1983

REPORT OF THE TENDER OFFER COMMITTEE REGARDING FUTURE ROLE OF NASAA IN TAKE-OVER REGULATION

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INTRODUCTION

In the past two years, NASAA, through its Tender Offer Committee, has actively represented the interests of the states in the field of tender offer and take-over regulation. The Association's activities have included the adoption of a Uniform Take-Over Act and the filing of an amicus brief in the U.S. Supreme Court in support of the Illinois Take-over law. To date, NASAA's actions have related primarily to the defense and modification of state laws in response to court challenges. Recent events, however, have compelled a reevaluation of NASAA's role in the tender offer regulation field. As a result of this reevaluation, the Tender Offer Committee recommends that NASAA shift its focus toward aggressively seeking changes in the federal law and regulations related to tender offers. The proposed changes would (1) close loopholes to prevent abuses under the current federal regulatory scheme; (2) provide specific authorization for state involvement in the regulation of tender offers under certain circumstances; and (3) encourage any federal legislation that would tend to slow down or impede tender offers generally until the perceived abuses in this area have been ameliorated or eliminated and shareholders are assured of appropriate investor protection. In addition, the Committee believes that NASAA should continue to suggest modifications in state laws to protect the interests of shareholders and to correct abuses associated with corporate acquisitions.

IMPACT OF MITE

The most significant recent event affecting the viability of state take-over laws was the decision by the U.S. Supreme Court in the case of Edgar v. MITE in June, 1982. In MITE, a sharply divided Court decided by a bare 5-4 majority that the Illinois take-over statute was invalid under the Commerce Clause. The Court concluded that the Illinois statute imposed a substantial, indirect burden on interstate commerce which outweighed its argued benefits.

From the states' perspective, the most important part of the decision was the concurring opinion of Justice Powell. He stated that he was joining the Court's opinion that the Illinois law constituted an excessive, indirect burden on interstate commerce because the "reasoning leaves some room for state regulation of tender offers." Justice Powell explained his decision as follows:

> "This period in our history is marked by conglomerate corporate formations essentially unrestricted by the antitrust laws. Often the offeror possesses resources, in terms of professional personnel experienced in takeovers as well as of capital, that vastly exceed those of the takeover target. This disparity in resources may seriously disadvantage a relatively small or regional target corporation. Inevitably there are certain adverse consequences in terms of general public interest when corporate headquarters are moved away from a city and State.*
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> The Williams Act provisions, implementing a policy of neutrality, seem to assume corporate entities of substantially equal resources. I agree with Justice Stevens that the Williams Act's neutrality policy does not necessarily imply a congressional intent to prohibit state legislation designed to assure--at least in some circumstances--greater protection to interests that include but often are broader than those of incumbent management.
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> * The corporate headquarters of the great national and multinational corporations tend to be located in the large cities of a few states. When corporate headquarters are transferred out of a city and State into one of these metropolitan centers, the State and locality from which the transfer is made

inevitably suffer significantly. Management personnel--many of whom have provided community leadership--may move to the new corporate headquarters. Contributions to cultural, charitable, and educational life--both in terms of leadership and financial support--also tend to diminish when there is a move of corporate headquarters."

POST MITE DECISIONS AND STATE REACTION

Although MITE ostensibly allows room for some state involvement in the regulation of tender offers, the extent of a state's role is uncertain due to the divergent views expressed in the various opinions. Some subsequent federal and state court decisions have added to the confusion by automatically, and without careful analysis of each individual case, striking down any state law that had extraterritorial effect.

Following MITE, Michigan and Maryland through their respective take-over or securities statutes, attempted to bring some semblance of order to the frenetic take-over battle between Martin Marietta and Bendix. At one point, each company acquired a majority interest in the other (through use by the target of the so-called "Pac-man" defense), leaving professionals uncertain about the ramifications. Despite the indication in MITE that there is some room for state regulation, the federal courts rendered broad rulings which declared the state laws unconstitutional, but which made no effort to further define the states' role. Indeed, some commentators have expressed serious concern that these decisions may eventually be extended to attack traditional Blue Sky securities regulation because of the alleged extraterritorial effect that a state's denial of registration has on a national offering.

