May 6, 1983

MEMORANDUM TO: Members of the SEC Advisory Committee on Tender Offers

FROM: Robert F. Greenhill
Joseph H. Flom

RE: Preliminary Subcommittee Report

On behalf of the Subcommittees on Regulation of Acquisition of Control and on Regulation of Opposition to Acquisition, we are enclosing a preliminary version of our joint report. This report represents a consensus of both subcommittees. One or two members of the subcommittees may reserve judgment or take different positions on certain of the recommendations herein, but we felt it important to provide you with our current thinking sufficiently in advance of the May 13 public meeting.

Enclosure

cc: Linda C. Quinn
David B.H. Martin, Jr.

May 6, 1983

SEC Advisory Committee on Tender Offers

Preliminary Report of Joint Subcommittee on Regulation of Acquisition of Control and Regulation of Opposition to Acquisition

I. Observations and Basic Objectives

A. Observations

1. The subcommittee believes that the capital markets and the mechanisms for change in corporate control generally function well in the United States. There is no strong body of evidence suggesting that tender offers or reasonable defensive activities are harmful either to shareholders or to the economy as a whole. The subcommittee's fundamental approach, therefore, favors a free market system which allows bidders and targets to interact freely. Regulation appropriate to this system should be drawn to correct specific abuses and to promote full disclosure and the opportunity for informed shareholder response.

2. Changes in corporate control and the redeployment of assets are designed to have positive economic consequences. Tender offers represent a vital and dynamic mechanism for shifting physical resources and managerial skills to their most highly valued uses on a large scale. The possibility of tender offers also promotes responsiveness to the market in management decisions and greater attention to the interests of shareholders.

3. In individual cases, it is possible for the shareholders of a target company to benefit from the rejection and defeat of a tender offer. Accordingly, there is no basis to interfere with present law which leaves to the business judgment of a target's board the decision whether to support or oppose a tender offer and to take action accordingly.

4. The subcommittee does not believe either that all tender offers are good or that all are bad. Just as with any key management decision, such as capital spending or a new product introduction, there will be some mistakes and some successes. The subcommittee is unwilling to impair or eliminate the tender offer process because some acquisitions prove uneconomic and prefers to allow the marketplace to be the ultimate judge.

5. Regulations must be evaluated in relation to their effect on all shareholders -- bidders, targets and the rest of the market alike (including the probability that any company will be a bidder or a target) -- rather than any single interest group. In addition, tender offer regulation must be evaluated in the context of its effect on other devices for accomplishing changes in corporate ownership, as the overall system is tightly interrelated.

B. Basic Objectives. The subcommittee accepts and adopts the recommendations of the subcommittee on Basic Objectives:

1. Neutrality and Protection of Shareholders. Tender offer regulation should not favor either the bidder or the target, but should aim to

achieve a reasonable balance while at the same time protecting the interests of shareholders and the integrity of the markets. Tender offer regulation should recognize that tender offers take place in a national securities market.

2. Innovation. Tender offer regulation should not unduly restrict innovations in tender offer techniques. These techniques should be able to evolve in relationship to changes in the market and the economy.

3. Scope of Regulation. Even though regulation may restrict innovations in tender offer techniques, it is desirable to have sufficient regulation to insure the integrity of the markets and to protect market participants against fraud, nondisclosure of material information and the creation of situations in which a significant number of small shareholders may be at a disadvantage to market professionals.

4. Relationship to Other Legislative Objectives.

(a) State Tender Offer Laws. State regulation of tender offers should be confined to "local" companies -- for example, those with more than 50% of their shares held within the state of incorporation, no listing on a national securities exchange, and outstanding "float" less than a certain size.

(b) State Regulation of Public Interest Businesses. Federal tender offer regulation should not preempt traditional state regulation of banks, utilities, insurance companies and similar businesses.

(c) Federal Regulation. Tender offer regulation should not override federal regulation of banks, broadcast licensees, railroads, ship operators, nuclear licensees, etc.

(d) Relationship with Other Federal Public Interest Regulation. Tender offer regulation should not be used to achieve antitrust, labor, tax, use of credit and similar objectives. Those objectives should be achieved by separate legislation or regulation.

