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News Release

THE FUTURE OF TAKEOVERS

Remarks to

Minnesota Institute of Legal Education
Hostile Takeovers Seminar

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Daniel L. Goelzer
General Counsel
Securities and Exchange Commission
Washington, D.C. 20549

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Thank you. I appreciate the opportunity to be here today and to be part of this conference on hostile takeovers. You should, however, be warned -- or perhaps reassured -- that the views I will express are solely my own, and do not necessarily reflect those of the Securities and Exchange Commission or of other members of the Commission's staff.

I. Introduction

Several months ago, I agreed to speak to you on the future of takeovers. I realize now that this was a mistake. I don't know what the future holds for takeovers. If I did, I would engage in them and make money, rather than talk about them to groups of lawyers. As George Bernard Shaw might have observed, "Those who can, do; those who cannot, speak after lunch at continuing legal education programs."

Despite my lack of a crystal ball, I am going to begin by keeping my promise and making two predictions about the future of takeovers. My first prediction is that takeovers -- friendly and hostile -- and the restructurings that accompany or anticipate them -- do _have_ a future. Despite tax law changes, steadily rising stock prices, and imaginatively-named structural defenses like poison pills and poision lollipops, the pace of takeover activity remains torrid. A recent article in _Business Week_ offers this explanation:

> "Restructuring continues because U.S. industry needs it. Deregulation, in industries from financial services to energy, from communications to transportation, has exposed managerial complacency and inefficient practices caused by years of shelter from market forces. Many companies and old-line industries are finally cutting back in response to the grim realization that they face permanent decline in demand for their products. And plenty of companies have simply recognized that, if they want to compete globally, they must slim down, toughen up, and focus on a narrower range of businesses." 1/

1/ Dobrzynsk, "Why Nothing Seems to Make a Dent in Deal Making," Bus. Wk., July 20, 1987 at 75.

Whether you accept that explanation or not, merger and acquisition activity continues apace. During the first quarter of 1987, there were 957 completed transactions reflecting a dollar volume of $31.9 billion. This is not much different that the 939 transactions aggregating $39.3 billion in the third quarter in 1986. The fourth quarter of 1986 doesn't provide much of a basis for comparison -- it saw 1,613 deals aggregating $79.6 billion -- driven largely by impending tax law revisions, no doubt. 2/

My second prediction is that, while the activity will continue, the future of takeover regulation will be different than the past. Indeed, Congress is awash with bills to change the way in which takeovers are regulated. A recent survey by the Commission's staff revealed that there are at least 19 bills pending in the 100th Congress to change the regulation of various aspects of the takeover process. For example:

-- Eleven would amend the Section 13(d) filing period.

-- Four bills would require Schedule 13D disclosure of the community impact of proposed acquisitions.

-- Nine would prohibit greenmail in some fashion.

-- Eight bills would extend the current 20-day minimum tender offer period.

-- Four bills would prohibit or penalize partial offers.

-- Six would amend the anti-trust laws.

-- Six bills would regulate poison pills.

-- Three bills would impose a one-share, one-vote requirement on all public companies.

2/ Id.

-- Four bills would regulate junk bonds or other aspects of takeover financing.

-- Two bills would regulate or prohibit acquisitions of U.S. companies by foreign acquirors.

With this level of Congressional interest, some changes are a likely bet.

II. Shareholder Protection

Now that I have the two predictions out of the way, I am going to examine several of the areas in which changes in the regulation of takeovers have been suggested. 3/

The principal federal law under which hostile takeovers are regulated today is the Williams Act. 4/ The Williams Act seeks to protect shareholders -- and in this context that means primarily target company shareholders -- through disclosure provisions that require that information be disseminated concerning a tender offer when one is made, and concerning those who have acquired more than 5% of an issuer's securities, and through substantive provisions designed to ensure that shareholders have a fair opportunity to participate in a tender offer. 5/ The Act seeks to accomplish the shareholder

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3/ The comments herein parallel to some extent recent Commission testimony on pending tender offer legislation. See Statement of Charles C. Cox, Acting Chairman of the Securities and Exchange Commission, Before the Senate Committee on Banking, Housing and Urban Affairs, Concerning Corporate Takeover Legislation (June 23, 1987).

