TESTIMONY OF MARTIN LIPTON

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE

OF THE

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON ENERGY AND COMMERCE

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TENDER OFFER REFORM ACT OF 1987

Overview

I am a member of the New York law firm of Wachtell, Lipton, Rosen & Katz. Much of my practice is in the takeover field. I was a member of the Securities and Exchange Commission Advisory Committee on Tender Offers which submitted its recommendations for takeover reforms in 1983. In 1984 and 1985, I submitted proposals for takeover reform legislation to this Subcommittee. For a number of years I have advocated restrictions on the abusive takeover tactics of corporate raiders and restrictions on the takeover promotion activities of the institutional investors who today dominate American business through their control of more than 750 of the 1000 largest companies.

I strongly favor legislation to correct takeover abuses and to protect the nation from the economic turmoil that follows periods of speculative excess.

Earlier this year, I provided the Subcommittee with an outline of a comprehensive, balanced proposal for Federal takeover reform legislation which would mandate a minimum 120-day period for tender offers and contain restrictions on both acquisition techniques and defenses. A copy of this outline is attached as Schedule I. Given the current opposition by the Administration to even the more limited takeover reform proposals contained in the Tender Offer Reform Act of 1987 (the "Dingell/Markey Bill"), the Securities Trading Reform Act of 1987 (the "Lent/Rinaldo Bill") and the Tender Offer Disclosure and Fairness Act of 1987 introduced in the Senate by Senator Proxmire (the "Proxmire Bill"), I recognize that there is little chance that comprehensive reform based upon a 120-day framework will be enacted this year. Accordingly, I will focus my remarks on an analysis of the Dingell/Markey Bill, the Lent/Rinaldo Bill and the Proxmire Bill. Takeover reform legislation is long overdue and it is my hope that a consensus can be built for meaningful reform.

Each of the Dingell/Markey Bill, the Lent/Rinaldo Bill and the Proxmire Bill provides a sound base on which to build a new takeover law. However, each requires substantive revisions and certain technical amendments.

The bills go a long way towards eliminating the most serious tender offer abuses by (1) reducing the 10-day window period for 13-D disclosures to one day, (2) lengthening the minimum tender offer period, (3) requiring that acquisitions of more than a threshold percentage of the shares of any class of equity securities be made by tender offer, (4) prohibiting greenmail, and (5), in the case of the Dingell/Markey Bill and the Lent/Rinaldo Bill, mandating a 30-day "cooling-off" period following the termination of a tender offer to prevent so-called "street sweeps."

The bills, however, do not eliminate all serious tender offer abuses. They do not prohibit partial tender offers, the source of many tender offer abuses. Each of the bills permits a raider to bid for only 50% of the shares of a company and then squeeze out the remaining public shareholders. The bills should be amended to require that, unless approved by the company's board of directors, if shares are to be acquired above the 10% threshold for cutting off open market purchases, such acquisition must be by means of a tender offer for all outstanding shares.

The bills do not address tender offer financing. Each permits a raider to launch a tender offer, thereby putting a company "into play," without financing in place but only with a letter from an investment banker that it is "highly confident" it can arrange the financing. The bills should be amended to prohibit an acquiror from launching a tender offer if it does not have in place binding financing commitments in customary form from recognized financial institutions.

Each bill contains a prohibition of defensive tactics during a takeover. The prohibition contained in the Proxmire Bill, which is limited to poison pills and golden parachutes, is much narrower than that contained in the Dingell/Markey Bill and the Lent/Rinaldo Bill. Unless a dramatically different approach (such as is outlined in Schedule I) to takeover regulation is adopted, such prohibitions must be deleted. They do not level the playing field; they tilt it back in favor of the corporate raiders.

Even the 60-calendar-day tender offer period established by the Dingell/Markey Bill is still too short a period to enable a shareholder vote on defensive actions. While a 60-day period is sufficient time for target shareholders to study a proposed tender offer, it is not sufficiently long to warrant a prohibition of defensive measures; any prohibition of defensive measures unless authorized by a shareholder vote would require a tender offer period of 120 days in order to permit the target to explore available alternatives, formulate a response and put any proposed defenses to a meaningful vote. Accordingly, legislation restricting a target company's ability to respond to a hostile takeover attempt must not be enacted. Prohibiting defensive actions without providing a workable mechanism for facilitating defensive and/or economic responses to a hostile bid would be extremely detrimental to shareholder interests, as well as the interests of non-shareholder constituencies, such as employees, suppliers, creditors, customers, local communities, and the economy as a whole.

Absent a comprehensive Federal approach involving a 120-day framework in which all matters involved in a contest for corporate control could be put to a shareholder vote, directorial responses to hostile takeover attempts should be left to the domain of state law. There is no evidence that state corporate law has not been adequate to deal with any perceived abuses. To the contrary, rather than sanctioning all defensive responses under the business judgment rule, the courts have increasingly reviewed directorial actions very closely, limiting a board's ability to undertake a defensive response. State law permits a court to set aside those actions which are shown not to be reasonably related to the best interests of the company and its shareholders. See, e.g., Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986); Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); AC Acquisition

Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986).

Federal regulation of fundamental corporate governance issues should take place only within a comprehensive regulatory approach designed to assure that shareholders who are long-term investors in the target company -- as opposed to the raider, arbitrageurs and short-term profit minded institutional investors -- determine the target's fate in a hostile tender offer context. Any Federal legislation short of such a comprehensive approach should be limited to traditional areas of Federal regulation, namely, those concerning disclosure, the fair treatment of shareholders by tender offerors and the regulation of the proxy solicitation process, and should leave other corporate governance issues to the states. Section 12 of the Proxmire Bill, which reaffirms the primacy of state law in the area of corporate governance, should be included in the final legislation.

While I would prefer that the one-share/one-vote provisions of the Dignell/Markey Bill and the Lent/Rinaldo Bill be adopted as part of a comprehensive Federal legislative approach, such as outlined in Schedule I, the one-share/one-vote concept is key to my philosophy of corporate governance and I support it. Similarly, I support the provision in the Dingell/Markey Bill providing for free and equal access to the proxy machinery for candidates for election as directors who are nominated by a 3% shareholder.

The bills do not deal with the critical problem of effective control of American business by institutional investors. The bills do little to deter the short-term speculative focus of much current takeover activity, activity which generates tremendous social costs and few social benefits.* The Proxmire Bill recognizes part of the problem in that it amends ERISA to provide that pension fund managers do not violate their fiduciary duties in not accepting a tender offer when they conclude that long-term values warrant holding the investment. This is a very welcome recognition of the short-term, long-term problem that threatens us, but it does nothing to solve the problem. Given the self-interest of investment managers and the competitive pressures they face, the only effective legislation would be a bill that substantially penalizes short-term investment. Such a proposal is attached as Schedule II.