5. Coordination with State Corporation Law.. Except to the extent necessary to eliminate abuses or interference with the intended functioning of federal tender offer regulation, federal tender offer regulation should not preempt or override state corporation law. Essentially the business judgment rule should continue to govern most tender offer activity.

6. Elimination of the Present Bias Against Securities Tender Offers. Cash and securities tender offers should be placed on an equal regulatory footing so that bidders, the market and shareholders, and not regulation, decide between the two.

7. Periodic Abuses Should be Restricted. The evolution of the market and innovation in tender offer techniques may from time to time produce abuses. Tender offer regulation should be flexible enough to allow the SEC to deal with such abuses as soon as they appear.

II. Tender Offer Timing and Procedures

A. Perceived Problems with Timing and Procedures

1. Shareholder Lists and Dissemination of Offer Documents. It is in the interest of all shareholders to have speedy and complete dissemination of information with respect to tender offers. Presently, bidders experience great difficulty obtaining shareholder lists or prompt mailing of materials by the target company, which frustrates this objective. (This problem is compounded by the difficulty of communicating directly with shareholders whose shares are held in street name. We understand that the SEC is presently reviewing this area.)

2. Exchange Offers. Under the present scheme, securities exchange offers are at a disadvantage with respect to all-cash tender offers because of the time delay associated with registration of securities.

3. Involuntary Extensions. Under the present system offers of initial bidders can be extended, and withdrawal rights reopened involuntarily, by the activities of other competing bidders. Such rules deprive initial bidders of their control over the offer, their expectation of a reasonably prompt response by target shareholders, and reduce the rewards for their speed and initiative. Such rules also introduce excessive confusion and gamesmanship into the process.

4. Proration Dates. Proration dates which are always coterminous with expiration dates create confusion, as they do not permit the bidder or

target company stockholders to evaluate their positions without the original offer being terminated and a new one commenced. This is especially inefficient as regards brief extensions of offers to "clean up" any remaining shares sought.

5. Business Days. Definition of timing in terms of "business days" is cumbersome and unnecessary.

B. Premises Underlying Recommendations

1. Fundamental fairness requires that the time periods available to target shareholders be long enough to permit any reasonably diligent shareholder -- institutional or individual -- to receive offering materials and to make an informed decision on the appropriate response.

2. While the subcommittee has not taken a position as to whether time periods should also be long enough to allow target management an opportunity to frustrate the offeror's bid, the subcommittee believes that the minimum initial time period contemplated here (30 days) provides sufficient time for both management and shareholder response.

3. The process should not be permitted to become so complex that it is only understood by investment professionals. Shareholder interests can best be addressed through procedures which provide adequate time, information and predictability.

C. Recommendations

1. Shareholder Lists

a. Shareholder lists and clearinghouse security position listings must be made available at bidder's expense, within five calendar days of a bona fide request by a bidder who has announced a tender offer. The SEC may also wish to consider prescribing standard forms (written or electronic) for the delivery of such information.

2. Securities on Same Footing as Cash

a. The subcommittee strongly recommends that the SEC implement a steamlined registration process for securities to be offered in an exchange offer. This would reduce the current bias in favor of all-cash offers and two-step transactions.

b. An issuer would be permitted to file a registration statement at the same time it files Schedule 14D-1 to commence its exchange offer. The initial mailing would be a Preliminary Prospectus and payment under the exchange offer would be conditioned on the registration statement becoming effective. Tenders would be permitted prior to effectiveness. Ordinarily, effectiveness of the registration statement would be anticipated within 30 days, although the subcommittee is reluctant to designate a fixed period within which the SEC must respond.

At the date of effectiveness of the registration statement, the bidder would issue a Final Prospectus. If the Final Prospectus is materially different from the Preliminary Prospectus, the bidder would be required to maintain, by extension, a 10-day period between the date the Final Prospectus is mailed and the proration, withdrawal and expiration dates. This is to assure adequate dissemination of information to shareholders and the opportunity to react prior to any irrevocable dates.

c. The form of registration statement would be limited to the summary section in present merger proxy statements.

d. This recommendation is intended to place securities on as equal a footing with cash as possible in the tender offer context, but not to slow down cash offers.

3. Commencement Date

a. As under present rules, a tender offer would commence for Williams Act purposes either by an appropriate public announcement or by distribution of offer materials, in addition to filing a Schedule 14D-1 with the SEC.

b. Documents must be mailed within seven days of commencement by announcement.

