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News Release

ANTI-MERGER MANIA -- CURRENT PROPOSALS FOR TENDER OFFER REGULATION

Remarks to

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of the
Association for Corporate Growth

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The views expressed herein are those of Commissioner Cox and do not necessarily represent those of the Commission, other Commissioners or the staff.

Good morning. I'd like to thank the Association for Corporate Growth and its distinguished membership for giving me the opportunity to join their formidable roster of speakers in addressing a number of timely and important topics. Of course, it also didn't hurt that you decided to hold this conference at a fabulous resort hotel in Florida.

I would like specifically to talk about the issues raised by current proposals for reshaping federal regulation of corporate takeovers and to note some recent SEC action in this area. Wall Street has been more in the news lately than in many years, and with most of the attention having been generated by a string of large insider trading cases -- often related to takeover activity -- neither Wall Street nor takeovers have been cast in the best light. However, it is essential that the issue of takeovers *per se* be distinguished from concern over the abuse of information about takeovers. Virtually all commerce presents some opportunity for fraud, but few would conclude that this requires an end to commerce. In the same sense, the existence of insider trading tells us little about the advisability of restricting takeovers.

The fundamental issues raised by takeovers were identified well before Levine, Boesky and the other well-publicized cases, and one's reaction to proposed takeover legislation is likely to depend on one's feelings about such issues as whether takeovers tend to be economically beneficial for shareholders and the economy as a whole; whether efforts to insure an equal sharing of the premium on takeover stock prices will result mainly in there being fewer premiums to share; and whether federal intervention in relations among managers, bidders and other shareholders should be limited to assuring full and effective disclosure or should prescribe particular standards of corporate management and governance.

At present, the Williams Act amendments to the Securities Exchange Act provide the principal federal regulation of tender offers and establish disclosure requirements for substantial acquisitions of publicly traded equity securities. The Act is designed to be neutral between bidders and targets, but at the same time to provide investors with information about potential control-share acquisitions and, in the event of a tender offer, to give investors adequate information and opportunity to make an informed decision. Currently, a person or group acquiring more than 5% of a company's shares must file a public statement of his position and intentions within ten days of passing the 5% threshold. If a tender offer is announced, it must be accompanied by specific information and held open for a specified period.

Tender offers for less than all outstanding shares must be open to all shareholders on a pro rata basis, and the tender offeror may not purchase shares outside the tender offer during its pendency.

Last July the Commission adopted its "all-holders" and "best-price" rules assuring a degree of equal treatment for shareholders. Under these rules, when either a bidder or the target company itself makes a tender offer, the offer need not be for all shares but must be open to all shareholders with the same price to be paid to each.

The Commission also issued a release soliciting public comment on three questions: first, whether there should be a government response to so-called "poison pill" plans, which typically involve a target company's issuance of securities with extraordinary rights against the target company if a hostile takeover attempt succeeds; second, whether corporations under certain circumstances should be permitted to opt out of takeover regulation; and third, whether the Williams Act should apply to large share acquisitions during or just after a tender offer. That last issue was raised by recent court decisions which held that a target firm's large-scale repurchase program during the course of a third-party tender offer did not itself amount to a tender offer under the Williams Act, and that a bidder was not evading the Williams Act when it terminated its tender offer and immediately thereafter purchased large blocks of shares from Wall Street professionals who had been accumulating them.

Last year the Commission also recommended, as it has since 1984, that Congress reduce the ten days that 5% shareholders presently have under Section 13(d) of the Securities Exchange Act to file notice of their holdings and their intentions.

Already in the current session of Congress, there have been a dozen takeover-related bills introduced, with some very important legislators yet to be heard from. The SEC has not yet considered the pending bills, although it is on record as favoring a reduction in the ten day filing period, and most of the current bills also feature a reduced filing period. Various other proposals include extending or modifying the minimum offering period for tender offers, limiting the use of partial and two-tier tender offers, requiring that share acquisitions beyond a threshold percentage be made only through tender offers, and restricting junk bond financing. The proposals also address common defensive tactics, such as "greenmail," i.e., targeted repurchases of the bidder's stock on terms not available to other shareholders, and "golden

parachutes," the extraordinary severance compensation a target management may provide for itself. There are also proposals to limit defensive restructuring of the target company and "poison pills."

