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Marti Cochran, Esq.
Staff Counsel, House Subcommittee
on Telecommunications, Consumer
Protection, and Finance of the
Committee on Energy and Commerce
B333 Rayburn House Office Building
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Dear Ms. Cochran:

I have received Chairman Wirth's letter of July 9, 1984 to me. Early next week, I will reply to that letter (which raises a number of broad-ranging issues concerning the regulation of tender offers) on behalf of The Ohio Manufacturers' Association.

Meanwhile, I am writing this letter, on behalf of the OMA, to comment upon the June 29, 1984 Committee Print of H. R. 5693. A copy of that print was attached to Chirman Wirth's letter and it reflects the Subcommittee's action in late June 1984.

First, the OMA wishes to repeat its position that the core problems with tender offer regulation are the lack of up-front shareholder protections--adequate disclosure, adequate time, and shareholder votes. Beginning the legislative process with provisions limiting defensive tactics while the SEC is acting at the same time to accelerate securities tender offers is a harmful irony. The OMA also continues to believe that the best route is one emphasizing the continued dominance of state law, which has--contrary to the stance of a majority of the SEC--emphasized adequate time, adequate disclosure, shareholder votes, and reliance upon the business judgment rule to govern defensive tactics that are not deceptive or manipulative (deceptive or manipulative tactics are now fully proscribed, as they should be, by §14(e) of the Exchange Act).

The thrust of this letter, however, is to comment again--at a technical, drafting level--upon the harmful shotgun overdrafting of the defensive tactics provisions of the Committee Print of H. R. 5693. These provisions govern far more than defensive tactics and can kill a target's ability to operate in a normal fashion once a tender offer is made.

Proposed new subsections (f) and (g) of §14 of the Exchange Act--which would regulate in four areas--are surely overly broad in each of the following respects:

1. They apply to all issuers (including, e.g., the company with six shareholders). The coverage clearly should be limited to the large public companies covered by §14(d).

2. They apply to all tender offers and all proxy solicitations. That is, they apply even to a tender offer for, or a proxy solicitation with respect to, a pure debt security. There should be a limitation to tender offers for or proxy solicitations with respect to voting securities.

3. They apply to issuer tender offers as well as to third-party tender offers. This is a clear mistake, for there is nothing about an issuer tender offer that should trigger any of the restrictions on the board of directors of the issuer.

The conceptual mistake that led to the errors discussed in the immediately preceding paragraph was to copy §14(e), rather than §14(d), of the Exchange Act for the jurisdictional reach. §14(e), which proscribes fraud and manipulation, properly reaches any tender offer for any security of any issuer--for fraud and manipulation are a proper subject of federal law even where the company is not public. But it is extremely harmful and unwise to extend substantive regulation to companies not covered by §14(d). §14(d), the basic tender offer regulatory provision, does not reach any companies except large and larger public companies. Any defensive tactics provisions should be co-extenstive with §14(d).

Proposed new §14(f)(1) would govern golden parachutes and much more. The section would prevent any increases in salaries or compensation for any officer or director once a tender offer is begun. In light of the extensive regulation of golden parachutes in the new tax act, the OMA submits that §14(f)(1) would be redundant and harmful. The absence of an exemption for compensation approved by a shareholders vote is difficult to understand.

Proposed new §14(f)(2) would prohibit the issuer from acquiring any of its securities once a tender offer is made. The only exception would be routine acquisitions through ongoing programs in the ordinary course of the issuer's business. The shotgun drafting is evidenced by the following:

(a) Security holders could not convert one class into another pursuant to prior contractual rights, for that would be the acquisition of securities by the issuer.

(b) Non-routine payments of loans could not be made, for the underlying notes would be acquired. This is a most serious problem, for creditors not paid at maturity can sue, levy, and execute and put the target out of business.

(c) The issuer could not liquidate, for that would involve the acquisition of the issuer's securities. Yet, a liquidation would require a shareholders vote.