Finally, the bills do not deal with the leverage problem. Nothing is done to retard the accelerating trend to dangerous levels of leverage resulting from junk bond, bust-up takeover raids and the defensive restructurings they engender. While the bills (if amended as suggested) would

* See, e.g., Adams & Brock, The Hidden Costs of Failed Mergers, N.Y. Times, June 21, 1987, at F3, col. 1. ("The billions spent on shuffling paper ownership shares are, at the same time, billions not spent on productivity-enhancing investments . . . . [I]n 1985, spending on mergers exceeded combined expenditures for R&D and net new investment.")

ensure that tender offers result in more equitable treatment of target shareholders, they would not remove the underlying economic incentives created by the ready availability of junk bond financing (with its associated tax deductible interest) for highly leveraged bust-up transactions. Only provisions which establish more stringent margin rules, eliminate tax deductions for the interest on junk bonds issued to finance hostile takeovers, prevent regulated or insured institutions from holding more than a specified percentage of their capital in junk bonds, and focus attention on long-term growth as opposed to short-term speculation, can prevent the leveraging of our productive future.

13-D Disclosures

There is pressing need for reform of the current 13-D disclosure requirements. Under current rules, a raider, sometimes acting through a group of persons, can quietly begin buying a target company's stock up to a level just short of 5% of the outstanding shares, the point at which public disclosure is required. The actual purchases are typically made through obscure corporations and partnerships in order to keep secret the identity of the raider. Before crossing the 5% level, at which point the raider has 10 days to make a public disclosure of its target company holdings, the raider firms up its group and obtains the financing required for its planned stock purchases. Once set, it crosses the 5% threshold, commencing a vigorous open market purchase program. Often an acquiror will be able to accumulate up to 10% or even 20% of the target's shares before being required to disclose such purchases, let alone the acquiror's intentions regarding the target company, in a Schedule 13-D filing.

Such secret accumulations deprive selling shareholders of a fair price for their shares. They also enable raiders to profit solely by putting a company "into play" even when the raider has no intention to acquire the target company, at least at a price that reflects the full value of the target's shares. Once a substantial stock position is obtained, the raider is in a position to attempt to acquire the target company himself, assuming the price is attractive, or, if not, to force either a sale of the company to a third party or a significant corporate restructuring. The result is that major acquisitions or corporate restructurings are implemented, not because of the long-term economic efficiency of such transactions, but because of a raider's desire to gain speculative profits by exploiting the fact that shares traded by passive investors in the public market are valued at lower levels than shares purchased in corporate control transactions.

We need legislation to reduce the 10-day window period for Schedule 13-D filings to one day, an approach (with minor variations) provided for in all three bills, and to reduce the reporting threshold from 5% to 3% as provided for in the Proxmire Bill. Arguments made against the one-day window period, stressing the practical difficulties of filing a Schedule 13-D within one day, are greatly overstated. Any practical difficulties can be resolved by simply preparing the requisite disclosure before crossing the trigger threshold.

I support the provision in the Dingell/Markey Bill providing for a two-day cooling-off period after the first public announcement by an acquiror that he has crossed the reporting threshold.* A cooling-off period is necessary to enable the market to absorb the information disclosed. At a minimum, if a cooling-off period is not provided for, the approach in Section 3(f) of the Proxmire Bill, which prohibits additional acquisitions until a statement has been filed with the SEC and a public announcement has been made by the acquiror, should be adopted.

I support the provision in Section 4 of the Proxmire Bill which closes the reporting window for amendments to 13-D disclosures. I also support the provision in Section 5 of the Proxmire Bill which strikes out paragraph

* I recommend, however, that an exception be provided for acquisitions pursuant to a tender offer, to permit acquirors to complete a short-form merger immediately upon closing their tender offer.

(6)(B) of Section 13(d) of the 1934 Act, eliminating the current exemption for acquisitions of shares of a class of securities within a twelve month period that do not exceed 2% of such class from the provisions of Section 13(d). The Dingell/Markey Bill and the Lent/Rinaldo Bill do not address these issues.

I support the broadened disclosure requirements for 13-D filings contained in the Proxmire Bill, with the exception of Section 3(b) of the Proxmire Bill which mandates disclosure with respect to persons with whom the filing person has had communications concerning the subject of his 13-D filing.* Section 3(c) of the Proxmire Bill expands disclosure of financing arrangements, including fees paid to lenders. There is great concern about the possible abuses that can arise in connection with highly-leveraged tender offers and full disclosure of all financing arrangements would be beneficial. Section 3(e) of the Proxmire Bill expands disclosure requirements with respect to fees and expenses to conform roughly with the disclosure of fees in going private transactions currently required under Rule 13e-3. Such additional disclosure would also be beneficial. The Dingell/Markey Bill and the Lent/Rinaldo Bill do not address these disclosure issues.

* Comprehensive disclosure with respect to persons with whom the filing person has had communications would be unduly burdensome.

I support the provision in Section 101 of the Lent/Rinaldo Bill which would require disclosure of the expected community and employment impacts of a takeover if the filing person intends to seek control. Neither the Dingell/Markey Bill nor the Proxmire Bill includes such a provision.

I support a requirement that a person who files a Schedule 13-D indicate whether or not his intent is to seek control, as provided for in the Lent/Rinaldo Bill and the Proxmire Bill. Currently, it is possible for an acquiror to avoid meaningful disclosure with respect to his intentions to seek control of the issuer by providing a broad narrative with respect to the purpose of his share purchases. I prefer the approach contained in the Proxmire Bill which would establish a 6-month waiting period for acquirors who originally indicate an "investment purpose" and then wish to make a tender offer. I suggest, however, that the exception to the 6-month waiting period contained in the Proxmire Bill for a "material change in circumstances" be replaced by a provision allowing tender offers by the filing person in the 6-month period only in response to a third party tender offer or other extraordinary corporate transactions.

I support a broadened definition of a group required to make 13-D disclosures. Under the current definition it is often difficult to establish sufficient proof of concerted action. I prefer the definition contained in Section 5 of the Proxmire Bill which embodies the concept of "conscious parallel action," but note that the definition contained in both the Dingell/Markey Bill and the Lent/Rinaldo Bill accomplishes much of the desired result.

Enforcement Measures

I support the provision in Section 6 of the Proxmire Bill which provides for a private right of action for disclosure violations under Sections 13(d), 13(g) or 13(f) of the 1934 Act or for violations of the margin requirements under Section 7 of the 1934 Act in connection with tender offer financing. I suggest, however, that the words "any shareholder of the issuer" be added after the word "question" in the first line of new Section 13(i)(1), to make it clear that shareholders have standing. I also suggest that the text following "bona fide error" in new Section 13(i)(2) be deleted to avoid ambiguity as to whether the provision eliminating monetary liability for violations resulting from a "bona fide error" is only available to persons who maintain detailed compliance procedures.

I believe that a provision clearly establishing a private right of action is essential in the Dingell/Markey Bill and the Lent/Rinaldo Bill in order to clarify that the new penalty provision established in those bills does not eliminate issuer and shareholder standing (other than in connection with the penalty provision). I note that the Commission has long stressed the importance of issuer standing with respect to 13-D disclosures, given the fact that it would be impossible for the Commission to police all 13-D disclosures itself.

