, telecommunications, transportation, and energy markets recently, all to the benefit of the public.

True, there will be "abuses" from time to time. All real markets are imperfect, all impose unwarranted losses on some people now and again. It is harder to know that a new regulation is an effective antidote for the abuse. Perhaps people will find a way around the regulation. For example, in recent years market professionals substituted hedged tendering for prohibited short tendering. When substitution occurs, there is

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1. Suppose that four widget corporations can supply the Nation's demand. One of them is in decline, showing lower profits. The argument that tender offers (and presumably mergers as well) are deleterious to the economy implies that the failing firm should be allowed to sputter unproductively, or even to go under and its assets left to rust, while a new firm is built from scratch. Isn't it far preferable to the economy for someone to acquire and resurrect the least successful of these four firms, sparing us the cost of wasted assets and new construction? To disparage this as "paper entrepreneurialism" that is undermining productivity (see Robert B. Reich, The Next American Frontier 140-72 (1983)) is to miss the whole point. (To his credit, Reich concedes that "[e]very economy needs some paper entrepreneurs to help allocate capital efficiently among product entrepreneurs," id at 157. Reich thinks we have too much dealing in paper, but he has no way to tell how much is too much, and the stock market data are a powerful indicator that investors think that we do not yet have enough.)

2. E.g., Judge Steven Breyer, Regulation and its Reform (1982); Judge Richard A. Posner, Theories of Economic Regulation, 5 Bell J. Econ. 335 (1974); Nobel Prize winner George J. Stigler, The Citizen and the State (1975); and, among many others, Paul W. MacAvoy, The Regulated Industries and the Economy (1979); Mancur Olson, The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities (1983); Sam Peltzman, Toward a More General Theory of Regulation, 19 J. Law & Econ. 211 (1976); Peter O. Steiner, The Legalization of American Society: Economic Regulation, 81 Mich. L. Rev. 1285, 1293-96 (1983). A growing literature supplies the evidence that these economic approaches are correct. For examples from regulation of capital markets, see Susan M. Phillips & J. Richard Zecher, The SEC and the Public Interest (1981); Gregg A. Jarrell, Change at the Exchange: The Causes and Effects of Deregulation, forthcoming in 27 J. Law & Econ. (1984).

either a continuation of the abuse, plus the cost of regulation, or a need for still more regulation. The Advisory Committee proves this point by recommending the abolition of hedged tendering. Professionals are apt to think up something else to take its place, too.

If it is hard to know whether a regulation will cure an abuse, it is harder still to know whether effective abuse-prevention is worth the cost. Even if the regulation puts an end to what we perceive as abusive, we do not know that we have made a net gain for society unless we are sure that (a) people could not have created their own remedies for the abuse, at lower costs than those of regulation, (b) market institutions that correct the abuse would not have arisen, and (c) the costs of regulation are lower than the costs of the abuse to which they are addressed.

In stock markets home-brewed safeguards against abuses are common and cheap. Investors who want equal returns can buy bonds or hold diversified portfolios of stocks. More on that at pages 10-13 below. Moreover, because tender offers have very large benefits for society, almost any deterrence of tender offers will be quite costly. Thus regulation will do more harm than good unless the abuses to be addressed are both dastardly and otherwise impossible to protect against.

All of this means, we think, that the Advisory Committee should have started with the position of the Department of Justice. The Department recommend that tender offers be regulated only the absolute minimum necessary to ensure confidence in securities markets and equitable treatment of the smallest investors. The Advisory Committee has taken a different tack, recommending regulation almost without regard to costs and benefits. We reject the Committee's approach in favor of the Department's.

The Advisory Committee's implicit definition is that a practice is an "abuse" if it could result in some investors earning more on a particular deal than others. See Report at 20, 23, 26. That is a short-term approach at best. It comes close to assuming that tender offers are like bags of money delivered by storks, and that the task of the law is to pass the gains around. But tender offers do not show up unannounced (except at the doors of lawyers). They are the product of hard work. So too is the operation of the market. Active investors, like the bidders, put money at risk. They do more than passive investors. Both those who make offers and those who are active market participants need extra compensation. The Advisory Committee assumes that redistribution of the gains from those who create them (bidders and market professionals) to passive investors would not have significant effects on the welfare of shareholders. The Advisory Committee is wrong.

Even if unequal distribution of gains is harmful, how great is the harm? The Advisory Committee does not try to estimate this cost, and it altogether ignores the ways in which markets, and the investors themselves, can achieve equal distribution. The price of stock reflects the possibilities of unequal distribution of gains, so investors are compensated automatically when they buy stock. They also can invest in safer securities (bonds, or stock of firms too large to be acquired) or in portfolios of stocks (which will include both bidders and targets) if they want to avoid risks on individual transactions. Ironically, the "smallest" investors do just this, committing their funds to the market in the care of professionals such as pension managers, mutual funds, and insurance companies. The money managers will act most quickly in response to any tender offer. Thus a large portion of any "extra" gains these market professionals reap land in the pockets of the smallest investors.

The practices to which the Advisory Committee objects thus are not abusive, and they are easy for investors to protect against if the investors agree with the Committee. What point then in regulation? On the other side of the balance, regulation drives down the number of offers and reduces their effectiveness in moving assets to better uses. Regulation thus harms investors and the economy. Better to be rid of federal regulation and allow tender offers to proceed just as other financial matters do. Corporations will offer different provisions in their charters, just as they now offer dozens of financial instruments and opportunities. They will compete with one another to sell what investors want to buy. Just as common stock dominates other instruments, so some charter provisions (whether offer-inducing or offer-resisting) will come to dominate other ways of responding to tender offers. Investors can take their pick, without the cost of regulation.

It is important to understand that the Advisory Committee's approach is 180 degrees at odds with the philosophy underlying the statutes that govern our securities markets. The Securities Act of 1933, and the Securities Exchange Act of 1934, are disclosure statutes. They rest on the assumption that investors must be allowed to take risks, to arrange their own affairs, if the capital markets are to flourish. They rest on the further assumption that the capital markets are competitive, and once fundamental facts have been disclosed either competition will protect investors, or investors will protect themselves. Today the Advisory Committee repudiates these premises and substitutes paternalism.

If we must have regulation, though, let it be as little as possible. The SEC should return to the minimum time periods provided in the Williams Act. Certainly we should not move in the direction of more regulation. Extending the offer periods makes tender offers riskier, costlier, and scarcer. Requiring firms to make tender offers for all shares in excess of 20% of a firm's stock, and to stop and wait before obtaining 5%, will increase the cost of obtaining minority positions. There is no reason to do this. Minority positions aid in the monitoring of managers, and shares outside the minority blocs appreciate as well. Minority positions aid in waging proxy contests, which again help shareholders, and they facilitate the making of tender offers for control.

If there is to be substantial regulation of bidders, then there must also be substantial regulation of targets. The time delays and disclosures created by regulation give targets the upper hand, again making bids more costly and more scarce. It is necessary to redress this imbalance, certainly by controlling lock-up options and perhaps by controlling the entire process of defense and auctioneering.

II

Our approach to regulation (let there be as little as possible, and then only if it passes a cost-benefit test) follows that of the Department of Justice. The recommendations of the Advisory Committee take a different approach to the analysis and regulation of tender offers — or, rather, two different approaches, one for regulation of targets and one for regulation of bidders. There is no effort to minimize the amount of regulation. There is no effort to evaluate the extent to which investors can protect themselves from unwelcome practives. There is no effort to determine the costs of regulation, or the extent to which the costs (principally discouraging new offers, wiping out the attendant gains) compare with the benefits of regulation.

With respect to the behavior of bidders, the Advisory Committee appears to reason as follows: if a tactic ever can be misused (meaning "used in such a way that different shareholders of the target obtain different returns from the offer"), then that tactic should be severely regulated or eliminated even if in most cases it is neutral or beneficial. Thus the Advisory Committee recommends elimination of short-term offers, proration pools and withdrawal dates shorter than the minimum offer period, open market purchases beyond 20%, and so on.

With respect to the behavior of targets, however, the Advisory Committee takes an almost opposite approach: if a tactic can ever be used constructively (where constructively means "with the effect of raising the price paid for the target's shares, given that an offer has been made"), then that tactic should be allowed, subject only to the business judgment rule under state law. Because the business judgment rule is highly deferential to managers — particularly managers who have indeed increased the price paid in a given tender offer — the approach amounts to general approval and the absence of regulation for most tactics.

Why should the Advisory Committee take such radically different approaches, on the one hand regulating or banning bidders' tactics whenever there is a possibility of abuse, on the other hand permitting targets' tactics whenever there is a possibility that they will not be abused?

The Advisory Committee apparently saw its task as "balancing" fairness and deterrence. It wanted to obtain more fairness — more equality in the distribution of gains, given the existence of an offer — without unduly reducing the number of gain-creating offers. The regulation of bidders is designed with this fairness goal in mind. If the only objective of regulation is "more gains to shareholders, given an offer", then it also makes sense to permit targets to engage in defensive tactics that create auctions, although not to try to defeat offers altogether. Perhaps this explains the Advisory Committee's treatment of defensive tactics; it tries to balance auctioneering against offer-defeating strategies.

The critical assumptions underlying the Advisory Committee's work is that the target's shareholders want "equal" or "fair" distribution of gains, given that an offer has occurred, and that regulation is concerned almost exclusively with these shareholders. The Advisory Committee's recommendations systematically ignore the interests of bidders' and bystanders' shareholders. The focus is exclusively targets' shareholders, the perspective ex post (that is, it assumes that an offer is on the table). The recommendations recognize the effect of regulations on the number of future offers only incidentally, as part of the "balancing" procedure. The shareholders of bidders get precious little recognition. Yet the shareholders of bidders and the shareholders of targets are, or can easily be, the same people, who want to maximize the value of their whole portfolios, not just to get the best price they can given than an offer has landed on the table. This suggests that it is fallacious to assume that shareholders want "fair" treatment in the first place.

The Advisory Committee also makes no effort to quantify the effects it describes. It reasons: if something is "abusive," eliminate the abuse. This is regulation by pejorative. If something is "abusive," how frequently is it abusive? What are the costs of abuse? How many abuses will be prevented by the regulations? What will the savings be? At what cost (including, as always, the cost in tender offers deterred and gains foregone)? We do not expect anyone to be able to quantify these things. We do not have the data for that. But before we recommend regulation, we should be sure of the comparative sizes of these things. We do not yet know these magnitudes.

When then of fairness? The Advisory Committee is for fairness. This is wonderful rhetoric but bad analysis. Who is for _un_fairness? What position is being rejected? The question is not whether we are in favor of fairness but what fairness means, and how much we are willing to sacrifice to achieve more fairness. The Committee equates unfairness and abuse with anything that divides the gains of an acquisition unequally among the target's shareholders. But it never justifies this equation or tells us how much fairness is worth.

The definition of unfairness with unequal returns, given that an offer has occurred, is an unusual one. Most of us think of a game as fair when it is conducted in accordance with rules laid down in advance. A roulette game is fair if there are no unknown magnets under the table; it need not pay off on every number every time in order to be fair, and it need not give the players even odds with the house. If there are _known_ magnets (so that red pays off twice as often as white), the game is still perfectly fair. There will be an adjustment in the odds. Similarly, insurance is fair if the premium reflects the chance of loss and the cost of administering the program. Many policyholders will never collect, and the total premiums may well exceed the total payout, yet the system is fair nonetheless.

Buying stock in new companies is risky business; many people will lose a bundle. We do not think of this as unfair, however, because shareholders go in with their eyes open. Shareholding is actuarially fair, the sense relevant here. The whole premise of the Securities Act of 1933 is that shareholders should be allowed to make choices — to take risks — if they have access to the information or advice necessary act intelligently. People either demand compensation for the risks they take or shift to less risky investments.

Moreover, the equation of unfairness and abuse with unequal division assumes that shareholders want equal divisions. There is no evidence that they do. It is more appropriate to assume that shareholders want to maximize the expected value of their shares, not to concentrate on how the gains are divided in a given case. Almost all shareholders are repeat players in the market. If they do not get cut in on the gains today, they will tomorrow.

A shareholder who owns a share of stock in a randomly-selected firm (that is, one that could be either a bidder, a target, or a bystander) would not want equitable division of gains at the expense of a reduction in the number of offers. Investors unanimously prefer to maximize the total gains of shareholdings, even at the risk of unequal division, unless they are significantly risk-averse.[3] The holder of a more-valuable share can sell it and realize the gains.

Thus there are two questions. Does equal distribution of gains reduce value? Are investors risk-averse (in a way they cannot overcome)? On the first question the answer is straightforward. Unequal division of gains may be very important in creating incentives to produce gains. The people who take active roles in gain production (the bidders and market professionals) incur substantial costs in searching for targets and bearing risk. They need more compensation than passive investors get to make this worthwhile.[4]

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3. Harry DeAngelo, Competition and Unanimity, 71 Am. Econ. Rev. 18 (1981); Louis Makowski, Competition and Unanimity Revisited, 73 Am. Econ. Rev. 329 (1983).

4. Just consider the "unequal" treatment of managers, who get stock options and bonuses denied to ordinary, small shareholders. Is this unfair, reprehensible treatment, or is it an incentive necessary to induce managers to create the gains the small share-
— Note Continued —

Passive investors would like to get more, given an offer, but they know that if there is a rule of equal divisions, then it pays to be passive rather than active. An incentive to be passive is a formula for economic slumber.

Those who bring opportunities into being also need to differentiate among the passive investors. If the passive shareholders know that all will be treated equally — if, for example, those who do not tender are guaranteed returns equal to or better than those who do — why should any passive investor take the time and risk necessary to tender his shares? Better to sit back and watch, getting the gains without the costs. If more than a few investors reason this way, though, tender offers again become harder and costlier to mount, to everyone's detriment. "Unequal" treatment of shareholders thus is beneficial to shareholders, because it encourages them to cooperate in the creation of economic gains. When they do not cooperate, offers are deterred. There is a reduction in the expected value of each share, whereas a reshuffling of the gains when an offer does occur would not affect the expected value of the share at all. An investor interested in total returns thus would gleefully permit extra payoffs to some — what the Advisory Committee calls "abuses" or "coercive" (Report at 25) — whenever they increased the number of offers.

These arguments about unequal divisions may appear to overlook the fact that small shareholders are likely to be risk averse, and that such shareholders also may not play the game often enough to get their cut of the gains. This brings us to the second problem in the Advisory Committee's approach: these small, risk-averse shareholders can protect themselves very easily, at costs far lower than those entailed by the proposed regulations.[5] As a practical matter, they are not risk-averse.

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holders enjoy? Tender offerors and active shareholders need similar compensation.

5. This point is made in greater detail in Frank H. Easterbrook & Daniel R. Fischel, Corporate Control Transactions, 91 Yale L.J. 698, 711-14 (1982); Frank H. Easterbrook & Daniel R. Fischel, Auctions and Sunk Costs in Tender Offers, 35 Stan. L. Rev. 1,
— Note Continued —

Self-protection is simple. The small, risk-averse shareholder may simply sell his shares in the market — getting the enhanced price available in a world of easy takeovers — and buy something else. One option is to buy debt. Bonds and bond funds are not affected very much by tender offers, and the investor seeking security and identical treatment with the pros can get it through debt. Money market funds and banks are not affected at all by tender offers. Neither are the stocks of the very largest companies, which may be too big to take over.

The other option is to buy a mutual fund or some other diversified portfolio. Then the investor is sure to hold bidders as well as targets and bystanders. More to the point, the "small" investor holding a mutual fund, pooled trust certificate, pension plan, or other diversified portfolio — the way "small" investors hold more than 90% of their investments — is delighted by any rule that enables market professionals to improve their position. Professionals manage these funds and trusts. There is no problem of timing when a mutual fund or pension trust hears about a tender offer. The money manager can move with dispatch.

We thus find it ironic that the Advisory Committee should express great concern for the plight of the small investor, unable to take advantage of a tender offer or open market purchase program. The risk-averse small investor is the one whose funds are under professional management or in instruments (debt or very large firms) that assure equal payouts. The person who needs to read the tender offer forms and decide for himself is generally the investor with a goodly stake in the market, $100,000 of investment and up, who can well afford to hold a diversified portfolio if he wants and is not likely to be baffled by the complexities of an offer. If he finds himself unsure, he can sell in the market, where professional investors, competing among themselves, have set a price fairly reflecting the probabilities of success of the various options open at the time.

7-9 (1982).

Doubtless these forms of self-protection are imperfect. Not all small investors diversify their holdings or place them under professional management. But those who do not do so have reasons of their own. As things are (or were before the Williams Act in 1968) they are free to choose. They can protect themselves or take risks. If regulation is put into place for the purpose of ensuring equal payouts to all shareholders in each offer, all shareholders lose this option. It is difficult to see how we help shareholders by denying them an option (taking risk in pursuit of larger gains) they now have, while not creating any new option that they now lack. Regulation seems wholly destructive here.

The self-protection mechanisms discussed here have costs, no doubt of that. All of us, though, should be willing to compare these costs — small by any count — with the costs of new regulation. The costs of regulation are unlikely to be smaller than the costs of self-protection.

III

These principles lead to our recommendation: Congress should repeal the Williams Act and terminate all federal regulation of tender offers with a single exception. We would preserve the rule of Edgar v. MITE Corp., 102 S. Ct. 2629 (1982), that state prohibitory regulation of tender offers is not lawful to the extent it affects interstate securities transactions.[6] Because MITE was based on the Supreme Court's view of the Commerce Clause rather than the Williams Act, this will continue to be the rule unless Congress affirmatively authorizes states to regulate tender offers. So long, however, as there are no federal restrictions on the activities of bidders, we also would not recommend federal rules for the activities of targets.

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6. That is to say, we agree with the premise of much federal legislation that we should preserve a national securities market. We think it important, for reasons that follow, to distinguish between state rules that simply implement agreements embodied in corporate articles and bylaws (which we would permit state courts to enforce) and state rules that override the terms of corporate articles and bylaws (which we think should be preempted whenever the firm is traded on the New York or American Exchanges or the NASDAQ system, or 50% or more of a corporation's shareholders live outside the state attempting to do the regulating).

