D. PERSONNEL AND BUSINESS RELATIONSHIPS

1. Introduction

Personnel and business relationships between institutions and companies may be an indicium of institutional control or influence over such companies. However, as in the case of stock holdings, it is not always possible to discern the direction of dominance in such relationships: it may be that the company has *its* representative on the board of the institution or that the company has obtained loans or other arrangements from the institution on a favorable basis. It is also possible that the countervailing power of institutions and corporations of comparable size results in no dominance on the part of either. Directors who sit on several boards do not necessarily serve the interests of any one company.

On the other hand, a relatively high incidence of interlocking personnel and business relationships may reinforce any institutional power conferred by shareholdings, multiply possible conflicts of interest, increase the opportunities for use of inside information and—if concentrated among relatively few large institutions and companies—produce anticompetitive effects.

The Study here limits its analysis to an examination of the extent to which institutions in its sample had personnel, creditor, depository and employee benefit plan manager relationships with sample companies. Thus, it is not possible to draw any conclusions from these data as to whether multiple shareholding, personnel and business relationships do, in fact, reinforce institutional power, create conflicts of interest, result in the improper use of inside information or produce anticompetitive effects. In this section, the Study focuses solely on the incidence of personnel and business ties between institutions and portfolio companies in an effort to ascertain the pervasiveness of these relationships in light of the potential problems they may create.

2. Personnel Relationships

To the extent that an institution might otherwise be in a position to influence corporate policy, the existence of personnel interlocks will tend to increase the opportunity to exercise such influence. It is unlikely, however, that the mere existence of interlocks would have any significance in the absence of some other present or potential relationship. Institutional power may be manifested by personnel interlocks, but it derives from more fundamental economic relationships—for example, those of shareholder or creditor. Thus, the degree of influence that an institutional director sitting on a company board may have as a representative of institutional interests will be directly related to the aggregate economic power of the institution over the company and not simply to the fact that it has a man on the board.[70]

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[70] Of course, it is improper to speak of any company director as a representative of institutional interests unless the director does, in fact, have a dominant allegiance to the institution and its interests. Few, if any, such directors would concede that their only function was the furtherance of institutional objectives, to the exclusion of corporate policies and purposes. Most directors conceive of their role as that of independent servant to both the institution and the company, acting in the best interests of each in the fulfillment of their respective fiduciary obligations.

While personnel ties may provide the institution with a continuous link to the corporate decision-making process at a level where institutional influence might be most potent, it is not necessarily to the advantage of the institution to engage in such conspicuous contacts. Particularly in the case of companies with large but relatively passive boards whose members are generally inclined to accept the recommendations of management, it is questionable whether one or two institutional directors could have a material impact on corporate policy. Institutions may prefer private consultation because of the potential problems and conflicts that may be generated by the more or less formal forum of the directors meeting.

The advantages of formal ties are (1) that they assure the institution that its views will be effectively communicated (even if not heeded), and (2) that the institutional director may have access to relevant information about the company. These supposed advantages may lead to undesirable side-effects: to the extent that the institutional director has a conflict of interest between his obligation to the institution and its beneficiaries and his obligation to the company and its shareholders, he may expose himself and his institution to liabilities for abusing his position of trust. The director's access to inside information may also subject him and his institution to trading inhibitions arising out of liabilities under Section 16(b) of the Exchange Act, and under Rule 10b–5, to the extent that the institution makes investment decisions based on such information.

a. The data

The Study obtained data on personnel relationships from the 215 institutions responding to Form I–12 and from the 312 companies responding to Form I–64. In some instances, institutions were requested to limit their responses to their relationships with the 800 companies on List A.[71]

b. Institutional and corporate policies

The institutions receiving Form I–12 and the companies receiving Form I–64 were asked to indicate their policies with respect to personnel relationships; 214 institutions and 312 companies responded to this question. The respondents were asked specifically whether they had a policy of encouraging, permitting, discouraging or forbidding their own officers or directors from serving as officers or directors of portfolio companies (in the case of institutional respondents) or institutions (in the case of corporate respondents).

As set forth in Table XV–26, very few institutions or companies responded that they have a policy of encouraging or forbidding either their officers or directors in this respect. The responses indicate that most companies either have no policy in this regard or permit affiliation of their officers and directors with institutions.