I believe that the civil penalty established in the Dingell/Markey Bill (new Section 13(d)(9) of the Act) and the Lent/Rinaldo Bill (new Section 13(d)(8) of the Act) which would enable the Commission to seek a civil penalty equal to 1% of the value of securities with respect to which a violation of Section 13(d) of the 1934 Act occurs for each day of the violation, should be limited to situations where there has been an outright failure to file a Schedule 13-D. To impose this severe penalty on a party who has filed a Schedule but has failed to include all information appears to be a bit extreme. The Commission has other remedies in that situation. I suggest, however, that the provision in Section 5 of the Proxmire Bill (new Section 13(d)(5) of the Act), which clarifies that existing penalty provisions of the 1934 Act would applicable to false and misleading filings in addition to the failure to file, be included in the other proposals.

Trading Halts

I support the provision in the Dingell/Markey Bill and the Lent/Rinaldo Bill which would prohibit brokers and dealers from trading securities in the so-called "third market" during any period that trading has been suspended in the primary market for the purpose of facilitating the orderly dissemination of material information concerning such securities. I believe that such a provision is an appropriate means of placing small public investors and large institutional traders on more equal footing.

Abusive Takeover Techniques

I strongly support legislation to prevent creeping acquisitions, "street sweeps," partial and two-tiered offers and greenmail. Prohibition of such takeover techniques is essential in order to eliminate the coercive aspects of much current takeover activity and to assure that all shareholders receive the full and fair value to which they are entitled in the event of a change of control.

Creeping Acquisitions. Each of the bills would prohibit creeping acquisitions by mandating that acquisitions of shares of equity securities beyond a certain threshold (10% in the Dingell/Markey Bill, 15% in the Proxmire Bill and 20% in the Lent/Rinaldo Bill) be made by tender offer. I believe that such legislation is imperative in order to achieve the original objectives of the Williams Act of "plac[ing] investors on an equal footing with the takeover bidder." Piper v. Chris-Craft Industries, 430 U.S. 1, 30 (1977). I support the 10% threshold established in the Dingell/Markey Bill.

Creeping acquisitions are abusive. First, they deny shareholders an opportunity to share equally in the control premium to which they are entitled upon a sale of the company. An acquiror interested in buying a control position can purchase shares either in private transactions with large stockholders or through selective open market purchases (mainly from professional sophisticated investors), thus providing only a select group of shareholders with a premium on their shares. Second, creeping acquisitions may limit the control premium paid even to such select group of shareholders by denying selling shareholders (especially unsophisticated investors) full and fair disclosure with respect to the acquiring person's acquisition. Shareholders may sell their shares in the open market when, if informed of the acquiror's intentions, they would demand a greater premium for their shares. Finally, creeping acquisitions deprive the target company of the opportunity to structure an alternative transaction that would maximize share values for all shareholders.

Creeping acquisitions are by their nature also partial acquisitions and they entail many of the coercive aspects of partial bids. However, unlike partial tender offers, creeping acquisitions deprive shareholders and the target's board of the opportunity to evaluate and respond to the potential threats posed by the partial acquisition. Independent shareholders are at a disadvantage with respect to a hostile takeover attempt since they cannot bargain collectively with the raider. This disadvantage is magnified when they are denied notice, disclosure and time to react. While a requirement that all substantial share acquisitions be made by tender offer would not completely resolve the collective action problem, it would at least provide shareholders with full disclosure and provide the target's board with an opportunity to intercede on behalf of the shareholders' collective interests.

Certain situations do warrant exceptions to the rule that all acquisitions of more than a threshold percentage be made by tender offer. Both the Dingell/Markey Bill and the Lent/Rinaldo Bill enumerate certain exceptions while providing the Commission with authority to establish additional exceptions; the Proxmire Bill leaves it all up to the Commission. I believe that the following exceptions should be included in the bill:

(i) acquisitions of any equity security by the issuer of such security;

(ii) acquisition of any equity security from the issuer of such security;

(iii) acquisitions of equity securities pursuant to an agreement with the issuer;

(iv) acquisitions of equity securities by gift or inheritance or by transfer from an existing holder to an individual related to such holder by blood or marriage;

(v) acquisitions of equity securities of any issuer which on the effective date of the legislation and on the date of such acquisition is a subsidiary of any other corporation by such other corporation or any other subsidiary of such corporation;

(vi) acquisitions of equity securities of any issuer by an employee benefit plan or pension fund of such issuer;

(vii) acquisitions of any securities within any 12 month period which do not increase the acquiror's beneficial ownership of any covered equity security by more than 2 per centum; and

(viii) an acquisition of any securities directly from a person who is the beneficial owner of more than 10 per centum of any class of covered equity securities, provided such beneficial owner has been the beneficial owner of such securities for more than 12 months and that immediately prior to such acquisition the acquiring person was the beneficial owner of less than 2 per centum of the outstanding shares of such class of covered equity securities.

Particularly important are the exceptions for acquisitions of equity securities (1) by the issuer or an employee benefit plan or pension plan of the issuer and (2) from the issuer or pursuant to an agreement with the issuer. Otherwise the provision would interfere with standard open-market purchase programs by issuers and negotiated transactions. Neither the Dingell/Markey Bill nor the Lent/Rinaldo Bill include an exception for acquisitions by an employee benefit plan or pension plan of the issuer or acquisitions pursuant to an agreement with the issuer (although the bills do contain a much narrower exception for acquisitions pursuant to a statutory merger or consolidation).

Both the Dingell/Markey Bill and the Lent/Rinaldo Bill contain an exception for acquisitions which occur as the result of the formation of a syndicate or group. I am concerned that this exception could lead to possible abuse. I suggest that the exception be modified so as to permit the formation of a syndicate or group only if the members can establish that their previous share acquisitions were not made in concert and that any transfer of shares among the members of such syndicate or group would not be a disguised acquisition of shares that would otherwise be prohibited.

I recognize that an exception must be provided to enable holders of large blocks of stock to transfer their shares. Any such provision, however, must be narrowly drafted so as to avoid the opportunity for abuse. The exception in Section 107 of the Lent/Rinaldo Bill, which would permit any block trade conducted in the normal course of business, is much too broad; it nearly eviscerates the rule. Instead, as indicated by the exceptions listed above, I suggest a provision which would permit the transfer of a large block of stock, provided such block had been held for more than one year and that the acquiror was the beneficial owner of less than 2% of the outstanding shares immediately prior to the acquisition. Such a provision would prevent a person from obtaining a larger stake in the target company through the purchase of a large block than the owner of such block could himself have accumulated without making a tender offer.

Sweeping the Street. I support the provision contained in Section 11 of the Dingell/Markey Bill and Section 105 of the Lent/Rinaldo Bill which would establish a 30-day "cooling-off" period following the termination of a tender offer, to prevent so-called "street sweeps." Such a provision would become absolutely essential if the threshold for banning creeping acquisitions is set at more than 10%.

Street sweeps are currently a fashionable method of obtaining control of a target in which large controlling share positions are purchased within a very short time frame, without affording shareholders the procedural protections of the Williams Act. Such acquisitions have been possible due to recent court holdings that such open market purchases are outside the scope of the Williams Act. See Hanson Trust PLC v. SCM Corporation, 774 F.2d 47 (2d Cir. 1985); Securities and Exchange Commission v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985).

