

GREGG A. JARRELL'S TALK BEFORE THE D.C. BAR

JANUARY 16, 1985

"THE DEBATE ON HOSTILE TAKEOVERS"

OR

IS T. BOONE PICKENS GOOD OR BAD FOR SOCIETY

INTRODUCTORY REMARKS

- ° THANKS KATHIE McGRATH FOR INVITATION
- ° ASKED ME TO TALK ABOUT OCE'S ROLE IN SEC
- ° INDIRECTLY DO THIS IN COURSE OF DISCUSSING
SEVERAL ISSUES SURROUNDING DEBATE ON
HOSTILE TAKEOVERS.

IT WILL BECOME CLEAR TO YOU;

- 1) WHAT THE SEC ECONOMISTS DO
- 2) HOW THE SEC ECONOMISTS THINK

AND YOU WILL COME TO WONDER, "WHY DOES THE
SEC KEEP THESE PEOPLE?"

SERIOUSLY, THESE "ECONOMIC POSITIONS" HAVE A VERY LOW
PAYOFF IN THE POLITICAL MARKETPLACE FOR IDEAS. SO
I ASK YOU TO PLEASE PITY THOSE OF US WHO CLING TO THEM.

IN RECOLLECTING HOW THE DEBATE ABOUT TENDER OFFER
REGULATION HAS UNFOLDED OVER THE PAST TEN YEARS,
I THINK THAT THE FOCUS HAS SHIFTED FROM RESTRAINING
BIDDERS (WILLIAMS ACT, STATE LAWS) TO RESTRAINING
TARGET DEFENSIVE MEASURES, ESPECIALLY OVER THE LAST
YEAR OR TWO.

EVIDENCE - SEC CLEARLY; CONGRESS (LESSER DEGREE)

SEC - LAST YEAR PROPOSED TO:

- ° PROHIBIT GOLDEN PARACHUTES DURING HEAT OF BATTLE
- ° PROHIBIT TARGET STOCK PURCHASES DURING T.O.
- ° PROHIBIT STOCK ISSUANCES THAT DILUTE VOTE OR
EXPLODE WITH TAKEOVER ATTEMPT (POISON PILL)
- ° PROHIBIT GREENMAIL UNLESS S.H. VOTE

THESE ARE ALL CONSIDERED LARGELY TO BE ABUSIVE DEFENSIVE
TECHNIQUES BY THE SEC.

ALSO: OPINION HAS BEEN EXPRESSED FROM "TOP" RECENTLY
THAT SEC HAS DISTASTE FOR WAVE OF ANTI-TAKEOVER
CHARTER AMENDMENTS, ON GROUNDS THAT THEY UNDULY
DISENFRANCHISE SHAREHOLDERS OR PROVIDE THEM WITH
AN OPPORTUNITY TO DISENFRANCHISE THEMSELVES.

ONLY ONE SUBSTANTIVE BIDDER RESTRICTION PROPOSED BY SEC
IN THIS PACKAGE.

- ° CLOSE TEN-DAY WINDOW BY REQUIRING IMMEDIATE
DISCLOSURE BY THE ACQUIRER OF MORE THAN 5%
OF A CLASS OF VOTING STOCK - PRE-FILING OPPOSED
BY SEC, ON GROUNDS THAT IT DETERS EXCESSIVELY
BENEFICIAL STOCK ACQUISITIONS.

MOREOVER, SEC TESTIFIED AGAINST

- ° INCREASING MINIMUM OFFER PERIOD TO 60
FROM 20 DAYS/DETERRENCE.
- ° RESTRICTING 2-TIER AND PARTIAL OFFERS BY
REQUIRING 2-WEEK EXTRA MINIMUM OFFER PERIOD.

So, SEC HAS SHIFTED ITS FOCUS IN RECENT
YEARS TO ABUSIVE DEFENSIVE TECHNIQUES, AND
AWAY FROM ABUSIVE BIDDER TACTICS. THERE SEEMS

TO BE A FEELING THAT REGULATIONS SINCE EARLY
1970s HAVE TILTED ADVANTAGE TO TARGETS, AND
THAT IT IS UNWISE TO GO MUCH FURTHER.

- ° FAIR TO SAY THAT CONGRESS AND LEGAL COMMUNITY
HAVE ALSO GONE IN THIS DIRECTION, ALTHO NOT AS
DRAMATICALLY AS THE SEC. LESS CRITICISM OF RAIDERS;
AND WE SAW PROPOSALS LAST YEAR THAT WOULD CREATE A
FEDERAL CAUSE OF ACTION FOR SEC AND SHAREHOLDERS
TO CHALLENGE CONDUCT BY THE BOARD OF DIRECTORS OF
AN ISSUER IN CONNECTION WITH CHANGE OF CONTROL
TRANSACTION.
- ° THIS IS STRONG MEDICINE - IT WOULD PRE-EMPT THE
BUSINESS JUDGEMENT RULE IN THESE CONTROL BATTLES.
- ° ALTHO CONGRESSIONAL PROPOSALS STILL CONTAIN ANTI-
RAIDER RHETORIC AND REAL RESTRICTIONS ON CERTAIN

