UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

February 22, 1985

The Honorable Alfonse M. D'Amato
Chairman, Senate Securities Subcommittee
SH-520 Hart Senate Office Building
Washington, D.C. 20510

Dear Chairman D'Amato:

Thank you for your letter of November 16, 1984, requesting the Commission's views concerning the impact of two proposals on the takeover market, state corporation law, capital formation, and management entrenchment.

The following are my views, in which three of the other Commissioners concur. The fifth Commissioner takes exception to the statements made with respect to partial acquisitions, particularly hostile partial tender offers.

The Commission would oppose Congressional adoption of either proposal. Both would place serious limitations on acquisitions of equity in public companies. These limitations would not only impede market forces and further entrench management, but also inhibit other sound economic justifications for partial acquisitions. Moreover, the Commission is not prepared to endorse federal preemption of state corporate law for such purposes.

The first proposal would limit holders of 5% to 90% of an issuer's common stock to 5% of the vote for three years and would require management to submit to its shareholders, and take no action to frustrate, any unconditional cash offer for all the stock at twice the current market price.

To require a holder of less than 90% of the stock of a company to give up voting for all but 5% of the shares for three years would inhibit, if not preclude partial acquisitions, whether friendly or unfriendly, and whether takeover or investment motivated. The investor would be deprived of important rights while at economic risk. Those who risk their funds should be entitled to the rights of ownership. The 5% voting power limitation also would seriously impair shareholders' ability to take legitimate issue with management through the proxy process.

The voting rights of corporate securities is a fundamental issue of state corporate law. The Commission does not support federal preemption of such rights for this purpose.

The proposed counter-balancing provision, that management could not oppose unconditional cash offers for all the shares at twice the market price, does not adequately offset the foregoing adverse consequences. Because of the variety of business, market, competitive, legal and other uncertainties and risks, there have been few, if any, unconditional 100% premium cash offers for all the shares of companies. In addition, the restriction on management actions would also involve a preemption of state corporate law that the Commission does not support for this purpose.

Finally, neither feature of this proposal requires federal legislation. Companies can implement them by submitting them to their shareholders for approval under the existing proxy rules.

The second proposal would require a person acquiring 20% of a company's common stock to make a tender offer for all the shares on identical terms and would extend the minimum offering period from the current 20 business days to 40 calendar days. The Commission opposed similar proposals by Senators Specter and Metzenbaum in testimony at the October 2, 1984 Senate Banking Committee hearings.

This proposal would also inhibit friendly and contested partial acquisitions, including equity investments of more than 20% and majority-owned subsidiaries. The consequences for the takeover market, capital formation and management entrenchment discussed above are equally applicable to this proposal.

Moreover, to require that any person acquiring over 20% of an issuer must offer to buy the entire company will tend to immunize large companies from takeovers. Studies indicate that the average target company subject to a partial tender offer has been three to five times larger than the average target company in an any-and-all offer.

Also, there are many sound and practical justifications of partial acquisitions. Such acquisitions:

(i) allow companies to invest in others, with less than 100% financial exposure;

(ii) facilitate technological exchanges and relationships;

(iii) permit proportional recognition of 20% or larger interests, under corporate equity accounting;

(iv) facilitate venture capital, foreign and other direct investments; and

(v) permit investors to become familiar with potential acquisitions, before deciding to increase their investment.

Some contend that two-tier and partial tender offers are coercive and that non-professional shareholders do not have adequate opportunity to participate in such offers. All friendly and contested tender offers, mergers and similar transactions are "coercive" to the extent that they afford shareholders the opportunity to accept or reject substantial premiums within a specified time period. Studies show that in 1980-83, the average premium for any-and-all offers was 63%, for two-tier offers a 55% blended premium (64% in the first tier and 47% in the second tier), and 31% for partial offers.

Further, there is little evidence that individual shareholders have had difficulty in participating in offers for less than all the shares. A survey of the successful partial offers for more than 50% of outstanding shares during fiscal 1984 shows that an average of approximately 87% of the shares were tendered prior to the expiration of the offer.

In response to Senator Metzenbaum's proposal to extend the minimum offering period to 40 calendar days, the Commission testified on October 2, 1984 that the current 20 business day (equivalent of 28 calendar day) offering period is adequate for shareholders to receive, consider and act on tender offers; that the longer period is not necessary for the protection of shareholders; and that the longer offering period would inhibit first bidders, but for whom there would be no competitive bids at higher prices.

The Commission opposed H.R. 5693, which would have extended the mimimum offering period to 40 calendar days. The House Energy and Commerce Committee Report (H. Rep. 98-1028) which accompanied the bill did not suggest that shareholders need

more time to make informed investment decisions. It focused on the advantages to target company managements of the longer offering period; noted the potential for more competing bids; and acknowledged the consequent reduction in the number of tender offers.

If you desire any additional information, please call me or Linda C. Quinn (272-2000), my Executive Assistant.

Sincerely yours,

John S.R. Shad