Unlike the Advisory Committee's approach, this one uses the same assumptions for both bidders and targets. It avoids tipping the balance by regulating one group (bidders) much more severely than targets. It implements the principle with which we began: if you aren't very sure of your ground, don't regulate. Most important, it implements the system most beneficial to investors: competition in advance of offers.

The Advisory Committee says, and we agree, that defenses against tender offers could be beneficial to targets in some circumstances. Some firms, at some times, may be managed best if they stay "independent." Perhaps independence amounts to beneficial tenure for managers, perhaps it aids long-run planning. Perhaps the ability to keep a firm independent will assist managers in negotiating the best terms for any given acquisition. Some firms may prosper if the articles contain "fair price" provisions for their shares, or "mandatory tender offer" rules (similar to the Advisory Committee's 20% proposal). There are many ways for firms to ensure monitoring of managers: tender offers, proxy contests, the market for managers, and other devices are substitutes, and firms will select different devices to offer to their investors. Shareholders who value equal treatment highly might desire to hold stock in firms restricting takeovers, just as people who value environmental protection highly may buy shares of mutual funds that limit their holdings to environmentally-responsible corporations.

We do not mean that the asserted benefits of articles regulating changes of control are always substantial, or even that they are often substantial. They are certainly logically possible — the fact that partnerships and close corporations have anti-takeover and equal-price features, and financial mutuals do not even have stock, is proof enough of this. Our point is that a market will develop and offer such features to shareholders if they are valuable, just as corporations now offer a thousand other kinds of provisions in their articles governing the rights and priorities of their securities and the terms of shareholders' suffrage.7

It might have been said, at the time the Williams Act was enacted, that the hostile tender offer was such a novel development that firms had not had the opportunity to tailor their organizations to respond to the possibilities. If that was ever true,[8] it is true no longer. We have had more than 20 years of hostile offers, and firms have by now identified themselves as amenable to acquisition or not. There is no need for legislation to ease the transition to a competitive marketplace in acquisitions.

Firms offer a dazzling number of investment instruments (bonds, preferred stock, convertable subordinated debentures, common stock with different sorts of rights, warrants, and so on) to attract invesors' money. They compete in the products they offer. They compete in the kinds of internal governance they use, including all sorts of differences in management structure and voting. These differences evolve over time according to the vicissitudes of the market and the value investors place on them. The more beneficial a structure for investors, the more likely it is to survive. Some rules are better for some corporations for others, and the degree of benefit changes from time to time.

The approach of the Advisory Committee seems to be that the Committee knows what is wise and beneficial for investors. We are far more skeptical. We do not know what is good for investors. Moreover, what is good for investors today, and in one firm, may be bad for them tomorrow or in another firm. Why should the Advisory Committee try to force all tender offers into one mold of procedure?

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7. See Eugene F. Fama & Michael C. Jensen, Separation of Ownership and Control, 26 J. Law & Econ. 301 (1983) (discussing the many agency cost control devices).

8. Which we doubt. Firms have always had the choice of holding themselves open to takeover or making themselves hard to digest. Firms with staggered boards, classified boards (elections by classes of security, some of which might be closely held), cumulative voting, preemptive rights, supermajority rules, and long-term contracts with managers have been hard to take over, by tender offer, proxy contest, or any other route. These anti-takeover provisions became less and less common throughout the 20th century, an evolution suggesting that openness to acquisition was beneficial to investors. It seemed to have more survival value than the opposite approach. See generally Frank H. Easterbrook & Daniel R. Fischel, Voting in Corporate Law, 26 J. Law & Econ. 395 (1983).

There is every reason to think that, left alone, corporations would offer investors as many different regimens of tender offer bidding and defense as they now offer different investment instruments and governance structures. Some firms would hold themselves open to acquisition; others would elect fair price provisions; others would set up super-majority rules; still others would make acquisition impossible (as it now is for close corporations and partnerships). Which of these methods or mixtures would prevail over the long run we do not know. Certainly only the methods beneficial to investors would survive in a competitive market.

If anti-takeover provisions are not beneficial to investors, they will depress the price of the stocks affected by them. At lower prices, these stocks will be more attractive as takeover targets. The market thus has at least one automatic compensation device for undesired opposition to takeovers. There are other methods as well: firms that insulate their managers from the pressure of replacement via takeover will falter in their product markets, their stocks will decline in value, and they will change course, or fail, or be taken over. In the long run, useful provisions will dominate in corporate articles and bylaws. And the competition among firms will accomplishe everything the Advisory Committee recommends. Investors who do not want to take the risk of missing out on the gains of tender offers can buy stock in corporations with fair-price, anti-two-tier-offer, or other rules that ensure equal treatment of investors in the event of an offer. Other investors can make different choices.

This is not a radical proposal. It is the system that prevailed in this country for tender offers until 1968. It is the system that prevails today for proxy contests, sales of control blocs of stock, and almost every other corporate or securities transaction. It is competition of the same sort that both state corporate law and the '33 Act envisage. State corporation laws are enabling statutes. Firms can pick almost any set of rules they want, so long as they announce them to the investors. State law usually just sets "default" terms, which govern in the event the articles and bylaws are silent. The states rarely attempt to dictate the substance of relations among investors and managers. See Judge Ralph K. Winter's powerful discussion of this, Government and the Corporation (1978).

Similarly, the Securities Act of 1933 is a disclosure stature. Firms may offer, and investors may purchase, anything they can dream up, so long as the terms are disclosed. Investors can buy any kind of instrument, at any level of risk. The Act rests on the assumption that investors with knowledge of the facts can and will make intelligent, self-interested decisions. It rests on the further assumption that if one firm tries to bilk investors, it will not long survive the light of publicity and the scrutiny of professional investors. Investors can sink their savings in warrants and financial futures if they want, and it is not "unfair" or "abusive" if these investors end up with empty pockets. Throughout securities law, equality of returns plays no role.[9] We have heard no argument in the Advisory Committee suggesting that we cannot safely follow the same assumptions in designing policy toward tender offers.

The only form of federal safeguard necessary here is one that facilitates the competition among corporations to design structures that investors want to have. There are two potential threats to the system of competition sketched above. One is state regulation, which may attempt to override the articles and bylaws and substitute a different scheme. The other is the activities of managers once a tender offer has been launched. The managers of a firm that has announced itself open to tender offers may attempt to welch on the deal and prevent the transfer of control. Arrangements that seemed advantageous to them when they were writing articles, bylaws, and contracts,

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9. Consider these examples, in addition to those in the text. If the firm does exceptionally well, shareholders (and especially warrant holders) get the gains, bondholders get nothing. If the firm does exceptionally poorly, shareholders may be wiped out, while bondholders get their full investments and preferred stockholders get some fraction of theirs. Control blocs sell for more than isolated stocks. Specialists on the exchange floors get the benefit of the spread. Insiders get discount stock. All of these inequalities would be condemned under the Advisory Committee's approach, yet all are tolerated and even welcomed in markets because they serve important functions.

the better to sell securities, may seem less beneficial once they have received the money and then feel their positions threatened. Managers thus cannot be allowed to change the rules once the game has begun.

Attempts to change the rules may be subtle. A firm that selects an open-to-bids posture may attempt to run an auction, perhaps using lock-up options, once a tender offer is made. This amounts to a change in rules because it puts the first bidder at a disadvantage, penalizing or deterring first bids as surely as any express discouraging provision in the articles. We would expect state courts to enforce articles and bylaws rigorously, but if they do not there might be cause for a federal tender offer rule ensuring that firms stick with whatever position on tender offers they adopt in the articles and bylaws.[10] Cf. Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981) (lock-up options, and option sales of princial assets, are illegal manipulation).

Of course, managers also might attempt to change the rules by putting new proposals to vote. Investors must be able to make important changes in the structure of the firm. Nonetheless, there is some danger of opportunism in allowing firms to sell stock with no anti-takeover provisions and then to insert such provisions later on. If the rules can be changed too easily, investors will not believe the promises implicitly or explicitly made when stock is sold, and the market mechanism we have described will not operate.

Changes in the articles and bylaws can be made rather easily by managers. Few investors scrutinize such changes carefully, because few investors own enough stock in any firm to make scrutiny worthwhile. Those who carefully study proposed changes find that their votes are insignificant, or that it is too costly to wage a proxy contest, so most investors are rationally passive and go along with the managers or sell their shares.

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10. Firms with no unusual provisions should be deemed "open" to offers, and the managers accordingly prohibited from defending or running any sort of auction with a potential for giving the second bidder a preference. That would include selective disclosures of information and lock-up options.

Regulation banning changes in the articles likely would have costs outweighing the benefits. There might be net benefits, though, in requiring firms that insert anti-takeover provisions in the articles and bylaws after the shares have been issued to seek reauthorization for these provisions every few years. Requiring the managers to initiate the process of review and approval relieves the shareholders of the costs of putting a proposal on the ballot, and the reauthorization vote gives shareholders an opportunity to organize to restore the status quo should they think that the change in the earlier vote is now hurting the firm. Binding votes seem altogether preferable to the advisory votes the Committee recommends.

IV

The Advisory Committee has taken a different approach. To the extent its recommendations support federal regulation, other than regulation to ensure the existence of a national market and the implementation of corporate articles, we disagree with them. Several of the recommendations nonetheless require more particular treatment. We take them up in the Advisory Committee's order, for reasons of clarity rather than importance.

Recommendation 13 calls for firms to file disclosure statements and wait at least 48 hours before acquiring more than 5% of any class of stock of a corporation. The notice requirement of Section 13(d) of the 1934 Act is troublesome to start with. It requires firms to tip their hands to the market and the target, giving away valuable information, and does not secure any gains in return if, as we have argued, investors are interested in more than just getting the highest price for a given target.[11] If there is to be a change in §13(d), it should be in the opposite direction, such as raising the threshhold to 10% (the original level) or 20%.

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11. See Sanford Grossman & Oliver Hart, Disclosure Laws and Takeover Bids, 35 J. Finance 323 (1980); Daniel R. Fischel, The Law and Economics of Dividend Policy, 67 Va. L. Rev. 699 (1981).

The "abuse" that has led the Advisory Committee to recommend a stop-and-wait period before acquiring 5% is that "the acquiror 'dashes' to buy as many shares as possible" (Report at 22) between the time it acquires 5% and the time (now ten days later) by which they are required to file. Why is this an "abuse"? Who loses? The Advisory Committee does not say, but the recommendation must again reflect an equal-access-to-premium view of fair treatment.

If rapid acquisition of shares is a problem, then there could be a limit on the rate of accumulation. For example, the rule could say: "File the Schedule 13D within 10 days after acquiring 5%, within five days after acquiring 8%, or within 24 hours after acquiring 10%, whichever comes first." The requirement of prior filing, on the other hand, would create roadblocks to the acquisitions of groups of shares (which might put the holder over the line in one fell swoop) and would create undue caution in acquisitions (again to the detriment of shareholders) as potential buyers tried to stay far enough below the line to avoid accidental violations. No purchase program can determine exactly how much will be acquired with a given bid: that is why the statute now gives a period for filing after the trigger. Holders of stock also find their percentages varying as the firms issue and acquire their own stock. Congress knew all these things when it wrote the law. Has our Advisory Committee forgotten them?

Recommendation 14, which limits to 20% the holdings of any person unless acquired from the issuer or via a tender offer, is the most unsettling of the Advisory Committee's recommendations. It too is based on undefined notions of fairness without recognition of the ways investors can protect themselves, and it takes no account of the cost. It was strongly opposed by the Department of Justice. Mr. Baxter's statement of June 2 pointed out that this rule:

> would have several detrimental effects. First, it could hamper the activities of arbitrageurs which facilitate the orderly functioning of the market. Second, it could make much more expensive and difficult to wage a successful proxy contest against entrenched management. Third, there would be adverse efficiency effects that result whenever a regulation limits the options of some market participants. . . . It is not obvious, how-

ever, that there are any benefits that justify the substantial costs of implementing this recommendation.

The Advisory Committee acknowledges (Report at 23) but does not respond to any of these points. Perhaps this is because they are unanswerable.

The recommendation is a Draconian response to a non-problem. It depends wholly on a view of "fairness" under which every shareholder is supposed to have access to every premium. Yet as we have shown this is not an end for which regulations need to be created. If open market purchases are ongoing (and disclosed, since the §13(d) trigger is 5%), anyone who wants to do so can sell to the market and get the benefit. If the open market purchases are too rapid for small shareholders to participate directly, they nonetheless gain indirectly because money managers (who collect small shareholders' investments) will be the ones doing the selling. There is no evidence that shareholders of any size experience losses in open market purchase programs. Certainly there is no argument supporting more than a go-slow rule (say, one limiting open market purchases to 5% per week.)

At the same time, the tender-offer-or-nothing rule of Recommendation 14 would have substantial costs. First, it would make assembly of a moderate-sized minority bloc (say 25%) more difficult by compelling the purchaser to use an expensive tender offer in place of open market purchases to acquire the last 5%. If the assembly of such blocs is made more costly, we can be confident that fewer blocs will be assembled. The incentive should run in the opposite direction. Blocs in the 15-30% range are a response to the separation of ownership and control, to the fact that widely scattered shareholders have difficulty in monitoring managers. They are a substitute for proxy contests, tender offers, and other responses to the agency problem of management. The evidence is overwhelming, and uncontradicted, that the assembly of such middle-size blocs is associated with gains to the investors whose shares are not acquired.[12] We should not make bloc

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12. E.g., Larry Y. Dann & Harry DeAngelo, Standstill Agreements, Privately
— Note Continued —

assembly more difficult.

Second, making the open market assembly of blocs more costly also makes tender offers more costly. Bidders will have to start with smaller blocs of shares if they seek control. Anything that makes acquisitions more costly means that there will be fewer acquisitions. (Assembling a bloc in quiet is itself a response to the Williams Act and implementing rules. Before 1968 bidders were more likely to open proceedings with an offer to all shareholders rather than buying shares on the open market. They started buying blocs as a means of covering their costs should they lose an auction of the sort made possible by regulatory delay. The perceived need to regulate bloc acquisitions thus is an example of how regulation begets regulation.)

Third, the rule would have a substantial effect on other methods of changing corporate control, particularly the proxy contest. Most proxy contests now combine a campaign for votes with a purchase of shares (and the attached votes). Managers have a natural advantage in all campaigns, so the ability of insurgents to purchase shares may be indispensable to them. Many marketplace professionals believe that the insurgents must control 30% to make the proxy fight worth the candle. Under the Advisory Committee's recommendations, however, all insurgents could be defined as a group (see **Recommendation 15**), and the group would be limited to 20%, after which it would have to stop, make a tender offer, and wait at least 44 days to acquire another share (this would be a partial offer). By then the record date would have come and gone, and the chances for success would have been reduced.

This might be an acceptable outcome if proxy fights were some plague in the market place. Far from it, though. The best available evidence suggests that shareholders gain roughly 6-8% from proxy contests, whether the insurgents win or lose.[13] There

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Negotiated Stock Repurchases, and the Market for Corporate Control, 11 J. Financial Econ. (1983) (forthcoming).

13. Peter Dodd & Jerold B. Warner, On Corporate Governance: A Study of Proxy Contests, 11 J. Financial Econ. (1983) (forthcoming).

seems to be a benefit here — at least shareholders perceive a benefit, and those who have a different view can cash in their 8% gain and buy something else. Perhaps the gain arises because any contest keeps managers on their toes. Perhaps the debate about the corporation's future supplies new ideas for improvements. Perhaps the gain arises because during the contest someone has assembled a large bloc of stock, thus reducing the separation of ownership and control and, with it, reducing agency costs. We do not know the source of the gains, and we do not think the source makes much difference. What matters is that the gains are real, and the proposal of the Advisory Committee would jeopardize these gains for no good reason.

Fourth, if there is to be a restriction on the accumulation of blocs, it is essential to have an exception for the purchase of existing blocs. Consider a bloc of 60% of the stock of Widgets Inc. held by Diversified General Industries. The bloc may have been assembled at great cost, and Diversified may have devoted time and effort to improving the operation of Widgets. It is well accepted, in both state law and economic theory, that such control blocs properly exist (they reduce the agency costs of management) and trade at a premium.[14] Contrary to the Advisory Committee's bland assertion (Report at 23), the control premium is not a "corporate asset" under the law of any state. It represents, instead, some of the additional value produced by those who control and manage a firm. The shareholders outside the control group either had a crack at a control premium while the bloc was being assembled or bought into the firm later, knowing of the outstanding bloc, and can hardly claim that its existence or sale does them harm.

Under the Advisory Committee's proposal, Diversified could not sell the 60% bloc to anyone. It could sell no more than 20%, after which the buyer would need to announce a tender offer and acquire Diversified's stock only pro rata. This would break up the control bloc, to the detriment of all, and also deny Diversified the full return for its

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14. See Zetlin v. Hanson Holdings, 48 N.Y.2d 684, 397 N.E.2d 387 (1979). See also Easterbrook & Fischel, Corporate Control Transactions, supra note 5.

efforts. It is not hard to see the result of all of this: fewer people would assemble control blocs; those who had control blocs would be less likely to improve the fortunes of the controlled companies; they would be less likely to sell (even if a new buyer could make better use of the controlled company). This is a substantial economic price to pay for the pursuit of the evanescent ideal of "fairness".

The problem is hard enough when the holder of the bloc is some conglomerate. It is worse when the holder of the bloc is a single person or family. This bloc holder may be tired of managing the firm or may be old and ill. He wants to sell out, and from an economic point he must. The history of corporate law is filled with instances of such mutually-beneficial sales.15 Yet the Advisory Committee's position limits his ability to sell the bloc; he must take a premium on what he can sell and disperse the rest. Faced with this alternative, he may well hold the stock instead, because he can still take the perquisites of management.

