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Remarks of

David S. Ruder
Chairman
Securities and Exchange Commission

Before the
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Federal Preemption of State Anti-takeover Legislation

The views expressed herein are those of Chairman Ruder and do not necessarily reflect those of the Commission, other Commissioners or the staff.

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Good afternoon, and thank you very much for giving me this opportunity to speak at the Corporate Counsel Institute. Indeed, as a former Planning Director of this Institute, my secret wish came true when today's luncheon speaker withdrew and I was able to make one of my first major talks as Chairman of the Securities and Exchange Commission to this audience. My topic today is "Federal Preemption of State Anti-takeover Legislation." My purpose is to explain to you the position urging preemption which I took recently in testimony before the House Subcommittee on Telecommunications and Finance. 1/

During my long association with corporate counsel, I have developed a very real sense of cohesion with the corporate community. I hope that each of you will listen to my remarks today as those of a friend concerned with the welfare of America's corporations and their shareholders.

1/ Statement of David S. Ruder, SEC Chairman, Before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce (September 17, 1987).

It should not surprise you to learn it is my strong view that the Federal Government should not interfere with the internal business affairs of corporations. In a talk in 1981 dealing with proposed legislation to increase federal regulation of internal corporate affairs, I urged corporations to take the initiative in correcting their problems privately so that Congress will not be tempted to intercede into their affairs. 2/ Once again, I urge the responsible exercise of power by corporations, this time in the takeover area. My conclusions in this regard are based upon two principles: first, that corporate officers and directors owe their primary obligations to shareholders; and second, that the health of our capital markets requires an unimpeded environment in which shareholders can sell their shares.

Currently, Congress is considering several bills to amend the Williams Act in order to provide increased federal regulation of corporate takeovers. Supporters of these bills have cited various reasons why they view increased federal regulation as necessary. They assert that unfriendly takeovers primarily benefit unscrupulous corporate raiders and their investment bankers. They assert that the fear of raiders diverts American

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2/ See, "Current Issues Between Corporations and Shareholders: Private Sector Responses to Proposals for Federal Intervention Into Corporate Governance," 36 Bus. Law. 771 (1981). In respon to The Corporate Democracy Act of 1980, H.R. 7010, 96th Cong., 2d Sess., 126 Cong. Rec. H2490 (1980), and The Protection of Shareholders' Rights Act of 1980, S. 2567, 96th Cong., 2d Sess. 126 Cong. Rec. S3754 (1980), I noted that the best way for corporations to avoid the need for such legislation would be to engage in self-examination, to adopt positive attitudes, and to provide effective internal mechanisms to prevent the misuse of the corporate entity.

executives from their business operations tasks. They assert that the fear of takeovers is causing corporations to look to short-run profits and stock prices rather than to long-term planning. They cite takeovers as causing a huge corporate debt build-up, thereby increasing the economy's vulnerability to a recession. 3/ They object to the dismantling of research and development departments in order to save costs. They point to job losses and plant closings resulting from takeovers.

These arguments share one feature: they seem to ignore what I regard as the fundamental premise of tender offer regulation, that corporations are owned by their shareholders.

From my position as Chairman of the Securities and Exchange Commission, the most obvious example of the shareholder protection principle is the Williams Act, the amendments to the Securities Exchange Act which comprise the principle regulatory scheme governing tender offers. That Act is designed to protect the shareholders of target companies in tender offers by providing a careful balance between bidders and the management of the target company. 4/ The Williams Act accomplishes this goal in two ways. First, it requires that any person acquiring substantial amounts of a corporation's equity securities make disclosures of that fact. Second, it requires tender offerors to provide adequate information about themselves and the terms of the tender offer.

3/ See, e.g., "Proxmire Takes Aim at Takeovers," The Wall Street Journal, p. 33 (Sept. 28, 1987).