The proposal with perhaps the broadest support is to reduce the filing period for reports under Section 13(d)(1) of the Securities Exchange Act, although some of the pending bills would reduce not only the filing time but also the number of shares triggering the filing requirement.

Because an acquiring shareholder presently has ten days after crossing the 5% threshold within which to file the required notice, he can accumulate a position substantially above 5% before the market becomes aware of it. There have been cases where as much as twenty percent of the shares were acquired before the ten day period elapsed. In this sense, the statute has not always operated to ensure that shareholders are informed in a timely fashion.

Supporters of the legislation argue that it is necessary to close this "ten day window" to effect the basic disclosure policy of the Williams Act. Opponents argue that earlier disclosure raises the cost of foothold acquisitions and thus discourages potential bidders. The criticism may be true, but if one accepts the premise of current statute -- that shareholders are entitled to know about 5% holders -- then closing the ten-day window makes sense by insuring that this disclosure will be more timely. As I mentioned, the Commission has been seeking a reduction in the Section 13(d) filing period since 1984. Perhaps this Congress will pass such legislation.

A number of the pending bills would extend the minimum offering period for tender offers. At present, tender offers must remain open for at least twenty business days, and changes in the offer require an extension of the offering period.

Those favoring longer minimum offering periods argue that this would benefit both shareholders and management of target companies by giving them time to evaluate more fully and to respond to a tender offer. They contend that the present twenty business day period is too short to allow non-professional shareholders to fully understand the information disclosed to them, particularly where more than one bid is involved. Additional time would also off-set the bidder's "element of surprise" and allow management more time to solicit competing bids or formulate other responses. Some say the system pressures target management

to adopt defenses not in the company's overall best interests, solely for the purpose of "buying time."

Opponents of longer time periods argue that further delay in the tender offer process favors target management at the expense of bidders and discourages justifiable takeover attempts by increasing the costs of the offer both to bidders and to tendering shareholders. A longer minimum offering period providing management more time to mount defenses might be viewed as an effort to compensate management for the loss of specific defensive tactics, such as poison pills or greenmail payments, that some of the pending bills would restrict. If this is the goal, it is difficult to say whether such a trade-off would over- or under-compensate management's defensive opportunities.

However, from the standpoint of providing investors with adequate time to receive and analyze information, a longer minimum offering period isn't necessary. The SEC arrived at the present twenty business day period in 1979 after three years of public comment and analysis. It attempted to strike a balance that insured adequate time for review, without favoring either bidders or targets. The Commission indirectly addressed offering periods again in 1982 when it solicited comments on requiring that shares tendered into a partial tender offer be eligible for purchase on a pro-rata basis throughout the offering period -- once again twenty days were found to be adequate. The Commission reaffirmed its view in January 1986 when it applied to tender offers made by the target company itself the same twenty business day minimum offering period that applies to third party tender offers.

Other legislative proposals would limit the use of partial and two-tier tender offers. A "partial" offer is a tender offer for less than 100% of the outstanding shares. A "two-tier" bid results in acquisition of all outstanding shares, but in two steps. The first step is a tender offer to establish a controlling position in the target; the second step is a business combination, usually a merger, taking out the minority shareholders for consideration frequently valued at a lower price than the original tender offer price. One proposal would extend the offering period for those specific types of offers. Others would prohibit a tender offer for a substantial percentage of shares unless the offer were for all of the shares, or prohibit any substantial purchases unless they were made by means of a tender offer.

Partial and two-tier offers are often said to "stampede" shareholders, making them feel compelled to tender as quickly as possible in order to avoid losing the