The position underlying Recommendation 14 must be: the Advisory Committee thinks blocs greater than 20% should not exist, and it wants to discourage them. This dislike for minority positions underlies the discrimination against partial offers reflected in **Recommendation 16,** and it also explains the positions of several members of the Committee who would go even further and ban partial or two-tier offers. The Advisory Committee's view of corporate structure is that shareholdings should be atomistic, none large enough to influence the actions of managers, no investor able to reap the benefits of his efforts but instead required to "share" the benefits with others who remain passive. This may be comforting to managers, but it is not comforting to investors, who

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15. One example is the sale of a 37% bloc of Newport Steel in one of the most famous sale-of-control cases. Perlman v. Feldmann, 219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955). The court of appeals concluded that the sale here deprived the corporation of "its" right to a premium reflecting the shortage of steel in the Korean War. Yet as it turns out the "excluded" shareholders (the 63% majority) obtained enormous gains from the sale. The firm apparently had been mismanaged in its old hands, and promptly after the sale the price of the "excluded 63%" doubled. See Easterbrook & Fischel, Corporate Control Transactions, supra note 5, 91 Yale L.J. at 717-19 & n.43.

need some method of responding to the fundamental difficulty in monitoring and controlling managers in large firms characterized by separation of ownership and control. Recommendations 14, 16, and all other aspects of the report discriminating against partial or minority positions would best be forgotten.

Recommendations 17 to 32, which set out the procedural rules for the conduct of tender offers, are largely modeled on current statutes. They are based, implicitly or explicitly, on unarticulated notions of "fairness." We find them troubling to the extent they implement federal regulation, for the reasons we have explained. Shareholders can arrange for equal treatment if they find that valuable, and regulation thus forecloses options to both shareholders and bidders without making any new options available. Regulations of this sort also show no concern for either the shareholders of bidders or the shareholders of firms that never receive bids because the regulations have discouraged such activities. As the Department of Justice explained:

> Regulations that myopically focus on correcting perceived problems with tender offers that have already materialized and that do not also consider the adverse effect those regulations may have on the long-term incentives that motivate tender offers in the first place may ultimately frustrate the very goals they are designed to promote.

Some of the new wrinkles contained in these recommendations improve on current rules. The no-extension rule (**Recommendation 17**) and its shortening of the offering period for a second bidder are in this category. So are standardization and expedition of document processing (**Recommendations 21-23**). Others are helpful clarifications. The calculation of time in calendar days, rejection of fair price regulation (**Recommendation 24**) and not requiring approval of bids by shareholder votes (**Recommendation 31**) fit in this category. (The price of a tender offer is fair when the shareholders accept it. They are the best judges of whether a price is high enough.)

Other wrinkles are not improvements. The 30 (or 44, depending on the kind of offer) day minimum period is much too long. When the rules also permit defensive and auctioneering tactics, even 30 days is an eternity. The bid tips off the market, gives away valuable information, and permits managers to dig moats and trenches. The time seriously discourages offers, yet it does not help shareholders (who, as we have emphasized, do not gain from equal treatment and can protect themselves from risk, if they want, by buying debt, holding diversified portfolios, or hiring money managers). Moreover, the bidder's principal methods to encourage tenders — and thus to make first bids pay — are short proration and withdrawal periods, which these recommendations would eliminate.[16] These devices make prompt tenders more valuable than deferred tenders (or non-tenders) and thus reduce the incentive of shareholders to be passive. Indeed, bidders and shareholders alike gain by designing offers that encourage shareholders to tender quickly. Those who wait are taking free rides on the efforts of other shareholders, as we explained above. To deprive the first bidder of the methods it uses to address this problem is to make bids more expensive, more risky, and thus more scarce, to everyone's detriment.[17]

Similarly, the short and hedged tendering proviso of **Recommendation 44** is unnecessary except to prevent evasion of the proration rules. Short tenders permit market professionals to "beat" the proration system by overtendering and thus getting more of their actual shares accepted. Change the proration rules, and the need for the ban on short tenders disappears. (There is never a need to regulate short and hedged tenders in bids for all stock, and the SEC should change the rules accordingly even if it continues their regulation in partial bids. On the treatment of other cases, though, we disagree: Jarrell would preclude short and hedged tendering, while Easterbrook would allow either if the bidder so elects.)

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16. See Sanford Grossman & Oliver Hart, Takeover Bids, the Free Rider Problem, and the Theory of the Corporation, 11 Bell J. Econ. 42 (1980).

17. See Daniel R. Fischel, Efficent Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 Tex. L. Rev. 1 (1978); Henry G. Manne, Mergers and the Market for Corporate Control, 97 J. Political Econ. 110 (1965). See also Robert H. Mundheim, Why the Bill on Tender Offers Should Not be Passed, 1 Institutional Investor 24 (May 1967); Victor Brudney, A Note on Chilling Tender Solicitations, 21 Rutgers L. Rev. 609 (1967).

If there must be regulation of timing, and the proration and withdrawal periods, we would return to the offer, proration, and withdrawal periods stated in the Williams Act itself. There is no evidence that these periods are inadequate for the market to react in an informed way, and there is good evidence that longer periods are very costly. There is no evidence that longer periods (or extensions) are needed in partial offers, and the longer 44 day periods here are even worse than the 30 day periods for full bids. The recommendations here are yet more examples of plunging foreward to cure imaginary, undefined abuses without regard to cost. As Assistant Attorney General Baxter put it in his statement of June 2, 1983: "I am unpersuaded that the very marginal benefits of an extension would outweigh the attendant costs of increasing the opportunity for management to thwart hostile tender offers and thereby decrease further the level of tender offer activity."

We also would reduce the number of private rights of action. These are not created by the statute, and private litigation is used as often to delay an offer for the benefits of managers as it is to redress real violations of the rules. A substantial case can be made for limiting enforcement to administrative and penal sanctions, which can be considered and imposed without the haste of litigation in mid-offer and without creating opportunities for the parties to impose by litigation costs that are out of line with any possible harm from the violations asserted.

Recommendation 19, which calls for requiring the disclosure of "assumptions" whenever a firm makes a projection of asset valuation, is troubling without regard to any effect on the nunber of offers. It conflicts with the considered decision of the SEC at the time it issued Rule 175, the safe harbor for projections. The Commission declined to require assumptions because that would be a swamp and a breeding ground for litigation. See Release No. 6084, June 25, 1979. There would be so many uncertainties that making any projection would be risky business. Fewer firms would make projections.

Any profit projection or asset valuation will rest on numerous and complex assumptions. They include, among other things, engineering data, the nature and plans of the firm and all of its rivals, the development of new technologies, the state of negotiations with suppliers and unions, and the plans of any governmental agencies with power to affect the business. Which of these are "principal supporting assumptions" (the Advisory Committee's term)? Some of these factors are in the public domain, so that disclosure is redundant. Others are too complex to be disclosed in less than an encyclopedia's worth of documents. Still others concern confidential information, which if disclosed would be of more use to the firm's rivals than its stockholders. The disclosure rules to date have been designed to avoid compulsory disclosure of such valuable commercial information. As it turns out, the design has not always succeeded: the plans of a tender offeror are valuable information that the rules require to be disclosed. There is no reason for new disclosure requirements that will penalize even more those firms that create new information.

A firm that discloses a projection without assumptions will find that its projection is discounted by the readers. No one is fooled if he sees that a projection stands on air. There is, nonetheless, some information value in projections.[18] If they are wilfully false, projections (even without assumptions) are actionable. Even when not actionable, false statements impair the reputation of their maker. They thus have some value to the market, assumptions or no, and the SEC should do nothing to discourage firms from making available as much information as they can, consistent with their concomitant obligation to the investors not to disclose information valuable to rivals.

Defensive Tactics: Recommendations 33 to 43. These recommendations permit defensive and auctioneering tactics to proceed substantially unimpeded by federal law. This would be fine if bidders' tactics also were unimpeded, as we argued in Part III. But

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18. See Sanford Grossman, The Informational Role of Warranties and Private Disclosure of Product Quality, 24 J. Law & Econ. 461 (1981).

bidders' tactics are substantially regulated, their best strategies foreclosed. Unless targets are to have the dominant hand, there is need of regulation here too as a second-best solution.

Given the Advisory Committee's determination to regulate bids at almost every turn, we would ban defensive tactics outright. This is the rule in the United Kingdom, and it is the recommendation of every economically-sophisticated commentator.[19] Defenses reduce the profits to be made from tender offers, and so they lead to fewer. The stock price of prospective targets must fall farther than currently before it becomes wothwhile to make a bid. Because successful offers are beneficial to investors and society alike, successful defenses are detrimental. The investors lose the premiums they were offered (see the details in the Appendix), and society loses the gains from the monitoring of managers and the more productive use of resources.

Whether the rules should interdict bidders' efforts to run auctions for their firms is a much harder question, on which there is fair ground for differences of opinion.[20] The data summarized in the Appendix show that auctions are associated with small gains to the targets' shareholders. At the same time, the higher price of acquisitions — and the fact that first bidders experience many costs in addition to those borne by subsequent bidders — mean that auctions reduce the number and effectiveness of such offers. From

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19. Lucian Bebchuk, The Case for Facilitating Competing Tender Offers, 95 Harv. L. Rev. 1028 (1982); Ronald J. Gilson, A Structural Approach to Corporations: The Case Against Defensive Tactics In Tender Offers, 33 Stan. L. Rev. 819 (1981); David P. Barron, Tender Offers and Management Resistance, forthcoming in J. Finance (1983). Both of us have taken the same position, but we will leave to the reader the question whether we are economically sophisticated. Frank H. Easterbrook & Daniel R. Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161 (1981); Gregg A. Jarrell, The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?, forthcoming.

20. Compare Easterbrook & Fischel, Auctions and Sunk Costs, supra note 5 (auctions are not beneficial), with Baron, supra note 19 (not possible to determine) and Jarrell, supra note 19 (defensive litigation often increases price but discourages future offers), and with Bebchuk, supra note 19 (auctions are beneficial), and Gilson, Seeking Competitive Bids Versus Pure Passivity in Tender Offers, 35 Stan. L. Rev. 51 (1982) (same, although on different arguments).

an ex ante perspective, even auctions thus may be deleterious. They make it impossible for first bidders to capture the fruits of their labors: valuable information about the market. If it pays to be a second bidder rather than a first bidder, the number of tender offers decreases. Again, Assistant Attorney General Baxter has made the point well:

> Regulations that decrease the incentives to search out and develop potential acquisitions or alternatively that force those acquisitions to be consummated through a mechanism that is less efficient than a tender offer impede the efficient deployment of assets in our economy. Moreover, such regulations at the extreme can be inimical to the very goals they seek to further. If we view the market for corporate control statically and take the information about the tender offer as a given that is unaffected by regulation, it very well might be desirable to implement regulations that facilitate an auction among competing bidders for a target's assets. In that way, the shareholders of the target likely can receive the highest possible price for their stock. However, if regulations ultimately decrease the total number of offers so that some shareholders receive no offer at all, it is unclear whether such regulations can be considered "fair," in any sense of the word.
>
> It becomes even more difficult to say that such regulations are beneficial when one realizes that at the time regulations are promulgated it may be impossible to foretell which shareholders will be the beneficiaries of the regulations and which will suffer. A priori, one may be just as likely to be holding shares of a bidder as to be holding shares of a target. If they had no effect on the number of acquisitions or on the efficiency with which those acquisitions are made, regulations designed to increase the benefits to target shareholders (at the expense of bidder shareholders) would have zero net effect on the welfare of shareholders as a group — the increase in the value of targets would be offset by the decrease of the value of bidders. However, because such regulations probably do increase the cost of takeovers, reduce the benefits to bidders, and so decrease the overall level of acquisitions, the ex ante net effect of the regulation on shareholders in general will be negative. I doubt that many shareholders would find such a result to be in any sense "fair."

This Department of Justice's position should have been the Advisory Committee's as well. Instead, the Advisory Committee has simply ignored the effects of defenses and auctions on the behavior of bidders and the welfare of bidders' (and bystanders') investors. The Advisory Committee does say (Report at 13) that auctions are presumptively beneficial in competitive markets, but this presumption applies only when bidders also may elect competitive strategies. Surely there would be no presumption of economic benefit if every time a firm found natural gas it had to announce a public auction and seek to acquire the gas-bearing lands on an equal basis with firms that had done no exploration. Yet that is the situation in many tender offer auctions.

The Advisory Committee does recognize (e.g., Report at 33-34) that given the regulation of bids there is some need for regulation of defenses. Yet the recommendations on this subject seek to restrict provisions in articles and bylaws, the very form of competition we see as beneficial to investors, while allowing without hindrance most forms of defensive strategy that managers elect at the last minute. This approach is almost the reverse of the one we believe would help investors.

The responses most in need of control are PAC-MAN attacks and lock-up (and crown jewel) options. These are the source of the greatest costs and risks to initial bidders. Firms may be able to protect themselves against the PAC-MAN defense.[21] Lock-up options, though, are harder to address, and they not only repel offers but also may enable second-highest bidders to win auctions. The argument that the lock-up may be legitimate because it's "frequently . . . necessary to induce the second bidder into a takeover contest" (Report at 44), that is, to cover the second bidder's costs, neglects the fact that if a tender offer is so costly and risky for a bidder favored by the managers, it must be even more costly for a first bidder. Any argument about the utility of lock-up options suggests strongly the need to preserve rather than undermine the incentives of first bidders, for if there are no first bidders there are no auctions.

"Golden parachutes," on the other hand, may well be beneficial to shareholders. Although large golden parachutes may raise the costs of and hence deter acquisitions,

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21. The PAC-MAN defense depends on disparities in state law, and articles of incorporation, concerning the time necessary to oust the directors of a firm. In the recent Bendix / Martin Marietta contest, for example, Bendix was incorporated in Delaware, which permits a majority of the shares to change the board instantaneously by signing a certificate, unless the articles provide otherwise. 8 Del. Code § 228(a). Martin Marietta was incorporated in Maryland, which requires 30 days' notice of a meeting to change the board. Thus Bendix, which made the first bid, could have been stalled during this 30 days, while Martin Marietta, which made the second (PAC-MAN) bid could have acted immediately. Any future bidder could eliminate the risk of the PAC-MAN bid by amending its articles to make the time necessary to convene a meeting of its board (for the purpose of changing directors) the same length as the time necessary to convene the board of any firm holding a majority of its shares. Then the first firm to obtain a majority of the shares wins.

small guaranteed payments to managers probably are beneficial. They align the interests of managers with those of shareholders, who want to obtain the premium available from the tender offer. Perhaps such guarantees are "unseemly," but they grease the skids of offers by decreasing the role managerial self-protection plays in defending. It is thus encouraging that the Advisory Committee recognizes their value (**Recommendation 38**). The recommendation distinguishes between parachutes approved before an offer commences and last-minute additions. Firms that seek to facilitate offers in this way thus can employ change-of-control compensation if they want, a position in general agreement with our analysis in Part III.

Recommendations 34-37 also have something in common with Part III. We agree with the principle underlying these recommendations: There are dangers in allowing managers to change the articles of incorporation and bylaws by inserting anti-takeover provisos. We would deal with this, though, in the manner described in Part III.

First, we would permit any provisions of the articles and bylaws in effect when a firm issues new stock to remain in effect indefinitly. The people who buy the stock get exactly what they pay for. Nonvoting stock can be used as an anti-takeover device, but if Ford Motor Co. goes public with nonvoting or diluted-voting stock, in order to maintain the Ford family's control, there is no reason to subject this decision to subsequent scrutiny. Indeed, the implication of Recommendations 35 and 36(c) — that these shares are entitled to vote in three years on the question whether they should be given full votes — amounts to offering these investors something for nothing. The only way to secure the right of firms to offer, and investors to buy, securities with anti-takeover provisos attached is to enforce them rigorously, with no later votes.

Second, for articles and bylaws that are changed in the anti-takeover direction after issuance of stock, we would require binding votes, not just advisory ones. We also are inclined to delay the effectiveness of anti-takeover amendments for one year after their first approval, so that if these amendments indeed are designed to protect managers at the expense of shareholders, the disaffected shareholders can wage a proxy fight or arrange a tender offer before the rules take effect.

Advisory votes, on the other hand, promise to be costly and complicated, yet without concrete benefits. If bidders are hobbled in selecting strategies, we need to restrict defensive tactics for real. Many advisory votes would meet the same fate as the recommendations of this Advisory Committee: They won't be adopted. If we shared the Advisory Committee's belief that managers would follow the advice, we would be more favorably inclined, but there is a further problem. Because the votes would be advisory only, it would not be worth the while of investors to study the issues and rally their fellow investors to vote. Opinion polls are far less effective than real elections in eliciting the true position of the electorate. One can't be sure in advance whether the votes would be effective, but the fact that advisory votes are not now used in corporate law is a strong hint that the do not have benefits worth the costs.

Third, we think that Recommendations 34-37 appropriately can be viewed as endorsement of using federal law, if necessary, to enforce any pro- or anti-takeover provisions in the articles and bylaws, thus ensuring that shareholders obtain the protections for which they paid (or perhaps bargained) when they bought stock.

V

Our position is simple: "fairness" in investment means not equal access to premiums case by case but actuarial equality. Investors obtain the greatest gains when managers are free to create the most value for their firms, not when gains are spread around "equally" ex post. Shareholders are best off when these gains are large and frequent. Then they can either sell their shares, realizing the gain, and buy more diversified portfolios, or accept risk in any amount in pursuit of larger gains. The marketplace produces opportunities for both risk-preferring and risk-averse investors, so that ultimately the ability to diversify does not matter very much. What is important is that opportunities for gain-creation not be hindered by rules for gain-sharing.

The implication of this approach is that federal regulation of tender offers is harmful and unnecessary. Harmful because efforts to coerce the sharing of gains simply ensure that there will be less to share. Unnecessary because investors who want to arrange gain-sharing can do so on their own, by selecting low-risk instruments. Regulation thus harms society as a whole by reducing productivity.

The source of the harm is that tender offers, like other corporate control transactions, must be profitable to the active parties who generate the information and take the risks necessary to make things happen. At the margin, efforts to share gains will reduce the returns to corporate control changes, so there will be fewer. Moreover, regulations that enable passive investors and other potential bidders to take free rides on the work of the first bidders also reduce the gains from monitoring and corporate control changes.