In the wake of the Martin Marietta/Bendix spectacle, which some have characterized as largely an exercise in ego gratification, prominent business leaders, politicians, and columnists have called for reforms in the banking, securities and tax laws. (See attachments) Moreover, some SEC commissioners while commenting on the recent promulgation of the new pro-rata

rules, have expressed dissatisfaction with the present Williams Act.

Ohio responded to the MITE decision by enacting dramatic changes in its corporate law, which now requires shareholder approval of substantial stock acquisitions in Ohio corporations. These corporate law changes presumably are based on the language in MITE suggesting continued regulation of internal corporate affairs by state law. The Ohio approach has received widespread interest among the states as a substitute for existing state take-over laws. Other states have redrafted or introduced legislation designed to avoid the "extraterritorial effect" prohibition of the MITE case by providing fraud powers relating to offers subject to the Williams Act made to offerees residing in the state, and that retains traditional admininstrative oversight over offers not subject to the Williams Act. (New York and Wisconsin).

CONCLUSIONS

After discussing these recent events with experts and conducting its own assessment, the Tender Offer Committee has concluded:

(1) There are a number of serious problems associated with tender offers and take-overs impacting negatively on shareholders and the local and national economies that require prompt, remedial action.

(2) While the SEC appears unwilling or unable to take the lead in addressing these problems, there is increasing political support in Congress for changes in several areas, to wit: The financing and the tax treatment of take-overs, amendments to the Williams Act, and the SEC's authority in the tender offer area.

(3) At least one state, Ohio, has sought to avoid the MITE decision's adverse impact on state take-over laws by enacting legislation under its state corporation law to protect resident shareholders and local economic interests. The Ohio response may be followed by other states.

(4) The MITE decision allows for some state regulation of tender offers. However, it and subsequent decisions provide little guidance as to the scope of permitted state involvement. Revisions to state take-over laws as an answer to MITE are likely to result in the continuation of legal challenges to such laws.
(5) NASAA should provide the leadership in advocating changes in federal and state laws which are designed to eliminate take-over abuses.

PROPOSALS FOR NASAA

Action on Federal Level

There are presently two principal arenas for NASAA involvement at the federal level--the appropriate regulatory agencies (primarily the SEC) and Congress. Because of timing considerations, it is suggested that NASAA immediately seek to work directly with the SEC. There has not been a direct dialogue between NASAA and the SEC in this area for at least five years. This Committee ascertained that the SEC recently has been directed by the Senate Banking Committee to undertake a study to be completed by July of this year, focusing on the current problems in the take-over area and some possible solutions to these problems. (See attachments) In addition, it was reported in the February 8, 1983 edition of the Wall Street Journal that the SEC will be forming a separate panel to recommend changes in federal tender offer regulations.

We believe it would be appropriate for NASAA to contact the SEC by written communication, or otherwise and offer to provide imput and assistance to this undertaking either by participating as a member of any study group or by having meetings and dialogue with the Commissioners or the staff. This should be done immediately. (It is significant to note that the SEC is due for Congressional reauthorization this year.)

The Committee also believes there are several significant reasons for NASAA to concentrate its energies on congressional action. The primary reasons are: (1) the public outcry for take-over restrictions in the wake of the Martin Marietta/Bendix take-over battle, which has already generated

congressional reaction, as discussed below; (2) the hostility of the SEC towards state involvement in the tender offer field which may prevent any effective NASAA-SEC dialogue; (3) the past resistance of the SEC to correct tender offer abuses whether due to political or industry opposition, bureaucratic inertia or lack of personnel; (4) the concern that the SEC lacks the legal authority to deal with some of the problems, -- including the use of rule making -- to accomplish substantive changes in the Williams Act. Accordingly, NASAA's efforts should be directed toward seeking changes in federal law in the following areas, hopefully, with the assistance and cooperation of the SEC.