Among institutional respondents, investment advisers appear to forbid or discourage such ties to a greater extent than other institutional types. This may be explained by the provisions of the Investment Company Act, discussed earlier, that prohibit or regulate transactions between affiliated persons and investment companies. Banks

[71] Institutional and corporate respondents are identified in Supplementary Volume II.

also were found to discourage dual affiliations of their officers in a significant number of instances (17 banks); that the same policy does not prevail as to non-officer bank directors may reflect the status of such persons as relatively free of institutional bias.

It is perhaps surprising that only 2 banks flatly forbid their officers from serving as officers or directors of portfolio companies, in view of the potential conflicts and liabilities that may arise from such relationships. Even more surprising is the number of companies (110) and of institutions (54) that have no policy at all with respect to their own officers. An even larger number of companies (114) and institutions (94) have no policy with respect to their directors.

c. Institutional practices

The 215 institutions responding to Form I-12 were asked to indicate the nature and number of personnel relationships with the 800 companies on List A as of September 30, 1969.

(*1*) *Aggregate instances of interlocks.*—Table XV-27 indicates the number of instances of personnel interlocks between the sample institutions, categorized by type, and List A companies without regard to any other relationships, such as stockholdings or loans. Multiple common personnel ties are not included; thus, if an institution had two directors, both of whom were also directors of the same List A company, the table would reflect only one instance of an interlock between the particular institution and company. In addition, all ties between institutions and their subsidiaries have been eliminated.

The table shows the number of instances where an institutional director, officer or affiliated person was also a director or officer of a company or a member of the company's executive or finance committee. An "affiliated person" includes any person directly or indirectly owning, controlling or holding with power to vote 5 percent or more of the outstanding voting shares of the institution; any employee of the institution; and, if the institution is an investment adviser to an investment company, it includes any officer, director, general partner or employee of the investment company or member of an advisory board.

Where a director of the institution was also an officer or affiliated person, he is treated only as a director. However, if an individual is both officer and director of a company, he is treated in both categories.

The table shows, for example, that as of September 30, 1969, the 49 banks surveyed had at least 494 directors who were also directors of List A companies, 65 non-director officers who were also directors of List A companies and four non-officer and non-director affiliates who were also directors of such companies. There were 122 bank directors who were also officers of List A companies, two banks officers who were also officers of such companies, 122 bank directors, officers or affiliates who were also members of List A company executive committees and 49 such persons who were also members of List A company finance committees. Executive and finance committee ties would be more significant than ordinary director relationships.

Among institutional types, banks and insurance companies, respectively, had the largest number of ties with companies. These data reflect the common practice of such institutions to have outside directors on their own boards and their previously noted policy of neither forbidding nor discouraging personnel ties in most cases.

By far the most frequent relationship occurs where the institutional director is also a director of a company. However, it is virtually impossible to conclude that the relatively high number of such ties is indicative of strong institutional influence; as previously noted, it may well be the case that a director with institutional and corporate affiliations may be primarily representing corporate interests or that his position is "neutral." [72]

(2) Interlocks with portfolio companies.—Table XV–28 indicates the number of instances of personnel interlocks between the sample institutions, categorized by type, and List A companies whose equity securities are held and managed by such institutions. The table also indicates the number of portfolio companies in which such ties existed. In addition to the types of personnel relationships disclosed in Table XV–27, this table shows instances where a director, officer or affiliate of an institution is also a trustee of the portfolio company's employee benefit plan (such as a stock option, bonus or pension plan).

Comparison of Table XV–27 with Table XV–28 shows that most personnel interlocks between banks and companies (about 85 percent) occur in cases where the bank trust department also holds an equity interest in the company. This was not the case for other institutional types.

Banks had common director ties with 196 List A portfolio companies, while other institutional types each had such ties with less than half that number of companies.

Table XV–28 also indicates that bank personnel were trustees of company employee benefit plans in 21 instances. It should be recognized that where these plans provide for purchase only of shares issued by the founding company or permit the removal of the trustee by the company, the bank may have relatively little influence over the company or the shares it is administering.

The findings on the extent of personnel ties among institutional types are essentially unchanged when only the 288 I–64 companies (which are also List A companies) are considered. Thus, for example, the sample banks had personnel relationships with the 288 I–64 companies in 293 instances; in 254 instances, the bank also held shares in the company.

(3) *Multiple interlocks.*—Table XV–29 shows the frequency of multiple director ties between institutions and their portfolio companies. To the extent that institutions are able to influence portfolio company policy by having their directors on the boards of such companies, the impact of any such influence would be increased by multiple interlocks—more than one common director between the institution and the portfolio company.

The table discloses relatively few instances of multiple director ties. Most of these occurred where banks had common directors. There were, however, only eight instances where the bank had more than three common directors with a portfolio company.