premium and, in the case of two-tier offers, in order to avoid being forced to accept a lower premium at a later time. However, there are legitimate reasons for obtaining a substantial share of a company without purchasing all shares. Partial tender offers can allow one company to invest in another with less than 100% financial exposure; facilitate technological changes and relationships; facilitate venture capital, foreign and other direct investments; and permit investors to become familiar with potential acquisitions before deciding to increase their investment. Two-tier offers are defended on the ground that bidders may make two-tier tender offers where otherwise no bids would be made, and prohibiting such offers would deter legitimate, valuable takeovers. A study by the Commission's Office of the Chief Economist in 1985 showed that between 1981 and 1984 the average initial bid in a two-tier offer was made at a 63% premium over the prior market price of the stock, and that the second step merger was, on average, at a 45% premium to the market price. The resulting average blended premium was approximately 55%, somewhat less than the average 60% premium for "any-or-all" offers but a substantial premium nonetheless. Furthermore, there may be tax advantages to the second tier of the offer. Shareholders who sell in the first tier for cash must recognize their gain at the time of the sale. But shareholders who exchange their stock for the acquiror's stock in a second tier merger that qualifies as a tax-exempt "reorganization" may not be required to recognize any gain at that time. In any event, potential target companies are free to adopt "fair price" charter provisions requiring that the price paid in a second step merger equal or exceed the price paid in the first stage tender offer.

Finally, as the Commission concluded when it declined last year to recommend action against two-tier offers, use of two-tier offers appears to be waning without federal intervention. While a few years ago, 26% of all offers were two-tier offers, the figures more recently have been about three percent, coming to only three such offers in 1985 and four in 1986.

Two of the pending Senate bills propose that large shareholders be required to make any further significant acquisitions by means of a tender offer. This would help insure that a person who acquires corporate control would pay a substantial premium for it and provide smaller shareholders an opportunity to share in that premium to an extent they might not if control were acquired through gradual open market purchases or through a privately negotiated block purchase. It has also been suggested that such proposals would address issues raised by recent

judicial decisions under the Williams Act that permitted substantial purchases by a tender offeror immediately following the tender offer's termination and by a target company during the course of a third party tender offer.

Statutory amendments of this type would represent a significant departure from the present regulatory scheme, which was not designed to specify a particular means for the transfer of corporate control.

Furthermore, I am concerned that mandatory tender offers would impose additional significant costs on both purchasers and sellers of blocks of shares, regardless of whether any change of control was involved. Purchasers could be constrained from employing more suitable alternative methods for structuring purchases, and block owners wishing to liquidate their holdings might be left with no alternative but open market sales, which could depress the value of the stock overall, while simultaneously denying the shareholder any control premium that his block might otherwise command. This is a significant problem. Recent statistics show that about 20% of publicly traded companies had at least one non-officer shareholder who owned a block of over 10% of the firm's shares; and such blocks were owned by officers for about 15% of the firms. I think that concerns over evasion of current tender offer procedures would be better addressed by new rules subjecting substantial share acquisitions, during or shortly after a tender offer, to the Williams Act -- rather than by requiring <u>all</u> large purchases to be made by tender offer.

Another departure from current policy is the restrictions proposed on so-called junk bond financing, a regulatory step clearly beyond assurance of disclosure and review opportunities. One House bill calls for a moratorium on hostile takeovers financed by low-grade, high-yield, so-called "junk bonds" and would forbid federally insured institutions from purchasing such bonds. Critics of these speculative bonds fear that, at best, high debt service requirements reduce the funds available to companies for reinvestment, and, at worst, threaten widespread bankruptcy in the event of an economic downturn. On the other hand, interest payments extracted from one company may be recycled by investors into other companies, and the macro-economic dangers posed by debt are a matter much larger than junk bonds or hostile takeovers. It makes little sense to direct debt restrictions only at the latter phenomena -- unless takeovers are disliked for reasons other than their effect, such as it is, on debt in the economy as a whole. One should also note that low-grade bonds issued at the time of a tender offer accounted for

only 7.6% of all tender offer financings in the first nine months of last year, and, by one estimate, only 9% of $76 billion in outstanding low-grade debt was raised to finance tender offers.

Many of the pending bills would also curb defensive tactics often employed by target management. Since these bills would restrict the substantive discretion of corporate management, a matter generally left to state law, they raise issues of federalism as well as of efficiency, fairness and contractual freedom. The bills particularly disfavor the practice of greenmail. Greenmail is a company's selective repurchase of a block of shares, generally at a premium over its market value. Greenmail can be used to buy out a hostile bidder or to remove dissident shareholders. Some view it as a payment for the value of corporate control, which should be distributed equally among the shareholders, or as a waste of corporate assets purely for the benefit of a single shareholder and the incumbent management. And it may even encourage hostile tender offers by persons whose real hope is not to run or reform the corporation, but instead to be bought off by management. Finally, greenmail is criticized for leading companies to take on excessive debt to buy out the large shareholder.