4. Communications with Shareholders

a. Tender offer advertisements and offer materials should be required to highlight price, terms and key conditions, while eliminating unhelpful boilerplate.

b. Tender offer reply forms should be standardized to the extent possible to facilitate handling by the reorganization departments of brokerage firms, banks and depositories.

5. Initial Offer

a. Minimum offer period should be 30 calendar days for all offers. This is adequate time for shareholders to receive full information and to respond.

b. Withdrawal period and proration period (if any) may be no shorter than the minimum offer period.

6. Effect of Competing Offers on Preexisting Offers' Dates

a. Competing offers should have no effect on the minimum period, withdrawal or proration dates of earlier offers. To do otherwise deprives the initial bidder of the advantage of speed and tips the bidder/target balance in favor of the target. In addition, involuntary extensions lead to excessive gamesmanship and shareholder confusion.

7. Price Changes and Other Material Changes

a. A bidder may change the price offered for shares (or other material terms or conditions) at any time, except that if the proration or expiration dates of its offer would occur within five calendar days after announcement of the price change or other key change, the bidder must extend any such date to a date no earlier than five days after the announcement. Withdrawal dates would not be affected, so long as shareholders who have already tendered are not disadvantaged by the change.

8. Extensions of Offers

a. Extensions of offers beyond the initial expiration date would not require that proration or withdrawal dates be extended as well.

b. If the proration and withdrawal dates are not extended in an offer involving prorationing, the bidder would be allowed to purchase all shares tendered into the original proration pool, and would be required to disclose the number purchased promptly thereafter. Subsequent purchases could be made on a first-come, first-served basis. This mechanism would permit a "clean up" extension of an undersubscribed offer.

9. Open Market Purchases During Tender Offer

a. A bidder who has announced a tender offer should not be permitted to purchase target company shares other than under the offer. This recommendation continues present regulation.

10. Calendar Days

a. All SEC tender offer regulations should define time periods in terms of calendar days rather than business days.

III. Disclosure Issues

A. Perceived Disclosure Problems

1. Projections. Under the present scheme, disclosure to shareholders of internal earnings projections or asset valuations received by a bidder has little meaning, without a statement of the underlying assumptions.

2. Confidential Information. Not all bidders for a company are on an equal informational footing. In particular, target management may supply a white knight with substantial internal documentation and analysis, while another bidder may be restricted principally to information in the public domain.

B. Recommendations

1. Disclosure by a bidder to target shareholders of projections or asset valuations provided by the target must include disclosure of the principal supporting assumptions provided to the bidder by the target.

2. Requiring equal disclosure of written information to all bidders appears to be unworkable. The subcommittee does not recommend any such requirement.

IV. Open Market Purchase Programs

A. Perceived Problems

1. 13D Disclosure. The 10-day window between the acquisition of a 5% interest and the required 13D filing presents an opportunity for abuse, as buyers "dash" to buy as many shares as possible between the time they cross the 5% threshold and the time they are required to disclose publicly their identity, intent, plans, etc., by filing a 13D.

2. Acquisition of Control. Some have argued that it is inequitable for a buyer in the open market to achieve control without making a tender offer to all shareholders. Others maintain that free transfer of shares and control with minimum interference is important to the efficient and effective functioning of the marketplace.

B. Recommendations

1. 13D Disclosure. The subcommittee recommends that a buyer be prohibited from buying 5% or more of a company before filing a Schedule 13D. (In other words, a buyer must either disclose or abstain from entering into a transaction which would bring total holdings to 5% or more of a company.) Once above the 5% threshold, the filing would continue to be amended as current law provides.

2. No person may purchase voting securities of an issuer if, immediately following such purchase, such person would own more than [15%*] of the outstanding voting securities of that issuer, unless such purchase were made (i) from the issuer directly; (ii) pursuant to a tender offer; or (iii) in a transaction involving a block of stock held by the seller for more than two years.

    a. The objective of this suggested rule is to prevent open-market accumulation programs from being used to achieve control positions without the shareholder protections of the tender offer process.

    b. It is the subcommittee's objective not to impair the value or liquidity of minority control blocks once they come into existence for a reasonable period of time. Such minority positions serve many useful functions in the capital markets, and should be freely saleable after creation through a partial tender offer, new direct investment, aged block assembly or founder-related holdings.

    c. The subcommittee would encourage the SEC to explore the possibility of making equity accounting available to shareholders at the [15%] ownership level referred to above, if a level lower than 20% is adopted.

