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Washington, D. C. 20549
(202) 755-4846

TENDER OFFERS: AN SEC PERSPECTIVE

ADDRESS BY

John R. Evans
Commissioner
Securities and Exchange Commission

National Association of
Corporate Directors
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Tender Offers—"the process by which existing shareholders are solicited to tender their shares to the offering or bidding individual, group or corporation,"—are receiving considerable attention at the Commission, and I am pleased to be with you this afternoon to discuss a perspective from the SEC on this very dynamic area of securities regulation.

The Commission's statutory authority to regulate tender offers was enacted in 1968. This legislation, amending the Securities Exchange Act of 1934 and commonly referred to as the Williams Act, was a response to abuses which were identified in the late 1960's as increasing numbers of corporations participated in mergers and other forms of acquisitions often through tender offers or through private or open market purchases.

Among the specific abuses cited in the legislative history are the secrecy often associated with tender offers, which can result in investment decision-making on the basis of rumor and contradictory information, and the unreasonable pressures which may be imposed upon investment decision-makers. As one witness at the Senate Hearings put it, there was "undue pressure on shareholders to act hastily and to accept the offer, before management or any other group has an opportunity to present opposing arguments or competing offers."1/ Other identified abuses included manipulative selling and buying practices in the marketplace intended to drive the price of the subject company's security up or down depending on whether manipulation had been engineered

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by management to frustrate the tender offer by making the price of the security too expensive or by the offeror attempting to facilitate the offer by keeping the price to be paid lower than it otherwise would be. None of these practices seems appropriate in the regulatory framework of full and fair disclosure, informed investment decisionmaking, and investor protection mandated by the federal securities laws.

To remedy these abuses, Congress enacted a regulatory scheme intended to protect all shareholders subject to the tender offer process without favoring either the bidder or the target. The Senate Report indicates that extreme care was taken:

> to avoid tipping the balance of regulation either in favor of management or in favor of the person making the tender offer bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.2/

This statutory framework includes filing and disclosure requirements and regulatory provisions according shareholders' rights to withdraw their shares for a certain period of time, and to have their shares accepted on a pro rata basis. It also imposes an obligation on the offeror to treat all tendering shareholders equally with respect to consideration paid for tendered shares and makes it unlawful for any person to make an untrue statement of a material fact or to omit to state a necessary fact or to engage in any fraudulent, deceptive or manipulative acts or practices in connection with any actual or planned tender offer. The Act also gives the Commission broad rulemaking authority.

It is important to note that the legislation was not intended to discourage tender offers. As Minority Staff Director of the Senate Banking Committee when the legislation was considered, I remember well the testimony from a number of witnesses who believed the original bill was heavily weighted against tender offers. They argued persuasively that a change in management can be beneficial for a company and that often significant financial benefits accrue to shareholders when their companies are acquired. The final bill was amended with the intent that it be neutral. On the floor of the Senate, Senator Javits asked Senator Williams, who was the floor manager of the bill, whether the legislation was intended to condemn tender offers and pointed out that sometimes shareholders benefit from tender offers. Senator Williams replied:

> There is no intention in any way to prohibit tender offers. As a matter of fact, I think it may encourage them. Through this legislation people will have more information, and will be able to intelligently decide whether to accept a tender offer and sell their shares to a group which may wish to obtain a controlling interest.3/

In administering these provisions the Commission has attempted to reflect the Congressional intent and to avoid "tipping the balance" either in favor of the bidder or the incumbent management.

With this by way of background, I would like to discuss the Commission's current rulemaking effort relating to tender offers and what it is intended to achieve, the relationship of the Williams Act to state antitakeover statutes, and whether the Commission should attempt to define the term "tender offer".

In February of this year the Commission published for comment a comprehensive package of proposed rules regulating the conduct of tender offers. The proposals supercede an earlier series of rules issued in 1976. Although some of the 1976 proposals could have been adopted without being reissued for comment, it was our judgment that the better course would be to publish the entire package again because of intervening legislative and judicial developments and so that the Commission could have the benefit of the commentators views on the entire regulatory scheme.

Those of you who are familiar with the complexity of our proposals may relax. I am not going to attempt to describe them in detail in a luncheon speech. I will sketch them briefly however, and mention some of the problems which commentators have seen. The proposals regulate both the bidder and the subject company and may be divided into four categories: filing requirements; dissemination provisions; disclosure requirements; and substantive provisions. Our proposed regulation of the bidder's conduct would require filing of a Schedule 14D-1 with the Commission on the date that the offer is commenced which is defined generally as the date on which the offer is first published, sent or given to security holders. A copy of the filing would be required to be delivered to the target, the National Association of Securities Dealers, the various securities exchanges, and any other bidder.