BIDDER TACTICS, THE PROPOSALS REFLECT CLEARLY GROWING IMPATIENCE WITH DEFENSIVE TACTICS SUCH AS GREENMAIL, POISON PILLS, AND SCORTCHED - EARTH DEFENSIVES. GROWING IMPATIENCE WITH TACTICS THAT APPARENTLY ROB TARGET SHAREHOLDERS OF LARGE PREMIUMS, AND BIDDER SHAREHOLDERS OF SOME VALUE, IN ORDER TO PRESERVE THE TARGET'S INDEPENDENCE.

° WHY INCREASED CONCERN OVER DEFENSIVE TACTICS?

ANSWER: RECENTLY THERE HAVE BEEN WIDELY-PUBLICIZED CASES OF DEFEATED TAKEOVER ATTEMPTS.

- WARNER'S BUYOUT OF STEINBERG
- CARTER HAWLEY HALE DEFEAT OF LIMITED
- JUST DAYS AGO - PHILLIPS BOUGHT OUT T. BOONE PICKENS

- ° PUBLICITY IS PROBABLY NECESSARY TO GENERATE CONGRESSIONAL "CONCERN", BUT THIS IS TOO EASY OF AN ANSWER. IT BEGS THE QUESTION - WHY HAVE THESE NOTORIOUS CASES ARISEN?

ANSWER: THERE ARE MORE HOSTILE TAKEOVERS!?

LETS LOOK AT THE FIGURES.

WITHOUT A BUNCH OF BORING STATISTICS, THE FOLLOWING

FACTS CAN BE SUPPORTED:

- ° TENDER OFFERS ACCOUNT FOR SMALL FRACTION OF ALL MERGER AND ACQUISITION ACTIVITY. THIS IS STILL TRUE; NO SIGNIFICANT INCREASE IN T.O. ACTIVITY RELATIVE TO TOTAL.
- ° HOSTILE TAKEOVERS HISTORICALLY ACCOUNT FOR ABOUT 1/3 TO 40% OF ALL TENDER OFFERS FOR CONTROL. THIS HAS NOT CHANGED IN RECENT YEARS - NO RISE.

- ° 1984 WAS EXTRAORDINARY - NOT IN THE NUMBER OF MERGERS OR NUMBER OF TENDER OFFERS - BUT IN THE HUGE SIZE OF A HANDFUL OF DEALS, SUCH AS GULF, SUPERIOR OIL, GETTY OIL, AND ST. REGIS; THIS MADE 1984 RECORD YEAR IN \$ VALUE OF MERGERS AND IN TENDER OFFERS.
- ° THESE LARGE DEALS PERHAPS HELP EXPLAIN THE INCREASED ATTENTION.

THERE ARE OTHER CONTRIBUTING FACTORS TO THIS NOTORIETY.

- ° (GIVEN THE ACQUISITION ACTIVITY) THERE HAVE BEEN REAL IMPROVEMENTS IN DEFENSIVE TECHNIQUES THAT WORK AND DON'T VIOLATE FEDERAL LAW. (MEMBER OF SEC TEAM THAT WAS TROUNCED IN L.A. BY FLOM; BRILLIANT IMPLEMENTATION OF THEIR OPEN MARKET REPURCHASES - OR WHAT WE REFER TO AS THEIR

ILLEGAL TWO-TIER, FRONT-END-LOADED, FIRST-COME,
FIRST-SERVE SELF TENDER OFFER - (50% IN FEW
DAYS AND STOPPED LIMITED COLD).

° POISON PILLS ARE INGENIOUS DEVICES THAT FORCE
UNSOLICITED, UNAPPROVED TENDER OFFERS TO BE
BACK-END LOADED, THEREBY PROVIDING VERY LARGE
INCENTIVE FOR INDIVIDUAL SHAREHOLDERS TO HOLD.
HOUSEHOLD INT. CLASSIC EXAMPLE; NO SHAREHOLDER
VOTE; LITIGATED IN DELAWARE COURTS NOW. BIG
CASE.

° INCREASED EXPERIENCE WITH LITIGATION OVER THESE
TECHNIQUES HAVE SHOWN HOW VERY FAR TARGET
MANAGEMENT CAN STRETCH THE PROTECTION AFFORDED
BY BUSINESS JUDGEMENT RULE TO THEIR DEFENSIVE
ACTIONS. THIS ENCOURAGES MORE DARING DEFENSES
TO PRESERVE INDEPENDENCE.

THIS PUBLICITY HAS BEEN DIRECTED TOWARDS A RECENT

STRING OF DEFEATED HOSTILE TAKEOVER ATTEMPTS.