There is harm, too, in any regulation that does not recognize that what is beneficial given an offer is not apt to be beneficial when viewed as prospective regulation. There is a conflict between what is good for shareholders ex post and what they desire ex ante. Competition among firms to offer good articles and bylaws, and competition among shareholders to choose investment portfoilios, is ex ante rivalry almost certain to be beneficial. Nothing of the sort can be said about regulations just designed to increase the price, or divide the gains, ex post.

Indeed, in a world of "easy" takeovers, the price of all firms will rise. The best defense against tender offers is to keep the price up, which managers will try to do. When the price falls below what could be achieved by other managers, there will be a takeover without the delay that now occurs. Today the price must fall by quite a bit. The average premium of 50% or more illustrates how far a price must be depressed, relative to the bidder's valuation, to make an offer worthwhile. When premiums are smaller, offers are easier and the no-offer price is higher. That is how all shareholders, and all of society, gain; that is what we all lose when offers are inhibited.

At all events, if there is to be regulation of tender offers, there must be a careful cost-benefit assessment. The Advisory Committee carried out no such thing. The Committee did not attempt to measure either costs or benefits, and it has ignored altogether the costs of its regulations for the shareholders of bidding firms and society at large. The recommendations it does make, discussed in Part IV, are worse than useless because they discourage many kinds of mechanisms for control of agency costs — bloc assembly and proxy contests as well as tender offers — without producing offsetting gains.

The best of all worlds is the termination of federal regulation (except what is necessary to preserve a national market and enforce the contents of corporate articles and bylaws). The second best is the return to the original provisions of the Williams Act, plus the interdiction of defensive tactics as a partial offset to the interference with bidders' tactics. The third best is the shelving of this Advisory Committee's report without further ado. Any other option is not worth considering.

APPENDIX: THE ECONOMIC EVIDENCE ABOUT TENDER OFFERS

We organize this appendix as follows: Part I provides an introduction to the economic methodology used to evaluate corporate control transactions. Part II digests the findings of the tests using this methodology. It also discusses challenges to the findings. Part III then explores some of the implications of the findings.

I. INTRODUCTION

The work we summarize below draws on movements in the price of stock. A large data base compiled by the Center for Research in Security Prices at the University of Chicago contains daily price movements for every stock traded on the New York and American Stock Exchanges for the last 20 years. This makes it possible to do two things: learn how much a given stock's price changed, and learn how much other stocks of a similar degree of risk changed at the same time. By subtracting the latter from the former, one can deduce the price movements net of market movements, that is, the changes that are attributable to facts peculiar to the firm being studied rather than attributable to the economy, the market as a whole, or even the industry in which the firm competes. See G. William Schwert, Using Financial Data to Measure Effects of Regulation, 24 J. Law & Econ. 121 (1981), for a description and critique of the methodology.

Returns. In studying a given transaction, the researcher focuses on the extent to which the change in the price of a stock is attributable to firm-specific events, rather than economy- or market-specific events. The firm-specific price movements, called "residuals" or "returns" in the scholarly literature, automatically account for the ordinary rate of return on investment, any general social changes in that return, and similar matters. Thus it is possible to say with great confidence that if a firm has a positive residual over some period of time, something good has happened (at least as shareholders see things) in the interim. If the market (or the industry) is rising, a firm with a positive return has risen faster. If the market is falling, a firm with a positive return has fallen less than comparable stocks. Because use of residuals entails comparative judgments — which are, after all, what investors really care about — the analysis can be much more informative than one focusing on unadjusted or even "discounted" prices.

Assumptions. The studies we summarize here all examine the movements in residuals at and around the time of critical control events, such as the announcement of tender offers, announcement (and adoption) of shark repellant amendments, going private, and so on. Thus there is an important assumption underlying the findings. They assume that markets react quickly to any new information about the stock, and also that the reaction is "unbiased" — meaning that if sometimes the reaction proves to be too great in light of subsequent events, other times it proves to be too little, so that when we look at large numbers of reactions to similar events we can see a fairly accurate picture of the real gains or losses incurred in the transaction.

The price reaction to any one event may be slow, or the new price may be mistaken in light of subsequent events. These possibilities are troublesome in evaluating isolated cases, but they are not obstacles to evaluating large numbers of cases, where the differences average out. The available data overwhelmingly show that prices change quickly and without bias. Professional traders cannot afford to delay in taking advantage of new information (hence the quick movement) and are generally astute about the meaning of new information (hence the unbiased movement). James H. Lorie & Mary T. Hamilton, The Stock Market: Theories and Evidence (1973); Richard A. Brealey, An Introduction to Risk and Return from Common Stocks (2d ed. 1983).

Efficiency. It is sometimes said that studies of residuals also assume that the market is "efficient" in the sense that prices correctly reflect all of the available information, and this is a controversial assumption. Everyone knows of many occasions on which prices of stocks turned out to be quite unjustified in light of later events. Sometimes the price does reflect the probabilities of these events, so that big price changes reflect new information about the probabilities rather than earlier "mistakes." But the important point is that market efficiency is not an assumption of this work. It assumes only that the degree of efficiency does not change dramatically over short spans of time.

Conoco's acquisition by DuPont illustrates the point. Mobil and DuPont both said in bidding for Conoco that Conoco's reserves of oil were undervalued in the market, so that the shares were trading for less than the real value of the reserves. Whether this is true does not affect the reliability of the results of the methodology, so long as investors that undervalue the reserves in the hands of Conoco also undervalue them in the hands of DuPont. If investors make the same error consistently, and the acquisition does not create some real gains, any premium paid for Conoco will be exactly offset by a reduction in the value of DuPont's stock. To the extent we see a different pattern we can infer that there was good news somewhere in the process. (In Conoco-DuPont, the shareholders of Conoco received a premium of about $3.2 billion, while the residual for DuPont reflected a capital loss of roughly $800 million. Shareholders evidently did not have the same perception of the value of Conoco's assets after the deal as they did before. Prices reflect a real gain of about $2.4 billion, which inured to the benefit of Conoco's shareholders and thus to the economy as a whole.)

Similarly, even if the price changes at the time of a tender offer can be said to be "too much" in light of real values, these are still prices that can be realized by the shareholders. They may cash out anytime they want. So long as price rises are not followed by price declines, we do not need to know that "the price is right" in order to conclude that shareholders have gained from the deal. At all events, there are no big changes in market efficiency over time. Indeed, there are not even predictable changes in the price of particular stocks. If there were such changes, professional traders could take advantage of them. It turns out, however, that pros cannot beat the market, which suggests strongly that prices at any given time reflect the available information without bias. See John G. Cragg & Burton G. Malkiel, Expectations and the Structure of Share Prices (1982).

Aggregation. In order to reduce, to the extent possible, any consequences of sluggish price responses, erroneous initial judgments, and similar problems, the studies we discuss below all employ portfolios of similarly situated firms. The mistakes and conundrums of case-by-case studies do not degrade the results of these pooled studies. Moreover, the studies all evaluate the residuals for some time (usually 20 days) before and after the events in question, so that any leakage of information to the market before hand, or price corrections afterward, will be caught.

Sources of Data. The data we describe here come from dozens of scholarly studies performed in the last decade using the best available methodology. We cannot begin to cite them all. Michael C. Jensen & Richard S. Ruback, The Market for Corporate Control: The Scientific Evidence, forthcoming in 11 J. Financial Economics (1983), performs this task, collecting the studies, assessing their strengths and weaknesses, providing summary tables. Much of what follows digests this work still further.

II. EMPIRICAL STUDIES OF TENDER OFFERS

A. Returns to Targets

Average Gains. When offers are announced, all shares of targets appreciate approximately 30% relative to the immediately prior price. These positive returns simply measure the size of tender offer premiums: the larger the premium, the larger the return. The returns at the time of the offer are not as large as the premiums offered, though, because (a) the bidder may not seek all of the stock, and (b) traders anticipate some risk that the offer will not be successful, and hence they do not bid up the market price to the offer price.

For successful offers, the bidders pay a premium averaging 50% for the shares they acquire. But the remaining unacquired shares do not return to the pre-offer price. They continue to trade at approximately a 30% premium relative to the pre-offer price. This premium reflects investors' belief that either (a) the acquiring firm will effect a merger at a premium, or (b) the value of the acquired firm is greater, for whatever reason, under the new control than the old.

Auctions and Defense. There is a difference in the size of the premium according to the degree of rivalry among bidders. Single-bidder offers do not produce premiums as high as multiple-bidder (auction) contests. The auction contests bring targets' shareholders about 4% more on average.* There are gains of about 17% when the auction succeeds in selling the firm, but losses when the auction ends with all bids withdrawn.

Note that this does not show the effect of the threat of auctions in future cases. The prospect of an auction may affect prospective bidders' decisions to initiate a takeover contest, and if the prospect of auctions discourages initial bids the wealth of the investors in would-be targets could decrease. The existence of the price increase in auction cases also may reflect bidders' strategies. Those who anticipate contests may make lower bids initially in order to have room for increase; similarly, those who make high bids initially may forestall auctions.

Targets that litigate in response to a hostile tender offer, but that are eventually acquired, account for nearly all of the multiple-bidder contests. Litigation apparently adds time and bargaining chips to the Williams Act delay, thus producing auctions. But the auction strategy also produces disparate results. When the auction ends in an acquisition, these litigating targets gain relative to the initial bid. Targets that defeat all offers (about a fourth of the litigating targets) lose the entire premium.

Unsuccessful Bids. When a tender offer is unsuccessful, the initially large returns that accompany the announcements are dissipated. The dissipation does not come all at once, for traders anticipate that defeat is sometimes just a waystation in an extended auction. Targets that receive other offers within two years retain some, but not all, of

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* The data on auctions and litigation reported here can be found in Gregg A. Jarrell, The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?, draft of January 28, 1983.

the initial gains. The retention rate appears to be about two-thirds. Targets that do not receive such offers (i.e., targets that demonstrate a willingness and ability to remain independent) lose the entire gains. Investors in both categories of target (the later-acquired and the never-acquired) do worse than investors in targets acquired on the initial bid (single or auction).

B. Returns to Bidders

Average Gains. Investors in bidders, like investors in targets, gain from tender offers. Bidders earn much lower percentage returns than do targets, however. While targets' shares appreciate some 30% at the time offers are announced, bidders' shares appreciate only about 4%.

The fact that bidders gain, on average, shows that the tender offer business is not just a transfer of funds from one set of pockets to another. It is not just managerial self-aggrandizement. It is not paper-shuffling. Real values are being created. If they were not, targets' gains would be offest by identical losses or greater for bidders' investors. We do not see this. Tender offers thus must be beneficial for bidders, targets, and society alike.

Explanations. The difference in the size of the gains is initially surprising, however, because both bidders and targets are essential ingredients of the gains. There are several possible explanations. Two stand out.

One is that there is substantial competition to be a bidder. If many different firms are able to do whatever produces the gains in an acquisition, they would compete (in searching for targets, learning what to do with them, and offering higher bids) until the returns were driven down. The lion's share of the gains would end up with investors in targets.

The other is that bidders are much larger than targets. Many bidders are diversified firms, and a given acquisition is not a large part of the bidder's operation. We would expect a smaller percentage change than when the bid affects the whole business (as it does for the targets). One must use a statistical "magnifying glass", effectively converting bidders and acquirers into "same-size" firms. This has been done by one of us, and it shows substantial gains to bidders.* Moreover, if the stock market returns are converted into dollar amounts, the data show that on average the bidders receive one-third of the total gains from takeovers.

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* Gregg A. Jarrell, Do Acquirers Benefit from Corporate Acquisitions?, Center for the Study of the Economy and the State working paper, March 1983.

Some Bidders Lose. "On average" is especially important in dealing with gains to bidders. Targets' investors always receive gains from successful tender offers. Bidders' investors do not always receive gains. By some accounts, bidders' investors lose in approximately one-third of all offers. The large stock market losses that DuPont and U.S. Steel incurred at the time of their recent acquisitions of Conoco and Marathon are illustrative. But they are also in the minority. These losses are outweighed by gains to other bidders (thus the 4% gain on average) and by gains to targets' shareholders (as the DuPont-Conoco example in Part I showed).

Acquisition Programs. There is also evidence that diversified firms gain when they announce, or the market infers, that they plan to undertake a program of acquisitions. These gains appear to be about 10% of the value of the acquiring firms, and they are realized without regard to the outcome of a particular bid. The existence of these gains may show that the market views acquisitions as beneficial and capitalizes the gains before a particular bid. This may be why gains are small (or even negative) when a particular bid is announced: the proposed acquisition was no better than (or worse than) what had been expected. The small or even negative size of returns to bidders thus may show only that the gains are small (negative) relative to expectations, even though they are positive in absolute terms.

C. Sources of Gains

The data we have summarized show that the acquiring and acquired firms, taken as a unit, have a market value 6% to 10.5% higher after (and because of) the acquisition than before. The data do not, however, establish the source or sources of the gains, and there is no scholarly consensus on that subject. Bafflement is the best description of current views.

The gains may derive from improved management of the target, from improved use of information, from "synergy", from tax advantages, or from other sources. None of these can be ruled out. The data permit us, however, to rule out two sources of gain that have sometimes been advanced.

Undervalued Targets. The first of these is that targets are just "undervalued" by the market — perhaps because they have lucrative projects that have not been announced, or perhaps because they have assets the value of which is not appreciated (Marathon's oil reserves), or perhaps because the market does not recognize the value of long-term projects on the way to fruition. On this view, the bidder is just trying to take advantage of the fact that the future price will be higher than the current one when the market wises up. The acquisition creates no real gains; it just pays part of the future appreciation as a premium and appropriates the rest for the bidder's investors. This explanation of the gains implies that if an offer is defeated by the target, the target's investors will get all or most of the impending appreciation. But the data we have discussed above establish that if the offer is defeated, and there is no acquisition within two years, there is no appreciation at all (relative to the market). Thus bidders' taking advantage of future appreciation is not the source of gain. Similarly, the data show that when a non-control bloc is acquired, the gains are not nearly as large as when a control bloc is assembled. This suggests that the benefits come from the change of control, not from bidders' acquiring inside information or just beating the market to a conclusion it would reach anyway.

Monopoly power is the second suggested source of gains. It was suggested, for example, in connection with Mobil's bids for Marathon and Conoco, and LTV's bid for Grumman. This may well be the explanation for some acquisitions (although it seems likely that the monopoly mergers will be consensual rather than hostile, for neither party gains by drawing extra attention to the deal). Monopoly does not appear to be the source of gain on avarage, however. DuPont and U.S. Steel paid huge premiums for Marathon and Conoco without any colorable monopoly advantage, and there are tens of similar cases.

The stock price data also offer tests of the monopoly hypothesis. One approach is to examine gains in horizontal versus conglomerate acquisitions. The monopoly explanation implies higher gains in the horizontal acquisitions, but this does not happen. Another approach: If an acquisition leads to monopoly prices, than other sellers in the market should experience gains — they can sell their goods at the higher prices set by the monopolists. Three recent studies search for such gains by rivals in cases that pose the greatest risk of monopoly, the ones investigated by the FTC or Antitrust Division. They generally find rivals' stock returns unaffected or negative, thus undermining (but not conclusively disproving) a monopoly explanation even in these questionable cases.

D. <u>The Economic Effects of Regulation</u>

The Williams Act and the many state anti-takeover statutes provide a basis for assessing some of the consequences of regulation. The data support the following conclusions:

1. The frequency of defensive and preemptive litigation rises as the time needed to obtain control rises.

2. The frequency of auctions rises, again dramatically, with the length of delay.

3. The more extensive the regulation (i.e., the longer the waiting periods; the more regulatory hurdles, such as illegality of short tenders, lining up warehousers, and making advance purchases of shares via creeping tender offers or bloc purchases; and the greater the uncertainty), the higher the average positive return for targets. The mean return to targets has doubled since the Williams Act was passed and is higher still in states with additional regulation.

4. The more extensive the regulation, the lower the average positive return for bidders. The mean return to acquirers has halved since the Williams Act was passed.

5. The more extensive the regulation, the fewer bids are made, taking account of the other economic factors that call forth bids.

6. The more extensive the regulation, the lower the price of prospective bidders falls. Firms engaged in acquisition programs had negative returns of about 6% when the Williams Act was enacted and experienced further negative returns when additional regulations were added.

These facts taken singly may be coincidental. One cannot confidently attribute them to regulation. But taken together they suggest that regulation has had substantial effects in altering the distribution of gains and losses from offers, in permitting defensive or auctioneering tactics (which help some targets and hurt others), and decreasing the number of offers. Targets and bidders affected by state laws, which provide the greatest arsenal of devices, show all of these effects to the greatest degree, suggesting direct causation.

There is substantial difficulty in evaluating these changes in premiums. The market method we have been using says volumes about returns (percentage changes in price) but very little about absolute prices. We cannot be certain from this data whether regulation helps, hurts, or is indifferent to investors.

One possibility is that regulation raises the returns without offsetting loss. The data appear to suggest losses, but it is difficult to estimate the size of loss.

Another possibility, more congruent with the data but not compelled, is that regulation transfers benefits from investors in bidders to investors in targets. It is conceivable that the transfer is accomplished without reducing the number of offers, but data seem to support the contrary view that as the price of anything, including the price of tender offer acquisitions, rises, less is purchased.

E. <u>Challenges to the Data and its Meaning</u>. The data and inferences we have presented here have not escaped challenge within and without the Advisory Committee. We deal briefly with some of these challenges. It is important to understand at the outset, though, that the methods and results we have used are not controversial within the economics profession. There is no debate about this subject in the way monetarists, Keynesians, and supply-siders debate employment and inflation. The method is almost universally accepted as valid, subject only to questions about the sources of data and the exact structure of the equations.

There is, for example, a debate about whether the "arbitrage pricing model" offers slightly better estimates than the model used in the studies we described. There is debate about the strength of the inferences, and there is debate about the comprehensiveness of the samples of events on which the conclusions are based. These differences, even taken together, affect only the magnitude rather than the existence or direction of the effects described. Thus, for present purposes, there is no (significant) debate within the economics profession; there is only attack from without. We briefly address some of these challenges.