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* The subcommittee has discussed a threshold of 15%, although ultimately a higher or lower threshold may be recommended.

d. The concept of "groups," which must be addressed in connection with any threshold-based regulation, has eroded in recent years. The subcommittee encourages a study by the SEC into means of strengthening the "group" definition. Considerable legal problems arise in connection with the "group" issue, however, which risk severely restricting the economic rights of market participants. Such issues must be satisfactorily resolved before any effective restriction on open-market purchase programs can be implemented. Similar problems arise concerning shareholdings of affiliated companies.

e. The threshold concept creates other difficulties related to involuntary percentage ownership changes which the subcommittee has not yet resolved. What if issuer repurchases cause a shareholder to exceed the threshold? If new issuances dilute a shareholder below the percentage he needs to maintain equity accounting, must he make a tender offer to acquire a few additional shares?

f. In order to resolve potential difficulties with the suggested rule, some of which are outlined above, the subcommittee recommends that the SEC retain rulemaking power to define specific types of transactions which would be exempt from the rule. The standard for determining whether a transaction should be exempt is whether it involves a purchaser who is seeking, as a principal purpose of the transaction, to assemble working control of a

company. The following is an initial list of some categories of transactions which may require exemption:

(i) Transactions approved by the Board of Directors of the issuer;

(ii) Underwritings;

(iii) Transactions involving dealers engaged in ordinary block trading activities; and

(iv) Transactions which do not increase beneficial ownership above the highest percentage owned in the preceding two years.

V. Other Issues Relating to Acquisition of Control

A. Two-Tier Pricing

1. Perceived Problem. Some observers believe that two-tier pricing presents a problem of fairness, because not all shares are accorded the same value.

2. Analysis

   a. A transaction involving two-tier pricing must be evaluated in its entirety (i.e., in terms of the average price paid for all shares) and compared with the market price of the target company's shares prior to commencement of the offer. It is the experience of the subcommittee that, on this basis, there is a premium produced for shareholders. Moreover, a second tier at a lower value than the first normally produces a premium to the secondary market prior to the first tier, and still must meet legal standards of fairness. If the lower tier is a second step, it is usually done by merger and appraisal remedies under state law are available. Target shareholders are clearly better off with a two-tier offer than with a partial acquisition consisting only of a high "front end."

   b. It is also unrealistic to enforce fair value provisions for the second tier of a transaction involving securities of the acquiring company rather than cash. Values of securities can fluctuate

significantly during even the brief course of an offer in response to general market conditions and to the particular circumstances of the issuing company. The value of securities by comparison to cash also differs for each shareholder in relation to his own tax circumstances and to his perspective on the long-term potential upside of the securities. A similar argument applies also to transactions involving two different types of securities.

c. The fairness problem is resolved successfully if all shareholders have an equal opportunity to participate in the initial prorationing. The subcommittee believes this will be achieved through its recommendation that the initial proration period be extended to 30 calendar days.

3. Recommendation. The subcommittee does not recommend any additional restrictions on two-tier pricing.

B. Two-Step Acquisitions

1. Perceived Problem. It has been suggested that two-step acquisitions present target shareholders with a difficult decision, because knowledge of the likelihood and the terms of the second step are important to the decision to tender in the first step.

2. Analysis. The subcommittee believes that the frequent use of two-step acquisitions resulted in large measure from a now abolished rule permitting 10-day prorationing and the difficulty of using cash and

securities simultaneously in a tender offer. Because of the reforms recommended with regard to the timing of offers (i.e., 30-day pro-rationing) and with regard to rapid use of securities in exchange offers, the subcommittee believes that, in the future, partial tender offers with a view to a second step will occur much less frequently. Concerns about two-step acquisitions should thus be largely ameliorated.

The subcommittee also believes that requiring disclosure of the second step of an acquisition at the outset of the first step is unworkable because, among other reasons, not all the factors on which a buyer might decide to proceed with a second step are known at the outset.