4/ The Williams Act, enacted in 1968 and amended in 1970, added Sections 13(d), 13(e), 14(d), 14(e), 14(f) to the Securities Exchange Act.

5/ Major examples of these latter provisions are proration and withdrawal rights. See Securities Exchange Act, Sections 14(d)(5) and 14(d)(6).

protection objectives I just mentioned without favoring either target or bidder, 6/ through means that assure the generally free transferability of securities.

The merits of takeovers for the economy as a whole, for corporate managements, employees, local communities, and for other constituencies not currently protected under the Williams Act, are still being debated. However, from the perspective of the shareholder -- the intended beneficiary of the Williams Act -- they are a bonanza. A study conducted by the Commission's Office of the Chief Economist revealed that target shareholders enjoy, on average, a 47% premium over market prices when their company is the object of a tender offer. 7/ In just the five years 1981-1985, that 47% premium resulted in aggregate benefits to target shareholders of roughly $39 billion. The same study showed that the bidder's shareholders receive a small, but measureable, benefit -- about $4 on average. 8/

III. Proposed Changes in Takeover Regulation

Given the objectives of current law and the financial rewards to shareholders identified by the OCE study, it is, I think, appropriate to ask whether proposed changes in tender offer regulation would foster shareholder protection or serve some other end. I want to discuss some of the most widely-debated ideas.

6/ Takeover Bids: Hearings on H.R. 14475 and S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 90th Cong., 2d Sess. 4, 47-48 (1968); Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 17, 19, 25, 182 (1967). *See Great Western United Corp. v. Kidwell*, 577 F.2d 1256, 1279-80 (5th Cir. 1978), *rev'd on other grounds sub nom. Leroy v. Great Western United Corp.*, 443 U.S. 173 (1979).

7/ Office of the Chief Economist, SEC, "The Economics of Any-or-all, Partial and Two-tier Tender Offers" (1985).

8/ *Id.*

A. Closing the Section 13(d) Window

The legislative proposal with perhaps the broadest support is reduction of the filing period for reports under Section 13(d) of the Securities Exchange Act. A shareholder who acquires over 5% of the shares of a public company presently has ten days after crossing the 5% threshold within which to file a Schedule 13D with the Commission disclosing the acquisition, the acquiror's intent, and various other information. There have been cases where as much as 20% of the shares were acquired during the ten day period before the public filing. Thus, shareholders -- the intended beneficiaries of the Williams Act -- are not always informed of potential changes in control in a timely fashion.

Several pending bills would reduce the 10-day filing period. Some would require filing within 24 hours and would require the acquiror to forego additional purchases for up to 2 days to make sure that the market is able to assimilate the filing. 9/ Some proposals would also reduce the 5% reporting threshold -- for example, to 3% or 2.5%. 10/

The Commission supports closing the "10-day window." The question is how this can be accomplished in a way that promotes the dissemination of information concerning acquisitions to the investing public without unnecessarily hampering legitimate transactions. The one-day reporting requirement proposed in some bills would create the potential for numerous technical violations of the rule where reports could not be prepared and transmitted in time to meet the filing deadline.

9/ S. 1323 would require initial Schedule 13D filing "not later than the close of business on the next trading day after such acquisition." Purchasers crossing the threshold would be prohibited from purchasing or agreeing to purchase additional shares prior to the filing of the report and the dissemination of a public announcement. S. 1324 would similarly impose a next business day filing requirement and impose a two-day standstill requirement. S. 227 would require filing and a public announcement within 24 hours, and impose a two-day standstill requirement.

10/ S. 1323 and S. 1324 contain these proposals, respectively.