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[72] While institutional officers would tend to represent the institution's interest on corporate boards, the questionnaire was drawn to categorize institutional officers who were also institutional directors as "directors." The resulting data are thus not sufficiently indicative of the flow of dominance, if any.

3. Business Relationships

The fact that an institution has a business relationship—as creditor, depository or employee benefit plan manager—with a company whose shares it holds may simply reflect a mutually advantageous arrangement. On the other hand, such a situation presents an inherent potential conflict of interest, however innocent its origin. A large institutional shareholder may have the economic power to compel a portfolio company to do business with it; at the same time, its concern for the maintenance of good business relationships with a company might tend to deter the institution from using its shareholdings—by voting or otherwise—to oppose corporate management or from disposing of portfolio company shares. Such business relationships may also have anticompetitive impacts.

When an institution's position as creditor enables it to acquire inside information about the company in excess of what it might receive as a shareholder, there is an ever-present possibility that the information might be used for investment purposes unless the institution has rigid internal restrictions and controls. As noted earlier, this raises problems from the standpoint of the antifraud and inside trading provisions of the federal securities laws.

a. The data

The Study obtained data on creditor, depository and employee benefit plan manager relationships as of September 30, 1969 from the 288 companies responding to Form I–64.[73]

These companies were asked to limit their responses to relationships with the institutions named in List R. The List R institutions included the 49 largest banks, the investment advisers for the 69 largest registered investment companies or complexes of such companies, the 21 largest property and liability insurance companies (or groups of such companies) and the 22 largest life insurance companies.[74]

The companies receiving Form I–64 included (1) each of the 27 largest New York Stock Exchange companies (in terms of market value of their outstanding shares); (2) every second company included in the Study's random samples of New York Stock Exchange companies (List C), American Stock Exchange companies (List D) and over-the-counter companies (List E); (3) every company from the Study's judgment sample of over-the-counter companies, banks and insurance companies (except for the 50 largest banks); (4) every company in the Study's list of merger and proxy contests; and (5) every List A company whose self-administered employee benefit plan is covered by Form I–3.[75] The first two categories represent a "random sample" of 181 companies, while the last three categories represent a "judgment sample" of 107 companies.

b. Aggregate instances of relationships

Table XV–30 shows the number of instances of shareholding, creditor, depository and employee benefit plan manager relationships be-

[73] Data on shareholdings by institutions were obtained from Form I–3, described in section C of this chapter.

[74] A somewhat different sample of institutions is used in the correlation analyses reported in section 4, below. As previously noted, the use of 49 (instead of 50) banks merely reflects the fact that two of the banks in the Study's sample are affiliated with each other and are therefore combined for purposes of certain analyses.

[75] All of these institutions and companies are set forth in Supplementary Volume II.

tween the sample institutions, categorized by type, and all I–64 companies. Thus, for example, there were 5,324 instances of shareholder ties between the 49 banks in the sample and the 288 I–64 companies, or an average of 108 shareholder ties per bank.[76] Creditor relationships existed in 1,581 instances for banks, or an average of about 34 creditor ties per bank. Depository relationships existed in 2,133 instances for banks, or an average of about 35 depository ties per bank. Employee benefit plan manager relationships existed in 285 instances for banks, or an average of about five such relationships per bank with the sample companies.

As the table indicates, there were relatively few business ties for other institutional types. The depository relationship is unique to banks,[77] while creditor and benefit plan manager ties occur less frequently in the case of investment advisers and insurance companies. There is an average of less than one creditor or plan manager tie for each investment adviser in the sample and an average of only about two creditor ties for each property and liability insurance company in the sample.[78] The life insurance companies in the sample had an average of about 22 creditor ties each with I–64 companies, and an average of about four benefit plan ties with such companies.
plans.

c. Aggregate instances of business relationships with portfolio companies

Table XV–31 indicates the number of instances of business relationships between the sample institutions, categorized by type, and all I–64 companies whose shares are held and managed by those institutions. The number of ties drops substantially for all institutional types when only business relationships coupled with stock holdings are considered. Significant numbers of ties appear only in the case of banks, indicating that banks usually hold the shares of companies with which they have business relationships.

d. Creditor relationships

Table XV–32 indicates the number of institutions having creditor relationships with the specified numbers of I–64 companies.[79] The same data are furnished for creditor relationships with I–64 portfolio companies, *i.e.*, companies in which the institution also has stock holdings. The table shows, for example, that one of the banks in the Study's sample had no creditor relationships with any I–64 companies; 11 banks each had such relationships with between 10 and 19 such companies; nine banks each had such relationships with between 20 and 29 such companies; 10 banks each had such relationships with between 30 and 49 such companies; eight banks each had such relationships with between 50 and 89 such companies; and two banks each had such relationships with between 89 and 107 companies.