3. Recommendation. No additional action concerning two-step acquisitions is recommended.

C. Shareholder Approval of Acquiror's Offer

1. Perceived Problem. It has been suggested that an acquiror's shareholders should be required to approve acquisitions above a certain size, measured as a percentage of the company's assets.

2. Recommendation. The subcommittee believes that this is an internal matter between shareholders and management, and is best left to companies which may voluntarily adopt such rules, or to state corporation law.

VI. Protective Charter Amendments

A. Perceived Problems

1. State securities laws and corporate charter provisions which erect high barriers to changes in corporate control through provisions such as those relating to staggered boards, supermajority provisions and fair value provisions, operate against the interests of the national marketplace and, consequently, against the interest of shareholders. Much of this concern is evidently shared by many shareholders, including institutions, who have become more active recently in voting to reject such provisions.

2. "Antitakeover" charter provisions are enacted virtually for perpetuity, with the effect of potentially disenfranchising future generations of shareholders.

B. Premises Underlying Recommendations

1. The subcommittee supports a system of state corporation laws and any reforms should not undermine that system.

2. The subcommittee believes that, in general, "antitakeover" charter provisions are not effective in the face of an offer for 100% of a company at a reasonable premium. On the other hand, they can be effective in discouraging partial and two-tier offers.

3. Recognizing that "antitakeover" charter provisions installed in the past have been approved by shareholders, the subcommittee believes that, over time, conditions and attitudes of investors may change, warranting the review and possibly the amendment of such provisions.

4. The subcommittee believes that the issue of "antitakeover" charter provisions should be addressed from the standpoint of preserving the integrity of the national securities marketplace. Free transfer of shares, and control, in those companies participating in the national securities market are important to the market's effective functioning.

C. Recommendations

The following recommendations would not apply to "local" companies (more than 50% of voting shares held within the state of incorporation, no listing on a national securities exchange, aggregate market value of voting stock held by non-affiliated stockholders of $20 million or less, and annual trading volume of such stock less one million shares) or companies in industries with a long history of public regulation where change of control is separately regulated by state or federal law (e.g., banking, insurance, communications, etc.).

1. State Tender Offer Laws. The subcommittee does not wish to revise the views expressed by the U.S. Supreme Court in this area. State laws and regulations which purport to restrict the ability of an out-of-state company to make a tender offer should not be permitted, as they constitute an undue burden on interstate commerce. This category of

laws, however, should explicitly include recently-developed statutes (such as Ohio's), drafted in the form of state corporation laws, which prohibit the completion of certain tender offers unless the offer has received target company shareholder approval.

2. Proxy Statement Disclosure. Companies with "antitakeover" charter provisions and bylaws would be required to disclose them to shareholders explicitly and separately in a "Change of Control" section in the annual proxy statement relating to election of directors. (See also Recommendations VII.C.2 and VIII.F.2 regarding other change in control disclosures.)

3. Advisory Vote. At each annual meeting, shareholders would be requested to vote on an advisory basis as to whether they continue to be in favor of the "antitakeover" charter provisions and bylaws disclosed in the proxy. The board would not be bound by the results of the advisory vote, but may, in its own judgment, decide whether elimination of any "antitakeover" provisions should be pursued.

4. Covered "Antitakeover" Provisions. The following is a list of charter and bylaw provisions which the subcommittee believes should be covered by the above disclosure and advisory vote rules. The SEC should amend this list on an ongoing basis, in the interest of promoting management accountability, and as circumstances and practices evolve.

   a. Supermajority provisions. Provisions requiring more than a 50% vote of shareholders to accomplish a merger, including provisions

which require supermajority voting under special conditions (e.g., "fair value" provisions).

b. Removal of directors. Provisions which prevent 50% of the shareholders from removing of a director from office at an annual meeting without cause, other than directors elected by cumulative voting (e.g., classified boards).

c. Disenfranchisement. Provisions (other than cumulative voting) which abandon the one-share, one-vote rule based on the concentration of share ownership.

VII. Golden Parachutes

A. Perceived Problem

1. So-called "golden parachute" contracts are widely perceived as management self-dealing at a moment of corporate vulnerability, to the detriment of shareholders.