THESE EPISODES HAVE PROVIDED STRIKING EXAMPLES

OF WHAT ACADEMIC RESEARCHERS OF TENDER OFFERS

HAVE BEEN SAYING THAT ABSOLUTE DEFENSES ARE VERY

COSTLY TO TARGET SHAREHOLDERS, ON AVERAGE.

EVIDENCE FROM STOCK PRICE STUDIES DONE BY FINANCE

PROFESSORS AND OCE HAVE ALSO HELPED US REJECT

CERTAIN POPULAR NOTIONS ABOUT TENDER OFFERS.

LET ME SUMMARIZE SOME OF THE FACTS WE ARE FAIRLY

CONFIDENT ABOUT.

1. REMAINING INDEPENDENT IS HORRIBLE OUTCOME -

CAUSING LARGE LOSSES OF TARGET SHAREHOLDER

WEALTH VERY CONSISTENTLY. ON AVERAGE, THEY

LOSE NEARLY ENTIRE (30+% AVERAGE) PREMIUM, AND

OVER 80% CASES STUDIED, SHAREHOLDER'S WERE WORSE OFF THAN IF THEY HAD ACCEPTED OFFER AND PUT THE PROCEEDS IN A MUTUAL FUND HAVING COMPARABLE FINANCIAL RISK.

° THIS DOES NOT MEAN RESISTANCE TO UNFRIENDLY OFFERS ALWAYS HURTS TARGET SHAREHOLDERS.

2. FIGHTING HOSTILE OFFER CAN BE HELPFUL ONLY IF AN ACQUISITION RESULTS - USUALLY WHITE KNIGHT. THE RESISTANCE OFTEN HELPS BUY TIME AND BRINGS EVEN GREATER PREMIUM. (SO-CALLED AUCTIONS).
3. MICHAEL BRADLEY, FINANCE PROFESSOR AT UNIVERSITY OF MICHIGAN AND OTHERS HAVE SHOWN THAT SUCCESSFUL ACQUIRERS OF LESS THAN 100% CONTROL DO NOT, AS MANY HAD CLAIMED IN CONGRESSIONAL TESTIMONY ON THE 1968 WILLIAMS ACT, "RAID" THE

TARGET LEAVING A CORPORATE SHELL TO MINORITY
HOLDERS. STOCK VALUES TO MINORITY HOLDERS
REMAIN WELL ABOVE PRE-TAKEOVER MARKET PRICE,
ALTHO BELOW TAKEOVER PRICE.

4. GREENMAIL IS A BAD OUTCOME FOR TARGET SHAREHOLDERS.

STOCK PRICES FALL ON ANNOUNCEMENT, AND OUR
RESEARCH SHOWS THAT THIS LOSS MORE THAN OUTWEIGHS
PREVIOUS RUN-UP IN STOCK PRICE THAT ACCOMPANIED
13D FILING AND RELATED SKIRMISHING.

5. 13D FILINGS CAUSE SIGNIFICANT INCREASES IN STOCK

VALUE, AND THE LONGEST AVERAGE INCREASES OCCUR
FOR NOTORIOUS TAKEOVER ENTREPRENEURS. BECAUSE
"GOOD OUTCOMES" THAT CAN RESULT FROM THE LARGE-
SHAREHOLDER PARTICIPATION SUCH AS TAKEOVERS,
CHANGES TO MORE PROFITABLE CORPORATE STRATEGIES,
PROXY FIGHTS - OUTWEIGH THE BAD OUTCOMES - GREENMAIL,
LIQUIDATION OF HOLDINGS.

6. FINALLY, OCE'S STUDY OF TENDER OFFER ACQUISITIONS BETWEEN 1981-1983 SHOWS THAT TARGET SHAREHOLDERS FARE VERY WELL WITH TWO-TIER OFFERS. THE BLENDED PREMIUMS ARE COMPARABLE TO THE UNIFORM ANY-OR-ALL PREMIUMS, ON AVERAGE; AND THERE IS NO EVIDENCE THAT A TWO-TIER OFFER CAN DEFEAT A HIGHER ANY-OR-ALL OFFER, HAS BEEN SUSPECTED. TWO-TIER TAKEOVERS ARE NOT QUITE THE BOGGY-MEN THAT MANY CLAIM, ACCORDING TO THESE FIGURES.

THESE STUDIES HAVE BEEN USED IN COURT CASES AND IN CONGRESSIONAL TESTIMONY - AND I THINK IT'S SAFE TO SAY THAT THEY HAVE CONTRIBUTED TO EMERGING ATTITUDE THAT ABSOLUTE DEFENSES FOR INDEPENDENCE AND GREENMAIL ARE VERY BAD FOR TARGET SHAREHOLDERS. INCREASINGLY, THESE DEFENSIVE ACTIONS ARE SEEN

AS SHAMEFUL AND SELF-SERVING WHEN TARGET MANAGERS
AND BOARDS IMPLEMENT THEM TO REMAIN INDEPENDENT.