A. WILLIAMS ACT AMENDMENTS RELATING TO SEC ACTIVITY

After almost 15 years of experience under the Williams Act without significant changes, it is apparent that the Act does not adequately deal with a number of practices and problems relating to tender offers and take-over battles. This Committee has identified the following as major problems and proposes possible solutions for such is the following respects:

1. Extension of Time Periods. The Williams Act presently provides a 20 day minimum offering period. This period is too short to ensure that information about an offer and its effects can be fully disseminated to and understood by offerees. As a result, the market place is frequently disrupted when a bidding war begins. Empirical studies have shown that the longer the period of time that an offer is open, the greater the financial rewards financially to the target's stockholders. Any extension of the time periods presently in effect would be of significant benefit to the shareholders and to the public generally. In addition, the Williams Act time periods do not adequately protect investors when there are multiple bids by competing offerors. The additional time built into the process through the pre-offer filing requirement discussed below should remedy this problem.

2. Two Tiered Offers. Two-tiered offers are a recent phenomenon which have become a major abuse. In

two-tiered offers, bidders pay cash during the first part of the offer and usually give cash, stock, debentures or other securities in the second part, that are of substantially less value than the first tier price. Two-tiered offers allow bidders to provide a substantial cash premium for part of the targets shares and thereby make its offer look more attractive than a competing offer.Frequently, however, the nature of the securities to be offered in the second tier is inadequately disclosed at the outset. Furthermore, it may be impossible for offerees to evaluate the value of the securities in the second tier of the offer and to compare competing offers such that tendering shareholders may end up with securities of the bidder which are of questionable value. As a practical matter, target company shareholders in a two-tiered offer are stampeded into tendering, in order to make sure they receive the first tier price for at least part of their shares in the event the offeror is successful in obtaining the minimum number of shares it sought. Most commentators and this Committee believe that two-tiered offers involving substantially different first tier and second tier prices or values are per se manipulative and should be prohibited. A recently adopted SEC rule (14D-8) requiring the pro ration period to be open for the full term of the offer should help to curb some of the abuse in the area. However, the rule will not eliminate the problem, and there is some question about the statutory authority of the SEC to promulgate this new rule. In addition, states may take action in this area by amending their corporation law statutes, as discussed below.

3. Prior SEC Review of Offering. Under the present law and rules, a bidder may commence an offer without prior SEC review of the adequacy of the disclosures or the offer's terms. Furthermore, once the offer is made, there is virtually no SEC involvement in terms of active review and comment.

It is difficult to understand the logic of requiring pre-commencement review by the SEC in a $3 million public offering of securities by an offeror,

but no review in a multi-billion dollar take-over initiated by the same entity. In this respect, the Williams Act is different from the '33 Act and the Hart-Scott-Rodino Antitrust Law, among others. As a result, the current federal take-over law, rather than being neutral, gives substantial advantage to bidders and puts significant pressure on target shareholders to tender their shares even though there may be subsequent material changes in the terms of the offer or in the information disclosed. Furthermore, once shares have been tendered it is virtually impossible to "unscramble the eggs" in the event of fraud. This Committee believes the Williams Act should be amended to require a prospective bidder to file with the SEC prior to making an offer. Most state laws before they were declared unconstitutional, contained a 20 day pre-offer notification and filing requirement. This Committee feels a similar federal requirement would provide sufficient time for review by the SEC and for "digestion" of the offer by the market and by shareholders. Such a requirement would also allow adequate time for the SEC or other interested parties to seek to enjoin fraudulent or unfair offers and thereby prevent shareholders or the public from being injured. To avoid insider information problems, all such filings would be public. The pre-offer notification concept has received the support of Congressman Peter W. Rodino, Jr., Chairman of the House Judiciary Committee are indicated by his letter in The Wall Street Journal of 1/18/83. He suggests a "cooling off period" for unfriendly takeover bids that could be incorporated into the pre-merger notification procedures under the Hart-Scott-Rodino Anti Trust Act.

4. Definition of Take-Over. Presently, neither the Williams Act nor SEC rules define a "tender offer." Consequently, it is uncertain what types of acquisitions are covered by the law -- in particular, so called "creeping" tender offers. To date, this problem has been resolved, if at all, on a case by case basis through the application by courts of informal SEC criteria for determining what constitutes a tender offer. Because of the lack of formality and precision

of the SEC guidelines and the lack of uniform interpretation and application by the courts, a number of corporate raiders have been able to take advantage of this loophole to the detriment of target shareholders. To remedy this situation, the William Act should be amended to include a clear definition of the types of acquisitions that trigger the substantive requirements of the Act. The Committee believes the Act should be made applicable to acquisitions by whatever means, i.e., open market or privately negotiated purchases, etc., and not just the classic tender offer for a designated percentage (i.e. 10%) of a target company's shares. A clear definition will help not only to curb abuses by corporate raiders, but also to eliminate creeping tender offers.