In several situations, large accumulations of stock through open market purchases have been made by the raider following the termination of a previously announced tender offer. For example, Campeau Corp. dropped its takeover bid for Allied Stores and obtained control of Allied Stores after purchasing a block assembled by Jeffries & Co. from a small number of large holders. Hanson Trust utilized the same technique to acquire control of SCM. Small shareholders, of course, are given no opportunity to take advantage of such premium purchases.

Partial and Two-Tiered Bids. None of the bills contains a prohibition on partial tender offers, the source of many of the most serious takeover abuses. I suggest a provision to prohibit partial offers, by requiring that any tender offer which would result in the offeror's becoming the beneficial owner of 10% or more of the shares of any class of the target's equity securities, be made for all of the outstanding shares of such class. The ban on partial offers would be subject to the same exceptions set forth for creeping acquisitions, including the exception for acquisitions pursuant to an agreement with the issuer, which is necessary in order to facilitate two-step negotiated transactions.

Partial bids are abusive because they allow a raider to gain control of a target and hold a minority interest captive, with little protection against self-dealing or a squeeze-out merger. Indeed, the threat of being locked into such a minority position provides a strong incentive to tender. See Bebchuk, Toward Undistorted Choice and Equal Treatment in Corporate Takeovers, 98 Harv. L. Rev. 1693, 1710-13 (1985); Finkelstein, Antitakeover Protection Against Two-Tier and Partial Tender Offers: The Validity of Fair Price, Mandatory Bid, and Flip-Over Provisions under Delaware Law, 11 Sec. Reg. L.J. 291, 293 (1984).

The two-tiered tender offer gives the raider a mechanism for forcing target shareholders to tender because the squeeze-out merger is an announced part of the deal. In such an offer, the raider makes a cash tender offer for a controlling interest in the target and, upon obtaining control, merges the target into itself at a lower second-tier price and usually in exchange for securities. _See_ Mirvis, _Two-Tier Pricing: Some Appraisal and "Entire Fairness" Valuation Issues_, 38 Bus. Law. 485, 485 (1983).

The only limit on the two-tier pricing mechanism lies in any appraisal remedy granted by state law. Although this remedy guarantees "fair value" to shareholders who dissent from the merger, it is subject to complicated procedural requirements, and fair value is not deemed to include any portion of the tender offer premium or any synergistic gains flowing from the merger. As a consequence, state appraisal law allows a wide divergence between the first- and second-tier prices. _See_ Note, _Second-Step Transactions in Two-Tiered Takeovers: The Case for State Regulation_, 19 Ga. L. Rev. 343, 366-69 (1985).

The coercion inherent in the typical two-tiered offer flows from the difference in the prices of the tiers. A shareholder who would prefer that the target remain independent will usually still tender out of fear that a majority of his colleagues will do so and he will be squeezed out of his investment at the lower second-tier price.* Moreover, because individuals do not possess the same access to information or investment skills as institutional investors, they are less likely to respond quickly and efficiently to takeover bids and are more likely to be saddled with the lower second-tier price.

While it is true that the number of hostile two-tier tender offers has diminished since 1984 -- as the availability of junk bond takeover financing and the increased use of poison pill defenses against partial bids has led to the resurgence of the any and all cash bid -- this fact does not mean that legislation banning two-tiered offers is not needed. First, the technique still exists; just because an abuse is currently not in fashion does not mean that the abuse should not be prohibited. Second, and more importantly, the takeover process is a dynamic one and there is no reason to assume that there will not be a resurgence of partial and two-tiered offers at some time in the near future. Takeover reform legislation may in itself

* The coercive nature of the two-tiered tender offer has been widely noted. See Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 630 (D. Md. 1982); Radol v. Thomas, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982); Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 Harv. L. Rev. 297, 337 (1974); Finkelstein, supra, at 291-93; Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249, 307-9 (1983); Note, Protecting Shareholders Against Partial and Two-Tiered Takeovers: The "Poison Pill" Preferred, 97 Harv. L. Rev. 1964, 1966 (1984).

lead to a resurgence of such coercive offers. Any legislation that makes junk bond financing for hostile takeovers more difficult to obtain, including legislation extending the time period that a tender offer must remain open, could have the unfortunate side effect of encouraging bidders to make partial and two-tiered offers. Any legislation restricting the use of poison pills, the most effective defense against coercive partial and two-tiered offers, would most certainly lead to a resurgence of such offers.

SEC Commissioner Grundfest has recently questioned the completeness and logic of legislation which restricts hostile two-tier offers without restricting management supported two-tier offers and self-tenders.* The rationale for drawing a distinction between hostile two-tier offers and actions authorized by an issuer's board of directors is clear. The board is bound by a fiduciary duty to protect shareholder interests and its actions are closely scrutinized by the courts under state law doctrines. The raider is not bound by such a fiduciary duty and may pursue its own self-interest.

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* See J. Grundfest, Two-Tier Tender Offers: A Mythectomy, Address to The United Shareholders Association Annual Meeting and The National Association of Manufacturers' Congress of American Industry, Government Regulation and Competition Session (May 27, 1987).

Greenmail. Each of the bills contains a prohibition on greenmail, perhaps the most visible sign of the parasitic nature of the junk-bond, bust-up takeover frenzy that has gripped corporate America during the 1980s.

Greenmail encourages bust-up takeover activity and should therefore be prohibited. But greenmail is not the acute problem itself; it is only the symptom of the larger problem, namely, the short-term speculative nature of highly-leveraged bust-up takeover activity, which places tremendous emphasis on short-term results at the expense of long-term productivity and growth. It is the threat, made real by the availability of junk-bond financing, of a bust-up takeover of the target at a price that inadequately reflects long-term share values, that enables a raider to extract a greenmail payment.

Greenmail encourages a raider to put a target company "into play," since all the possible outcomes of his actions are attractive. Either the raider will (i) acquire the target if the price level is attractive enough to permit a bust-up liquidation at an attractive profit; (ii) act as the catalyst for forcing a white knight transaction or corporate restructuring in which the raider can profit handsomely; or (iii) in the event that the target's board determines that it is not in the best interests of the shareholders to sell the company at that time (a time strategically picked by the raider to benefit himself), profit by a greenmail transaction, justified from the target's perspective as necessary to preserve long-term values for the shareholders.*

Absent other takeover reforms, a prohibition on greenmail could be detrimental to shareholder interests. Restricting corporations from paying greenmail would simply channel the efforts of creeping-acquiror takeover entrepreneurs into different avenues detrimental to unsophisticated investors. With the protections of a 10% limit on creeping acquisitions and improved disclosure mandated under Section 13(d), however, a 3% proscription on greenmail (a level provided for in each bill) is appropriate and will eliminate greenmail without encouraging takeover entrepreneurs to pursue other abusive tactics.