The rules provide for three non-mandatory, non-exclusive methods of disseminating information concerning a cash tender offer: long form publication, summary publication, and individual shareholder mailing through the use of shareholder lists. With respect to the third alternative, the subject company, if requested by the bidder, would be required either to furnish a shareholder list or to mail tender offer materials for the bidder at the bidder's expense. Disclosure is required of the identities of the bidder and the target, the description of securities being sought, the consideration to be paid, date of expiration of the offer and terms and conditions under which it might be extended, description of withdrawal rights, plans with regard to oversubscription, if applicable, and other material financial and business information currently required on Schedule 14D-1.

Among the substantive regulatory provisions proposed is Rule 14e-1 which would require a tender offer to remain open for thirty business days from the date the offer commences and for ten business days after the date of a notice of increase in the offering consideration or the soliciting dealer's fee. Rule 14d-7 proposes a right to withdraw tendered shares for 15 days and if a competing offer is made, an additional ten day period would be required under specified conditions. For purposes of the best price rule, (the provision which requires all holders to be paid the best price offered any holder), Rule 14d-8 would integrate with the tender offer, certain purchases by the bidder within 40 days following termination of the offer. Subject companies would be required to satisfy certain disclosure and filing requirements if a solicitation or recommendation is made to security holders with respect to the offer.

Finally, the Commission proposed an "anti-leak" rule which would prohibit the purchase of subject company securities by any person who, on the basis of non-public information received directly or indirectly from the bidder, knows or has reason to believe the bidder will make an offer unless that person makes a public announcement of the information received and its source. In addition, a bidder who believes or has reason to believe that this provision has been, is being, or will be violated would be required to make a public announcement with respect to the tender offer.

In proposing these rules it was our belief that this was a balanced regulatory scheme which did not favor either party in the transaction, but as you can imagine, proposals as complex and far reaching as these have provoked considerable comment. The most controversial provision is the anti-leak rule with its prohibition against a bidder making purchases before publicly announcing its fixed intention to make a tender offer.

Certain commentators have expressed the view that the Commission does not have the authority to adopt such a requirement and criticized the rule because of an asserted chilling effect which they believe the requirement will have on negotiated purchases and purchases made to test the market. Commentators have also questioned how it can be decided with any degree of certainty when a bidder has "determined" to make a tender offer within the meaning of this rule.

Purchases before the offer is made public by those who have determined to make a tender offer, can frustrate the purposes and operation of the Williams Act and pose problems similar to those created by the trading of persons who have been "tipped" that a tender offer will occur. Thus, shareholders who do not know of the bidder's determination to make a tender offer and who sell the subject company's securities shortly before the start of an offer are effectively denied the benefits of disclosure and the substantive protections provided by the Williams Act. If furnished with such information, these shareholders would be able to make an informed investment decision, which may involve deferring the sale of the securities until the commencement of the tender offer. Moreover, purchases made by a bidder after it has determined to make a tender offer generally reflect an intention to purchase securities at a lower price than will be offered in the tender or to ensure the success of the tender offer.

Another requirement which has been the subject of considerable controversy is the proposed extension of the minimum period of a tender offer to thirty business days. The Williams Act does not provide an explicit minimum period requirement. Section 14(d)(5), however, through its provision for a seven day withdrawal right, effectively requires that all offers remain open at least seven days, and Section 14(d)(6), through its provision for proration of all shares tendered in the first ten days of an offer, effectively establishes a ten day minimum period for tender offers which seek less than all of the securities in the relevant class.

A number of commentators favored a longer minimum period than the seven or ten day period currently required. However, several commentators questioned the Commission's authority to adopt such a requirement and criticized the period selected. Those favoring a longer period were of the view that it would facilitate informed investment decisionmaking, would result in financial benefit to shareholders, and would provide management and the bidder with an equal opportunity to present their case fairly. Those favoring a shorter period were of the view that a 30 business day period would be inconsistent with the policy of neutrality since management of the target would have additional time to find a "white knight" and to take defensive action.

The Commission is not wedded to the 30 day time period, nor is it attempting to favor the management of the target. Nonetheless "Saturday Night Specials" and other forms of offers which do not stay open for a reasonable length of time may compel security holders to make investment decisions on the basis of inadequate or incomplete information, and without a full opportunity for management or other interested parties to present their views.

Moreover, unreasonably short tender offers are incompatible with other provisions of our proposed regulation. Our proposals contemplate methods of dissemination (such as summary publication and the use of stockholder lists) which will require a significant period of time to effect. In addition, the proposed fifteen business day period for withdrawal, is intended to operate in tandem with the requirement that the offer be open for thirty days.