4/ See Piper v. Chris-Craft Industries, Inc., 430 U.S. 1 (1977)

The Act also contains provisions designed to achieve equal treatment for target shareholders, to permit these shareholders ample time and opportunities to make informed decisions, and to prevent fraud. The Commission has implemented these shareholder protection goals in many ways, including setting forth the detailed disclosure obligations, 5/ regulating the timing of tender offer announcements, 6/ extending pro rata and withdrawal rights, 7/ requiring tender offers to remain open for 20 days, 8/ adopting all-holders

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5/ Rule 14d-6, Schedule 14D-1, 17 CFR 240.14d-6, 14d-100. Regulation 14D, 17 CFR 240.14d-1 *et seq.*, prescribes the means by which material information concerning a tender offer is filed and disseminated to shareholders.

6/ Rule 14d-2(b), 17 CFR 240.14d-2(b), provides that an announcement of the essential terms of a tender offer constitutes commencement of the offer, requiring the filing of a Schedule 14D-1 and dissemination of offering materials within five business days.

7/ Rules 14d-7, 14d-8, 17 CFR 240.14d-7, 240.14d-8. The Commission extended proration and withdrawal rights out of concern that more time was needed by shareholders to evaluate tender offers. Proration and withdrawal rights are now coextensive with the term of the offer.

8/ Rule 14e-1(a), 17 CFR 240.14e-1(a), establishes a minimum offering period of 20 business days. That minimum period is supplemented by Rule 14e-1(b), 17 CFR 240.14e-1(b), which requires that a tender offer remain open for at least 10 business days from the date that notice is provided of a change in (1) the percentage of the class of securities being sought, (2) the consideration offered, or (3) the dealer's soliciting fee.

and best price rules, 9/ regulating issuer tender offers, 10/ and mandating management responses to tender offers. 11/

The Williams Act reflects a policy of minimal interference with shareholders' rights to sell their shares. The Act's policy of neutrality between tender offerors and target company management is intended to assure the free transferability of securities. This goal of neutrality as a means of protecting target shareholders remains as sensible today as it was when the Williams Act first became law. That goal also carries with it the implicit assumption that a competitive, honest market is the best arbiter of the many complex and intricate issues inevitably raised by takeover activity.

The Commission has expressed its concern that the bills presently being considered by Congress may alter the even balance of Williams Act regulation. With regard to takeover legislation introduced in the Senate 12/ and the House, the Commission has

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9/ Rules 13e-4(f)(8), 14d-10, 17 CFR 240.13e, 140.14d-19. These rules require that the offer be made to all holders of the class of securities subject to the offer and that each shareholder receive the highest price paid to any shareholders tendering into the offer.

10/ Rule 13e-4, 17 CFR 240.13e-4. The Commission has also adopted detailed disclosure requirements for "going private" transactions by issuers and their affiliates to allow shareholders to evaluate the fairness of the transaction. Rule 13e-3, 17 CFR 240.13e-3.

11/ Rule 14e-2, 17 CFR 240.14e-2. Target companies must file a Schedule 14D-9, 17 CFR 240.14d-101, within 10 business days following the commencement of the offer.

12/ One week ago, the Senate Banking Committee approved its version of takeover reform legislation. Largely consistent with the Commission's recommendation, the Senate bill would close the 13D window to five days with a standstill on further purchases until filing of a Schedule 13D. In the House, hearings have been completed on H.R. 2172, the "Tender Offer Reform Act of 1987," introduced by Chairmen Dingell and Markey, and H.R. 2668, the "Securities Trading Reform Act of 1987," introduced by Congressman Lent.

supported measures which would require more prompt disclosure that the 5 percent beneficial ownership level has been crossed, with a standstill on further purchases until filing of a Schedule 13D. By and large, however, the Commission has not supported other aspects of the bills.

For example, while the provisions of the bills differ in various respects, all of them include provisions that would restrict the activities of buyers after certain threshold levels of beneficial ownership are reached. The Commission does not support such legislation because it believes that restrictions on substantial share acquisitions outside of tender offers are not beneficial to target shareholders. Tender offers place pressures on shareholders to determine quickly whether to sell their shares. Generally, purchases of substantial amounts of stock in normal open market and privately negotiated transactions are not likely to create such pressures.