THE MEMBERS OF THE LARGE AND POWERFUL MANAGEMENT
GROUPS, QUITE UNDERSTANDABLY, WISH TO AVOID BEING
THE TARGET OF A HOSTILE TAKEOVER ATTEMPT. THIS
PUTS THEM IN THE POSITION OF LOSING THEIR FIRM,
THEIR BOARD POSITIONS AND POSSIBLY THEIR
CAREERS, OR PARTICIPATING IN THESE UNPOPULAR,
TAINTED DEFENSIVE MANUEVERS. THEY HAVE, THEREFORE,
REACTED STRONGLY BY SEEKING TO PREVENT POTENTIAL
BIDDERS FROM MAKING UNSOLICITED TENDER OFFERS
DIRECTLY TO TARGET SHAREHOLDERS - FROM "GOING OVER
THEIR HEADS".

° THEY HAVE ATTEMPTED TO DO THIS IN TWO WAYS

- ENACTING AMENDMENTS TO THEIR CORPORATE

CHARTERS THAT DETER UNSOLICITED BIDS.

- LOBBYING BEFORE STATE AND FEDERAL
GOVERNMENTS FOR PROTECTIVE LEGISLATION
OF VARIOUS KINDS.

LET'S TALK FIRM ABOUT THE CHARTER-AMENDMENTS,

SO-CALLED SHARK REPELLENTS.

° THE MOST COMMON SHARK REPELLENT IS A REQUIREMENT
THAT A SUPER-MAJORITY OF SHAREHOLDERS MUST APPROVE
BY VOTE TENDER OFFERS THAT ARE UNACCEPTED BY
A MAJORITY OF THE BOARD OF DIRECTORS.
200 IN 1983, 400 IN 1984, ESTIMATE 400-500
IN 1985.

° A LARGE AND GROWING NUMBER ARE FAIR PRICE
AMENDMENTS: UNSOLICITED OFFERS UNACCEPTED BY
BOARD MUST GET SUPER-MAJORITY SHAREHOLDER

APPROVAL UNLESS THE TENDER OFFER MEETS CERTAIN TESTS OF FAIRNESS; THE PRICE MUST EXCEED THE PRICE PAID TO ACQUIRE THE GREATEST NUMBER OF SHARES, OR SOME SIMILAR REQUIREMENT.

° THESE AMENDMENTS ARE DESIGNED TO DISCOURAGE UNSOLICITED TAKEOVER ATTEMPTS, ESPECIALLY TWO-TIER OFFERS. THEIR PROXY STATEMENTS NOTE THAT THESE CONDITIONS MAKE UNAPPROVED TWO-TIER OFFERS MUCH MORE DIFFICULT, AND OTHERWISE ATTEMPT TO FORCE A WOULD-BE ACQUIRER TO NEGOTIATE A DEAL TO GET IT APPROVED BY THE TARGET'S BOARD BEFORE MAKING SHAREHOLDER'S THE OFFER.

° DETERRENCE IS CONCEDED EVEN BY THEIR PROMOTERS:

- MAY MAKE IT MORE DIFFICULT TO REMOVE INCUMBENT MANAGEMENT, THEY SAY.

- SHAREHOLDERS MAY NOT BE ABLE TO PARTICIPATE
IN A TENDER OFFER DESPITE THEIR DESIRE TO
DO SO; THIS WILL DEPRIVE THEM "OF HIGHER
MARKET PRICES FOR THEIR STOCK THAT OFTEN
PREVAILS AS A RESULT OF SUCH EVENTS".

DETERRENCE IS CONCEDED; THE INCIDENCE OF

UNSOLICITED, UNAPPROVED TAKEOVERS MUST BE REDUCED.

° BUT, IS THIS REDUCTION LARGELY REPLACED BY FRIENDLY
DEALS, THAT ARE MORE LUCRATIVE AND EQUITABLE FOR
ALL SHAREHOLDERS? OR DOES THE DETERRENCE EFFECT
RESULT TOO OFTEN IN MORE ENTRENCHED INCUMBENTS
AT THE EXPENSE OF SHAREHOLDERS AND OTHERS WHO
BENEFIT FROM A COMPETITIVE MARKET FOR CORPORATE
CONTROL?

- ° WE JUST DON'T KNOW FOR SURE, BUT WE ARE SEARCHING HARD FOR ANSWERS. LUCKILY, HUNDREDS OF FIRMS ARE ADOPTING THESE AMENDMENTS, PROVIDING US ECONOMISTS WITH THE LARGE SAMPLES THAT WE CHERISH SO DEARLY.
- ° THERE ARE STUDIES OF THE STOCK PRICE REACTION WHEN CAPITAL MARKET FIRST LEARNS A PARTICULAR FIRM WILL PROPOSE ONE. MIXED EVIDENCE; AVERAGE EFFECT IS NEGATIVE, BUT STATISTICALLY A CLOSE CALL. CURRENT RESEARCH EFFORTS SHOULD YIELD IMPROVED RESULTS BECAUSE OF LARGER SAMPLES AND SOME NEW IDEAS.
- ° AND AS WE ACQUIRE MORE EXPERIENCE, WE CAN MORE DIRECTLY MEASURE THE DETERRENCE EFFECT, BY COMPARING THE INCIDENCE OF TAKEOVERS BETWEEN FIRMS WITH AND WITHOUT AMENDMENTS. AND WE

CAN SEE IF THE OFFERS DIFFER IN THEIR TERMS
BETWEEN THESE GROUPS OS FIRMS.