The minimum time period chosen should be long enough to assure that investors can receive information from both sides, analyze that information, and make an informed decision whether or not to tender their shares and yet not so long as to tip the balance of regulation in favor of subject companies. Public comment which has been received with respect to the period which best effectuates those policies will assist the Commission to determine whether 30 business days is a reasonable minimum period.

Perhaps the most uniformly critical comments have been received with respect to the requirement that under certain circumstances, the subject company disclose any negotiation or transaction undertaken by it in response to the tender offer with respect to: (1) an extraordinary transaction, such as a merger or reorganization, involving the subject company or any subsidiary of the subject company; (2) a purchase, sale or transfer of a material amount of assets of the subject company or any of its subsidiaries; (3) a tender offer for or other acquisition of subject company securities; or (4) any material change in the subject company's present capitalization or dividend policy.

A principle criticism of this proposed requirement is that premature disclosure of negotiations with potential competing bidders would dissuade them from making a friendly offer and therefore would be harmful to shareholders who want the highest possible price for their shares. There is also concern that such disclosure may, either innocently or fraudulently, induce shareholders of the subject company to reject a tender offer on the basis of an unjustified inference that a competing bid is imminent.

While it would appear that disclosure of major developments such as a proposed merger or the imminence of a bid from a competing offeror can be one of the most material items of information received by a shareholder, the substantial criticism received suggests that such disclosure may have a net detrimental effect on shareholder's interests. Accordingly, I believe the Commission will have to reassess the desirability of this proposed requirement.

One of our proposals would increase the conflict that presently exists between the federal law and state anti-takeover statutes. Rule 14d-6(b) provides generally that a cash tender offer shall be deemed to have been "published or sent or given" to security holders when the bidder has publicly made available information concerning its identity, the identify of the subject company, the amount and class of securities being sought and the price to be paid. Disclosure of this information commences the tender offer and triggers various obligations pursuant to other parts of the proposed regulation, such as the substantive provisions for proration and withdrawal.

We proposed the concept of commencement of a tender offer, even though neither the present rules nor the statute defines when a tender offer starts, because the method by which tender offers are conducted has changed significantly since the Williams Act became law. At that time, ordinarily the bidder's intent to engage in a tender offer first became publicly known with the formal announcement of the offer to security holders. By means of that announcement, the bidder would have furnished to shareholders required information with respect to the offer when they were first confronted with the need to make investment decisions.

Now, public announcements of the terms of a proposed offer are often made long before the offer starts. As a result, certain market mechanisms normally associated with a tender offer, such as arbitrageur activity, commence, forcing shareholders to make significant investment decisions on the basis of newspaper articles or other public announcements without the disclosure by the bidder which the Williams Act was intended to provide. Moreover, the market activity triggered by the public announcement frequently results in a contest for control of the subject company prior to the formal application of the federal requirements. Arbitrageur activity during that period may assure the success of the tender offer and make the tender offer itself a mere formality since the contest for control has already been decided. Depending on the results of this pre-commencement contest, the security holders may or may not be provided the opportunity to tender to the bidder.

By defining when a tender offer is deemed to commence and providing that commencement of the offer triggers certain obligations on the bidder's part, particularly the obligation to file and deliver the Schedule 14D-1, and publish, send or give to security holders certain required information, the Commission hopes to assure that investors have available the information which they need at the time they have to make an investment decision.

The problem with this approach is that it is in direct conflict with the pre-commencement filing, publication, waiting, and hearing procedures of the state anti-takeover statutes. Nineteen states require pre-commencement public announcements and thirty-seven states require precommencement filings. Our proposed rules would deem the offer to commence at the time the pre-commencement public statement appears in the newspaper or the pre-commencement filing is made. State law bars the offer until a waiting period or a hearing is held. By deeming commencement to occur on the date of the public statement, the minimum period, best price, withdrawal and proration rights accorded by the state statutes could not function since they are usually predicated on the tender offer commencing after the conclusion of the waiting period and hearing process.

This conflict is unfortunate but it would appear that our proposal or something like it is necessary if the purposes of the Exchange Act with respect to tender offers are to be accomplished. As a general rule, state blue sky statutes have a very important role to play in securities regulation and the Commission and the states complement each other very effectively. This is not true, however, in the tender offer area.