B. Analysis

1. The subcommittee shares the public concerns that such forms of compensation can present the appearance of self-dealing on the part of management and a failure to place the interests of shareholders foremost.

2. The subcommittee would also be concerned by an attempt to restrict the free bargaining of management employment agreements by federal regulation. The subcommittee would prefer to adapt to this problem the present regulatory approach -- disclosure of management compensation in the proxy statement.

C. Recommendations

1. During a Tender Offer. The board would not be permitted to adopt contracts with "change of control" compensation once a tender offer for the company has been made.

2. Disclosure. Specific disclosure of the nature of, amounts of, and names of individuals with contracts making them eligible to receive "change of control" compensation should be provided in the Change of Control section of the annual proxy statement. (See Recommendations VI.C.2 and VIII.F.2 regarding additional change in control disclosure.)

3. Advisory Vote. In each annual meeting, shareholders would be requested to vote, on an advisory basis, as to whether the company should continue to provide "change of control" compensation to its management and employees. The board would not be obligated by the results of the vote to take any specific steps, and the outcome of the vote, in itself, would have no legal effect on any existing employment agreement.

VIII. Affirmative Defensive Measures

A. Self Tenders

1. Perceived Problem. Self tenders run the risk of decapitalizing a company and leaving shareholders with little but a debt-ridden shell.

2. Analysis. Self tenders are merely a means of getting more value out to shareholders if in fact there is more present than the bidder is offering. In many ways, self tenders resemble a special dividend.

3. Recommendation. Self tenders do not pose a problem for tender offer regulation.

B. "Pac-Man" Defenses

1. Perceived Problems. Like self tenders, pac-man defenses (in which the target of a tender offer reacts by initiating a tender offer for control of the bidder) risk decapitalizing a company.

2. Analysis

a. The subcommittee is concerned with some uses of the pac-man defense, because in some cases it can be invoked not with the motive of obtaining a higher price for shareholders, but rather as a means of defeating an offer and removing from shareholders the opportunity to earn a premium for their shares. It is probably impossible, however, to regulate this and other defensive

measures on the basis of a target company's motives, inasmuch as pac-man defenses can (and have been) used to negotiate a higher price or different terms for target shareholders.

b. In mounting a pac-man defense, the original target implicitly acknowledges the appropriateness of a merger between itself and the original bidder, but contests the ultimate management control and shareholding structure of the combined enterprise. Such a defense may be necessary to protect the interests of target shareholders who will remain shareholders in the combined enterprise if the original offer succeeds. Whenever some target shareholders would end up with an ongoing interest in the combined enterprise, the law should not prevent the target's management from seeking the most favorable terms for the combination.

c. The subcommittee believes that, in actual practice, the forces of economics and the self-interest of lenders restrain targets from taking on unmanageable debt burdens in order to finance a pac-man defense. No pac-man defense has resulted in serious financial losses to the shareholders involved.

3. Recommendation. Inasmuch as there are sufficient justifiable reasons for the use of the pac-man defense, the subcommittee does not recommend restrictions on its use generally. The SEC may wish to consider, however, restrictions on the employment of a pac-man defense once a bidder has made a tender offer for 100% of a target.

C. Stock and Asset Transactions With White Knights

1. Perceived Problem. "Lock-up" and "leg-up" arrangements with white knights are thought by some to stifle competition by other bidders and potential bidders, possibly reducing the value received by shareholders.

2. Analysis. Often such options on stock or assets are necessary to induce the white knight to enter a bidding contest. Thus, rather than stifling competition they may enhance it. However, beyond a certain level such transactions may foreclose competition altogether.

3. Recommendation. Contracts for the sale of stock or assets to white knights should continue to be tested against the business judgment rule. The subcommittee believes and assumes that directors who approve such contracts must be satisfied that the corporation is receiving full value under the contracts and that they are in the best interests of the shareholders. During a tender offer, the issuance of stock representing more than [18%] of the issuer's fully diluted shares should be subject to shareholder approval. (Extension of the NYSE rule).

D. Third Party Asset Sales

1. Perceived Problem. The sale of important assets ("crown jewels") of a target company during the course of a tender offer may fundamentally alter the value of the company to its shareholders, should the bidder retract its offer.

