One more draft

MEMORANDUM

TO: The Corporate Advisory Board

FROM: Dennis C. Hensley

DATE: March 29, 1984

RE: SEC Action on Report of Recommendation of Advisory Committee On Tender Offers

On March 13, 1984 the SEC held an open meeting on the above-referenced recommendations. On March 28, 1984, Chairman Shad testified before a House Subcommittee on which of the fifty recommendations the Commission supported and whether these recommendations could be implemented by legislation or rulemaking. A copy of his testimony is attached.

Chairman Shad on behalf of the Commission supported thirty-four of the recommendations, qualified thirteen, disagreed with six and concluded that three require further study. Because some of the recommendations have ~~support~~ subparts, these ~~members~~ num total more than fifty. The Commission also concluded that six require federal legislation and fourteen can be implemented under the Commission's rulemaking authority with the others requiring no formal action.

The following is a summary of the recommendations the Commission disagreed with and an attempt to highlight those others which might be of importance to you as businessmen.

The Commission disagreed with Recommendation No. 15 reasoning that it has reviewed its definition of "group" and concluded that additional action is not necessary at

this time. The Commission also disagreed with a requirement for a bidder to disclose principal supporting assumptions provided by the ~~interpretation~~ Target when it discloses projections or asset valuations to target ~~copying~~ company shareholders under Recommendation No. 19. The Commission also rejected the idea that time periods should be defined in calendar days as opposed to business days under Recommendation No. 27. It also rejected the concept of "advisory vote matters" under Recommendation No. 37a which would have no binding effect on ~~direction~~ directors because the legal effect is unclear and they would subject the corporation to considerable time and expense and might interfere with state law. It also reiterated its belief that defensive issue tender offers should be prohibited and thus disagreed with Recommendation No. 39a and Recommendation No. 40 which suggested no general prohibiton of the counter-tender offer as a defense except where a bidder has made a cash tender offer for 100% of a target company.

The Commission reasoned that it:

> . . .has serious concerns about the use of counter tender offers as defensive tactics. Management should bear the burden of proving that a counter tender offer is not motivated by management's self-interest and reflects a reasonable business judgment. No specific action is planned by the Commission.

The other recommendations which the Commission agreed with, qualified or believed required further study included: the general propositions that the regulatory scheme should neither promote nor deter takeovers, and that there is no material distortion in the credit markets resulting from control acquisition transactions; federal takeover regulation should not preempt or override state corporate law and the business judgment rule but that the courts must recognize the potential conflicts of interest

between management and shareholders, the concept of integration of disclosure should be extended to exchange offers with amendments to certain rules and policies required.

With respect to time periods for bidders, the Commission proposed a requirement of immediate public announcement, next day filing of a Schedule 13D and/or a standstill until filing with an amendment in the Act itself. The Commission wants further study of a requirement that a tender offer is required for a 20% ownership and a longer offering period for an offer for less than all shares of a class of securities. The Commission also agreed with requiring a target company to make available at the acquirer's expense its shareholder lists and maintaining current law with respect to the fairness of prices paid by an acquirer unaffiliated with the target company. ~~[illegible]~~. Under current law there is no "fair price" requirement.

Perhaps the most significant recommendations are those dealing with the "Regulation of Opposition to Acquisition of Control". In this area the Commission agreed with concern over charter and by-law provisions that erect high barriers ~~effect big business~~ to change of control (SHARE REPURCHASE) ~~contract~~ but was not prepared to make any ~~only~~ "broad instrusion into state corporate law". The Commission supports the concept of requiring shareholder approval for issuance of securities representing more than 5% to preferred acquirers but not 15% as proposed by the Committee. It also agrees with a similar requirement for repurchase of shares at a premium from those who have held the shares for less than two years.

Finally, two recommendations involving the general area of regulation of opposition and "golden parachutes" ~~purchases~~ are worth quoting in their entirety: The Commission agreed with Recommendation No. 34 which states:

> 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. An exception to this basic prohibition may be appropriate where a significant portion of the target company is in a 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 provisons under the Williams Act.

With respect to "golden parachutes" in Recommendation No. 38, it stated:

The Commission shares the Committee's concerns with the adoption of change of control compensation in the face of a takeover and concurs in the Committee's judgment that such activities may so undermine the public's confidence in the integrity of the takeover process as to require a federal

response. The Commission takes no position on whether this is best done through tax legislation or other federal regulation, but would be happy to assist in the preparation of such legislation. The Commission would suggest distinguishing between arrangements entered into after a takeover is threatened and those adopted in the ordinary course of buisness. This avoids the substantial problems of separating "golden parachutes" from ordinary employment contracts. As noted with Recommendation 37, the Commission does not favor advisory votes at this time. The Commission does agree that, as is currently required, issuers should disclose change of control related compensation, regardless of the timing of its adoption.

At least one member of the Commission, James C. Treadway, in a speech to the National Association of Manufacturers, critized the report's basic premise that the government should be a neutral referee in this area. He explained that while most people equate neutral with fair, the report opposes state regulations which try to impose a "fairness" standard in tender offers such as measures that require a minimum period to consider a tender offer. He was critical generally of those recommendations that would require preemption of state laws which provide for "shark repellants". He characterized the report as loving state laws up to the point where it doesn't love state laws. Recommendation No. 33 of the report addresses state laws generally as follows.

> 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.

He also critized prohibition of "golden parachutes" and a requirement that a person make a tender offer if a stock purchase gives the person more than 20% of the voting power of the target. Recommendation No. 14. He also questioned why the Committee had not prohibited "scorched earth" policies such as the selling off of valuable assets in a hostile takeover situation instead of testing it against the business judgment rule. Recommendation No. 43.

Treadway also disagreed with a prohibition on counter-tender offers (PAC-MAN) defenses which occur when a bidder makes a cash tender offer for 100% of a target. Recommendation No. 40. He further critized a recommendation on non-binding shareholder advisory votes ~~because~~ because of the "chilling effect" on the best efforts of director[s]. Recommendation No. 37.

He also opposed a Recommendation which requires shareholder approval of an increase in outstanding stock of more than 15% designed to give preferred acquirors a "leg-up" or "lock-up".

At the hearing Congressman Wirth criticized Chairman Shad for not supporting many of the ideas as did certain members of the Committee. The SEC plans to send drafts of legislation to Congress by May on the six recommendations that will require Congressional action and proceed on those that need only regulation.