(d) The target could not enter into a reverse triangular merger, although shareholders would have to approve this step.

(e) The comments upon (c) and (d) suggest another serious flaw: §14(f)(2) would not exempt acquisitions that are approved by shareholders vote. If shareholders approve a transaction, §14(f)(2) should not prohibit it.

Proposed new §14(g) would be triggered by either any tender offer or by any third party proxy solicitation. Once triggered, §14(g)(1) would prohibit the issuance of any security carrying 5% or more of the voting power or constiting 5% or more of any class, unless there is shareholder approval. Proposed §14(g)(1) is quite harmful in that the board of directors would be prohibited from raising ordinary working capital or funds for expansion, for almost every loan of money to a corporation involves the issuance of a security (a note) by the corporation. What a sweet set-up for a competitor or malcontent--make a token tender offer or proxy solicitation and cut off working capital and the ability of a business to expand. §14(g)(1) is a death trap.

§14(g)(2), the anti-greenmail provison, is defective in that there is no exemption for a holder of the target's securities who has a personal contractual right negotiated at time of issuance to re-sell such securities to the issuer at a fixed price. If, for example, notes are issued in a series with differing maturity dates and if those notes are selling for a price below the face amount, this provision would prohibit the redemption of a series of notes at maturity if the owner holds more than 3%. Absent a shareholders vote, the only way this can be avoided would be to pay off all other notes of the same class at the same time, even those notes with a far more distant maturity. In addition, if the notes are convertible, in order for the exception to be available the company would have to make an offer of redemption to all security holders of the class of securities into which the notes may be converted. What this would appear to mean is that in many cases, debt instruments could not, as a practical matter, be paid off at maturity, absent a shareholders vote. <u>This is a serious problem, for creditors who are unpaid at maturity can sue, levy, execute on assets, and put the company out of business</u>. Since §14(g)(2) is no longer limited to purchases from persons who have held their securities for less than two years, this overbreadth is exceedingly harmful.

* * * * *

The OMA wishes to re-emphasize the larger issues:

I. The placing of shareholder votes in the defensive tactics portion of H. R. 5693 suggests their use up front--bidder and target shareholder votes before an offer is closed. Hostile tender offers should have the same protections as negotiated mergers, which require such votes.

II. The SEC has already proposed new rules to accelerate securities tender offers, the most complex type of tender offer. <u>Thus, another central need is adequate time up front</u>.

III. The central issue is whether--as the OMA believes--fewer but better hostile tender offers are needed or whether (as the majority of the SEC believes) a greatly increased number of hostile offers are needed. The defensive tactics provisions of H. R. 5693 go solely in the direction favored by a majority of the SEC. More hostile tender offers mean more questionable tender offers and more pressure upon corporate executives to act and plan solely for the short term. <u>This is just what America does NOT need</u>.

IV. Full hearings are needed upon H. R. 5693. The defects that I spotted are undoubtedly far from all that are present. Corporate America has not yet had an opportunity to focus upon the myriad problems raised by the bill.

V. The OMA believes that all of the defensive tactic restrictions should contain an exemption for action approved by the majority of the independent outside directors of a company. We should not forget that the tender offer area is basically a corporate governance issue. One of the main advances in the past decade has been the increased utilization of independent outside directors. It would appear to the OMA that where the majority of the independent outside directors approve an action, the reasoning behind the proposed new provisions governing defensive tactics largely disappears. One should remember that defensive tactics that are fraudulent or manipulative are completely banned--as they should be--by §14(e) of the Exchange Act. When an action is not fraudulent or manipulative and the independent outside directors have approved the action after proper study and deliberation and the receipt of expert advice, it would appear that there should be no prohibition under federal law.

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As indicated at the beginning of this letter, the OMA will reply early next week to Chairman Wirth's July 9, 1984 letter, but it was felt that this technical analysis of the defensive tactics portion of H. R. 5693 was needed now.

Respectfully,

Morgan Shipman

Morgan Shipman

MS/z