Halving the filing threshold to 2.5% would certainly give more advance warning of possible control contests. But, it would also result in a tremendous increase -- nearly a tripling -- in the 7,000 Schedule 13D filings received annually by the Commission -- most of which would contain no useful control-related information. 11/

The Commission's proposed solution is to maintain the 5% threshold, to require that a Schedule 13D be filed within five business days of crossing 5%, and to prohibit further purchases until the filing requirement is satisifed. This standstill-until-filing proposal would prevent acquirers from using the 13(d) window to increase their holdings without public notification. Under this approach, the acquiring person would control the length of time the standstill is imposed -- an immediate filing would allow the resumption of acquisitions immediately. Such a standstill would provide an incentive for prompt filing, but would not impose delays unrelated to information dissemination.

B. Market Sweeps

A second area in which there is wide agreement that the Williams Act is not protecting shareholders as it was intended is the treatment of open market purchases, especially market sweeps -- rapid accumulations of large positions in companies already "in play" as takeover targets. 12/

11/ In 1980, at the request of Congress, the Commission studied this issue and concluded that 5% was the appropriate reporting threshold. At that time, the Commission estimated that reducing the threshold to 2% would result in a 175% increase in the number of initial Schedule 13D filings with the Commission and that a reduction to 1% would result in a 394% increase. In fiscal year 1986, the Commission received over 7,000 initial Schedule 13Ds and amendments.

12/ Recent examples include Campeau Corporation's 1986 acquisition of Allied Stores; Dixon Group PLC's 1987 acquisition of Cyclops Corporation; and Amalgamated Sugar Co.'s 1986 acquisition of NL Laboratories.

Market sweeps can create the same pressures on target shareholders that the Williams Act was intended to alleviate. The courts, however, have refused to treat them as tender offers. In SEC v. Carter Hawley Hale Stores, for example, the Ninth Circuit refused to enjoin an issuer market sweep. 13/ As a defense against a hostile bid by The Limited, Carter Hawley initiated a wide array of defenses, including the transfer of significant voting power and a "crown jewel option" to an ally, General Cinema. Then, over a six-day period, Carter Hawley acquired about 17.9 million shares, 50.3% of its outstanding common, in open market and privately negotiated transactions. The Commission sued Carter Hawley, arguing that these purchases amount to a de facto tender offer. However, both the district court and the Ninth Circuit held that Carter Hawley's purchases were not subject to tender offer regulation.

Another troublesome market sweep case involved Hanson Trust's acquisition of SCM. 14/ Hanson commenced an offer for SCM, but later announced its termination in response to SCM defensive measures. A few hours later, however, Hanson began acquiring SCM's shares in the open market. Within an hour and a half, Hanson had purchased approximately 25% of SCM's common stock, all at $73.50 per share. The Second Circuit -- over the Commission's objections as amicus curiae -- held that, since Hanson purchased primarily from arbitrageurs and other large investors, the protections of the Williams Act were unnecessary and no tender offer had occurred. 15/ The Wall Street Journal, in an editorial entitled "A Happy Jig," applauded this development, calling the new tactic "the Williams Act two-step." 16/ "Side-step" might have been more accurate.

13/ SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985).

14/ Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985).

15/ Indeed, the court analogized the case to SEC v. Ralston-Purina, the 1953 Supreme Court decision holding that the private placement exemption from Securities Act registration applies only where the offerees are sophisticated and able to fend for themselves. SEC v. Ralston Purina Co., 346 U.S. 119 (1953).

16/ "A Happy Jig," Wall St. J., October 7, 1985 at 22.

One way to address the problem of market sweeps would be to require that all acquisitions resulting in ownership of more than a given percentage -- say, 15% or 10% -- must be made by tender offer. Several pending bills take this approach. 17/ Proposals of this type would foreclose the ability of an investor to acquire or to dispose of a block of stock over the proposed threshold through open market or privately negotiated transactions, regardless of the purpose, timing, or investor impact of the transaction.