5. Remedy for inadequate 13D disclosure. The present law fails to provide a sufficient remedy for inadequate or improper disclosures of the purpose of acquisition of shares in excess of 5% with regard to the acquirer's intention to obtain control of the target and other significant material information. Courts, even after finding that material misstatements or omissions have taken place have done little more than require disclosure amendments and have seldom required the acquirer to give up the benefits of his actions. Specific remedies and sanctions to deter such activity should be added to the Williams Act such as: preventing the voting of shares, rescission of open market take-overs, and enjoining future acquisitions of shares.

B. Williams Act Amendments Authorizing State Involvement.

1. State Standing in Federal Court. At present, the SEC does not have the desire or sufficient resources to deal with all the problems arising from tender offers and take-over bids. Because states are closer and more accessible to the shareholders and the companies involved, they have a strong interest in preventing and resolving these problems. The Committee believes federal law should provide a mechanism for the states to represent their interests while possibly providing

assistance to the SEC. This can be accomplished by a specific amendment to the Williams Act authorizing a state or states to file suit in federal court seeking injunctive relief against a bidder or target company, similar to the recent amendments to the Commodity Exchange Act specifically allowing state actions. Standing, however, would be limited to the state of incorporation or any state or group of states representing a substantial percentage of shareholders and assets.

2. State Regulation. As we have indicated, as a result of the MITE decision and subsequent federal court decisions the extent of permissible state involvement in the regulation of tender offers is uncertain. Language in the MITE decision indicates that the states may, to some extent, constitutionally regulate tender offers in order to protect their resident shareholders. However, several post-MITE decisions cast doubt on the limited role suggested by the Supreme Court. In order to avoid expensive and lengthy litigation regarding the constitutionality of restructured state take-over laws which would be necessary to obtain further Supreme Court clarification, the Committee believes that Federal legislation clearly authorizing certain activities of the states, in keeping with MITE parameters, will be a useful way of avoiding this problem.

Presently there are two possible approaches: a) a proposal of the Ohio Manufacturers Association (OMA), which provides that a state may enact legislation regulating take-overs within certain paramaters; i.e., (1) minimum standards for the state's assumption of jurisdiction, (2) not more than one state being able to assume jurisdiction, and (3) administrative proceedings being completed within 60 days. Preliminary contact with the staff of the Senate Banking Committee indicates (i) the Banking Committee will not introduce any of its own legislation until there is a consensus on the Committee, which probably will not occur until after hearings are held on the

issues and solutions are suggested, (ii) that the OMA draft has already been forwarded to the Banking Committee for review by its staff, (iii) the staffer for one of the members of the Committee is interested in meeting with our Committee to obtain input in this area.

b) a second concept would be comparable to the current regulation of exchange offers under state Blue Sky laws. Each state would be permitted to deny registration if the offer failed to meet anti-fraud or substantive requirements contained in the state's law or regulations. To ensure fairness, provisions currently contained in some state laws would be prohibited, including exemptions for friendly offers, issuer tenders and mandatory hearings at the request of target companies.

C. FINANCING RESTRICTIONS

In response to the recent, large take-over battles, several members of Congress as well as congressional committees have either introduced legislation or have called for hearings in this area:

1) Representatives Schumer (D-NY) and Leach(Iowa) introduced H.R. 7272 at the end of the last Congressional Session which would give the Federal Reserve Board authority to disapprove the extending of financing in connection with any acquisition or merger involving more than 100 million dollars in financing if the benefits to the public resulting from the acquisition or merger are outweighed by adverse effects (copy attached). Preliminary contact by this Committee with members of the staff of Representatives Schumer and Leach indicates that this proposal is still viable for this session of Congress.

2) The House Subcommittee on Domestic Monetary Policy, chaired by Rep. Walter Fauntroy (D-DC), is pressuring the Federal Reserve Board to interpret its existing rules to curtail bank credits in "unproductive"

takeovers. The Federal Reserve Board's resistance has led the House Committee to publicly state its intention to require the Federal Reserve to block such bank credit. Preliminary contacts by this Committee with the House Subcommittee staff indicates that hearings will be held soon on these issues.