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[76] Shareholdings comprising less than 1/100 of 1 percent of the outstanding shares of the company or of the institution s portfolio are omitted.
[77] In any event, the Study inquired only about depository relationships with banks.
[78] Property and liability insurance companies do not manage or advise employee benefit
[79] Creditor relationships do not include loans of $1 million or less or debt obligations with a maturity of more than one year which have been registered under the Securities Act of 1933. All other debt issued since December 31, 1967—whether or not evidenced by notes, debentures, bonds or other evidences of indebtedness—is included as are unutilized lines of credit. Loans are reported only for the commercial side of banks, and loans by the separate accounts of insurance companies are excluded. Since the questionnaire was answered by companies, some bearer debt held by institutions is necessarily excluded.

The table also shows that if only creditor relationships coupled with shareholdings are considered, the banks have creditor relationships with considerably fewer companies. Among other institutional types, only life insurance companies have any significant number of creditor ties with I–64 companies.

e. Depository relationships

Table XV–33 indicates the number of banks having depository relationships with the specified numbers of I–64 companies.[80] The table shows that 32 of the 49 banks in the sample each had depository relationships with between 20 and 89 I–64 companies. If only portfolio companies are considered, 28 of the banks each had depository relationships with between 10 and 49 of the I–64 companies.

f. Employee benefit plan manager relationships

Table XV–34 indicates the number of institutions having employee benefit plan manager relationships with the specified numbers of I–64 companies.[81] The table shows that banks not only manage the largest number of benefit plans among all institutional types, but that they also hold shares in the founding company in a large number of instances. In some cases, this may reflect the fact that the benefit plan purchases shares of the founding company—as is the practice of many profit-sharing plans—or that the bank is managing accounts or trusts for the founding company's officers which include the company's shares.

By contrast, although life insurance companies manage benefit plans in 96 instances (Table XV–30), they hold the founding company's securities in only 29 of these instances. While eight of the 49 banks each manage the benefit plans of between 10 and 30 portfolio companies, there are no life insurance companies in the sample which manage the plans of so large a number of portfolio companies. Only 11 life insurance companies manage any plans of portfolio companies, while 37 of the banks manage such plans.

g. Comparison with stock holdings

Table XV–35 places the preceding data in perspective by indicating the number of institutions having shareholding relationships with the specified numbers of I–64 companies.[82] The table shows that all of the banks in the sample each held the shares of 30 or more I–64 companies in their portfolios. Twenty-nine of the banks held the shares of between 100 and 165 such companies. Among other institutional types, few institutions held more than 70 I–64 stocks and most insurance companies held fewer than 30 such stocks. These data demonstrate the obvious fact that stockholdings do not automatically indicate the existence of business relationships nor do such relationships necessarily result in equity holdings. At the same time, the data show that in the case of banks, business relationships are more frequently accompanied by equity holdings than is the case for other institutional types.

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[80] Depository relationships include only demand deposits in excess of $100,000.

[81] These relationships include instances where the institution is retained for the purpose of managing or giving advice on the management of the plan. As in the case of other relationships, it is possible that some companies may have benefit plan relationships with more than one institution.

[82] See note 76, above.

4. Functional Interrelationships Between Institutions and Companies

As section C and this section of chapter indicate. institutions may have a variety of relationships with non-financial corporations:

(*1*) *Shareholdings*—The institution may hold and manage common stock issued by the company, comprising a portion of the institution's own investment portfolio as well as a portion of the company's total outstanding shares.

(*2*) *Personnel Ties*—The institution and the company may have common decision-making personnel—officers, directors or affiliates.

(*3*) *Business Ties*—The institution may provide financial services to the company in the institution's capacity as creditor, depository or employee benefit plan manager. Obviously, not all institutions are, as a matter of law or custom, engaged in providing all such services. Banks, through their trust departments, provide investment services to a broad range of individual and corporate savers, including corporate employee benefits plans; through their commercial departments, they provide credit and depository services to individual and corporate customers. No other type of institution provides such a comprehensive package of financial services, although investment advisers and life insurance companies do manage and advise employee benefit plans and these two institutional types along with property and liability insurers also offer credit services.