BESIDES PUSHING SHARK REPELLENTS, THESE MANAGEMENT
GROUPS HAVE BEEN LOBBYING FOR PROTECTIVE REGULATIONS
AT THE STATE AND FEDERAL LEVEL.

- ° THEY HAVE ATTEMPTED TO CLOSE RANKS AND TO IDENTIFY
WHAT THEY REGARD AS THE MORE GENERAL PROBLEM
THAT CAUSES HOSTILE RAIDS; THEIR ATTITUDE IS
"DON'T BLAME ME FOR UNPLEASANT RESPONSES TO
DANGERS THAT ARE NOT MY DOING". OR ... WE ARE
JUST TRYING TO PROTECT OUR SHAREHOLDERS FROM
DANGERS THAT WASHINGTON IS IGNORING.
- ° THEY (AND THEIR SECURITIES LAWYERS) CRITICIZE THE
SEC AND OTHERS FOR FOCUSING ON THE SYMPTOMS
(DEFENSIVE MEASURES) INSTEAD OF THE DISEASE.

° WHAT IS THIS DANGEROUS DISEASE? WELL ...

THERE ARE SEVERAL VERSIONS. THEY ARE REST
ON THE ASSUMPTION THAT SOME SORT OF SYSTEMATIC
INEFFICIENCY IN THE WAY THE CAPITAL MARKET
PRICES SECURITIES IS CAUSING CERTAIN FIRMS
TO BECOME UNDERVALUED AND THEREFORE VULNERABLE
TO HOSTILE RAIDERS. THIS VULNERABILITY HAS
NOTHING TO DO WITH THE QUALITY OF TARGET
MANAGEMENT.

SIGLER - DRUCKER HYPOTHESIS: SIGLER IS HEAD OF CHAMPION

INTERNATIONAL AND A PROMINENT SPOKESMAN FOR THE BUSINESS
ROUNDTABLE; DRUCKER IS A PROFESSOR WHO WROTE A WSJ
EDITORIAL PUSHING THE SAME VIEW THAT MR. SIGLER HAS
ARTICULATED RECENTLY BEFORE THE COMMISSION.

° THE TREMENDOUS GROWTH OF INSTITUTIONAL STOCKHOLDERS

IN LAST DECADE HAS RESULTED IN AN INEFFICIENT

CAPITAL MARKET; MANIFESTED BY AN OVER-EMPHASIS ON SHORT-TERM STOCK RETURNS (DUE TO INTENSE SR COMPETITION FOR BEST PERFORMANCE AMONG FUND MANAGERS). THIS CAUSES FIRMS WITH LONG-TERM INVESTMENTS TO BE UNDER-VALUED; IN TURN CAUSING UNCOMFORTABLE VULNERABILITY TO TAKEOVER. THE REACTION BY MANAGEMENT TO THIS ANXIOUS SITUATION, WHICH IS NOT THEIR FAULT, IS TO EITHER SACRIFICE LT PROJECTS IN FAVOR OF ST PROJECTS TO BOOST STOCK PRICES, OR TO ADOPT STRONG ANTI-TAKEOVER AMENDMENTS.

PROBLEMS:

- ° IF TRUE, IT SEEMS SILLY TO SACRIFICE LT TO BOOST ST, BECAUSE YOU MUST BECOME UNDERVALUED IN MT. TO SAY ONE CAN ALWAYS BOOST ST FOR MANY SUCCESSIVE PERIODS IS TO SAY THAT ONE COULD BOOST LT WITH NO SACRIFICE.

- ° HOW DO TAKEOVERS SOLVE UNDER-PRICING? RAIDERS
BUYS STOCK CHEAP AND SELL ASSET DEAR. ASSET
VALUES EXCEED STOCK VALUES? THIS IS STORY.
BUT, WHO BUYS THEM? PUBLIC FIRMS USUALLY.
BUT, BUYER HAS ITS STOCK PRICED IN VERY SAME
CAPITAL MARKET? (MESA SOCIAL, CHAMPION
INTERNATIONAL, LIMITED)
- ° INSTITUTIONAL TRADERS HAS COME TO DOMINATE
OVERWHELMINGLY BOND TRADING; NOT SO 50 YEARS
AGO. THIS CAPITAL MARKET WORKS EXTREMELY WELL,
WITH NO TRACES OF THESE PECULIAR BIASES.
- ° CAPITAL MARKETS PRINCIPLE JOB IS TO ALLOCATE
OPTIMALLY SCARCE CAPITAL BETWEEN ST
INVESTMENTS AND LT INVESTMENTS; THERE IS
A LOT OF RESEARCH THAT SHOWS IT DOES THIS
VERY WELL. EVIDENCE FROM TERM-STRUCTURE OF