2. Analysis. Asset dispositions may be a legitimate part of a plan to realize value for the shareholders in excess of a proposed bid. Transactions of this sort should be allowed, because in many cases value for a company can only be maximized by selling different components in different markets. There may be no white knight for the entire company.

3. Recommendation. The business judgment rule should continue to govern such actions. Again, directors should be satisfied that full value is being received for the assets disposed.

E. Block Repurchases at a Premium

1. Perceived Problems. Block repurchases at a premium to market, with the intent of eliminating a dissident shareholder, represent an abuse which impairs the economic interests of the remaining shareholders.

2. Recommendation. Repurchase of a company's shares from an individual holder at a premium to market should require shareholder approval. Strong evidence should be available, however, that a "premium" is being paid, so as not to interfere with normal recapitalization (e.g., debt for stock) transactions. This rule would not cover offers made to all holders of a class of securities (e.g., a self tender or a special bid), nor would it apply to repurchases of shares which had been held by the seller for more than two years.

F. Standstill Agreements

1. Perceived Problem. Long-term standstill agreements between a company and a shareholder, and agreements preventing a person or company from becoming a shareholder, impair the free functioning of the securities market and the economic interests of other shareholders.

2. Recommendations.

a. Disclosure. The existence and nature of current standstill agreements and no-purchase agreements with remaining lives longer than one year between a company and other parties should be disclosed annually in the Change of Control section of the proxy statement. (See also Recommendations VI.C.2 and VII.C.2).

b. Advisory Vote. In each annual meeting, shareholders would be requested to vote, on an advisory basis, as to whether the board of directors should consider taking steps to eliminate existing standstill and no-purchase agreements with a remaining life of more than one year. The board would not be obligated to take any such steps, and such a vote would have no automatic effect on the validity of existing agreements.

G. Use of Employee Benefit Plans

1. Perceived Problems.

a. Sales of plan-held shares. Retirement plan managers may occasionally be instructed by a company not to tender company shares to an unapproved bidder, even though such an offer may be viewed by the plan managers as economically advantageous to plan beneficiaries. Such instructions can result in costs to plan beneficiaries, whose interests are not necessarily congruent with those of corporate management.

b. Purchases of company shares by a plan. Purchases of company shares by an employee benefit plan with a view to defeating a hostile tender offer (e.g., Grumman) can represent an economically unsound investment practice and result in substantial risks to plan beneficiaries.

2. Recommendations

a. Sales of plan-held shares. Fiduciary obligations already appear to prohibit plans from obeying "no sale" instructions (e.g., Bendix), and the subcommittee feels this is appropriate and sufficient. Companies wishing to provide a choice to beneficiaries should be encouraged to set up a "pass-through" mechanism, whereby plan beneficiaries can elect individually whether or not to tender their shares.

b. Purchases of company shares. Purchases of company shares by a company-sponsored retirement plan with a view to defeating a tender offer should be prohibited. Existing pension regulations appear to provide for this.

It is important, however, to distinguish the situation of a plan which is established for the very purpose of acquiring the company (e.g., Dan River's ESOP). Rules should permit the formation of ESOPs and other plans which have no mission other than as a vehicle for the acquisition of all or a controlling interest in a company, even in the face of a competing offer.

IX. The "British System"

Attention has been drawn to certain provisions of the City Code on Take-overs and Mergers which regulate takeover activity in the United Kingdom, in particular:

a) Restrictions on open market purchases above 15%; and

b) The obligation to make an offer for all shares if the amount owned or sought exceeds 30%.

The subcommittee has carefully studied the aspect and implications of incorporating features similar to these in its recommendations. The most suitable format for doing so would be to require share purchases above a defined threshold to be accomplished through a tender offer for all shares -- for cash, securities or a mix thereof, at the same or different values. An essential corollary would be the elimination of supermajority and fair value charter provisions.

The subcommittee has concluded that, while the United Kingdom system has considerable attractions, the reforms proposed by the subcommittee, in particular those relating to open market purchases, represent an evolutionary development in the U.S. system which is preferable to the more radical changes suggested by the United Kingdom system.

The subcommittee recommends, however, that all changes adopted as a result of this report be reviewed at a future date to determine whether they have had the desired effect and if the tender offer process is functioning well. At that time, it may be appropriate again to consider the incorporation of some features of the British System into our own.