Opponents of anti-greenmail legislation, while often recognizing problems with the practice, argue that it is better controlled by other means, such as corporate management's refusal to be greenmailed, the adoption of anti-greenmail corporate charter amendments, and shareholder law suits. This is also one of the areas where state-federal issues arise. As long as the relevant facts are disclosed, a board's decision to pay greenmail traditionally has been governed by state law under the "business judgment rule," and redressed by shareholder votes or shareholder lawsuits. If the federal securities laws are going to address greenmail, perhaps disclosure would be the appropriate way, such as requiring a filing at or before the payment of greenmail so that alerted stockholders could make timely pursuit of the remedies available to them.

The SEC recommended anti-greenmail legislation in 1984 but withdrew its support for this proposal the following year. The direct economic consequences to the paying corporations, market forces, state actions, shareholder litigation and changes in the tax laws all appeared to be reducing greenmail, without further federal intervention. Shareholders were suing companies that paid greenmail; companies were adopting anti-greenmail amendments to their charters; and companies that did make greenmail payments

found that paying one group often led to demands for payments from others. Tax laws also made greenmail less profitable to the recipient. Nonetheless, in light of several more recent and highly publicized block repurchases, the Commission is reexamining the greenmail issue.

Current legislative proposals also include measures to discourage target companies from increasing management compensation after a tender offer has been initiated. Proponents of this type of legislation argue that the adoption of extraordinary compensation packages, known as "golden parachutes," following the commencement of a tender offer presents, at a minimum, the appearance of self-dealing on the part of management and may pose a conflict of interest.

Contracts between companies and their managers are another of the decisions traditionally left to state law. Moreover, it is also argued that golden parachute compensation usually represents a small fraction of an acquisition price and that these compensation packages can help attract high quality management, keep managers' attention focused on running the business rather than on concerns about their own futures, and thereby lessen rather than increase conflicts of interest.

Some also predict that legislation tied to commencement of a tender offer would be ineffectual. Many corporations no longer wait for a takeover threat before packing their golden parachutes. In April 1986, 387 of the "Standard & Poor's 500" companies and about 200 of the "Fortune 500" had provided for such compensation. The proposed legislation would also not address the recently developed "tin parachute," which provides change-of-control compensation for a range of employees well beyond top management. For this reason, the expenses of tin parachutes deter hostile bidders in much the same way as a poison pill. Possibly they should have been named "poison parachutes."

Although the SEC recommended legislation against golden parachutes in 1984, it subsequently concluded that because of changes in the taxation of golden parachutes and the availability of remedies under state law, there was insufficient reason to federalize the law in this area.

Congress also is considering proposals aimed at certain types of defensive restructuring, such as the acquisition or disposition of significant corporate assets, moves known as "show stoppers" or selling the "crown jewels," and the issuance or redemption of securities with

extraordinary rights, commonly referred to as "poison pills," designed to make an acquired company less attractive to the would-be acquiror.

These types of practices are accused of having no purpose other than foiling tender offers at any cost. But others say these defenses can be beneficial. Target management can use these strategies to block a tender offer and hold out for better terms for shareholders where individual shareholders might otherwise accept too low a price. Similarly, asset dispositions, such as "selling the crown jewels," may be seen as a legitimate part of a plan to realize value for shareholders in excess of a proposed bid. And, like other proposals for federal standards as to how managers should manage, laws against poison pills and defensive restructuring are subject to the objection that they encroach on the sphere of state law.

This summary does not exhaust the list of pending Congressional responses to the takeover phenomenon. Other proposals would require the filing of statements on the general economic or social consequences of a takeover, or would amend the merger review process under the antitrust laws or would require equal voting rights for equal numbers of common shares -- an issue the SEC will consider in the near future in connection with a proposal by the New York Stock Exchange.

However, I think I have touched upon the types of issues that new takeover legislation would present, and I would be happy to respond to any questions you might have.