I support the two-year time bar on share repurchases contained in the Dingell/Markey Bill, but note that the one-year period established in the Lent/Rinaldo Bill and even the six-month period established in the Proxmire Bill would accomplish much of the desired result.

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* In practice, many companies have found that paying greenmail is only a short-term solution to their problem as they have later become the target of another takeover attempt. Interestingly, in most of those situations, the wisdom of the board of directors of the target in side-stepping the first takeover attempt was established by the company being sold at a much higher price than was available at the time of the initial greenmail transaction.

I support the definition of market price contained in the Proxmire Bill, which uses a 30-trading-day average market price preceding the date of purchase, but provides that if the 3% shareholder has commenced a tender offer or has announced an intention to seek control of the issuer, the price is determined during the 30 trading days preceding such tender offer or announcement.

I suggest that the prohibition on share repurchases be limited to prearranged private transactions (i.e., permit open market purchases by the issuer which might be barred by the language in the bills since the current market price may be higher than the permitted purchase price). Prearranged transactions with a 3% shareholder facilitated through open market purchases would still be barred. Alternatively, there should be a carve out for open market purchases by an issuer in compliance with Rule 10b-18 of the General Rules and Regulations promulgated under the 1934 Act.*

The prohibition on greenmail contained in each of the proposals should be amended to clarify that it is only unlawful for an issuer "knowingly to purchase" securities from a 3% shareholder. Otherwise an issuer purchasing

* Since the definition of "market value" contained in the bills differs from the price established in Rule 10b-18(b)(3), purchases pursuant to Rule 10b-18 from a greater than 3% holder (which could include a passive institutional investor) could be barred.

shares in the open market could be held strictly liable for purchasing shares which happen to be sold by a 3% shareholder. The legislative history should also indicate that mere knowledge of the existence of a 3% shareholder does not prohibit all open market or private purchases by an issuer, but rather only those intended as indirect purchases of shares held by a 3% holder.

Duration of Tender Offers and Takeover Defenses

As currently structured, the tender offer process gives a target's management only 20 business days to evaluate a takeover bid and consider alternatives. This time frame should be extended to 60 calender days as proposed in the Dingell/Markey Bill.* Such an extension would give shareholders a fair opportunity to study a proposed takeover and would give the target's board a realistic opportunity to determine whether the target is best served by remaining independent or, if a sale is desired, whether the first offeror has made the most advantageous bid.

A 60-day period, however, is not sufficiently long to warrant a prohibition on defensive measures. Any prohibition of defensive tactics without a shareholder vote would

* In conjunction with this amendment, the present statutory provision allowing securities deposited pursuant to a tender offer to be withdrawn after 60 days should be amended to allow withdrawal after 90 days.

require a tender offer period of 120 days, the period of time needed to complete a meaningful shareholder proxy solicitation process.

While extending the tender offer period may reduce the urgency of responding to a hostile tender offer, a longer period will not eliminate the need for a response. Since a shareholder vote is impracticable within a 60-day period, the target's board of directors must be permitted to act. Board action is the only effective means of protecting the shareholders' collective interests during a hostile takeover.*

Both the Dingell/Markey Bill and the Lent/Rinaldo Bill contain broad prohibitions on defensive tactics (unless approved by the target's shareholders) and grant the Commission unprecedented discretion to establish rules and regulations governing such prohibitions. The Dingell/Markey Bill covers defenses established or implemented during any proxy fight or tender offer while the Lent/Rinaldo Bill does not specify a time period. The Proxmire Bill contains a much

* Under Delaware law the interests of non-shareholder constituencies, such as employees, suppliers, creditors, customers, local communities, and the economy as a whole, may also be considered if "there are rationally related benefits accruing to the stockholders." Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 182 (Del. 1986). A number of states, including Ohio, Pennsylvania, Maine, Minnesota and Missouri have passed legislation permitting a target's board to consider a wide variety of constituencies when responding to a takeover bid.

more limited prohibition of poison pills and golden parachutes adopted in the face of a hostile tender offer.

These prohibitions must be eliminated. Any bill containing a broad prohibition on defensive actions absent a 120-day tender offer period, even when coupled with comprehensive regulation of takeover abuses, would do more harm than good. It would deprive shareholders and other corporate constituencies of the most effective champion of their rights, the target's board of directors. Any abuse of this role by the board can be policed by the courts under the fiduciary duty doctrine and by shareholders through the proxy machinery.

The regulation of defensive tactics should be left to the domain of state law. There is no evidence that state corporate law has not been adequate to deal with any perceived abuses. To the contrary, Federal and state courts have closely scrutinized the adoption of defensive measures in the midst of a hostile takeover contest under state-law doctrines, setting aside those actions which are shown not to be reasonably related to the best interests of the shareholders.*

* See, e.g., Dynamics Corporation of America v. CTS Corporation, 805 F.2d 705 (7th Cir. 1986) ("CTS II") (remanding case involving a back-end rights plan adopted during a takeover battle for further consideration as to whether the procedure by which the rights plan had been formulated met the requisite standards of reasonableness and good faith); Dynamics Corporation of America v. CTS Corporation, 794 F.2d 250 (7th Cir. 1986), rev'd on other grounds, 107 S. Ct. 1637 (1987) ("CTS I") (enjoining a discriminatory flip-in rights plan adopted in response to a partial tender offer); Hanson

(footnote continued)

A Federal prohibition of defensive tactics would constitute a major intrusion of Federal law into the traditional domain of state corporation law. The concept of a Federal law of corporations has been repeatedly rejected. Without repeating all of the solid reasons for this rejection, it is noted that recent developments only underscore its wisdom. The Supreme Court recently reaffirmed the primacy of state law in the area of corporate governance in CTS Corporation v. Dynamics Corporation of America, 107 S. Ct. 1637 (1987). The Court stated that "no principle of corporation law and practice is more firmly established than a

(footnote continued)

Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986) (enjoining an asset lock-up granted to a white knight during a bidding contest); Edelman v. Fruehauf Corp., 798 F.2d 882 (6th Cir. 1986) (enjoining a pension parachute, bust-up fee and no-shop clause granted to a white knight leveraged buyout group in the face of a hostile bid); Norlin Corp. v. Rooney Pace Inc., 744 F.2d 255 (2d Cir. 1984) (enjoining the issuance of voting stock to a newly formed employee stock ownership plan ("ESOP") in the face of a takeover threat); Buckhorn Inc. v. Ropak Corp., No. C-2-86-1489 (S.D. Ohio Feb. 11, 1987), aff'd by sum. ord., No. 87-3127 (8th Cir. Feb. 24, 1987) (enjoining stock option grants, a newly created ESOP, and a back-end rights plan adopted in the face of a hostile bid, while upholding certain golden parachutes and the concept of a back-end rights plan); Unilever Acquisition Corp. v. Richardson Vicks, Inc., 618 F. Supp. 407 (S.D.N.Y. 1985) (enjoining issuance of preferred stock dividend designed to deprive short term shareholders of significant voting rights); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (enjoining an asset lock-up granted to a white knight during a bidding contest); AC Acquisition Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986) (holding that certain coercive aspects of a self tender/recapitalization transaction designed to thwart a hostile bid were not reasonable in relation to the threat posed).