1. **Profits versus Prices.** The data we use are based on stock market movements at the time of the events, not accounting numbers, "real" profits, or prices later on. Thus, it may be said, they do not show either social gains or "reliable" gains to investors. As it turns out, accounting profit studies also do not measure real social gains, see Franklin M. Fisher & John J. McGowan, On the Misuse of Accounting Rates of Return to Infer Monopoly Profits, 73 Am. Econ. Rev. 82 (1983); S.J. Liebowitz, What Do Census Price-Cost Margins Measure?, 25 J. Law & Econ. 231 (1982), but this is not terribly important here. For investors, what matters is that they can cash out immediately at a gain and invest elsewhere if they want. For society, what matters is that the higher prices accompanying acquisitions reflect estimates of future gains. Prices are reasonably good proxies for these gains, at least when large numbers of firms are involved, because stock prices are based on estimates of future real profits and dividends. Higher equity prices also attract new capital into the market and increase the rate of savings. (For what it is worth, the available evidence on the profitability of tender offers suggests that there is no unusual profit or loss from them. In other words, an investment of $X in a target appears to be about as profitable for a bidder as an investment of $X in other assets, such as new plants. This is what one would expect to see if managers of bidders are behaving rationally.)

2. **Unusual Events.** The studies of tender offers treat gains and losses to investors as averages, while individual cases may diverge from the pattern. This is true, but the implication is obscure. Society gains from inventions and the construction of new plants, even though many inventions and new plants are wastes. We do not have complex rules

to regulate or stymie the construction of new factories on the ground that managers might be mistaken in their conclusions that their plans will prove beneficial and that investors in these firms then will lose. To regulate new investment decisions would discourage new plants to everyone's detriment. Such regulation also is unnecessary, for managers who make bad business decisions are penalized automatically by lower profits, lower salaries, and less job security.

3. **Imperfect and Incomplete Evidence.** The studies we have described inevitably have flaws. Some are based on incomplete samples of tender offers. Others may be affected by the quirks of particular offers. Thus one cannot say the data are "conclusive." Yet this is an unrealistic demand for economic data. Suppose the SEC were to study business decisions about whether to engage in searching for new ways to grow corn, or about introducing new products, or building new plants. The evidence about the profitability of these highly-beneficial things is much less powerful than the evidence about tender offers. To believe, as some apparently do, that society does not lose much in discouraging tender offers because the data do not conclusively prove their benefits, is to believe that society also would not lose if Congress systematically set about to discourage new ideas, new products, and new plants.

4. **Inefficient Markets.** Many people just can't believe that stock markets are efficient, and they reject all studies and inferences that in their view are based on assumptions concerning efficiency. A good example of this is Louis Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249 (1983). He argues on the basis of armchair empiricism that many targets are "well managed", so tender offers are unlikely to be value increasing, and that markets cannot be efficient because stock prices jump around "too much" in relation to "intrinsic values" for the market to be pricing them well.

As it turns out, the approach we have used here does not depend on the efficiency of markets. Evaluation of the gains and losses from offers depends only on the assumption that the degree of efficiency does not change rapidly. See pages 39-40, supra. It is undoubtedly true that a few people can beat the market by astute observation and action, but this does not undermine any of the assumptions we have used.

We are reluctant to stop with this observation, however. One sometimes gets the impression from reading this dreary literature, almost all produced by lawyers, that these writers do not believe anything at odds with their immediate impressions. As it turns out, though, the history of science has been marked by the substitution of counterintuitive theories for common observation, by the consideration of indirect effects as well as immediate consequences. The mercantilists believed that restricting trade was a method of getting an advantage over one's trading partners, because they did not see the reciprocal but longer range benefits of free trade. Supporters of the Smoot-Hawley tariff saw it as a great way to raise revenue and protect jobs, neglecting the longer run effects (including the Great Depression).

"Common observation and common sense" have misled the world's greatest thinkers. Aristotle, Ptolomy, and much of mankind thought that the world is flat and that the Sun revolves around the earth, because that is what "common observation and common sense" tell us. People believed that matter is solid (they didn't see any atoms), that time is a constant (it's hard to see how time could be relativistic), that animals inherit the acquired characteristics of their parents, and that a pervading "ether" transmits light and gravity. For hundreds of years armchair, "common-sense" assessments of markets have impeded economic thought in the same way other "common-sense" assessments impeded astronomy, chemistry, physics, and biology.

The practitioner of armchair empiricism has no reliable way to test his intuitions. He cannot distinguish the current view that attraction at a distance is a function of the exchange of gravitons and the relativistic warping of space from the forgotten view that the heat of combustion is caused by the emission of phlogiston. The assertions are logically indistinguishable, the methods of verifying them outside our common senses. The scientists who unscrambled these problems wrote in a way incomprehensible to lawyers, but that did not make the scientists wrong.

We test a scientific theory by its internal logic and its ability to explain and organize data, not by its appeal to the intuitions of casual observers. The proposition that capital markets are efficient follows logically from a few assumptions, such as the self-interested behavior of traders. It is internally consistent. It also explains the data better than any alternative now available. There is an enormous body of evidence strongly supporting the efficiency of our capital markets (e.g., Brealey, supra; Lorie & Hamilton, supra; Cragg & Malkiel, supra). The lawyers who write in opposition do not bother with internal coherence (they usually assume both that many people act irrationally and that the rational few cannot take advantage of this to reap profits and affect prices). They do not sully their hands with data. For example, the argument favored by Lowenstein is that tender bidders just identify "mispriced" securities and so perform only an arbitrage, rather than a value-increasing, function (83 Colum. L. Rev. at 254). If that is true, then targets that defeat offers should show gains anyway as the market learns its lesson, and bidders should show losses that roughly offset targets' gains. Neither prediction is borne out.* See pages 43-44, supra.

True, no market is perfectly efficient. Information is costly, its value cannot be fully appropriated, and the actors' rationality is bounded. No one believes in frictionless markets, and the data do not support perfect efficiency. On the other hand, no market is more efficient that our financial markets, which are competitive to a degree that puts the wheat market to shame. Analysis based on the implications of rationally self-interested action, by the thousands of traders and firms that make up our atomistic capital markets, is by far the most promising way to understand what we can see. Competing approaches based on ad hoc assumptions and the belief that irrational conduct is persistent and unpunished explain nothing.

5. **Do Targets Gain from Defeating Offers?** There is one study contending that targets' shareholders gain if offers are defeated. If this is true, it is a serious challenge to, perhaps a disproof of, the methods and data summarized above. Kidder, Peabody & Co. (KP) collected a sample of 38 defeated hostile tender offers between 1974 and early 1982 in which the target remained independent for at least one year. KP then determined the current price of the target's stock and the highest price of the stock at any time after the defeat of the offer. (In seven cases this price reflects a subsequent acquisition.) Finally, KP "adjusted" these current and highest prices by deflating them according to the Consumer Price Index changes for the intervals in question. It determined that 65% of the current adjusted prices, and 97% of the highest adjusted prices, exceed the highest (defeated) offer price. Some infer from this that resistance to tender offers is beneficial to targets' shareholders.

We have checked the data and the adjustments made by KP and found them to be accurate. Nonetheless, these data do not support an inference contrary to the financial studies we have discussed, for a simple reason: KP asked and answered the wrong question.

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* The arguments about whether targets are well managed, or whether prices move too much, are views that only the beholders can appreciate, and each will react differently. Firms are "well managed", for example, only in relation to some alternative, and the observation that Firm X is "highly profitable" may just obscure the possibility that with a change of control it would be more profitable. How can one tell? The observation that prices of equities fluctuate is true but trivial. The price of equity depends largely about projections of future growth, and one can show (although the formulas are omitted here) that relatively small changes in profits can produce relatively large changes in the price of equity. See Brealey, supra, at 71 (giving an example in which a reduction in the expected growth of a firm from 10% per year to 9% causes the stock's price to drop from $100 to $67). See also Basil L. Copeland, Jr., Do Stock Prices Move too Much to be Justified by Subsequent Changes in Dividends?: Comment, 73 Am. Econ. Rev. 234 (1983). Comparison against some intuitive standard of "intrinsic" price harkens to the feudal culture when people thought that they could determine such things.

Take a simple example. Suppose you own stock in Widgets Inc., which on December 1, 1980, was trading for $20. The next day Raider Corp. bids $30 for 100% of the stock. If successful, the bidder would pay cash on January 1, 1981. Widgets Inc. beats back the offer, and you are left with shares that on January 1 trade for $20. Two years later, your stock trades for $34 (including the value of reinvested dividends). The 70% gain over $20 looks pretty good. Are you better off? KP would say "yes." The $34 is higher than the $30 bid, and if you adjust the $34 to "1981 dollars" (taking out the increase in the CPI of 8.9% in 1981 and 3.9% in 1982) you still have more than $30. KP would view anything over $33.94 as a gain.

You would disagree with KP, though, if you thought you could do better than inflation with your investments. Suppose you had $30 in hand on January 1, 1981, to invest however you wanted. If you had bought a market basket of stocks, you would have had more than $34 by January 1, 1983, because during that time a value-weighted index of York Stock Exchange firms, including dividends, rose 14.64%, exceeding inflation. Knowing how Widget does against how you would have done with the cash is the sort of comparison you would care about. The stock versus the CPI doesn't tell you much unless by accident the market just tracks inflation. As it turns out, though, for most of the period covered by the KP study, especially 1980 and 1982-83, the stock market gain was much greater than inflation. Thus the KP study is seriously biased.

To see how investors really fared, we did a new study, using the KP sample, according to the following method. We "accepted" the bidders' offers and invested the proceeds in a diversified portfolio of equities represented by the New York Stock Exchange Index. Then we looked in on this investment one, two, three, etc., months after the offer to see how the portfolio was doing versus how the targets' actual stocks (given the real defeats of the offers) were doing. If the portfolio was doing better than the target, we viewed the defeat of the offer as bad news for the targets' shareholders.*

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* This method actually understates, by a substantial amount, the gains the investors would demand to make them indifferent between the success of the offers and their defeats. There has been a generally rising market in equities. The stocks of individual targets are riskier investments than the stocks of the market as a whole. In order to be indifferent between targets' stocks and the market, investors demand compensation for the risk, and these individual stocks actually rise faster than the market (while other firms, such as AT&T and big utilities, rise more slowly). In treating targets' stocks as if they were as safe as the whole market, we give a substantial advantage to the thesis that defense is beneficial. (In other words, the method described in the text erroneously assumes that targets' stocks have beta coefficients of one.)

The results of this study are striking. Looking in about a month after the offers, we see the targets' stock trading for about 10% less than the "invested proceeds." Looking in two months after, we see a further 10% decline. Over the course of two years after the offer, the targets as a group fluctuate at a 10% to 20% loss relative to the "invested proceeds." There they sit. The targets never recover. The invested proceeds always do better. So it turns out, if you ask the right question, that the single apparently-contrary study is not so contrary after all. (We have copies of the study for those who are interested in the details of the results.)

III. INTERPRETING THE RESULTS

What one makes of the data depends almost entirely on how we answer two questions. **First**, are we interested in how rules affect the number of offers, or do we care only about maximizing the gains once an offer takes place? **Second**, are we interested in the welfare of investors in bidders and targets, taken together, or are we interested only in maximizing the wealth of shareholders in targets given that an offer is on the table?

A. Inducements to Make Bids

Throughout the data we have surveyed runs a theme: Waiting periods, auctions, defensive tactics, and so on, on average raise the returns received by the targets' shareholders. Although they also lead to the failure of some offers, and defeating a bid unambiguously makes the target's investors worse off, the targets' gains from auctions exceed the losses from defeated bids. (We have discussed whether higher returns are the same as higher prices.)

On the other hand, the data also show that waiting periods, auctions, defensive tactics, etc., on average cut in half the returns received by the bidders' shareholders. This reduces the number of offers, for two reasons. First, as the profitability of any business strategy decreases, other things equal, managers turn to other things. Second, the regulatory systems put first bidders at a disadvantage. Before the Williams Act, first bids almost always succeeded. Now about half of all first bids fail. The initial bidders do not recover the costs of searching for targets that they incur; it pays to be a second bidder rather than a first bidder.

If the appropriate focus of regulation is on offers that in fact are made, rather than on offers than could be made, it appears to follow from the data that rules should provide generous waiting periods and not interfere with targets' efforts to create auctions. They should, in contrast, interdict outright defenses.

If, however, public policy must consider both the treatment of existing offers and the incentives to make new offers, the data suggest that regulations be written with the realization that anything that raises the return to targets also reduces the return to bidders and hence the number of bids. Every offer deterred is a lost opportunity to make real gains -- and, if targets' higher premiums attributable to regulation are just offset by lower returns to bidders, these lost tender offers are not offset by any real gains.

B. Targets' Investors vs. All Investors

The questions raised above concerning premiums versus number of offers present a further problem: whose interests does regulation protect? The customary answer to this question is "the interests of investors in targets". The Williams Act and implementing regulations seem to assume both (a) that bids arrive exogenously, and (b) that the point of the rules is to do the best one can for the target's shareholders.

None of the existing legal rules is designed to assist anyone other than the shareholders of a firm subject to an offer. This is clear enough if one recalls that even the most simple regulation, a short waiting period, inevitably creates some auctions, making tender offers more risky and less profitable for bidders and their shareholders. Similarly, targets and their shareholders have private rights of action to enforce the Act and regulations; bidders do not.

From this perspective, the data showing that certain regulations reduce the number of auctions and reduce the returns to bidders are irrelevant.

From a different perspective, however, the economic data take on significance. Firms are not born as targets. Price data suggest that the prices of firms that end up being targets do not begin to move upward until very shortly before the bids are announced. Thus the market does not easily distinguish potential targets from bidders and non-targets.

One could pose the following question: What rules are most beneficial for a shareholder under a veil of ignorance, not knowing whether the firm in which he holds stock will be a bidder, a target, or a bystander? This shareholder wants to get the maximum value of his shares. From his perspective, a rule that simply raises returns to targets and lowers returns to bidders is harmful. He loses just as much money if he turns out to hold a bidder as he gains if he turns out to hold a target. Higher returns do not bring him benefit. At the same time, if higher bid prices reduce the number of bids, as the data indicate, he loses whenever a potentially beneficial acquisition does not occur.

SEPARATE STATEMENT
OF
ARTHUR J. GOLDBERG

The mandate of the Advisory Committee on Tender Offers derives from the February 1, 1983 letter of the Committee on Banking, Housing and Urban Affairs of the United States to Chairman John S.R. Shad of the Securities and Exchange Commission and the February 25, 1983 Charter of the Securities and Exchange Commission Advisory Committee on Tender Offers. Copies of this letter and Charter are annexed to this statement as Appendices 1 and 2.

The concern about abuses in tender offers, although of long duration, was accentuated by the acquisition of substantial stock in each other, by Bendix Corp. and Martin-Marietta Corp., in a take over situation. This episode was obviously a "distortion" (Chairman Volcker's term) which has done public injury to our capital markets.

The problems concerning tender offers, however, transcend this bizarre occurrence.

The abuses which have occurred in recent tender offers are dramatically illustrated by the terms of usage employed in the art or "game" of tender offers: golden parachutes, poison pills, lock-ups, two-tier system, sales of crown jewels, Pac Man defenses, scorched earth policies, and the like. These terms would seem more appropriate to video games rather than the acquisition of capital assets of major companies. They are singularly inappropriate in characterizing substantial financial and economic matters involving shareholders and the public.

There is annexed a glossary of these terms as Appendix 3. Usage of these terms is symptomatic of the fact that tender offers involve gamesmanship relating to control of management. By and large, in the words of the Chairman and Chief Executive officers of a major company, quoted in the letter of the Senate Banking Committee, "Maybe there's something wrong with our system when ... companies line up large amounts of money in order to purchase stock, when it doesn't help build one new factory, buy one more piece of equipment, or provide even one more job."

Mergers, unlike most tender situations, result in the acquisition of the assets and operating facilities of a business and are most often undertaken following shareholder approval. Tender offers frequently involve a contest for control of management of a company in transactions not subject to shareholder vote by either the offeror or target company. Characteristically, a premium is paid for only enough shares to accomplish the change in control. Although a few tender offers may be designed to acquire an entire company, most are designed to affect management control.

Changes in management may or may not be in the interest of shareholders of the offeror or the target company. What seems to be ignored in the Advisory Committee's Report is whether such changes are in the public interest. Yet, the Senate Banking Committee in its letter to the Chairman of the Commission said: "We believe that the public interest and the Congress would be best served by a broad study of the many issues surrounding tender offers and particularly hostile take-overs, and, therefore, we encourage the Commission panel to be comprehensive in both its approach and charter."

A complicating factor is that no evidence was presented to the Advisory Committee and no authoritative study seems to have been made as to whether, in the long run, tender offers have contributed to corporate viability or profitability or have benefitted shareholders of the offeror or target company or the public. Rather, attention is focussed on stock prices which are primarily based on market quotations at the time of the tender offer. Moreover, the market is influenced by many factors, some of which relate to stock values and others to the general economy, inflation, interest rates and the like.

As a country, we justifiably take pride in the fact that shares in our publicly held companies are widely held and actively traded.

As of the end of 1982, well over 32 million Americans held shares in these companies. Many Americans hold shares in small amounts, which, nevertheless, represent significant investments and, in aggregate, are substantial. Small shareholders, in the nature of things, do not have access to competent and readily available independent advice in evaluating tender offers. Institutional investors, unlike small shareholders, do resort to professional and expert advice.

The small shareholder, therefore, is literally at sea in a tender offer situation. Although even some small shareholders may be able to follow market quotations, this is not, for the reason stated, an adequate basis for evaluating a tender offer. A real and unanswered question is whether a typical non-institutional investor, in a target company, is better off in the long run if he accepts a tender offer. Conversely, the same is true of a small shareholder in the offering company. He likewise suffers a disability in evaluating whether his company and consequently his shareholding is better or worse off by the making of a tender. In both cases the market is inadequate to answer this action.

A prevailing consideration is that SEC filings do not, under present regulations, inform as to whether a tender offer is good or bad from the shareholder's perspective. SEC filings are disclosure statements in a form geared to professional investors. They are as esoteric to a small shareholder as a Form 1040 is to an average taxpayer. In both cases, professional advice is virtually a necessity.