The Commission's staff has drafted a proposed rule, more narrowly focused than the legislative proposals, specifically to address "market sweeps." The Commission's staff proposal would prohibit all persons, including the issuer, from purchasing more than 10% of a company's securities during a specified period after a tender offer has commenced or has been announced, unless the purchases are conducted by tender offer. The intent of the proposal is to address the real problem -- purchasers that use the market pressures of a tender offer against investors -- without interfering with more routine open market purchases. The Commission will discuss this proposal within the next several weeks.

C. Defensive Tactics

Legislative proposals are not limited to the regulation of bidders' conduct; many also seek to curtail or eliminate certain management defenses. Greenmail, golden parachutes, and poison pills are common targets of Congressional concern. The Commission, however, has not generally supported federal legislation that would prohibit defensive tactics, since these matters are traditionally subject to state law. If a board of directors fails to fulfill its fiduciary obligation to shareholders, the remedies lie under state doctrines, such as corporate waste and breach of fiduciary duties.

17/ Examples of these are S. 227, S. 1323 and S. 1324. S. 227 would apply tender offer regulation to acquisitions of more than 2% of a class in a 12-month period once the purchaser acquires beneficial ownership of 20% of the class. S. 227, S. 1323, and S. 1324 each include provisions that would mandate compliance with tender offer requirements based upon the extent of beneficial ownership of the securities that a purchaser would acquire. S. 1323 and S. 1324 would apply at the 15% and 10% levels, respectively.

There is, however, one type of structural takeover defense which the Commission has been compelled to address under existing law -- the dilution of the voting rights of public shareholders. The New York Stock Exchange has, for many years, required its listed companies to accord equal voting rights to all common shares. Recently, however, listed companies have sought to create two, unequal, classes of voting stock -- often as an anti-takeover device, although other motivations also exist. The idea is that, if the public's shares cannot, in the aggregate, constitute voting control, then a hostile tender offer for the public's shares will be futile. The high-vote class of shares can be placed in management or other friendly hands -- hands with which any potential acquiror would then have to deal.

Last year, the New York Stock Exchange proposed to modify its one-share, one-vote listing standard to accommodate these dual class companies. This proposal, in turn, brought the Commission into the picture, because Section 19(b) of the Securities Exchange Act requires the Commission to approve changes in exchange rules -- including those relating to listing standards. Changes must be approved if consistent with the Securities Exchange Act, and disapproved if not. Thus, the Commission is compelled to determine whether this particular type of takeover defense is consistent with the existing federal securities laws.

That question presents the Commission with something of a dilemma. On the one hand, matters of corporate structure are the province of state law, not Commission regulation. But, on the other hand, the Securities Exchange Act reflects a clear assumption that public companies do afford voting rights to the shareholders -- rights made effective by the proxy provisions of the Commission's rules. 18/

18/ The Office of the Chief Economist has released an update to its Study of "The Effects of Dual-Class Recapitalizations on Shareholder Wealth." The update increased the sample of analyzed firms to 97 by including 34 companies that had recapitalized by issuing a second class of common stock from March 1986 to May 1987. In contrast to its earlier conclusion that dual class recapitalizations do not have negative effects on stock prices, the OCE found significant and negative wealth effects result from the announcement by a company of a dual class recapitalization. In particular, the OCE found that such companies experienced significant negative average stock returns from the day of the announcement of the recapitalization through the following day of 0.93%. Office of the Chief Economist, SEC, "The Effects of Dual-Class Recapitalizations on the Wealth of Shareholders," (1987).

In order to resolve this conundrum, on June 22, 1987, the Commission announced the commencement of a proceeding to consider whether to prohibit exchange or NASDAQ listing of common stock if, after May 15, 1987, the company issues securities or takes other corporate action that would have the effect of nullifying, restricting or disparately reducing the voting rights of existing, publicly-traded shares.

It is important to recognize that this would not be a one-share, one-vote rule. It would be a rule prohibiting action which deprives existing public shareholders of their existing vote. Thus, the following actions would be among those prohibited by the proposed rule:

-- the issuance of securities that condition voting rights upon the amount of shares owned or the period of time they have been held;

-- recapitalizations whereby existing shareholders are offered lower voting stock in return for stock with higher voting rights;

-- the issuance of super-voting shares through, for example, a stock dividend;

-- the issuance of shares with restrictions on their transferability.