To the extent that any institution has more than one type of relationship with a company, the question may be raised as to whether there is any correlation between such multiple relationships. In this section, through the use of regression analyses (a commonly employed tool of economic study), an attempt will be made to determine whether there is any statistical correlation between the various institutional-corporate relationships considered in this chapter. These analyses are designed to measure the statistical probability that one type of relationship will be found to exist (or to exist in a particular magnitude) whenever another type of relationship does, in fact, exist. However, it would be inappropriate to conclude from these analyses that any relationship causes or is the product of another relationship. While there is some suggestion in sections E and F of this chapter that multiple relationships may have consequences in terms of actual institutional policies and practices, the Study made no systematic analysis of the impact of such relationships. Thus, while it may be concluded in certain instances that a particular relationship is positively associated with other relationships, it cannot be concluded that any type of relationship is the genesis for others.

a. The data

The data on institutional shareholding relationships were derived from Form I-3, previously described in section C of this chapter. The data on personnel relationships were derived from Form I-12, and the data on business relationships were derived from Form I-64, both of which were previously described earlier in this section of the chapter.

The relationships or variables selected for detailed analysis, together with a summary of their mean values and other descriptive summary statistics are set forth in Table XV-36:

(*1*) *Personnel ties* (a "dummy variable") is coded numerically as "1" if the institution in question has any personnel ties with the company in question, and is coded as "0" if there are no such ties.

(*2*) *Employee benefit plan management* also is coded as "1" if the institution manages or advises all or a part of an employee benefit plan sponsored by the company, and is coded as "0" if it does not.

(*3*) *Stock/Outstanding* represents the fraction of the portfolio company's outstanding shares held by the institution in question. This variable attempts to measure the relative importance of the institution's holding to the corporate issuer.

(*4*) *Stock/Portfolio* represents the fraction of the institution's total equity holdings invested in the shares of the particular company. This variable attempts to measure the relative importance to the institution of its holdings of the company's shares.

(*5*) *Loans/Outstanding* represents the fraction of a company's outstanding loans held by the institution.

(*6*) *Demand Deposits/Outstanding* represents the fraction of a company's demand deposits held by a particular bank. As in the case of Stock/Outstanding, both Loans/Outstanding and Demand Deposits/Outstanding attempt to measure the relative importance of these relationships to the company.

(*7*) *Region* (a "dummy variable") is coded as "1" if the institution and the company both are headquartered in the same Standard Metropolitan Statistical Area (or Standard Consolidated Area in the case of areas including New York and Chicago), and is coded as "0" if they are not.

(*8*) *Company size* represents the market value of the company's total outstanding common stock as of September 30, 1969.

(*9*) *Institution size* represents the market value of the institution's total investment assets under management as of September 30, 1969.[83]

b. Overview of data

The summary statistics contained in Table XV–36 indicate the number of institutions (50 banks, 21 property and liability insurance companies, 26 life insurance companies, 70 investment advisers) and companies (288) surveyed. As indicated in the third row, each observation consists of the combination of one of these institutions and each of the 288 companies. Thus, for example, if each bank had some relationship with each company, there would be a total of 14,400 (50×288) observations. The table shows that there are a great many possible institution-company combinations for which no relationships at all exist. These are referred to here as "null observations" and are deleted from subsequent analyses.

Without these "null observations," there are 6,070 (out of a possible total of 14,400) bank-company combinations covered by the data in

[83] For technical reasons, company and institution size measures are transformed to natural logarithms to reduce the violence ordinarily imparted by enormous variations in size to the assumption of linear (or straight line) relationships between variables built into traditional regression analyses.

which the sample banks have some relationship with the sample companies. It may be said that these are instances where the company is "known" by the institution. Some additional observations are lost for purposes of analysis by the Study's inability to obtain information on one or more of the region, company size or institution size variables.

The banks, on average, "know" 41.5 percent (or 120) of the sample companies. Other institutional types "know" a considerably smaller number of sample companies—between 11.8 percent and 15 percent or between 34 and 43 companies.

The mean values summarized in the upper half of Table XV-36 indicate the average incidence or size of particular types of relationships between institutions and companies in the sample. Thus, for example, the table shows the 50 banks, on average, have personnel ties with .0490 (or 4.9 percent) of the companies that they "know" from among the 288 companies in the sample; the banks, on average, manage employee benefit plans for 4.77 percent of the companies they "know;" the banks' average shareholdings of companies they "know" constitute .39 percent of the company's outstanding shares and .33 percent of the bank's investment portfolio;[84] and 13.45 percent of the companies "known" by banks are headquartered in the Standard Metropolitan Statistical Area or Standard Consolidated Area where the bank also is headquartered.