INTEREST RATES; PRICING OF SECURITIES WHEN
INFLATION IS EXPECTED TO CHANGE. FIRMS LIKE
UTILITIES WITH PROJECTS HAVING VERY DISTANT
PAY-OFFS ARE NOT PUNISHED BEYOND RISK-ADJUSTED
DISCOUNT RATE. NEW HI-TECH FIRMS WITH NO HOPE
OF PROFITS FOR YEARS TRADE AT POSITIVE PRICE,
NOT OVER-DISCOUNTED; FIRMS IN DECLINING
INDUSTRIES WITH HI CURRENT EARNINGS OFTEN TRADE
AT LOW PRICE RELATIVE TO EARNINGS BECAUSE OF
EXPECTATIONS OF DECLINING EARNINGS. AND SO ON.

° THE S-D THEORY PROVES TOO MUCH; IF THIS IS ACTUALLY
TRUE AS THEY STATE IT, IT IMPLIES PROBLEMS FAR
WORSE THAN EXCESSIVE TAKEOVERS. CAPITAL MARKETS
ARE PROBABLY THE MOST IMPORTANT ENGINES IN OUR
ECONOMIC MACHINE AND ITS MOST IMPORTANT JOB
IS TO SET PRICES TO PROVIDE EFFICIENT MIX OF

CAPITAL ST VS LT, AND ALLOCATED PROPERLY ACROSS
DIFFERENT INDUSTRIES.

PROponents OF THIS VIEW OFFER NO EVIDENCE IN SUPPORT
OF THIS EXTRAORDINARY THEORY. I KNOW THEY STRONGLY
BELIEVE IT. BUT THIS IS NEVER ENOUGH TO SATISFY EVEN
REASONABLE SKEPTICS. THERE ARE MANY OBVIOUS AND SIMPLE
TESTS.

- ° ARE FIRMS WITH HI INSTITUTIONAL OWNERSHIP
TRADING AT LOW PRICE-EARNINGS RELATIVE TO OTHERS?
- ° DO THESE FIRMS WITH HI-INSTITUTIONAL OWNERSHIP
HAVE LOW LT INVESTMENT? DOES A LARGE INCREASE
IN INSTITUTIONAL OWNERSHIP FOR FIRMS CAUSE A
DECREASE IN THEIR LT INVESTMENTS?
- ° IS THE PRESENCE OF ANTI-TAKEOVER AMENDMENTS
DIRECTLY CORRELATED WITH INTENSITY OF LT
INVESTMENTS?

° ARE FIRMS WITH LARGE INSIDER HOLDINGS ABLE TO
INVEST RELATIVELY MORE IN LT PROJECTS?

THE FUNDS REQUIRED TO SERIOUSLY ADDRESS THESE SIMPLE
QUESTIONS WITH EMPIRICAL RESEARCH ARE NOT PROHIBITIVE;
SURELY NOT LARGER THAN THE COST OF A FEW FIRST-CLASS
TICKETS BETWEEN D.C. AND THE CORPORATE HEADQUARTERS
OF SOME OF THESE VULNERABLE CORPORATIONS.

WE ARE STUDYING THESE QUESTIONS AT THE SEC, AND RELATED
ONES. IT IS DIFFICULT TO TAKE THE S-D THEORY
SERIOUSLY AS A VALID ECONOMIC HYPOTHESIS, BECAUSE
IT'S LOGICALLY INCONSISTENT AND IS REJECTED INDIRECTLY
BY SO MUCH EVIDENCE. BUT, THE THEORY MUST BE TAKEN
SERIOUSLY, FOR IT HAS POTENTIAL VALUE AS AN EXCUSE,
A POLITICAL MARKETING DEVICE, FOR ERECTING REGULATORY
BARRIERS IN THE TAKEOVER MARKET.

I THINK THE ONLY GENERAL EXPLANATION OF THE SOURCE OF VALUE CREATED BY THESE TAKEOVERS THAT CAN CONFORM TO THE LARGE COLLECTION OF DATA ON THESE CASES, IS THAT IT IS THE CONVERSION OF THE TARGET'S ASSETS TO HIGHER-VALUED USES. THE CAPITAL MARKET IS UNBIASED; IT VALUES THE ASSETS ACCORDING TO THE FUTURE STREAM OF PROFITS EMANATING FROM THEIR UTILIZATION. THE CONVERSION BY THE ACQUIRER OF THESE ASSETS TO DIFFERENT USES IS ACCOMPANIED, ON AVERAGE, BY AN INCREASED VALUATION IN THE CAPITAL MARKET - SIMPLY BECAUSE A HIGHER STREAM OF PROFITS IS EXPECTED. IT'S NOT MAGIC, OR SOCRY. IT'S NOT INEFFICIENT, PERVERSE CAPITAL MARKETS. IT'S ECONOMICS 101. I CRITICIZE THOSE WHO LEVEL THOSE SERIOUS CHANGES AT THE CAPITAL MARKET - THE ECONOMIST'S BEST FRIEND - WITHOUT ANY EVIDENCE.