As you know, legislative proposals introduced to date have not been limited to the regulation of bidders' conduct. The proposals have included provisions which would curtail or eliminate certain practices developed by management as defenses to takeover attempts. The House bills would control the practice known as "greenmail", limit the use of "golden parachutes", and limit issuers' ability to adopt "poison pill" plans. While I share Congressional concerns regarding the potential for abuse in these areas, I believe such activities are internal corporate affairs which should be regulated under state law. If a board of directors fails to fulfill its fiduciary obligations to shareholders,

appropriate remedies are available under state doctrines of corporate waste and breach of fiduciary duty. 13/ The Commission testified to this effect before the Senate Banking Committee, and I am pleased to note that Senate Committee voted last week not to include provisions in the Senate bill which would have inhibited the use of poison pills and golden parachutes. However, the Senate bill does include provisions that would address greenmail.

Concern for preservation of a system of governance of internal corporate affairs does not automatically mean that states should be allowed to interfere with a free national market for sale of shares. In the aftermath of the Supreme Court's decision in CTS Corp. v. Dynamics Corp. of America, 14/ more than a dozen states 15/ have adopted statutes whose clear design is to provide for state control over the takeover process. Certainly changes in control that occur through the vehicle of the nation's securities markets are matters of both state and federal interest. Each state has certain interests in the corporations it charters, especially those located within its boundaries. When a state's legislation primarily affects the transfer of shares in companies which are

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13/ See Buckhorn, Inc. v. Ropak Corporation, 656 F. Supp. 209 (S.D. Ohio), aff'd, 815 F.2d 76 (6th Cir. 1987) (enjoining issuance of new stock options to employees and accelerated vesting of existing options in response to tender offer); Feinberg Testamentary Trust v. Carter, 652 F. Supp. 1066 (S.D.N.Y. 1987) (denying motion to dismiss suit claiming breach of fiduciary duty and waste with respect to greenmail payment); Polk v. Good, 507 A.2d 531 (Del. 1986) (same).

14/ 107 S.Ct. 1637 (1987).

15/ These states include: Arizona, Florida, Hawaii, Louisiana, Massachusetts, Minnesota, Missouri, North Carolina, Nevada, Oklahoma, Oregon, Washington, and Wisconsin.

locally based and locally owned, the state clearly has a legitimate interest in regulating changes of control. On the other hand, Congress has determined that "transactions in securities . . . are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions . . . in order to protect interstate commerce, . . . and to ensure the maintenance of fair and honest markets in securities." 16/ This statement sets forth a federal securities law policy which I believe to be beneficial - the preservation of viable markets for the sale of securities. The existence of liquid secondary securities markets is extremely important for capital formation in our country, and Congress clearly supports this proposition.

Limitations on the free transferability of securities of corporations which are owned by shareholders nationwide diminish the efficiency, depth, and liquidity of the nation's securities markets. Accordingly, I believe that federal law should control in that area by preempting state statutes that unduly interfere with the free transferability of securities. I believe that corporations whose activities and ownership are national in scope should not be given protection against takeovers by the states where their primary production facilities are located. Just as I believe it to be imprudent for Congress to regulate internal corporate affairs through tender offer regulation, I believe it is

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16/ Section 2 of the Securities Exchange Act, 15 U.S.C. 78b.

imprudent for states to use their authority over matters of internal governance as a means of regulating the interstate market for corporate control. 17/

Proponents of state anti-takeover laws frequently argue that these laws are needed because they protect the target company's employees and the surrounding community from such ill effects as unemployment, plant closings, and the sale of assets. These arguments fail to recognize their full thrust. They isolate takeovers as causing dislocations when many other causes such as friendly acquisitions, leveraged buyouts, corporate restructurings, and internal corporate "downsizing" have the same effects.