The mean values for company size and institution size indicate the average size of sample companies "known" to institutions and the average size of the institutions. Since the logarithm of $1 billion is approximately 20.72, the resulting variation in average company and institution sizes reported here runs from approximately $540 million for companies in the sample known to banks, to more than $5 billion for average life insurance company holdings.[85]

c. Analyses of statistical correlations

The object of this analysis is to examine the extent to which the presence or size of one type of relationship between an institution and a company is correlated to the presence or size of one or more other types of relationships between the two. The analyses are controlled for certain other factors such as geography and size of institution or company, since these factors may be expected to pervade all such relationships.

The specific empirical hypothesis to be tested is that there is no systematic correlation between the various relationships connecting institutions and companies, other than those that can be explained by the facts of their respective sizes, regions, lines of business and other factors not considered in the analyses. Multiple regression analysis is

[84] The very small average fractions for stockholdings are affected by the large number of zero holdings remaining for any particular variable even after pairs of institutions and companies having no relationships with one another are eliminated from the observations. Thus, it would not be accurate to state that banks, on average, hold only .39 percent of the outstanding shares of a company whose shares they hold; for in many cases this company is "known" to the bank only through its commercial department.

[85] Two technical factors combine to affect these average values. The first is that averages based on logarithms of size produce what is commonly defined as geometric rather than arithmetic means. Geometric means typically are smaller in magnitude than arithmetic means drawn from samples of this type. The second is that average size measures reported here are weighted by the frequency of their appearance in (non-null) institution-company combinations. As large companies tend to be "known" to larger numbers of institutions than small companies and large institutions tend to "know" larger numbers of companies, both will tend to appear more frequently in these non-null observations, tending to offset somewhat the extent to which measured geometric means tend to understate conventional arithmetic mean values.

the primary statistical method employed for this purpose. As earlier noted, the existence of a systematic statistical correlation between any pair of variables, either in isolation or in combination with other characteristics of the institutions and companies surveyed, does not imply the existence of a causal connection between the two. For example, the existence of a positive correlation between the existence and size of stockholdings and various business relationships between institutions and companies cannot, on the basis of this data alone, be interpreted as implying either that such holdings could or would be used by an institution to obtain business from portfolio companies, or, conversely, that the existence of business relationships causes the institution to acquire, maintain or increase its holdings of a company's shares.

As a first step in these analyses, simple pairwise correlations (or regressions) are calculated between measures of stockholdings (as a fraction of outstanding shares) and personnel ties, employee benefit plan management, region, loans and demand deposits. A separate correlation is calculated between loans and demand deposits for banks. The results of these analyses are summarized in Table XV–37, which contains only the so-called "t-ratios" commonly used by statisticians to measure the statistical significance of estimated correlation or regression coefficients.

Each t-ratio is the ratio of an estimated correlation or regression coefficient to its own standard deviation. If, as in this case, the hypothesis to be tested is that there is no relationship whatever between a pair of variables such as stockholdings and loans—*i.e.*, that the true underlying correlation between these variables is zero—then, under conventional assumptions regarding the distribution of such estimates,[86] t-ratios provide an indication of the probability that such a hypothesis would be rejected incorrectly on the basis of chance alone—*i.e.*, due only to sampling variation. A t-ratio as large as 3—indicating that the estimated parameter is as much as 3 standard deviations from zero—would be expected to occur on the basis of chance, alone, only once in 100 trials. A t-ratio as large as 4 would occur by chance only 3 times out of 10,000 trials, and so on. Needless to say, t-ratios of 4, 5 or greater are even more unlikely to occur by chance in the absence of a systematic (non-zero) relationship between two variables. Conventional statistical rules of thumb ordinarily accept t-ratios as small as 2 or 3 as sufficiently strong evidence to reject a proposition that the underlying variables are, in fact, uncorrelated.

(*1*) *Simple correlation analyses.*—The t-ratios in Table XV–37 for simple, pairwise correlations between stock/outstanding held by banks and each of personnel ties, employee benefit plan management, region, loans/outstanding and demand deposits/outstanding, and between loans and demand deposits for banks, all are large. Their statistical significance consequently is also large. By comparison, corresponding relationships between these variables among other types of institutions are weak.