State's authority to regulate domestic corporations, including the authority to define voting rights of shareholders," id. at 1649, and that it "is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares." Id. at 1650. Moreover, strong recent evidence suggests that competition among the states has encouraged innovations in state corporate law doctrines which are beneficial to investors. See, e.g., Baysinger & Butler, Race for the Bottom v. Climb to the Top: The ALI Project the Uniformity in Corporate Law, 10 J. Corp. Law 431 (Winter 1985).

Even if one favored federalizing basic issues of corporate governance, there would be no basis for a blanket prohibition on defensive tactics adopted in the face of a tender offer. There is no meaningful evidence that defensive actions as a whole are detrimental to shareholder interests.

The takeover process is a dynamic one and the board of directors must be able to respond to a hostile takeover bid in a manner which it determines at the time of the hostile offer to be in the best interest of the corporation and its shareholders. A blanket prohibition on defensive tactics once a tender offer is commenced is inadvisable, since pre-planning for all the potential contingencies of a hostile battle is impossible. Such a measure would be detrimental to shareholder interests and to the interests of non-shareholder constituencies, such as employees, suppliers, creditors, customers, local communities, and the economy as a whole. This is especially true given the fact that the bills do not prohibit partial offers, the source of many takeover abuses.

Particularly problematic is the broad language contained in the Dingell/Markey Bill and the Lent/Rinaldo Bill which could severely inhibit a target's ability to maximize shareholder values in the face of a hostile bid.* Shareholders are powerless to negotiate on their own behalf. Board action seeking out preferable financial alternatives to a tender offer bid is the only realistic means of protecting shareholders from inadequate offers and assuring that shareholders receive the full control premium to which they are entitled upon a sale of the company. As currently drafted, the bills would prohibit a defensive response even to an inadequate or coercive bid. The broad restrictions in the Dingell/Markey Bill and the Lent/Rinaldo Bill could even

* Granting broad discretion to the Commission to determine which actions should be prohibited only exacerbates the problem. In recent years, the Commission has been dominated by the doctrines of the Chicago School of Economics, doctrines which are widely disputed and which should not form the basis for the regulation of takeover activity. The regulation of such fundamental issues of corporate goverance should be left to the states.

prohibit recapitalizations and other economic restructurings designed to provide shareholders with economic values in excess of the competing hostile bid. Recent defensive restructurings by Diamond Shamrock, GenCorp and Harcourt Brace, among others, show that when a target's board of directors is free to respond to an offer which it determines to be inadequate, the board can often create economic value for its shareholders far in excess of the original bid.

Finally, in some situations, the most appropriate response to a hostile tender offer is for the target corporation to remain independent. Defensive actions enable a target's board to preserve the target's independence in situations in which the only economic alternative presented to shareholders is an inadequate offer. As shown by a recent study by Professor Donald Margotta and Ms. Felicia Marston, of companies which (between 1974 and 1984) defeated hostile tender offers and stayed independent for at least one year, more often than not, companies which defeat tender offers serve shareholder interests.* Comparing the returns of target firms from the time of rejection of the tender offer through December 31, 1985 (or until the firm was delisted) to the returns that would have been earned had a stockholder sold his shares at the tender offer price and

* D. Margotta and F. Marston, Long-Term Results of Defeated Tender Offers, Working Paper 87-29 (June 1987).

invested the proceeds in the S&P 500 market index, the stock price performance of the targets exceeded the market index.*

Golden Parachutes

I do not support Federal regulation prohibiting the adoption of so-called golden parachutes during the pendency of a tender offer, as provided for in the Dingell/Markey Bill and the Proxmire Bill. Congress has already imposed significant tax penalties on certain golden parachute payments in an effort to curb perceived abuses and a corporation's actions in adopting golden parachutes, especially during a hostile takeover, are closely scrutinized under state law. See Buckhorn Inc. v. Ropak Corp., No. C-2-86-1489 (S.D. Ohio Feb. 11, 1987), aff'd by sum. ord., No. 87-3127 (8th Cir. Feb. 24, 1987).

Golden parachutes are primarily a mechanism for compensating a company's key officers for the risk that they may be displaced in a change of control transaction, a risk which if uncompensated might encourage some executives to

* The study found that while the loss of the bid premium was not fully recovered during the first two years following the rejection of the bid, which was the maximum time horizon analyzed by Frank Easterbrook and Gregg Jarrell in a critique of an earlier study by Kidder Peabody & Co., Easterbrook & Jarrell, Do Targets Gain From Defeating Tender Offers? 59 N.Y.U.L. Rev. 277 (1984), the stock price performance of the targets exceeded the market index for periods beyond two years.

seek other employment opportunities. Golden parachutes are not generally a takeover defense. The size of the parachute payment does not typically constitute a significant economic barrier for a potential acquiror.

If the prohibition on the adoption of golden parachutes contained in the Dingell/Markey Bill and Proxmire Bill is not deleted, I suggest that the provision be amended so that the prohibition on golden parachutes (broadly defined) is not triggered by a tender offer which is commenced pursuant to an agreement with the issuer. In negotiated transactions, arrangements are often made concerning the compensation of officers and directors (as well as other employees) and it is not always possible to complete all such arrangements prior to the commencement of the tender offer. There is no reason to interfere with such arrangements in connection with a negotiated transaction.

I also suggest that the provision contained in the Dingell/Markey Bill and the Lent/Rinaldo Bill making it illegal for a company to make a nondeductible parachute payment be amended to clarify that it is only illegal to knowingly make such a payment* and to provide that the only remedy for a violation is an injunction against the payment (the nondeductibility of the payment already acts as a fine).

* Given the nature of the tax provisions applicable to golden parachutes, it is sometimes impossible to determine in advance of payment whether or not a payment will be deductible.

<u>Tender Offer Disclosure</u>

I support the provision contained in Section 7 of the Dingell/Markey Bill and Section 104 the Lent/Rinaldo Bill which would require tender offer documents to contain an executive summary of the material terms and conditions of the offer. I believe that such summary disclosure would be useful in enabling shareholders to digest the complex information contained in an Offer to Purchase.

I do not support Section 10 of the Dingell/Markey Bill which would prohibit "no comment" responses to inquiries from the Commission or a national securities exchange or association concerning the pendency of a tender offer or other corporate control transaction. Requiring premature disclosure of takeover negotiations would interfere with friendly negotiated transactions. I believe that a corporation should have no duty to disclose such negotiations until an agreement on the price and structure of a transaction has been reached. I note, however, that the "price and structure" test is currently at issue in the <u>Levinson</u> case, which the Supreme Court is reviewing. <u>Levinson</u> v. <u>Basic Inc.</u>, 786 F.2d 741 (6th Cir. 1986), <u>cert. granted</u>, <u>Basic, Inc.</u> v. <u>Levinson</u>, 55 U.S.L.W. 3569 (1987).

I do not support Section 114 of the Lent/Rinaldo Bill which would specifically prohibit companies from making misleading statements concerning the pendency or likelihood of a corporate control transaction. I believe that public statements concerning takeovers are adequately governed by Rule 10b-5.