3) In addition, proposals have been set forth which would seek to disallow as a business expense deduction by corporations interest paid on loans taken for take-over purposes.

STATE ACTION

Although the Committee believes the principal focus of NASAA's activities should be on federal legislation, there are state law changes that we should continue to study and pursue.

Until the passage of clarifying federal legislation is passed concerning state authority in the take-over field, the states are limited to two areas of regulation: (1) the use of a take-over statute which would possibly fit within the parameters of MITE and (2) amendment of the corporation laws of the states in an attempt to eliminate the abuses perceived in take-overs.

A. Uniform Take-Over Act.

The Committee believes that under the present circumstances the current Uniform Act may have serious difficulties in surviving a constitutional challenge. States may consider limiting the application of any take-over statute to offers to resident shareholders and to extending traditional state take-over protection to offers not subject to the Williams Act (See the draft revisions to the New York and Wisconsin statutes currently being circulated)

B. State Corporation Law Revision

The MITE decision indicates that the states do have a legitimate interest in regulating the internal affairs

of their domestic corporations. In line with this, Ohio has enacted a corporation statute which requires majority shareholder approval of the transfer of certain significant percentages of the shares of target companies incorporated in the state. The Committee is studying other possible corporate law restrictions. Some of the suggestions under consideration include definitions of fiduciary duties and corporate waste restrictions on the business judgment rule to (i) prohibit "golden parachutes," (ii) restrict repurchase by a target company of its own securities ("green mail") and (iii) ensure payment of fair consideration in going private transactions or appraisal actions.

"Green Mail". Green mail is the popular name given to a practice developed by some corporate raiders involving the purchase of securities of a target in the open market and, in effect, forcing the target company to repurchase the shares by a mixture of threats of proxy and tender offer battles, shareholder litigation, liquidation, etc. The practice results in significant disruption in the target company's market price and in a waste of corporate assets in repurchasing its shares. To a certain extent, a broader definition of take-overs on the federal level as recommended above, should curb the practice. However, to eliminate the practice, the Committee believes the Act should clearly provide that acquisitions by a person made with a view towards repurchase by the target company is a manipulative practice. The Act should also restrict repurchasing of shares from a bidder by the target company.

Golden Parachutes. Golden parachutes are devices used by some target companies to try to fend off unwanted bidders. The term refers to extraordinarily munificent severance packages for the target company's management that are put into place prior to or during the course of a tender offer battle in order to make termination of the target companies executives extremely costly in the event the bidder is successful. This Committee believes golden parachutes involve a waste of a target company's assets and should be prohibited.

RECOMMENDATIONS

The Committee recommends that the Board of Directors of NASAA authorize the Committee to do the following:

(1) Communicate with the SEC immediately either as study committee participants or otherwise, to provide input into the studies that will be conducted by the advisory committee being formed by the SEC as described above.

NASAA's position would include the following general objectives: (a) extension of offering time periods; (b) elimination of abusive two-tiered offers; (c) prior review of offering by SEC or pursuant to Hart-Scott-Rodino anti-trust requirements; (d) clarification of definition of "take-over" to eliminate problems created by unconventional and creeping tenders; (e) effective sanctions for violations of ownership information filing requirements; (f) state standing to sue in federal court to enforce Williams Act.

(2) Permit the Committee to communicate with members of Congress and congressional committees and their staffs to provide input into Williams Act amendments (possibly in connection with SEC reauthorization hearings), and take-over financing legislation as described above and to arrange for meetings and appearances before appropriate congressional committees. NASAA's position would include the states' desire to afford investor protection in the take-over area, as described above, and general support of legislation that would (a) provide states a presence in take-over regulation without Commerce Clause violations or (b) tend to slow down take-overs by restricting bank financing or tax advantages. Such communication with Congress, etc. should be coordinated with any efforts of the NASAA Legislation Committee.

(3) Establish a liaison with other interested groups, organizations, or individuals who seek to eliminate abuses in the take-over areas.

Respectfully submitted,

Dated: New York, N.Y.
February 22, 1983

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