Recently, in a survey regarding "downsizing" conducted by the American Management Association, 18/ nearly half of the 1,134 responding corporations said they had undergone a reduction in force in the 18 months from January 1986 through June 1987. Of the 210 companies providing information regarding the reasons for such downsizings, only 24, or 11.4 percent, cited takeover activity as a reason. Significantly, even this relatively small minority of companies cited other reasons, such as an economic downturn, or decrease in consumer demand, or a desire to improve staff efficiency, or plant obsolescence.

17/ In a recent speech, Chairman Dingell of the House Energy and Commerce Committee expressed concerns that, "state statutes enacted recently may exceed traditional state corporate governance * * *." He cautioned against "balkanizing the economy." See Remarks of the Honorable John D. Dingell before the Garn Institute Conference on Restructuring of Corporate America (Sept. 21, 1987).

18/ See, AMA News Release, "New Survey Finds Corporate Downsizing Has Peaked; Fewer Job Cuts Expected Over Next 12 Months," (September 1987).

It is somewhat ironic that the issue of dislocation should be raised by the business community as a rationale for opposing takeovers. If Congress really were to address the dislocation issue, it would regulate plant closings, employee layoffs, and sales of assets directly. It is likely that industry representatives would oppose such legislation, just as they are doing with regard to a provision in the omnibus trade bill. 19/ That bill would require employers to provide 60 days' notice before a plant closing or before a 30-day layoff of one-third of the work force.

As I indicated earlier, the basic problem with assertions that employees, communities, and other constituencies should be protected against dislocations is that they ignore the interests of the owners of the corporation, the shareholders. What has been the effect of the takeover phenomenon on target shareholders? According to a study recently completed by one of our Commissioners, during the period 1981 to 1986 the average premium over pre-tender market prices in tender offers was 40 percent. 20/ My guess is that this premium has not diminished in the last year. The Commissioner's study also indicates that between 1981 and 1986 approximately $167 billion has been transferred to target shareholders as a result of takeover-related activities. Surely,

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19/ H.R. 3, Trade and International Economic Policy Reform Act of 1987.

20/ See, "Stock Market Profits from Takeover Activity Between 1981 and 1986: $167 Billion is a Lot of Money," by Joseph A. Grundfest, Commissioner, Securities and Exchange Commission, and Bernard S. Black, Counsel to Commissioner Grundfest, p. 8 (September 28, 1987).

these results are beneficial to target shareholders. Indeed, shareholders who have received substantial premiums over current market prices most likely have reinvested substantial portions of their proceeds in the stock market. I believe this scenario has been happily received by target shareholders in recent years.

Some of the arguments which I acknowledged in the opening portion of the remarks are not susceptible to easy analysis. Are American businessmen unnecessarily diverted toward short range goals by fear of takeovers? I believe the corporate planning process is affected by many events, of which a possible hostile tender offer is only one. I do know that corporate America seems to be addressing shareholder values, and I do not know what the long-range effect of such action will be. Nor do I know whether too much debt is being created. Only time will answer the question whether debt-to-equity ratios are correct.

Is research and development being abandoned? The answer is not clear. However, if the answer were yes, I would also like to know who is now employing the brilliant people who have been discharged. Have they been hired by other corporations in their industry? Have the entrepreneurial owners of divisions acquired by employees in corporate spin-offs hired them?

At the outset of these remarks, I said that I came to you as a friend. You may wish to ponder why a friend of the corporate community would argue against efforts to stop takeover activity through the use of state anti-takeover statutes. My concern is the same as it was in 1981 when I urged corporations to act responsibly in order to avoid interference at the Federal level. I continue to urge the responsible exercise of power by management.

I acknowledge that my views are influenced by a fundamental concern for the rights of shareholders and that, as Chairman of the Securities and Exchange Commission, I also must acknowledge my responsibility to assure that our capital markets continue to be strong, viable and uninhibited.

Thank you.