Since each of these simple, pairwise correlations is measured in isolation of all other variables considered here, as well as in isolation of any

[86] Specifically, that parameter estimates are "normally" distributed.

other possible factors, which could themselves be correlated with the variables in each pair (and therefore contribute toward their apparent intercorrelation), further analysis is necessary.

(2) *Multiple correlation analyses.*—Multivariate analyses attempt to separate out the independent impact on each of the relationships analyzed here of any of the other relationships, while controlling to the extent possible for additional explanatory variables that may jointly affect them all. Specifically, stock/portfolio, stock/outstanding, personnel ties, employee benefit plan management, loans/outstanding and demand deposits/outstanding are each treated separately as dependent variables whose variation may be explained by all the other variables, in combination with three external variables: region, company size and institution size. The external variables are expected to have effects that may be jointly pervasive. Results of these six analyses are summarized in Tables XV–38 through XV–43.

The bottom row of each table indicates the fraction of total variation in each equation's dependent variable that can be explained by reference to the entire set of independent or explanatory variables introduced into each equation. These statistics are conventionally identified as R^2 (the squared multiple correlation coefficient or so-called coefficient of determination). In Table XV–38, for example, 23 percent of the total variation displayed by stockholdings as a fraction of total bank portfolios is explained by *all* of the other variables in the equation. Equations for other dependent variables (Tables XV–39 through XV–43) explain smaller fractions of their respective total variation, averaging between 6 percent and 11 percent for banks and in some cases less for other institutional types. In general, the fraction of total variation explained by each equation varies less among banks—whose coefficients of determination cluster around 9 percent—than among other institutional types. Where the equation explains 9 percent of the variation, it follows that 91 percent of the variation may be accounted for by other factors not considered in these analyses or simply by random variation.

(*a*) *Stock/Portfolio.*—Table XV–38 attempts to explain any systematic variation in the average magnitude of an institution's stockholdings as a fraction of its own portfolio by relating measures of each holding's size to the presence or absence of personnel ties, employee benefit plan management, loans and demand deposits (whether or not the institution and company are located in the same geographic region) as well as to measures of company and institution size. With minor variations to account for the fact that property and liability insurance companies manage no employee benefit plans and that no institutions other than banks hold demand deposits, identical analyses are performed for each institutional type.

Each regression equation's numerical results are summarized in a pair of columns headed by the institutional type. The left-hand column summarizes regression coefficients; the right-hand column t-ratios (indicating the statistical strength of each estimated "partial relationship"). The table shows that each independent variable, with the exception of demand deposits, appears to be related significantly to the magnitude of stockholdings in bank trust departments.

Combining the constant coefficient in this equation (−.0504) with average company and institutional size effects produces the .33 percent average fraction of each bank's portfolio invested in a company from this sample that it "knows." [87] The table shows that a personnel tie between the bank and portfolio company, on the average, essentially doubles the expected magnitude of the bank's holdings of that company's shares.[88] Should an employee plan managerial relationship exist as well, an average increase of .0017 results.[89]

Should the institution, in addition, hold 10 percent of the company's loans and 10 percent of its deposits, a further increase of .0006 (or .06 percent) in holdings as a fraction of the bank's portfolio would be expected to result. A final upward adjustment of .0029 in fractional holdings would be expected to result if both bank and company were headquartered in the same geographic region.

Combining all of these hypothetical asumptions for a company and bank of average size from the sample (*i.e.*, an average sized company and bank from the same region, for which personnel, plan management, 10 percent loan and 10 percent depository relationships exist) still produces a rather small expected fractional holding in the bank's stock portfolio. While the average bank would be expected to have shares in an average company it "knew" amounting to .33 percent of the bank's portfolio, the existence of all of these relationships would be expected to result in a holding comprising about 1.15 percent of the bank's portfolio.

Since the average market value of these banks' shareholdings is $2.6 billion, this would amount to $30 million.

Comparable analyses of stock as a fraction of institutional stock portfolios and essentially the same set of independent or explanatory variables were performed for other types of institutions. As Table XV–38 shows, there is little, if any, positive correlation between such stockholdings and the various types of personnel and business relationships here analyzed.

(*b*) *Stock/Outstanding.*—Table XV–39 relates stockholdings by institutions as a fraction of the company's outstanding shares to the same set of explanatory variables considered immediately above. In the case of banks, relationships between stock/outstanding and personnel ties, benefit plan management, loans and deposits appear to be both positive and, in a statistical sense, significant. Region and size of bank trust department also carry considerable statistical weight.