Tender Offer Financing

None of the bills address the problem of tender offer financing. The proposals should be amended to provide that no tender offer may be allowed to commence unless the bidder has actual commitments for all the financing needed to consummate the tender.* Tender offers conditional on financing or founded on "highly confident" letters are transparent ploys that allow a bidder to put the target "in play" even if the bidder has no intention of consummating the offer.**

The bills do not address the broader economic problems posed by the dangerous levels of leverage that result from junk bond takeovers and defensive restructurings. To discourage junk bond, bust-up takeovers, and other junk-

* The Second Circuit has permitted a raider to launch a tender offer without financing but with a letter from an investment banker that it is highly confident it can arrange the financing. Warnaco Inc. v. Galef, No. B-86-146(PCD) (D. Conn. Apr. 3, 1986), aff'd by sum. ord., No. 86-727C (2d Cir. Apr. 11, 1986).

** See Bianco, How Drexel's Wunderkind Bankrolls the Raider, Bus. Wk., Mar. 4, 1985, at 90 (noting that purported junk financing arrangements are often a prelude to greenmail).

financed leveraging, interest on junk bonds issued to finance takeovers or issued by a company in exchange for its own equity should not be deductible for tax purposes. I also suggest that Congress tighten the margin rules applicable to junk bond financed acquisitions by enacting a rule similar to that originally proposed by the Federal Reserve Board as to the application of the margin rules to junk bonds issued by shell companies.

In addition, something must be done to decrease the risk to our national savings system posed by junk bonds.* I propose prohibiting federally regulated or insured institutions from holding more than 10% of their capital in junk bonds.

Shareholder Democracy

If we remove the incentives for abusive takeovers and short-term profit taking by institutional investors, it becomes possible to mandate more democratic access to the corporate proxy machinery without fear that such access will

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* The decline in the quality of debt has raised concerns regarding the willingness of certain financial institutions with fiduciary obligations to policyholders, depositors, and retirees, such as insurance companies, savings and loans, commercial banks, and pension funds, to invest in high-yield, high-risk instruments. See Rohatyn, The Blight on Wall Street, N.Y. Rev. Books, Mar. 12, 1987, at 22; Lowenstein, Three New Reasons to Fear Junk Bonds, N.Y. Times, Aug. 24, 1986, at 3, col. 1; Kaufman, Heavy Debt Poses Threat to Economic and Financial Stability, Am. Banker, Sept. 22, 1986.

be abused. To this end, I would support the provision in the Dingell/Markey Bill to allow free and equal access to the corporate proxy machinery for candidates for election as directors who are nominated by a shareholder holding 3% of the corporation's outstanding voting power.* I suggest, however, that the threshold for access based upon the market value of a person's holdings be set at $5 million (as opposed to the $500,000 threshold established in the Dingell/Markey Bill) in order to prevent shareholders and corporations from being plagued by proxy statement gadflies. Shareholders with less than a $5 million stake would remain free to pursue independent proxy solicitations, as at present.

Shareholder elections of corporate directors are the best method of assuring proper corporate governance. Unlike hostile tender offers, proxy contests provide shareholders with an opportunity to determine collectively who should govern the corporation and what broad policies should be pursued.

Some states have attempted to provide for such collective action with respect to hostile takeovers by

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* Under current law, insurgents will usually be reimbursed by the corporate treasury only if they are successful and the reimbursement is ratified by a majority of the stockholders. See Steinberg v. Adams, 90 F. Supp. 604 (S.D.N.Y. 1950) (applying Delaware law); Rosenfeld v. Fairchild Engine & Airplane Corp., 309 N.Y. 168, 128 N.E.2d 291 (1955).

adopting control share acquisition statutes which require shareholder approval before an acquiror can purchase a controlling voting position. Such statutes may become more common in the aftermath of the CTS decision* in which the Supreme Court upheld the Indiana control share acquisition statute, which mandates that a shareholder vote be held within a 50-day period on whether or not to grant voting rights to an acquiror who has purchased, or who seeks to purchase, a controlling block. Control share acquisition statutes, however, do not create an appropriate forum for shareholder determination of corporate governance matters. The procedures established by such statutes heavily favor the raider by mandating a short deadline for the shareholder vote.

To have a truly balanced shareholder referendum it is necessary to have a real choice. The difficulty presented by a hostile tender offer is that there is no real choice. The hostile bid will always win (no matter how coercive or inadequate) unless an alternative, more attractive, offer is provided. A 50 (or even 60) day period, however, does not provide a target company with ample time to formulate an alternative proposal and to solicit proxies with respect thereto. Thus, the only way to defeat a

* CTS Corporation v. Dynamics Corporation of America, 107 S. Ct. 1637 (1987).

raider's request for shareholder permission to proceed with an offer under a control share acquisition statute is for the target to find a white knight or to implement a corporate restructuring that provides greater value to the shareholders prior to the date of the shareholder vote. There is no meaningful opportunity for the target to realize its long-term potential by convincing the shareholders that they will be best served if the target remains independent and unrestructured.

In a proxy contest shareholders have ample time to evaluate the complex issues posed by competing proposals. Management and those who would pursue a different business strategy have ample time to formulate their proposals and to present their case to the shareholders. While it is often argued that management has an unfair advantage in a proxy fight, due to its ability to control the proxy machinery, a provision mandating equal access to the proxy machinery would remove such an advantage. Equal access to the proxy machinery is a small price for management to pay for the opportunity to avoid abusive takeovers.

A proxy contest also creates a forum in which a diversity of shareholder opinions can be expressed. In a tender offer institutional investors -- driven to accept the best premium price offered -- speak with one voice, tendering into the highest offer. In a proxy contest, however, institutions may speak with many voices. A typical large publicly-traded corporation will have 50 to 100 institutional investors. In a proxy contest, these institutions should weigh the merits of each side's position. Management has the opportunity to persuade them to forego an immediate premium for an attractive long-term prospect. Diversity of opinion among institutions would thus provide for a system of checks and balances, assuring victory to the most attractive business strategy and the people who are believed most capable of implementing it.

The rise to prominence of the institutional investor presents a unique opportunity to bridge the corporate governance gap between ownership and control. Most corporations now have shareholders who are sufficiently large to have a real stake in corporate governance and sufficiently professional to possess the skills necessary to bring their influence to bear. As such, shareholder democracy, which heretofore has been viewed as inherently unworkable because small, diversified shareholders generally lack the interest to become involved in corporate governance,* can become a

* See Hetherington, Fact and Legal Theory: Shareholders, Managers, and Corporate Social Responsibility, 21 Stan. L. Rev. 248, 253 (1969) ("The overwhelming majority of the shareholding public probably prefers reading ball scores to proxy statements . . . . If they become dissatisfied with the performance of management, the best thing for them to do is sell."); Easterbrook & Fischel, The Proper Role of Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1171 (1982) (free-riding problems make passivity in investors' self-interest); cf. Kripke, The SEC, Corporate Governance and the Real Issues, 36 Bus. Law. 173,

(footnote continued)

reality.