In an amicus curiae brief filed with the Supreme Court in the pending Great Western United Corporation 4/ case, the Commission has taken the position that the Idaho corporate take-over law is invalid under the Commerce Clause of the Constitution because it creates an undue burden on interstate commerce and that the federal law conflicts with the Idaho statute such that the state law is pre-empted under the Supremacy Clause. We argue that the statute is invalid under the Commerce Clause because it is an attempt to exercise extra territorial jurisdiction well beyond the traditional blue sky laws. The Idaho statute regulates any national tender offer wherever the offers, acceptances, and tenders occur provided the target company has certain contacts with Idaho. The result is that security holders with no relation to Idaho may be deprived of the opportunity to benefit from tender offers and bidders may be forced to choose between substantial penalties, or delay which may frustrate the offer. The Commission believes that "[b]ecause the Commerce Clause prohibits a state from exercising laws designed to regulate conduct that occurs outside the state's borders," the Idaho statute is invalid.

Our brief also takes the position that by imposing pre-commencement disclosure requirements the Idaho statute permits management of the target to delay or frustrate tender offers. We believe this is inconsistent with the Federal statutory policy of neutrality with respect to the competing parties in the offer and accordingly is invalid under the Supremacy Clause. The Commission is hopeful that the Supreme Court's decision in the Great Western United case will resolve these important questions.

The final issue which I would like to discuss is whether the Commission should define the term "tender offer," which our February release did not propose to do. This is a difficult issue, presenting as it does the familiar conflict between (i) the need of practitioners and their clients for certainty so that they can plan transactions with reasonable assurance of the anticipated consequences; and (ii) the need for flexibility to assure that the statutory purposes are fulfilled. It is argued that without a definition of the term "tender offer," a prospective purchaser is required to determine whether the facts and circumstances of its particular situation fall within the existing administrative and judicial interpretations. This exposes the prospective purchaser to the risk that its activities will later be determined by a court to have constituted a tender offer and to have been in violation of the federal law. This concern was articulated recently by Judge Leval in the Brascan Limited v. Edper Equities Ltd.5/ case. Moreover, the legal and financial implications of such a determination are not confined to the Federal securities laws. For example, permitting security holders to withdraw their securities pursuant to Section 14(d)(5) because the transaction must be restructured to meet tender offer requirements could result in the loss of tax advantages such as the ability to file consolidated income tax returns. Thus it is asserted that prospective purchasers are faced with the alternative of either assuming a high degree of risk or conforming the transaction to the conventional mode of compliance with Sections 14(d) and (e).

The apparent harshness imposed by such uncertainty is, however, mitigated in at least two respects. First, parties planning to use an unusual method of securities acquisition can, in advance of the transaction, seek advice from the Commission's staff as to whether the staff believes the proposed transaction would be a tender offer.

Second, the analysis of whether a transaction constitutes a tender offer is based on objective elements such as the nature of the solicitation, premium above market price and time limits, which can be considered and evaluated prior to entering into a transaction.

The Commission has been reluctant to define the term "tender offer" for fear that would facilitate cirumvention of the statutory goal. If the term "tender offer" were strictly defined, the requirements of Section 14(d) could be avoided easily by structuring the transactions to deviate slightly from the definition. This would be the case particularly if the term were defined according to the conventional understanding. A more flexible approach is consistent with the construction of the Williams Act as a remedial statute which is to be liberally interpreted to fulfill the Congressional purpose.

Moreover, the tender offer field is occupied by participants of perhaps unparalleled financial and legal sophistication. The constant evolution in tender offer practice is a tribute to their ingenuity and resourcefulness. What is now considered a tender offer was ill-defined in the early 1960's. Since the beginning of 1978 we have seen increasing attempts to acquire control through novel transactions. These transactions serve to illustrate the difficulties inherent in attempting to articulate a static definition of an activity which is dynamic in nature. This is presumably the basis for the view attributed to Congress by an often cited treatise, that "the absence of a definition is due to the fact that Congress . . . believed that . . . a tender offer might well encompass transactions yet unborn which were not considered tender offers in general custom and usage."6/ The reference in Section 14(d)(1) to tender offers conducted by use "of any facility of a national securities exchange or otherwise" also indicates that Sections 14(d) and 14(e) reach certain open market and privately negotiated purchases even though they do not fit within the description in the legislative history of what was then understood to be a tender offer.

The Commission could, of course, define a tender offer broadly enough to reach novel transactions. But such a definition might be so draconian as to inhibit normal market activity and thus be disruptive and damaging to our securities markets.

A better approach would be to develop an objective framework for analyzing on a case-by-case basis whether a tender offer exists. In light of the purposes of the Williams Act and the dynamic nature of tender offers, the following factors have been identified as relevant to the determination of whether a transaction is a tender offer.