On the other hand, proposed Rule 19c-4 would permit:

-- the issuance of stock with equal, lesser, or restricted voting rights pursuant to a registered public offering;

-- the issuance of stock with equal, lesser, or restricted voting rights to effect an acquisition; and

-- the issuance of transferable lesser-voting stock by way of a stock dividend.

Public hearings on the proposal were held Wednesday. A Commission decision may be issued this Fall.

D. Disclosure of Acquisition Sensitive Information

The final area I want to mention is the prompt disclosure of acquisition sensitive information. Four pending bills 19/ would provide that amendments to Schedule 13D filings that reflect material changes in the information previously disclosed be filed with the Commission no later than the first business day after the change occurs.

Legislation of this sort could present serious concerns because of its inflexibility. For example, in a contest for control by competing bidders, an amendment should be filed as soon as possible after the change. On the other hand, a less stringent amendment requirement may be appropriate for institutional investors, such as pension funds and investment companies which alter positions in their portfolio securities on a daily basis, and for investors with solely a passive investment purpose.

The importance the Commission attaches to this area is illustrated by several recent Commission administrative proceedings. In In re Cooper Laboratories, the Commission dealt with the need to promptly amend Schedule 13D. 20/ Cooper Laboratories had acquired 11.1% of Frigitronics' outstanding common stock as of August 9, 1984, at prices ranging from $22 to $24.25 per share. On August 20, 1984, Cooper filed a Schedule 13D, disclosing their acquisition of the stock and stating that it might acquire additional shares "by tender with a view of gaining control."

Predictably, the price of Frigitronics' stock shot up in anticipation that Cooper would launch a tender offer for the company. However, on August 29th, Cooper quietly began to sell its Frigitronics holdings. By September 6th, it had sold over 1% of Frigitronics' outstanding shares, and, between September 6th and 12th, Cooper proceeded to liquidate its entire interest in Frigitronics. On September 13th, the day after it had completed its sales, Cooper filed an amended Schedule 13D.

19/ S. 1323, S. 1324, H.R. 2172, H.R. 2668.

20/ In re Cooper Laboratories, Inc., Securities Exchange Act Release No. 22171 (June 25, 1985); See also In the Matter of Centrust Savings Bank, Securities Exchange Act Rel. No. 23076 (March 31, 1986).

In its order, the Commission alleged that, given that Cooper had mentioned the possibility of a tender offer and that Cooper had begun its sale of Frigitronics stock on August 29th, the amended Schedule 13D, filed September 13th, was not filed "promptly" as the Commission's rules require. 21/ Cooper Laboratories consented to the entry of an order finding violations, without admitting or denying the allegations in the Commission's order.

Two other recent proceedings deal with the similar requirement in Commission Rule 14d-9. Item 7 of Schedule 14D-9 requires the target of a takeover to disclose whether it is engaged in negotiations to sell assets, merge, or to enter into a variety of other extraordinary corporate events. Amendments reflecting changes in this information must be filed "promptly." This type of information concerning possible target defensive measures can be extremely material to shareholders evaluating the likelihood that a hostile bid will succeed. On the other hand, targets are naturally reluctant to reveal their defensive initiatives, since disclosure may frustrate efforts to enlist white knights.

In 1986, The Commission addressed this disclosure obligation in In Re Revlon, Inc. 22/ That Commission order sets forth the circumstances under which Item 7(a) of Schedule 14D-9 requires the target of a tender offer to disclose white knight negotiations. Revlon was engaged in negotiations to sell part of its business as a counter-maneuver to fend off a pending tender offer by Pantry Pride. In response to Item 7, Revlon stated that it "may undertake negotiations which relate to or could result in" various extraordinary corporate events, but that "currently, however, no negotiations have

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21/ Under the Commission's Rule 13d-2, 17 C.F.R. 240.13d-2, a Schedule 13D must be amended "promptly" to reflect any material changes, including, specifically, "any material increase or decrease in the percentage of the class beneficially owned."