It is essential, in my view, that new procedures be created to assure that all shareholders of offeror and target companies receive independent and expert advice as to the fairness of every tender offer of sufficient size to warrant regulation. And such procedures are essential if the public interest is also to be safeguarded and confidence in our securities markets assured.

The report of the Advisory Committee makes no significant reference to protection of the public interest. This arises from the misconception that only shareholders are involved and not the public at large except the limited determination by the Anti-trust Division of the Department of Justice and the Federal Trade Commission made under the Hart-Scott-Rodino Act as to the applicability of the anti-trust laws - a determination which, I believe, is inadequate because of the time limitation imposed by this legislation and the nature of the inquiry.

Protection of the public interest is not foreign to the federal securities laws. The Securities Exchange Act of 1934 declares that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest." The stock market crash which contributed to the depression in the 1930s and led to the enactment of the federal securities laws is proof enough of the public interest involved in appropriate regulation of the securities markets and the necessity in economic terms of proper regulation.

In light of these considerations and the Advisory Committee's mandate, I make the following recommendations:

1. Tender offers should be submitted to an independent person or institution, selected by the Securities and Exchange Commission, for evaluation as to whether the offer is fair to the shareholders of both the offeror and target company and whether, in economic terms, the public interest is protected. Generally, as I have said, an offeror or target company solicits professional advice in a tender situation, but such advice cannot be regarded as truly independent. This advice is basically designed to assist in the effectuation or resistance of a tender offer. Advisors of this character are scarcely independent or disinterested. In Great Britain, the Panel on Take-Overs and Mergers requires an independent evaluation of a tender offer. Testimony before the Advisory Committee, by representatives of the British Panel, confirms the value of an independent evaluation and also that such an evaluation does not impair the operations and effectiveness of the market place.

2. The independent evaluation should be performed expeditiously and made available to the shareholders of both the offeror and the target company as well as the public at large.

3. Golden Parachutes should be prohibited. They have become a scandal and a discredit to sound fiscal corporate governance. By and large, corporate executives of listed companies are well paid and receive substantial fringe benefits. I have no quarrel with this, when deserved. A laborer, whether white or blue collar, is worthy of his hire. Golden Parachutes, however, which typically provide for several years compensation to be paid to managers of a target company in anticipation of a tender offer, are basically either designed to frustrate such an offer or to "feather the nest" of corporate executives. Further, Golden Parachutes are creating great cynicism among shareholders and the public about the integrity of our corporate system. Assertions that Golden Parachutes are justified by the business judgment rule are without foundation and based upon a misconception of the rule. The business judgment rule is not designed to safeguard the personal interests of managers but rather the good faith judgment by a manager as to what is in the best interests of the corporation. This judgment must and should not be affected or tainted by a conflict of interest. Simply put, the business judgment rule is fashioned to permit latitude to managers of corporations in the ordinary good faith conduct of business affairs in the interest of the corporation, where there is no self dealing or other conflict of interest involved.

4. The sale of crown jewels during a tender offer should be prohibited. Such sales are designed to frustrate a tender offer by making the target company less desirable because of the sale of some of its best assets. This is not to say that a corporation should be prevented from conducting its ordinary business during a tender offer but simply that it be prevented from disposing of significant assets as a defensive tactic to resist a tender offer. The same prohibition should be applied to the scorched earth tactic, the poison pill device, and the sheer absurdity of the Pac Man defense, best illustrated by the Bendix and Martin-Marietta fiasco.

5. There should be a freeze period during a tender situation, both with respect to offensive and defensive maneuvers. Adequate time should be allowed so that competing offers can be made. British law, regulation and practice provide for a six month freeze. Perhaps, under our system, a shorter period may suffice. However, the period should be sufficient to permit competing tender offers and to allow a more adequate determination of possible anti-trust implications to be made by the Department of Justice and the Federal Trade Commission than now exists under the limited 30 day period prescribed by the Hart-Scott-Rodino Act. A reasonable freeze period, it seems to me, would be 120 days.

During the first 30 days competing tender offers would be permitted. After all competing tender offers are made, the Department of Justice and the Federal Trade Commission should be afforded a 60 day period to adequately discharge their responsibilities under Hart-Scott-Rodino. This 60 day period would also, and importantly, give the independent person or institution an adequate opportunity to evaluate the various tender offers in terms of fairness to shareholders and the public. Following the expiration of this 60 day period, a 30 day period should be provided to submit the various tender offers, the views of the anti-trust division of the Justice Department and the Federal Trade Commission and the independent evaluation to the shareholders on both sides for their approval or rejection of a tender offer.

In this regard, the recommendation of the Advisory Committee that an advisory vote of shareholders be taken is inadequate to protect vital shareholders' interests. Advisory votes are not binding on management. There should be definitive and binding votes of the shareholders of both the offeror and target companies.

6. Partial and two tier tender offers generally should be prohibited. Under our system of corporate governance, changes in control should, by and large, be accompanied through proxy solicitations and pursuant to the democratic

vote of shareholders of the offeror and target companies. Tender offers should not be a contest between competing persons or groups to acquire control of management. A partial tender offer leaves shareholders who, for one reason or another, do not tender to the mercy of the market which often declines after the partial offer is consummated.

In some unusual circumstances economic and corporate conditions may justify a partial tender offer. In such situations, the offeror seeking to make a partial tender offer should bear the burden of satisfying the SEC, under appropriate and specific regulations, that a partial tender offer is justified.

7. An acquisition of shares in a company resulting in ownership of 15% or more of its outstanding regulated securities should be required to make a tender offer for all shares. Appropriate "grandfather" treatment, under SEC regulations, should define the circumstances for granting "grandfather" clauses and should also give consideration to the owner of a private company which goes public where the owner is left with more than 15% of the shares.

8. As I have said, before a tender offer is made, it should be approved by shareholders of the offeror. Before it is accepted or rejected, it should be approved by a vote of shareholders of the target company. This requirement is simply an application of corporate democracy. After all, shareholders, not management, own corporations. They risk

their capital and consequently are entitled to make the ultimate decision on matters directly affecting the future of the offeror and target companies.

9. Super majority provisions in charters and bylaws of corporations should be prohibited. These provisions require votes by substantially greater majorities of shareholders to approve or defeat takeovers. Their use is a recent development in defensive strategy. They run contrary to this concept of corporate democracy which is, as with our political institutions, subject to the principle that in a democracy the majority prevails. I do not favor a federal corporations act. Prohibition of these provisions, however, is consistent with federal regulations designed to correct abuses in corporate governance and securities regulation.

CONCLUSION

The reforms I suggest may well be accomplished by revision or by imaginative application of the regulations of the SEC under Section 14 (e) of the Securities Exchange Act of 1934; (see Mobil Oil Corporation v. Marathon Oil Co., 669 F. 2d 336 (6 Cir., 1981)), or new rules of the New York Stock Exchange and other markets (see Silver v. New York Stock Exchange, 373 U.S. 341 (1963)). But, if after a detailed legal analysis, it appears that further legislation is necessary, the Senate Banking Committee, in its letter, has indicated that it is willing to consider appropriate legislation.

The abuses in the tender situation are substantial, serious and continuing. They cannot be treated with bandaids. Nor can they be swept under the rug. The abuses cast a shadow on our system of corporate governance. All of us who believe in the free market should be conscious of a simple fact: As long as the market is responsive to both shareholders and the public it will, by and large, be free; if the market is not responsive, it will be subject to legislative restraints far greater than the reforms I propose in this statement.

APPENDIX I

UNITED STATES SECURITIES AND EXCHANGE COMMISS
RECEIVED
FEB 3 1983
OFFICE OF ASSOCIATE DIRECTOR
DIVISION OF CORPORATION FINANCE

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

February 1, 1983

CHAIRMAN'S OFFICE
RECEIVED
FEB 03 1983
SEC. & EXCH. COMM.

The Honorable John S.R. Shad
Chairman
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

We welcome the announcement that the Securities and Exchange Commission will shortly begin a full-scale study of the federal tender offer regulations, with an eye to proposing new legislation in Congress.

Commentators have suggested that the most feasible approach to current problems with tender offer law would be for Congress to revisit the program it began a decade ago, expanding the provisions of the Williams Act to deal with tender offer abuses, providing the judiciary with guidelines for determining the validity of challenges to bidder or management conduct during the course of an offer, and clarifying the respective rules of federal and state regulation.

The proliferation of contested take-overs over the past few years and the corresponding publicity has resulted in considerable Congressional interest in this subject. It would be most helpful to us if the Commission would address, among others, the following issues in its study:

What should be the role of the government in hostile take-overs?

What is a corporation's obligations to its shareholders, its employees, consumers, and the community in a take-over situation?

What abuses have occurred under current tender offer law?

Chairman Paul A. Volcker, of the Federal Reserve, has expressed concern "about take-overs distorting banking judgments or the credit markets." How might such distortions be prevented?

What should be the involvement of states in regulating corporate take-overs?

Should shareholders of a corporation be given the right to vote on proposed tender offers within a specific period of time of the offer, and should a shareholder majority be required to approve acquisitions and take-overs?

Are "golden parachute" provisions guaranteeing executives salaries and other compensation after any change of control of a company in the best interests of shareholders of that company? Should federal securities law require shareholder approval of golden parachutes or that their provisions be spelled out in detail in companies' proxy materials?

Should interest on money borrowed specifically to buy the common stock of another corporation in a take-over situation be tax deductible?

Should retained earnings used to acquire other companies be subject to a minimum merger tax?

Should additional time for competing bids be provided under a rule of auctioneering?

Should a federally imposed period of advance notice be established requiring a bidder to file registration materials with both the SEC and subject company management prior to the implementation of a tender offer?

Are individual shareholders currently receiving adequate and timely notice and information about take-overs (including competing offers)?

Do target corporations currently have sufficiently direct access to all their individual shareholders to conduct a responsible and reasonable defense against a hostile take-over?

It has been suggested that tender offers serve as an effective mechanism to discipline incompetent management and to permit the transfer of productive assets to the control of more efficient management. On the other hand, it has been agreed that the fear of hostile take-overs tends to focus management's efforts on short-run profits while giving less attention to longer term investments needed for economic growth. What role, if any, should federal regulation play in striking the proper balance between these conflicting concerns?

The Honorable John S.R. Shad
February 1, 1983
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The Chairman and Chief Executive Officer of a company which was a major and successful player in a recent multibillion dollar acquisition contest has embraced the view that "Maybe there's something wrong with our system when ..... companies line up large amounts of money in order to purchase stock, when it doesn't help build one new factory, buy one more piece of equipment, or provide even one more job." How, if at all, should federal regulation address this widespread frustration?

We recognize that a number of these issues are outside the direct jurisdiction of the Commission. However, it is our understanding that the Advisory Panel being put together by the Commission to study tender offers will be made up of outside professionals, including economists.

We believe that the public interest and the Congress would be best served by a broad study of the many issues surrounding tender offers and particularly hostile take-overs, and, therefore, we encourage the Commission panel to be comprehensive in both its approach and charter.

On July 13, 1979, the Banking Committee requested the Commission to review 7 specific questions concerning coverage of the Williams Act. The Commission provided its response on February 15, 1980. It would also be helpful if the Advisory Panel could review the questions and answers and provide any updating which the Panel may deem necessary.

To assist us in considering this subject, we would appreciate receiving the study and recommended legislation from the Advisory Panel by July 31, 1983.

Sincerely,

~~Alfonse M. D'Amato~~ Alfonse D'Amato	Paul S. Sarbanes
Slade Gorton	Donald W. Riegle
John Heinz	Christopher J. Dodd
Paula Hawkins	Alan J. Dixon
Mack Mattingly	Alan Cranston
Jake Garn, Chairman	William Proxmire Ranking Minority Member

APPENDIX 2

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

CHARTER OF THE SECURITIES AND EXCHANGE COMMISSION
ADVISORY COMMITTEE ON TENDER OFFERS

Preamble

In accordance with the terms and provisions of the Federal Advisory Committee Act, as amended, 5 U.S.C. App. I, 86 Stat. 770 (1972), 90 Stat. 1247 (1976), Chairman John S.R. Shad with the concurrence of the other members of the Securities and Exchange Commission ("Commission") hereby establishes an Advisory Committee which will conduct an extensive examination of the tender offer process and other techniques for acquiring control of public issuers. The Commission will seek to determine the economic implications of such transactions on the economy in general and on bidders, subject companies, investors and the securities markets, and to define the need for, and nature of regulation of such activities, to assess the current regulatory scheme in light of the objectives of such regulations, and to recommend to the Commission legislative and/or regulatory changes the Committee may consider necessary or appropriate to accomplish such objectives.

Charter

Pursuant to Section 9(c)(A)-9(c)(J) of the Federal Advisory Committee Act, and by direction of the Chairman of the Commission, with the concurrence of the other members of the Commission:

(A) The Advisory Committee's official designation is the Advisory Committee on Tender Offers.

(B) The Advisory Committee's objectives are to:

1. Identify the economic implications of the tender offer process and other techniques for acquiring control of public issuers in general and specifically with respect to bidders, subject companies, investors in the bidder and subject company and the securities markets;

2. Determine the need for regulation of such activities, and articulate the nature and the objectives of such regulation;

3. Define the regulatory means to accomplish those objectives, weighing the costs against the benefits of such a regulatory response; and

4. As necessary, formulate recommendations to the Commission with respect to legislative and/or regulatory amendments to the current laws to effect such regulatory response.

(C) The Advisory Committee shall operate on a continuing basis until the Chairman of the Commission, with the concurrence of the other members of the Commission, determines that its continuance is no longer necessary in the public interest, subject to paragraph (I) of this Charter, set forth below, and Section 14(a)(2) of the Federal Advisory Committee Act.

(D) The Advisory Committee shall submit its reports and recommendations to the Commission.

(E) The Commission shall provide any necessary support services.

(F) The duties of the Advisory Committee shall be solely advisory and shall extend only to the submission of reports and recommendations to the Commission. Determinations of action to be taken and policy to be expressed with respect to the recommendations of the Advisory Committee shall be made solely by the Commission.

(G) The estimated annual operating costs in dollars and staff-years of the Advisory Committee are as follows:

Dollar Cost -- $30,000 for travel, per diem and miscellaneous expenses for Advisory Committee members and Commission personnel per year on a continuing basis.

Staff-Years -- 1 staff-year, per year, for Commission personnel on a continuing basis.

(H) The Advisory Committee shall meet at such intervals as are necessary to carry out its functions. It is estimated the meetings of the full Advisory Committee generally will not occur more frequently than monthly.

(I) The Advisory Committee shall terminate at the end of 10 months from the date of its establishment unless, prior to such time, its Charter is renewed in accordance with the Federal Advisory Committee Act, or unless the Chairman, with the concurrence of the other members of the Commission, determines that continuance of the Committee no longer is in the public interest. Upon such a determination, the Chairman, with the concurrence of the other members of the Commission, shall direct by amendment to this Charter that the Advisory Committee terminate at such earlier date.

(J) This Charter has been filed with the Chairman of the Commission, the House Committee on Energy and Commerce, the Senate Committee on Banking, Housing and Urban Affairs, and furnished to the Library of Congress on February 25, 1983.

JShad

John S.R. Shad
Chairman

APPENDIX 3

GLOSSARY OF TERMS

Crown Jewel -	The "crown jewel" is the most prized asset of a corporation, i.e. that which makes it an attractive takeover target. A defensive tactic against a hostile tender offer may be to sell this asset to another party, thereby removing the assets that the unfriendly bidder was hoping to acquire and encouraging him to cease his offer without purchasing any shares of the subject company.
Golden Parachute -	A generous severance package that protects certain key executives if control of their company changes.
Lock-Up -	An arrangement, made in connection with the proposed acquisition of a publicly held business, that gives the proposed acquiror an advantage in acquiring the subject company over other potential acquirors. Lock-ups may take the form of: a) a stock purchase agreement for treasury or unissued shares, b) options to purchase treasury or unissued shares, c) an option to buy certain assets (See "Crown Jewel"), d) a merger agreement, e) agreements providing for liquidated damages for failure to consummate an acquisition, f) options and stock purchase agreements between the "white knight" and principle shareholders, and g) other similar provisions.
Pac Man Defense -	A tender offer by the subject company for the securities of the original bidder.
Scorched Earth Defense -	Actions taken by the directors of the subject company to sell off the subject company's assets or failing this, to destroy the character of the company to circumvent the bidder's tender offer.

Two-tier Offer - A two step acquisition technique in which the first step (front end) is a cash tender offer and the second step (back end) is a merger in which remaining shareholders of the subject company typically receive securities of the bidder valued below the cash consideration offered in the first step tender offer. Despite the reduced consideration being offered in the merger, the merger is certain to be approved by the subject company's shareholders as the bidder, due to his acquisition of a controlling interest in the subject company through the tender offer, will vote in favor of the merger.

Poison Pill - A class of securities of the target company convertible upon consummation of any merger or similar transaction into the common stock of the acquiring entity.

Greenmail - The purchase of a substantial block of the subject company's securities by an unfriendly suitor with the primary purpose of coercing the subject company into repurchasing the block at a premium over the amount paid by the suitor.

Shark Repellants - Amendments to a potential subject company's certificate of incorporation or by-laws that have been devised to discourage unsolicited approaches from unwanted bidders.

White Knight - The party sought out by the subject company by purchasing shares in the market during another person's tender offer or proposed tender offer.

July 8, 1983

Mr. Dean LeBaron, Chairman
SEC Advisory Committee on Tender Offers
Batterymarch Financial Management
600 Atlantic Avenue
Boston, MA 02210

Dear Chairman LeBaron:

Having now read the Committee's draft report and the minutes of its June 2 and 10 meetings (which I was forced to miss by a trip abroad), I want to communicate my reaction to the Committee's recommendations and ask that my views be transmitted to the Securities & Exchange Commission along with the report.