Self interest motivates institutional investors to actively seek -- including by promoting or encouraging hostile takeovers -- short-term investment profits. The full benefits of shareholder democracy cannot be achieved until the short-term focus of investment managers and the competitive pressures they face are rectified. To this end, we need legislation that would substantially penalize short-term investment profits. This may be accomplished in several ways. A proposal to accomplish it by a special tax is attached as Schedule II. It is only when the institutional investors' opportunity for speculative profit-making is foreclosed that they will become a truly effective and positive force in assuring the long-term efficiency of management.

Even without corrective measures to assure that institutional investors take a long-term perspective, I still believe that fair and equal access to the proxy machinery is appropriate. The shareholder vote is still the best regulator of corporate behavior. Shareholders are the only constituency with the proper economic interests in the

(footnote continued)

175-78 (1981) (noting that a shareholder currently views himself as investor with power to sell rather than as an owner).

long-term profitability of the corporation and thus the only constituency to whom the job of monitoring corporate performance can be entrusted. While the short-term focus of institutional investors presents serious problems for the proper governance of corporations in the age of finance corporatism,* such problems can at least be minimized if contests for corporate control are played out through the proxy machinery and not in the artifically compressed time period of a hostile takeover.

I do not support the provision in the Lent/Rinaldo Bill that would require that all proxies be kept confidential. I believe that such a provision would make it more difficult for both management and a competing solicitor to solicit proxies in a proxy contest and thus would not further shareholder democracy. The requirement that proxies be kept confidential would also interfere with typical shareholder arrangements such as voting trusts and standstill arrangements. The requirement that a shareholder be able to confidentially assign his proxy to another person would conflict with disclosure requirements based upon beneficial ownership. Corporate elections are not completely analogous to governmental elections and concepts which are appropriate in the political forum are not necessarily appropriate for

* See Lipton, Corporate Governance in the Age of Finance Corporatism, U. Pa. L. Rev. (Forthcoming 1987).

corporate elections. While I do not object to requiring tabulation of proxies by an independent party, I am not aware of any widespread abuse that would necessitate legislation with regard to such matters.

Consistent with the foregoing and recognizing the inconsistency with my position on preserving state domain over corporate governance in the absence of a comprehensive Federal statute providing for a 120-day minimum tender offer period, I support Section 3 of the Dingell/Markey Bill and Section 109 of the Lent/Rinaldo Bill which would adopt a one-share/one-vote rule for the trading of a company's shares on a national securities exchange or through a national securities association. I believe that we must at least take a first step toward establishing new concepts of corporate governance in the age of finance corporatism and that one-share/one-vote is a keystone in the new structure of corporate governance. The negation of one-share/one-vote is the negation of the fundamental principle of shareholder democracy as the basis for restraining government control of corporate management.

TAKEOVER REFORM PROPOSALS

This is a summary outline of a balanced package of legislation designed to eliminate both takeover abuses and takeover defense abuses.

1. No more than 5% of a company's common stock can be purchased except by a tender offer for all of the company's common stock. The threshold for a 13D disclosure of an accumulation would be lowered to 2% and no more than 2% can be purchased until after a 13D is filed. Purely passive institutional investors can purchase up to 10% but if one does, it cannot ever change its intent and make a tender offer.

2. A tender offer must be open for a minimum of 120 days. No tender offer could be commenced unless the bidder had actual commitments for all the financing needed to consummate the tender offer.

3. A tender offer must be withdrawn if a majority of the shares of the target vote at a special meeting, held within the 120-day tender offer period, to reject the tender offer. Only shareholders who were such at least 60 days prior to the announcement of the tender offer would be eligible to vote.

4. Interest on junk bonds issued in takeovers or by a company in exchange for its own equity would not be deductible for tax purposes.

5. A federally regulated or insured institution could not hold more than 10% of its capital in junk bonds.

6. A graduated tax based on length of holding would be imposed on the profit on a security position of $5 million or more that was held for less than 5 years. This would reverse the destructive shift to insistence by institutional investors on short-term investment results that is destroying the ability to plan for long-term growth. A draft tax code provision is attached.

7. If the foregoing is enacted to deal with takeover abuses and to impose needed long-term investment objectives on institutions, and only if it is enacted, then takeover defense abuses would be dealt with by providing that to be traded on a stock exchange or in a national market a company;

   (a) must adhere to the one share, one vote concept (no non-voting or low voting common stock);

(b) must provide that all directors are elected annually (no staggered boards);

(c) must provide free and equal access to the proxy solicitation materials for the shareholder meetings at which directors are elected to any holder or group of holders of 3% of the voting securities;

(d) cannot have any super majority provisions (no shark repellants);

(e) cannot have any securities which have the effect of treating common stockholders unequally or which are triggered by a change of control (no poison pills); and

(f) would not be permitted to selectively repurchase its own shares (no greenmail).

Proposed Excise Tax on Security Profits
[to be added to the Internal Revenue Code of 1986]

Section __________. <u>Short-Term Securities Profits</u>.

(a) <u>Imposition of Tax</u>. -- (a) There is hereby imposed on any person who recognizes a short-term securities profit a tax equal to the relevant percentage of the amount of such profit.

(b) <u>Definitions</u>. --

(1) Security position shall mean stock, other than stock described in Section 1504(a)(4), which is readily tradable on an established securities market, or any option (including a convertible debt or stock) to acquire and any option to sell such stock;

(2) Short-term securities profit shall mean a gain recognized on the sale or exchange of a securities position which has been held for 5 years or less in a transaction other than an exempted transaction;

(3) Relevant percentage shall mean the applicable rate minus the maximum rate of tax imposed under section 1, section 11, section 511,

section 1374 or section 1375 on such short-term securities profit of the taxpayer for the year in which the short-term securities profit is recognized.

(4) The applicable rate shall mean --

(A) 60% in the case of a securities position held for not more than one year;

(B) 50% in the case of a securities position held for more than one year but not more than two years;

(C) 45% in the case of a securities position held for more than two years but not more than three years;

(D) 40% in the case of a securities position held for more than three years but not more than four years; and

(E) 35% in the case of a securities position held for more than four years but not more than five years.

(5) An exempted transaction shall mean a sale or exchange --

(A) in a redemption, liquidation, recapitalization, merger, or other similar transaction;

(B) by operation of law;

(C) made within 90 days after the initial issuance of the stock which is the subject of the security position;

(D) involving "employer securities" as defined in section 409(l) owned by a qualified trust (as defined in section 401(a)); or

(E) of a security position held by a person who has not, at any time during the 5 year period ending with the date of such sale or exchange, owned stock which is the subject of the security position having an aggregate value in excess of $5,000,000.

(c) Administrative Provisions. -- For purposes of subtitle F, any tax imposed by this section shall be treated as a tax imposed by subtitle A.

(d) Effective Date. -- The tax imposed by section __________ shall not apply to any sale or exchange of a security position acquired on or before _______________ [effective date] or acquired after _______________ pursuant to a contract which was binding on the taxpayer as of _________________.