1. Whether there is an "active and widespread solicitation of public shareholders" for shares of an issuer; 7/

2. Whether the solicitation is made for a substantial percentage of the issuer's stock; 8/

3. Whether the offer to purchase is made at a premium over the prevailing market price; 9/

4. Whether the terms of the offer are firm rather than negotiable; 10/

5. Whether the offer is contingent on the tender of a fixed minimum number of shares, and, perhaps, subject to the ceiling of a fixed maximum number to be purchased; 11/

6. Whether the offer is open for only a limited period of time; 12/

7. Whether the offerees are subjected to pressure to sell their stock; 13/ and

8. Whether public announcements of a purchasing program concerning the target company precede or accompany a rapid accumulation of large amounts of target company securities. 14/

None of the foregoing factors alone is dispositive and, others may apply. I believe, however, that the factors do provide substantial guidance to prospective purchasers as to whether they are within Sections 14(d) and 14(e). This approach also enables the Commission to preserve the flexibility necessary to ensure that the intended purposes of the law are fulfilled. Two courts have considered these enumerated factors and they came to different conclusions as to their usefulness. In Brascan, Judge Leval rejected them and stated that:

> the application of these vague factors would introduce a crippling uncertainty in an area in which practitioners should be entitled to be guided by reasonably clear rules of the road. 15/

In The Hoover Company v. Fuqua Industries 16/ case, Judge Contie applied them to conclude that there was a tender offer. If it appears that this approach is not going to be workable, the Commission will have to consider alternatives such as rule-making, interpretive releases or possibly seeking additional legislation. My current view is that these factors should provide sufficient guidance to practitioners as to when the tender offer provisions of the Act apply while at the same time providing the flexibility necessary to make the Act effective against novel tender offers.

The Commission's tender offer regulation responsibilities require us to consider a number of complex and difficult issues. We must assure that the rules do not favor either the bidder or the target, and because the players are often powerful and the stakes are high, it is important that we enforce compliance strictly. We had hoped to take action with respect to our proposed rules this summer. It now appears that we will not be in a position to approve final rules until the fall. I am confident, however, that the rules we finally determine to adopt will accord investors the protections the law intends in an even-handed fashion.

FOOTNOTES

1/ Senate Committee on Banking and Currency, Hearings Before the Subcommittee on Securities on S. 510, 90th Cong., 1st Sess., pp. 21, 35 (1967).

2/ S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967).

3/ 113 Cong. Rec. 24665 (1967).

4/ Great Western United Corporation v. Kidwell, 557 F. 2d 1256 (5th Cir. Aug. 10, 1978) prob. juris. noted ___ U.S. ___, 47 U.S.L.W. 3450 (U.S. Jun. 8, 1979).

5/ Brascan Ltd., et al. v. Edper Equities Ltd., et al., 79 Cir. 2288 (S.D.N.Y., May 25, 1979).

6/ E. Aranow, H. Einhorn & G. Berlstein, Developments in Tender Offers for Corporate Control 1 (1977). [hereinafter Aranow, et al.]

7/ Cattlemen's Investment Co. v. Fears, 343 F. Supp. 1248 (W.D. Okla, 1972).

8/ Aranow, et al. at 6-7.

9/ H.E. Rep. No. 1711, 90th Cong. 2d Sess, reprinted in [1968] U.S. Code Cong., Ad. News, 2811, at 2811; Kennecott Copper Corp. v. Curtiss-Wright Corp. 584 F. 2d 1195, 1206 (2d Cir. 1978); Great Western United Corp. v. Kidwell, 577 F. 2d 1256, 1261 n.2 (5th Cir. 1978).

10/ Nachman Corp. v. Halfred [1973-74 Transfer Binder] CCH Fed. Sec. L. Rep. §94,455 (N.D. Ill. 1973).

11/ Kennecott Copper Corp. v. Curtiss-Wright Corp., supra, at 1206 Smallwood v. Pearl Brewing Company, supra, at 597 n. 22; Great Western United Corp. v. Kidwell, supra, at 1261 n. 2.

12/ Great Western United Corp. v. Kidwell, supra, at 1261 n.2.

13/ Development in Tender Offers; "Developing Meaning of Tender Offer", 86 Harv. L. Rev. 1250, 1275 (1973).

14/ S-G Securities Inc. v. The Fuqua Investment Co., [Current] CCH §96,750 (D. Mass. 1978); Moylan, Exploring the Tender Offer Provisions of the Federal Securities Laws, 43 Geo. Wash. L. Rev. 551, 586 (1975).

15/ Brascan Ltd., et al. v. Edper Equities Ltd., et al., supra at 50.

16/ The Hoover Co. v. Fuqua Industries, Inc., Civ. Action C 79-1062-A (N.D. Ohio, 1979).