22/ Securities Exchange Act Release No. 23320, 35 SEC Docket 1541 (June 16, 1986).

been undertaken with third parties." 23/ Although Revlon subsequently modified this statement to delete the "no negotiations" passage, the company did not disclose that it was actually engaged in discussions until the day before a friendly merger agreement and asset sale were announced.

In its order, the Commission concluded that the discussion leading up to this agreement constituted negotiations required to be disclosed because "the term 'negotiations' includes not only final price bargaining, but also applies to substantive discussions between the parties or their legal and financial advisers concerning a possible transaction." 24/ Discussions between Revlon's advisers and other parties constituted "negotiations" by the time that the following events had occurred:

> "[T]he parties had established contact,
>
> had begun and concluded their initial reviews of confidential financial information,
>
> had retained counsel to discuss between and among themselves the structure and timing of the acquisitions, * * *
>
> had discussed the percentage of equity to be offered to * * * the Revlon management group. * * *
>
> [And had presented an offer] which, although rejected, became the basis upon which the parties negotiated, including discussions * * * over the structure of the * * * [transactions]. 25/

Similarly, in an administrative proceeding filed June 29, 1987, In Re Allied Stores Corp., 26/ the staff alleged that

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23/ 35 SEC Docket at 1543. In addition, as authorized under the Item 7(a) instructions, Revlon stated that it would not disclose the parties or possible terms of any transaction until an agreement in principle was reached. Id. at 1543-44.

24/ Id.

25/ Id.

26/ Administrative Proceeding File No. 3-6869 (June 29, 1987).

Allied failed to promptly amend its Schedule 14d-9. On September 12, 1986, Campeau commenced a tender offer for 55% of Allied's outstanding stock. On September 24, Allied filed a Schedule 14d-9 which stated that Allied's board had determined to "explore and investigate a number of possible transactions including a change in Allied's capitalization, the sale of shares to another company, the acquisition of its own stock, the acquisition by Allied of another company and the acquisition of Allied by another company." The staff alleges that subsequently, and without amendment to the September 24 filing, Allied officials

> met with representatives of Edward J. DeBartolo Corporation to discuss the sale of Allied shopping centers to DeBartolo;
>
> agreed on a price for six specified shopping centers;
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> negotiated the acquisition of Allied by a partnership consisting of DeBartolo and a private investor;
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> reached an agreement in principal; and
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> obtained board approval of that agreement contingent upon financing.

The staff charged that Allied failed to promptly disclose the shopping center negotiations, the merger negotiations, and the agreement in principle and the board resolution, thereby violating Rule 14d-9.

On Wednesday of this week (July 22, 1987), Allied, without admitting or denying any of the allegations in the Commission's order, consented to the entry of findings that it violated Rule 14d-9 by failing to amend promptly its September 24 Schedule 14d-9. The proceeding is still pending against an individual respondent. He was counsel to Allied and an outside director. He is alleged to have "caused" Allied's violations; since 1984, Section 15(c)(4) of the Securities Exchange Act has authorized the Commission to proceed against those who cause tender offer filing violations. The Commission's decision to proceed against a lawyer/director, based on his role in the failure to file an amended Schedule 14D-9, has attracted considerable attention. For present purposes, I would only note that the Allied Stores proceeding underscores the importance the Commission attaches to prompt and accurate disclosure of defensive merger negotiations.

IV. Conclusion

I have tried to summarize for you what I regard as the Commission's agenda for takeover reform. It consists of Section 13(d) legislation, a proposed market sweeps rule, the shareholder disenfranchisement proceeding, and aggressive efforts to enforce the takeover-related disclosure requirements. The Commission's agenda does not include a fundamental restructuring of the Williams Act. If the objective is shareholder protection, that Act continues to serve investors well.

Thank you.