My position with respect to the Committee's final report is probably best described as concurrence in part and dissent in part. I concur in many of the proposals suggested by the Committee to control abuses so widely identified in hostile tender offers today. But I dissent and refuse to join in the Committee's recommendations on two major points: (1) treatment of partial and two-tier offers, which the Committee believes should remain permissible tender offer tactics; and (2) the Committee's desire to restrict the application of state corporation law (beyond limitations imposed by the Commerce Clause) as applied to tender offer transactions. As to each of these conclusions, I strongly feel the Committee has misperceived the public interest and has missed an opportunity to endorse substantial improvements in the law governing regulated tender offers.

I recognize and appreciate that the Committee's report reflects numerous compromises and probably satisfies no Committee member entirely. I also recognize that these recommendations, if accepted by the Commission, will be subject to a great deal of refinement, and perhaps some rethinking. Indeed, I trust that all of the members of the Committee will be permitted to comment further to the Commission as it reviews the report. However, in presenting the final report to the Commission as we do today, because of the importance I place on the points of my dissent I feel an obligation to register the following views as a Committee member:

1) The Committee's charge--as broad as it was and dealing with as important an area of federal regulatory policy as it did--required a more thorough study by the Committee than was undertaken in the approximately four months during which the Committee met. I realize that the Senate Banking Committee's communique to Chairman Shad leading to the appointment of the Committee called for a response by July 31, 1983. I also know that most of the Committee's members are intimately familiar with the subject matter and required little, if any, education by the Committee's staff in order to address the issues. But another few months of work certainly would have been acceptable to the Senators and would have given the Committee a much better foundation on which to construct and test its hypotheses. It would have provided an opportunity to consider more carefully the various systems of tender offer regulation employed in other countries and jurisdictions which were recommended to the Committee. The relatively brief life of the Committee also virtually foreclosed the possibility of Committee recommendations for more comprehensive regulatory reforms. As I expressed previously both to you and to the Committee's staff, I believe the Committee needed more time to consider alternative reforms, permit greater public input and comments, and give thought to how its recommendations could be implemented.

2) I am in agreement with many of the Committee's recommendations. For instance, I am pleased the Committee did not accept as its major premise that corporate takeovers are necessarily good for the economy, the securities markets, shareholders and the general public. Having read the Separate Statement of Professors Easterbrook and Jarrell and having considered their arguments carefully, I remain unconvinced that our government's policy should be to encourage and protect these transactions. The Committee's conclusion that the purpose of the takeover regulatory scheme should be neither to promote nor deter takeovers is entirely appropriate. Likewise, I heartily approve of the recommendations closing the "ten-day window" for Schedule 13D filings, establishing a 20 percent "creeping acquisition" limit, lengthening the minimum time periods with respect to tender offers, continuing and tightening restrictions on short tendering, multiple tendering and other actions of market participants, and encouraging improvements in

the quality and timeliness of shareholder communications. I particularly commend the Committee's recommendations prohibiting post-offer "golden parachutes," requiring supermajority approval for supermajority charter amendments, imposing shareholder votes in connection with the issuance of more than 15 percent of the issuer's stock during a tender offer, and mandating an offer to all shareholders where the target proposes to repurchase its shares at a premium. All of these recommendations, if implemented, will improve both the fairness of the tender offer procedure and the public's perception of it.

3) I am vastly disappointed, however, that the Committee did not do anything meaningful to regulate certain tender offer tactics that I consider to be at the heart of many of the problems addressed by the Committee--that is, partial and two-tier bids. In the Executive Summary to the report, the Committee is said to be "concerned with the potentially coercive nature of partial and two-tier bids." Nevertheless, the Summary goes on, the Committee is not prepared to recommend that these tactics be prohibited because (with somewhat circular reasoning) "partial bids can serve valid business purposes, and . . . two-tier bids generally have proved more favorable to shareholders than partial offers with no second step." I regard the Committee's position on this issue as a "cop-out." The Committee erred in refusing to recognize that shareholders faced with partial bids and two-tier tender offers are virtually compelled to relinquish their shareholdings either in the offer or into the market; that competing proration pools resulting from these tactics create massive confusion and documented inequities; that public shareholders find it difficult or impossible to compare competing offers for less than all of the outstanding shares of a target, with or without a second step, and therefore cannot rationally act in their best interests; that the advantages enjoyed by market professionals over ordinary shareholders of a target in the context of a tender offer are greatly accentuated with respect to partial and two-tier offers; and that "Pac Man" and other abusive takeover defenses, proration and other timing difficulties, problems associated with equalizing regulatory treatment of cash and exchange offers, and various other of the system's current maladies have, at their root, partial and two-tier offers. Instead, the

Committee proposes an innocuous "regulatory disincentive" for partial and two-tier bids involving a slightly longer minimum offering period. I simply can't agree with the Committee's approach and must record a vigorous dissent. I regard this as a fundamental defect in the Committee's report.

4) Recommendation No. 34 (which was added to the report at the very end of the Committee's deliberations) calls for the abolition of all state laws and regulations, including those found in state corporation statutes, that "restrict the ability of an out-of-state company to make a tender offer." Expressly included in this disfavored group of state enactments are statutes that require shareholder approval to effectuate a change of corporate control, a direct reference to the State of Ohio's recent amendments to its corporate law. It is well recognized that the relationship among a corporation, its officers, directors and shareholders is clearly a legitimate concern of the state that grants the corporate charter. See Edgar v. MITE Corporation, 102 S.Ct. 2629, 73 L. Ed. 2d 269, 285, citing Restatement (2d) of Conflict of Laws, § 302, Comment b at 307-308 (1971). It seems anomalous to me that while the Committee professes confidence in state corporate law and the "business judgment" rule to secure the rights of shareholders of both bidders and target companies in a tender offer context, it objects to a corporate law provision specifically permitting shareholders to determine by majority vote whether control of their corporation should change hands. If such a provision or similar provisions in the corporate law of any state are determined to place an undue burden on interstate commerce, the courts will surely strike them down. But to indict all state laws and regulations "regardless of their form" that create any impediment to an out-of-state company's attempt to take over a domestic corporation (other than regulated companies) seems to me an overreaction and an unwise federal policy. Although I greatly respect the Securities & Exchange Commission and its work in the tender offer area, I strongly oppose the Committee's recommendation to rely exclusively on the Commission and to restrict the states in their traditional role of prescribing procedures for the conduct of internal corporate affairs, even those affecting tender offers.

5) Finally, I wish to offer a brief comment concerning the separate statement of our colleague on the Committee, Justice Arthur Goldberg. Of the 18 Advisory Committee members, Justice Goldberg would probably agree that he had the least prior contact and familiarity with corporate takeover transactions and tender offer regulation. Although his written contributions to the law of securities regulation as a Justice of the United States Supreme Court were substantial, he clearly regards himself as a "non-expert" in this field. Nevertheless, he has identified directly and clearly some of the publicly perceived abuses associated with tender offers and, just as importantly, has observed that these abuses "cast a shadow on our system of corporate governance." Justice Goldberg's proposed reforms are worthy of careful consideration not only because of the stature of this commentator, but also because of his status as a public, "non-expert" member of the Committee. I should say that I do not agree with all of his suggestions and I think he has not considered certain negative impacts of their implementation. But as a general statement of the direction in which tender offer regulation should be headed, I believe Justice Goldberg's report is valuable and on target.

* * *

Allow me to add a personal comment regarding the Chairman of the Committee. Having appointed a number of advisory committees during my tenure as Wisconsin Commissioner of Securities, and having participated on numerous other committees, I appreciate the difficulties in guiding a group of persons (both experts and non-experts) toward the completion of an assigned task of this dimension. Your handling of the Committee's deliberations was exemplary, and was largely responsible for the cogency of the final report. I particularly want to thank you for the special effort you made to bring me "up to speed" following my appointment as a committee member. I very much enjoyed our personal association.

I would be happy to discuss any of the matters mentioned herein with you, our fellow Committee members or the Commission.

Respectfully submitted,

Jeffrey B. Bartell

JBB:bl

APPENDIX A

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-19528]

Advisory Committee on Tender Offers

Establishment and Meeting

AGENCY: Securities and Exchange Commission.

ACTION: Notice of establishment of the Securities and Exchange Commission Advisory Committee on Tender Offers.

SUMMARY: The Chairman of the Commission, with the concurrence of the other members of the Commission, has established the Securities and Exchange Commission Advisory Committee on Tender Offers, which is to conduct an examination of tender offers and other related regulations and practices and to recommend to the Commission any legislative and/or regulatory changes the Committee may consider to be in the best interest of all shareholders (i.e., shareholders of all corporations, whether potential bidders, target companies or by-standers).

DATE: February 25, 1983

FOR FURTHER INFORMATION CONTACT: Linda C. Quinn, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549 (202) 272-2579.

SUPPLEMENTARY INFORMATION: In accordance with the requirements of the Federal Advisory Committee Act, 5 U.S.C. App. I, and the regulations thereunder, the Commission has ordered publication of this notice that Chairman John S.R. Shad, with the concurrence of the other members of the Commission, has established an advisory committee, under the Federal

Advisory Committee Act, which is designated the Securities and Exchange Commission Advisory Committee on Tender Offers. Chairman Shad certifies that he has considered carefully the establishment of this Committee and, with the concurrence of the other members of the Commission, has found the creation of this Committee to be in the public interest in that it will assist the Commission in the performance of its responsibilities under the federal securities laws.

The Advisory Committee is authorized to examine tender offer and other regulations and practices. Issues that may be considered by the Advisory Committee include: (1) the economic implications of tender offers and other acquisition techniques on the economy in general and specifically with respect to bidders, subject companies, investors and the securities markets; (2) the need for, and the nature and objectives of, regulation of such activities; (3) the regulatory means to accomplish these objectives, weighing the costs against the benefits of such a regulatory response; and (4) possible recommendations to the Commission with respect to legislative and/or regulatory amendments to the current laws to effect such regulatory response.

The Advisory Committee shall conduct its operations in accordance with the provisions of the Federal Advisory Committee Act.

The duties of the Committee shall be solely advisory and shall extend to submitting reports and recommendations to the Commission.

The Securities and Exchange Commission shall provide any necessary support services required by the Advisory Committee.

The Advisory Committee shall meet at such intervals as are necessary to carry out its functions. It is estimated that the meetings of the full committee generally will occur no more frequently than at four week intervals.

The Advisory Committee shall terminate at the end of ten months from the date of its establishment unless, prior to such time, its charter is renewed in accordance with the Federal Advisory Committee Act, or unless the Chairman, with the concurrence of the other members of the Commission, determines that continuance of the Advisory Committee no longer is in the public interest.

A copy of the Charter of the Committee has been filed with the Chairman of the Commission, the Senate Committee on Banking, Housing, and Urban Affairs, and the House of Representatives Committee on Energy and Commerce. A copy of the Charter also has been furnished to the Library of Congress and placed in the Commission's Public Reference Room for public inspection.

By the Commission.

George A. Fitzsimmons
Secretary

February 25, 1983

APPENDIX B

SEC Advisory Committee on Tender Offers
Agenda of Issues

Objectives: To review techniques for the acquisition of control of public companies ("takeovers") and the laws applicable thereto in terms of the best interests of all shareholders (i.e., shareholders of all corporations, whether potential acquirors, target companies or bystanders) and to propose specific legislative and regulatory improvements for the benefit of all shareholders.

I. Definition of Activities to be Reviewed.

The Committee has determined that, given the interrelationship of the various techniques to acquire control and the consequences of regulating one method of acquisition without taking into account the effect of such regulation on the relative advantages and disadvantages of other acquisition methods, it is necessary to consider the whole spectrum of acquisition techniques. The Committee recognizes, however, that given the anticipated date of its report to the Commission, it may not address in detail the full range of regulations, state and federal, applicable to proxy solicitations and mergers, but rather may focus on those issues that are common to such transactions and acquisitions of control through purchases of equity from investors.

II. Economics of Takeovers and their Regulation.

A. What is the economic effect of takeovers on:

1. acquirors and their shareholders - for example, what happens to an acquiror's financial condition, results of operations and stock price following an acquisition?

2. target companies and their shareholders - for example,

a. do takeovers provide a useful means of providing better management; and

b. does the prospect of takeover cause management to emphasize short-term results at the expense of long-term growth?

B. What is the relative effect of the following factors on the size and number of takeovers:

1. credit availability and policies;

2. tax policies;

3. antitrust policies;

4. market conditions;

5. general economic conditions;

6. accounting requirements (e.g., pooling, purchase, consolidation and equity accounting requirements);

7. laws applicable to change in control of regulated industries;

8. state takeover laws;

9. federal securities laws;

   a. 1933 Act (required registration of exchange offers)

   b. Williams Act

   c. other

10. state corporate law (e.g., fiduciary obligations); and

11. other?

C. What are the anticipated economic effects on acquirors, target companies, and the number and size of takeovers of adopting British type regulations that restrict or prohibit the ability of acquirors to:

   1. use two-tier pricing;

   2. engage in partial offers; and/or

   3. engage in open market accumulation programs at some defined level?

D. What is the economic effect on acquirors, target companies, their shareholders, and the number and size of takeovers of a regulatory environment that permits or encourages "auctions" of a target company?

E. What is the impact upon shareholders of the credit used to finance takeovers? Should the extension of credit for takeovers be regulated for the benefit of all shareholders?

III. Basic Objectives of the Federal Securities Laws Applicable to Takeovers.

The following issues are to be considered as an integral part of the Committee's consideration of the issues arising under captions IV, V, VI and VII.

Who should be protected under federal securities laws, what should the objectives of such regulation be and what premises should govern the balancing of these objectives?

A. Protection of shareholders (e.g., disclosure, proration, equality of treatment, substantive fairness).

B. Preservation of flexibility of business judgment for both the acquiror and target company.

C. Auctions of target companies.

D. Unfettered transfers of control.

E. Market liquidity and depth, efficiency in pricing. (Should takeovers be considered another dimension of market liquidity and thereby promoted under a mandate to extend market depth with full disclosure, promptness and reasonable cost?)

F. Ability of management to find alternative to takeover partners.

G. Neutrality (i.e. that the law have neither as its objective or effect, taking into account other regulatory objectives, the deterrence or promotion of takeovers).

IV. Regulation of Acquirors of Control.

A. To what extent can the procedures specified by law be made more uniform so that the current distinction between cash transactions and those using securities may be minimized? To what extent can the concept of integration of the 1933 and 1934 Acts be applied in the takeover area (where shareholders are compelled to make an investment decision) to streamline the procedures and disclosure required in connection with exchange offers and mergers?

B. Disclosure.

The primary purposes of the Williams Act are to assure that target company shareholders have the time and information to make informed investment decisions.

1. Are these purposes achieved by the current regulatory system?

   a. Is the current required disclosure meaningful and of use to most shareholders?

   b. Can some disclosure be eliminated or streamlined without lessening its effectiveness?

2. Should time and information continue to be the primary objectives of the law? Do such requirements serve the best interest of all shareholders?

3. What changes should be made in current disclosure requirements if disclosure continues to be a primary objective? For example:

   a. Should pro forma information be required in partial or proposed multiple step transactions?

   b. Should the accounting requirments with respect to purchase and pooling, consolidation and equity reporting be revised?

   c. Should tax disclosure be expanded and opinions of counsel on tax matters be required?

   d. Should projections of the target company given to the acquiror be required to be disclosed in its disclosure materials?

   e. Should tender offer materials be reviewed by the Commission prior to use as are proxy soliciting materials and registration statements used in connection with exchange offers and mergers?

4. Do acquirors and target companies have sufficient access to shareholders in an efficient, timely manner?

5. Do technological developments need to be taken into account in defining timing and disclosure requirements?

6. Do the current requirements under section 13(d) of the 1934 Act need revision? Is the disclosure required in the Schedule 13D useful to shareholders? Should acquirors be permitted to continue to purchase securities before the Schedule 13D is filed after the 5% threshold is reached? Should the criteria for reporting obligations be expanded to include any purchase that is part of an intended acquisition of control.

C. Terms of the Acquiror's Offer.

What substantive regulation should there be of the terms of the offer?

1. Price.

   a. Should it be required to be fair and if so by whose determination?

   b. Should all shareholders accepting the offer be entitled to the highest price paid in the offer?

   c. Should Dutch Auctions be permitted or encouraged?

   d. Should there be a limitation on, or prohibition of, two-tier pricing?

2. Limited Offers.

   a. Should partial tender offers be permitted?

   b. If partial offers are permitted, should shares be required to be accepted pro rata?

   c. Should there be a limitation on open market accumulation programs?

3. Minimum Offering Period.

   Should there be a minimum offering or solicitation period? If so, for what period?

4. Withdrawal Rights.

   Should withdrawal rights be required? If so, on what basis?

5. Should states law rights of appraisal be incorporated in federal law?

D. Approval of Acquiror's Shareholders.

   Should the acquiror have to obtain the prior approval of its shareholders of proposed major acquisitions and attendant financings?

V. Regulation of Opposition to Acquisition of Control.

   A. Should state corporate law fiduciary obligations applicable to the board of directors be the principal means by which its activities are regulated? If so, should the "business judgment" rule continue to be the principal applicable standard?

   B. If the business judgment rule is the appropriate standard against which to measure the board's actions, should there be different requirements (i.e. restrictions, requirements of shareholder approval or prohibition) with respect to one or more of the following actions:

      1. Pac-man defense;

      2. sales of "crown jewels";

      3. target tender offers for their own shares;

      4. use of employee benefit plans to defeat or deter tender offers;

      5. "golden parachutes" and "silver wheelchairs" (i.e. employment and severance provisions that take effect upon a change in control);

      6. lock-ups; leg-ups (e.g., sales of blocks of shares or options on shares to frustrate takeovers);

      7. "shark repellents" (charter and by-law amendments to discourage takeover attempts);

      8. "scorched earth" policies;

9. litigation; and

10. other defensive maneuvers?

C. Should the repurchase of shares by an issuer at a premium be proscribed?

VI. Regulation of Market Participants.

A. Is there a need to limit or prohibit short tendering, hedged tendering, double tendering?

1. What is the impact on the market and on the tender offer process of such practices?

2. Do such practices inordinately disadvantage the non-professional investor? If so, are there benefits to such investors that outweigh such disadvantages?