IT IS EASY - TOO EASY - TO POINT OUT THE DESTRUCTIVE
CONSEQUENCES OF TAKEOVERS. VICTIMS ARE EVERYWHERE -
SOME ARE FRIENDS.

° DESTRUCTIVE SIDE-EFFECTS OF NEGOTIATED MERGERS
ARE EVEN MORE COMMON - AND ITS LONG BEEN A
FOR ANTI-MERGER REGULATION.

° LAY-OFFS OF EMPLOYEES CAUSE HARDSHIPS; TOWNS
LOSE BUSINESS; BUT THE SAVED MONEY MUST GO
SOMEWHERE! IT IS HARDER TO TRACE, BUT
OTHER TOWNS AND COMMUNITIES MUST BENEFIT BY
A GREATER AMOUNT, ON AVERAGE. IT'S JUST
SPREAD OUT.

° LEVERAGED TRANSACTIONS ARE PERILOUS - BANKRUPTCIES
CAN RESULT WITH DOWNTURN. BUT, BANKS AND
CAPITAL MARKETS INSIST ON ADEQUATE COMPENSATION
OVERALL FOR RISK; AND THESE REVENUES CREATE

JOB AND PRODUCTIVE ASSETS IN OTHER INDUSTRIES WHICH MUST OUTWEIGH THE POTENTIAL BANKRUPTCY COSTS.

- ° ASSETS ARE SOLD AND THE FAMILIAR OLD FIRM IS RADICALLY ALTERED BY THIS CORPORATE SURGERY. PLANTS CLOSED, PRODUCTS NOT MADE. BUT, WHERE GO THE PROCEEDS FROM SELLING THESE PARTS OF THE OLD FIRM? THE SAVED WAGES? MOST TO TARGET SHAREHOLDERS, WHO SPEND OR INVEST. THESE BENEFITS MUST EXCEED THE VALUE OF THE ASSETS IN THE OLD USE, ON AVERAGE, HOW ELSE DOES THE RAIDER MAKE MONEY? HOW CAN HE PAY 50+% PREMIUM, SELL OFF PARTS, AND MAKE MONEY? CAN I DO THIS WITH YOUR HOUSE? IF I BORROW AGAINST THE EQUITY VALUE OF YOUR HOME? OF COURSE NOT.

° THE CLOSER YOU STUDY THE PROBLEM, THE HARDER IT BECOMES TO ESCAPE THE CONCLUSION THAT TAKEOVERS ARE ECONOMICALLY BENEFICIAL. THERE ARE MISTAKES, BUT WHO CAN PREDICT THESE AHEAD OF TIME? THE OVERALL DATA SHOW THAT THE MARKET VALUE OF THE COMBINED ENTERPRISE EXCEEDS THE SUM OF THE PRE-COMBINATION MARKET VALUES. ALL OF US OWE A TREMENDOUS DEBT TO THIS NATION'S SECURITIES MARKETS. THEY ARE OPEN, FREELY-COMPETITIVE, AND HIGHLY EFFICIENT. PRICES ARE UNBIASED - NOT PERFECT - BUT, THERE ARE NO SYSTEMATIC ERRORS, NO "MONEY TREES". LOOK AT HOW THE PRO'S FAIL TO "BEAT THE MARKET" WITH ANY CONSISTENCY! THIS PRICING EFFICIENCY IS OBVIOUS EVEN TO THOSE WHO ARE NOT AWARE OF THE HUNDREDS OF STATISTICAL STUDIES THAT FAIL TO FIND AN IMPORTANT

EXAMPLE OF CAPITAL MARKET INEFFICIENCY. THE
ACADEMIC PAYOFF WOULD BE IMMORTALITY!

° BUT ACCEPTING THIS CONCLUSION THAT TAKEOVERS
CREATE NET ECONOMIC BENEFITS DOES NOT REALLY
SLAM THE DOOR TO GOVERNMENT INTERVENTION IN THE
MARKET FOR CORPORATE CONTROL. COMMISSIONER LINDY
MARINACCIO PRESENTED A THOUGHT-PROVOKING SPEECH
THE OTHERDAY, AND HIS DISCUSSION OF TENDER OFFERS
CONTAINS THE SEEDS OF WHAT I THINK WILL BLOSSOM
INTO THE SOPHISTICATED CRITICISM OF THE TAKEOVER
MARKET. THE ARGUMENT OF 85!

COMMISSIONER MARINACCIO ARGUES - AND SIGLER OFFERED THIS
VERSION IN AN ORAL PRESENTATION BEFORE THE COMMISSION
RECENTLY - THAT THE MODERN LARGE CORPORATION HAS A
"RESERVE BASE" OF EQUITY VALUE BUILT UP OVER THE YEARS
BECAUSE ITS MANAGEMENT HAVE FOLLOWED POLICIES DESIGNED,

NOT TO STRICTLY MAXIMIZE SHAREHOLDER WEALTH, BUT TO MEET OTHER OBJECTIVES AS WELL, NECESSARILY TRADING-OFF SOME SHAREHOLDER VALUE, WHICH THEY ARE ENABLED TO DO ONLY BECAUSE OF PROTECTION UNDER THE BUSINESS JUDGEMENT RULE.

"HOSTILE TENDERS DO HAVE A SALUTORY EFFECT ON INCUMBENT MANAGEMENT. BUT MANY BIDDERS DO NOT WISH TO ACQUIRE TARGETS TO OPERATE THEM, BUILD A BETTER PRODUCT OR COMPETE MORE EFFECTIVELY. THEIR INTEREST IS A FINANCIAL ONE IN THE RESERVE BASE OF THE TARGET BUILT UP BY INCUMBENT MANAGEMENT UNDER THE BUSINESS JUDGEMENT RULE" PAGE 3.

THIS ARGUMENT DOES NOT REST ON UNDERVALUED TARGETS, MYOPIC CAPITAL MARKETS, OR EVEN UNECONOMIC TAKEOVERS. THIS COMPLAINT CAN EVEN WITHSTAND THE THEORY AND EVIDENCE THAT THESE TAKEOVERS CREATE NET ECONOMIC BENEFITS.

STRIPPED TO ITS ESSENTIALS, THIS ARGUMENT STATES THAT TAKEOVER TARGETS ARE UNDERVALUED BECAUSE THEIR INCUMBENT MANagements HAVE NOT, AND DON'T PLAN TO, MAXIMIZE SHAREHOLDER VALUE. INSTEAD, THEY SERVE OTHER GOALS TOO - STABLE EMPLOYEE AND COMMUNITY RELATIONS, ETC. - CAUSING STOCK PRICES TO FALL SHORT OF THE LEVEL ATTAINABLE BY A STRICT ATTEMPT TO MAXIMIZE SHAREHOLDER VALUE. THIS THEORY OF THE MOTIVE BEHIND HOSTILE TAKEOVERS IS IDENTICAL TO THAT OF THE SO-CALLED CHICAGO SCHOOL, OF WHICH I AM AN EXPERT.

COMMISSIONER MARINACCIO ARGUES THAT OUR LONG-TERM ECONOMIC WEALTH AND HEALTH WOULD BE ENHANCED BY DETERING HOSTILE TAKEOVERS, BY ALLOWING INCUMBENT MANagements LEGAL LEEWAY TO INDULGE IN WHAT SOME MAY THINK ARE NOBLE GOALS. I AGREE WITH

COMMISSIONER MARINACCIO'S THEORY BUT NOT WITH THIS NARRATIVE IMPLICATION. I THINK THE MARKET FOR CORPORATE CONTROL SHOULD BE FREE TO FORCE A TIGHT ADHERENCE BY THESE MANAGERS TO A RULE OF MAXIMIZING SHAREHOLDER VALUE - THIS WILL ACHIEVE THE OPTIMAL ECONOMIC RESULTS. RATHER THAN ALLOW CORPORATE MANAGERS TO INVEST THIS "RESIDUAL VALUE" ACCORDING TO THEIR SOCIAL CONSCIENCES, THE FREE MARKET FOR CORPORATE CONTROL SHOULD HELP FORCE THEM TO PROVIDE THIS WEALTH TO THEIR SHAREHOLDERS, ALLOWING SHAREHOLDER'S TO DESIDE WHICH OTHER SOCIAL GOALS TO PURSUE.

° I DON'T KNOW WHAT ELSE ONE CAN MEAN BY "SHAREHOLDER RIGHTS" IF IT'S NOT THE RIGHT TO INSIST THAT THEIR AGENTS ACT AS PERFECT AGENTS, NOT "ALMOST PERFECT" SO THAT SOME SOCIAL SLUSH FUND CAN BE

CREATED TO PURSUE UNECONOMIC PROJECTS IN THE NAME
OF SOCIAL ENLIGHTENMENT, LONG-TERM COMPETITIVE
VIABILITY, OR WHATEVER ELSE SOUNDS COMFORTING.

° RUMBLING SPEECHES LIKE THIS DON'T FAVOR CONCISE
SUMMATIONS. LET ME END BY THANKING YOU ALL FOR
YOUR ATTENDANCE AND ATTENTION. I'LL GO BACK NOW
AND BEGIN PACKING UP MY OFFICE.