3. Is there a need to regulate substantively the tender guarantee mechanism?

B. Options.

Do problems exist in the tender offer process as the result of or because of the options markets? E.g., can and should there be a limitation on or other regulation of uncovered call writing during tender offers?

C. Clearing Systems.

Should regulations be adopted to require the use of depository book entry systems and/or require clearing corporations to maintain continuous netting programs during tender offers and to adopt uniform closeout and liability notice programs?

D. Risk Arbitrage.

Is there a need for substantive regulation of the activities of risk arbitrageurs?

VII. Interrelationship of Various Regulatory Schemes.

A. Should the Committee consider substantive issues with respect to tax, banking, antitrust, ERISA, etc. or limit itself to considering whether in general the various regulatory schemes eventually should or could be coordinated procedurally and/or substantively?

B. What is the proper relationship of federal and state securities and corporate laws and laws applicable to regulated industries?

1. Should there be state regulation of third party acquisitions of securities from shareholders (e.g., new Ohio statute)?

2. At present acquirors' activities are, as a practical matter, principally restricted by the federal securities laws, while the target's responses are, as a practical matter, principally subject to state regulation. Is this appropriate? If not, what should be done about it? What is the appropriate relationship between the federal securities laws and state laws applicable to changes of control of regulated industries?

VIII. Additional Issues.

A. See the additional issues raised by 12 members of the Senate Banking Committee in the attached letter.

B. What Commission enforcement presence is possible or appropriate, given the timing of control acquisitions? Are changes needed in the applicable laws to permit an effective enforcement presence?

C. To what extent do continuing changes in the law applicable to takeovers create inordinate difficulties for participants and shareholders?

United States Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, D.C. 20510

UNITED STATES SECURITIES AND EXCHANGE COMMIS
RECEIVED
FEB 3 1983
OFFICE OF ASSOCIATE DIRECTOR
DIVISION OF CORPORATION FINANCE

February 1, 1983

CHAIRMAN'S OFFICE
RECEIVED
FEB 03 1983
SEC. & EXCH. COMM.

The Honorable John S.R. Shad
Chairman
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Dear Chairman Shad:

We welcome the announcement that the Securities and Exchange Commission will shortly begin a full-scale study of the federal tender offer regulations, with an eye to proposing new legislation in Congress.

Commentators have suggested that the most feasible approach to current problems with tender offer law would be for Congress to revisit the program it began a decade ago, expanding the provisions of the Williams Act to deal with tender offer abuses, providing the judiciary with guidelines for determining the validity of challenges to bidder or management conduct during the course of an offer, and clarifying the respective rules of federal and state regulation.

The proliferation of contested take-overs over the past few years and the corresponding publicity has resulted in considerable Congressional interest in this subject. It would be most helpful to us if the Commission would address, among others, the following issues in its study:

What should be the role of the government in hostile take-overs?

What is a corporation's obligations to its shareholders, its employees, consumers, and the community in a take-over situation?

What abuses have occurred under current tender offer law?

Chairman Paul A. Volcker, of the Federal Reserve, has expressed concern "about take-overs distorting banking judgments or the credit markets." How might such distortions be prevented?

The Honorable John S.R. Shad
February 1, 1983
Page 2

What should be the involvement of states in regulating corporate take-overs?

Should shareholders of a corporation be given the right to vote on proposed tender offers within a specific period of time of the offer, and should a shareholder majority be required to approve acquisitions and take-overs?

Are "golden parachute" provisions guaranteeing executives salaries and other compensation after any change of control of a company in the best interests of shareholders of that company? Should federal securities law require shareholder approval of golden parachutes or that their provisions be spelled out in detail in companies' proxy materials?

Should interest on money borrowed specifically to buy the common stock of another corporation in a take-over situation be tax deductible?

Should retained earnings used to acquire other companies be subject to a minimum merger tax?

Should additional time for competing bids be provided under a rule of auctioneering?

Should a federally imposed period of advance notice be established requiring a bidder to file registration materials with both the SEC and subject company management prior to the implementation of a tender offer?

Are individual shareholders currently receiving adequate and timely notice and information about take-overs (including competing offers)?

Do target corporations currently have sufficiently direct access to all their individual shareholders to conduct a responsible and reasonable defense against a hostile take-over?

It has been suggested that tender offers serve as an effective mechanism to discipline incompetent management and to permit the transfer of productive assets to the control of more efficient management. On the other hand, it has been agreed that the fear of hostile take-overs tends to focus management's efforts on short-run profits while giving less attention to longer term investments needed for economic growth. What role, if any, should federal regulation play in striking the proper balance between these conflicting concerns?

The Honorable John S.R. Shad
February 1, 1983
Page 3

The Chairman and Chief Executive Officer of a company which was a major and successful player in a recent multibillion dollar acquisition contest has embraced the view that "Maybe there's something wrong with our system when .... companies line up large amounts of money in order to purchase stock, when it doesn't help build one new factory, buy one more piece of equipment, or provide even one more job." How, if at all, should federal regulation address this widespread frustration?

We recognize that a number of these issues are outside the direct jurisdiction of the Commission. However, it is our understanding that the Advisory Panel being put together by the Commission to study tender offers will be made up of outside professionals, including economists.

We believe that the public interest and the Congress would be best served by a broad study of the many issues surrounding tender offers and particularly hostile take-overs, and, therefore, we encourage the Commission panel to be comprehensive in both its approach and charter.

On July 13, 1979, the Banking Committee requested the Commission to review 7 specific questions concerning coverage of the Williams Act. The Commission provided its response on February 15, 1980. It would also be helpful if the Advisory Panel could review the questions and answers and provide any updating which the Panel may deem necessary.

To assist us in considering this subject, we would appreciate receiving the study and recommended legislation from the Advisory Panel by July 31, 1983.

Sincerely,

Alfonse ~~M.~~ D'Amato	Paul S. Sarbanes
Slade Gorton	Donald W. Riegle
John Heinz	Christopher J. Dodd
Paula Hawkins	Alan J. Dixon
Mack Mattingly	Alan Cranston
Jake Garn, Chairman	William Proxmire Ranking Minority Member

APPENDIX C

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-19635)

Advisory Committee on Tender Offers; Notice of Meeting and Request for Public Comment

AGENCY: Securities and Exchange Commission.

ACTION: Notice of meeting of the Securities and Exchange Commission Advisory Committee on Tender Offers and request for public comment.

SUMMARY: This is to give public notice that the Securities and Exchange Commission Advisory Committee on Tender Offers will conduct a meeting on April 15, 1983 in Morgan Guaranty Hall, 28th Floor, 15 Broad Street, New York, New York, beginning at 10:00 a.m. This meeting will be open to the public. This is also to invite members of the public to submit written comments to the Committee.

ADDRESSES: All communications on this matter should be submitted in triplicate to David B.H. Martin, Jr., Secretary, Advisory Committee on Tender Offers, Room 3024, Securities and Exchange Commission, Washington, D.C. 20549. All comment letters should refer to File No. 265-15.

FOR FURTHER INFORMATION, CONTACT: David B.H. Martin, Jr., Division of Corporation Finance, Securities and Exchange Commission, Washington, D.C. 20549, (202-272-2573).

SUPPLEMENTARY INFORMATION: In accordance with section 10(a) of the Federal Advisory Committee Act, 5 U.S.C. App. 1, 10(a), the Securities and Exchange Commission Advisory Committee on Tender Offers 1/ gives notice that it will conduct a meeting on April 15, 1983 in Morgan Guaranty Hall, 28th Floor, 15 Broad Street, New York, New York, beginning at 10:00 a.m. The meeting, which will be open to the public, will be the second meeting of the Advisory Committee. Its purpose and agenda will be to consider the issues set forth below and to receive reports from its various working groups on such issues. The Committee has also scheduled meetings for May 13, 1983 in New York City at a place to be announced, and for June 10 and July 8, 1983 in Room 1C30 at the Commission's main offices, 450 Fifth Street, N.W., Washington, D.C. The Advisory Committee's first meeting was held on March 18, 1983 at the Commission's main offices.

The Committee believes that it is important to receive views from the public. To this end, through the facilities of the Securities and Exchange Commission, the Committee is soliciting written comments on the issues set forth below. This solicitation is made solely by the Advisory Committee and the Commission is providing its facilities to assist the Committee in receiving public comment from the widest possible audience. Because of the time constraints affecting the Committee's work schedule, it is requested that written views be submitted not later than May 1, 1983. All comment letters received will be available for public inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C.

1/ The Advisory Committee was established on February 25, 1983. See Release No. 34-19528.

Issues to be Addressed

I. Basic Objectives. Who should be protected under federal securities laws in tender offer transactions and other acquisitions of corporate control? What should be the objectives of regulation that achieves such protection? What premises should govern the balancing of these objectives.

II. Economics of Tender Offers. What economic factors affect the number, size and other characteristics of tender offers? What are the anticipated economic effects on the number, size and other characteristics of tender offers of changing the current regulatory scheme? What are the economic implications of tender offers and other acquisition techniques on the economy in general and specifically with respect to bidders, subject companies, investors and the securities markets?

III. Regulation of Acquisition of Corporate Control. What should be the primary purposes of the federal securities laws with respect to acquisitions of corporate control? What changes are needed in the current regulatory scheme? Should timing and informational requirements continue to be the primary objectives? To what extent should equality of treatment and substantive fairness be regulatory objectives?

IV. Regulation of Opposition to Acquisitions of Corporate Control. Should the "business judgment" rule continue to be the principal substantive standard governing opposition to acquisition of corporate control? Should there be substantive regulation of opposition in general or specifically with respect to particular defensive practices such as "scorched earth" policies, "golden parachute" provisions, sales of "crown jewels", "shark repellent" provisions, and issuer repurchases of securities at a premium?

V. Regulation of Market Participants. Is there a need for substantive regulation of market participants in connection with acquisitions of corporate control, particularly with respect to short, hedge, or multiple tendering? If so, what regulation is appropriate.

VI. Interrelationship with Other Regulatory Schemes. What is the proper relationship between federal and state securities and corporate laws with respect to acquisitions of corporate control? To the extent the federal securities laws governing acquisitions of corporate control interrelate with other federal and state regulatory schemes, such as tax laws applicable to tax, banking, antitrust, employee benefit plans or regulated industries, is there a need for substantive or procedural coordination?

George A. Fitzsimmons,
Advisory Committee Management Officer.

March 29, 1983

APPENDIX D

NEWS
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 272-2650

For Immediate Release: 83-10

SEC TENDER OFFER COMMITTEE FORMED

At the March 18th organization meeting of the SEC Advisory Committee on Tender Offers, Dean LeBaron was appointed Chairman of the Committee. Mr. LeBaron is the President of Batterymarch Financial Management, which manages $9 billion of equity securities. The Batterymarch portfolio has included most of the target and many of the bidder corporations involved in recent tender offers.

The Committee requested that written comments be provided David Martin, Secretary to the Committee, by shareholder groups, individual shareholders and other interested parties, preferably within 30 days. The next meeting of the Committee will be held in New York City on April 15th. The Committee's final report is scheduled to be submitted to the full Commission and the Senate Committee on Banking, Housing and Urban Affairs in July.

In the course of the six-hour organizational meeting, the Committee of prominent members of the business and financial community, legal and accounting professions and academia revised and refined the agenda of major issues to be addressed. In addition to tender offers, it will include the broad spectrum of transactions involving changes in corporate control, because if one method is made less attractive, it will simply cause others to be used.

The Committee divided the issues among the following subcommittees:

The basic objectives of regulation, chaired by Martin Lipton of Wachtell, Lipton, Rosen & Katz.

The economics of tender offers, jointly chaired by Professors Frank H. Easterbrook and Greg Jarrell of the University of Chicago.

The regulation of acquisition of corporate control, chaired by Robert F. Greenhill, Managing Director of Morgan Stanley & Co.

Regulation of opposition to acquisitions, chaired by Joseph H. Flom of Skadden, Arps, Slate, Meagher & Flom.

Regulation of market participants, chaired by Robert E. Rubin, General Partner of Goldman Sachs & Co.

Interrelationship with other regulatory schemes, chaired by Irwin Schneiderman of Cahill, Gordon & Reindel.

Other members of the Committee include Michael D. Dingman, Chairman of Wheelabrator-Frye Inc.; Ray J. Groves, Chairman of Ernst & Whinney; Alan R. Gruber, Chairman of Orion Capital Corporation; Edward L. Hennessy, Jr.; Chairman of the Allied Corporation; Robert P. Jensen, the former President of G.K. Technologies, Inc.; John W. Spurdle, Jr.; Senior Vice President of the Morgan Guaranty Trust Company; Jeff Tarr, Managing Partner of Junction Partners; and Bruce Wasserstein, Managing Director of First Boston Corporation.

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APPENDIX E

LIST OF COMMENTATORS

Aetna Life & Casualty Company
American Council of Life Insurance (2 letters)
American Insurance Association (2 letters)
American Mining Congress (2 letters)
American Society of Corporate Secretaries, Inc.

The Bar Association of Greater Cleveland
Bate, Rodney E.
Bauer, Ray E.

Control Data Corporation

D'Arcy, Serafina F.
DeAngelo, Harry (Assistant Professor, The Graduate School of Management, University of Rochester) (3 articles)
DeMott, Deborah A. (Professor of Law, Duke University School of Law) (2 articles)

Federal Trade Commission

Gary, Norman L.
Genter, Frank M.
Gregory, Harry K.

Kaye, Scholer, Fierman, Hays & Handler

Leighton, William (Option Advisory Service, Inc.) (2 letters)
Lewis, Walter
Lowenstein, Louis (Associate Professor, Columbia University School of Law) (article)

Marley, Frank E., Jr., Esq. (Van Camp & Johnson) (2 letters)
Mendell, Ira L.
Morris, Walter S.

North American Securities Administrators Association, Inc.

Perkins, Malcolm D., Esq. (Herrick & Smith)
Profusek, Robert A., Esq. (Jones, Day, Reavis & Pogue) (article)

Ratliff, George D., Jr.
Riger, Martin (Professor of Law Emeritus, Georgetown University Law Center) (2 letters) (article)
Roberts, William J. (Bacon, Whipple & Co.)
Rosenzweig, Victor M., Esq. (Olshan Grundman & Frome) (article)

Securities Industry Association, Reorganization Division
Shefsky, Saitlin & Froelich, Ltd.
Sidak, Joseph Gregory, Esq. (article)
Smith, J. Walter
Steinberg, Marc I. (Visiting Associate Professor of Law, The George Washington University, The National Law Center) (3 articles)

Tobin, James M., Esq. (Squire, Sanders & Dempsey) (article)
Topkis, Jay, Esq. (Paul, Weiss, Rifkind, Wharton & Garrison)
Trevor, Leigh B., Esq. (Jones, Day, Reavis & Pogue)

The Union Corporation
United States Department of Justice (Antitrust Division)

Vorys, Sater, Seymour and Pease

White, Hugh V., Jr., Esq. (Hunton & Williams)
Wolf, Marshall

Anonymous

APPENDIX F

SECURITIES AND EXCHANGE COMMISSION
ADVISORY COMMITTEE ON TENDER OFFERS
AGENDA OF MEETING
June 2, 1983

A. Role of States

John Elam - Attorney - Vorys, Sater, Seymour and Pease *
Columbus, Ohio

James Tobin - Attorney - Squire, Sanders & Dempsey *
Columbus, Ohio

Leigh Trevor - Attorney - Jones, Day, Reavis & Pogue *
Cleveland, Ohio

Peter Robertson - General Counsel - Massachusetts Securities Division

B. North American Securities Administrators Association (NASAA)

Orestes Mihaly - Chairman, NASAA Tender Offer Committee; Assistant Attorney General in Charge, New York Bureau of Investor Protection and Securities *

C. Securities Processing and Shareholder Communications

Elef Fitrakis - President, Reorganization Division, Securities Industry Association; Assistant Vice President, Operations - Paine, Webber, Jackson & Curtis *

John Yahoves - Section Manager, Special Cashiering Operations Department - Merrill Lynch, Pierce, Fenner & Smith, Inc.

John Schmidlin - Vice President, Morgan Guaranty Trust Company of New York

Angelo Cordaro - Morgan Guaranty Trust Company of New York

Barry Weiss - Vice President, Operation Division - Goldman Sachs & Co.

Kenneth Schol - The Depository Trust Company, Inc.

Cal Van DerGiesen - Bankers Trust Company

Emil Solpati - Asiel & Co.

Gene Vanhorn - First Jersey National Bank

Michael Foley - Chemical Bank

D. Tender Offer Regulation in Canada

Charles Salter - Director, Ontario Securities Commission

Pierre Lortie - President, Montreal Exchange

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* Submitted comment letter

Agenda Meeting June 2, 1983
Page Two

D. Tender Offer Regulation in Canada (con't)

Gordon Coleman - Attorney - Tory, Tory, DesLauriers & Binnington
Toronto, Ontario

Henry Knowles - Former Chairman, Ontario Securities Commission

LUNCHEON RECESS

E. Participants

Jay Topkis - Attorney - Paul, Weiss, Rifkind, Wharton & Garrison *
New York, New York

Marshall Berkman - Chairman of the Board & Chief Executive Officer
Ampco-Pittsburgh Corporation
Pittsburgh, Pennsylvania

Carl Icahn - President & Chairman, Icahn & Company
New York, New York

Steven Olson - Assistant General Counsel, Control Data Corporation *
Minneapolis, Minnesota

Peter Bator - Attorney - Davis, Polk & Wardwell
New York, New York

Victor Rosenzweig - Attorney - Olshan Grundman & Frome *
New York, New York

F. Shareholders

Robert Profusek - Attorney - Jones, Day, Reavis & Pogue *
Dallas, Texas

William Leighton - President - Option Advisory Service Inc. *
New York, New York

Rodney Bate - Ho-Ho-Kus, New Jersey *

Walter Lewis - Scarsdale, New York *

G. Economics

Harry DeAngelo - Assistant Professor, Graduate School of Management *
University of Rochester
Rochester, New York

Louis Lowenstein - Associate Professor, Columbia University School of Law *
New York, New York

H. U.S. Department of Justice

William Baxter - Assistant Attorney General, Antitrust Division *

* Submitted comment letter