Where such relationships exist among other types of institutions, the correlation tends to be weak or negative. Thus, for example, property and liability insurers and investment advisers having personnel ties with a portfolio company, on the average, tend to hold lesser fractions of the company's outstanding shares than when such ties are not present.

(*c*) *Personnel ties.*—As indicated in Table XV–40, the statistical probability that a bank will have a personnel relationship with a company increases significantly if the bank manages the company's employee benefit plan, holds a larger fraction of the company's outstanding shares, holds a larger fraction of its own portfolio in these shares

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[87] Company size: .0030 (the coefficient) × 20.11 (Table 15–36) = .0603.
Institution size: —.0003 (the coefficient) × 21.92 (Table 15–36) = —.0066.
To obtain the average fraction of the portfolio comprised of the company's stock: —.0504 + .0603 — .0066 = .0033 (Table 15–36), or .33 percent.

[88] By adding .0030 (the coefficient) to .0033.

[89] .0033 + .0030 + .0017 = .0080 (or .8%).

and has a larger fraction of the company's demand deposits. Loan relationships (independently of depository relationships with which they are highly correlated (Table XV–37)) appear to carry very little statistical weight.

Regional proximity is positively associated with the existence of personnel ties for all institutional types. Company size also appears to be an important consideration for most institutions. Among banks, personnel ties are more likely to occur with larger companies, while property and liability insurers and investment advisers are more likely to have such ties with smaller companies. Company size is not a statistically significant factor for life insurance companies; however, personnel ties are more likely to exist among larger life insurers.

In general, personnel ties for non-bank institutions are only weakly correlated or negatively correlated with stockholdings and other business relationships.

(*d*) *Employee Benefit Plan Management.*—As Table XV–41 shows, the statistical probability that a bank will manage or advise a company's employee benefit plan (pension, stock bonus, profit-sharing) is positively associated with the existence of personnel ties between the bank and the company. Literally interpreted, the probability that a bank will manage all or part of an employee benefit plan is increased by 12.72 percent if the bank has a personnel tie with the company. Similarly, the magnitude of a bank's holding of the company's shares as a fraction of the company's outstanding shares is positively related to the presence of managerial relationships. However, as previously observed, some benefit plans invest in substantial amounts of the founding company's shares; thus, the bank's holdings may merely reflect the plan's investment policies rather than those of the bank.

Loans and demand deposits also are associated positively with the existence of a managerial relationship between a bank and a company. Region, company size and institution size are positively correlated as well. Among other institutional types,[90] the only positive, systematic correlation is between plan management and institution size, indicating that these services are ordinarily provided by larger institutions.

(*e*) *Loans/Outstanding.*—Table XV–42 indicates that loans held by banks (as a fraction of all of the company's outstanding loans) tend to be related positively to the existence of personnel ties, employee plan management and stockholdings (as a fraction of the company's outstanding shares), as well as to region and the size of the bank in question. A strong negative relationship is measured between loans and the size of the company itself. Stockholdings as a fraction of the bank's portfolio is a relatively weak relationship. Among other types of institutions, the correlations between loans and other types of relationships are generally either weak or negative.

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[90] Property and liability insurance companies do not manage employee benefit plans.

(*f*) *Demand Deposits/Outstanding.*—Table XV–43 relates demand deposits held by banks (as a fraction of the company's outstanding deposits) to other types of relationships. Deposits are considered when present without a loan relationship and when a loan relationship also exists. Personnel ties, employee benefit plan management and stockholdings as a fraction of the company's outstanding shares (but not as a fraction of the bank's investment portfolio) are positively related to the size of a company's depository relationship with the banks in the sample. Region and institution size also appear to be positively related to deposits. Not surprisingly, loans and deposits are strongly and positively interrelated.

d. Sensitivity analyses

In order to test the sensitivity of analyses reported here both to the composition of the I–64 sample of 288 portfolio companies and to possible differences between the significance of long-term and short-term lending relationships, each of the analyses reported in Tables XV–36 through XV–43 was repeated with

—the 181 company "random sample" of portfolio companies described in subsection 3.a above, and

—separate measures of long and short-term loans (instead of the single measure of loans/outstanding).

Neither variation resulted in a substantive change in any of the results summarized above.

5. Conclusion

The number of factors that may account for shareholding, personnel and business relationships is virtually limitless, and the Study makes no attempt to analyze all such factors. As a result, only a fraction of the total variation in each type of relationship is explained by the presence or magnitude of the other types of relationships and control variables considered.[91] Restricted to those factors for which data are available, the Study is able to test whether there is any systematic pattern of intercorrelation among shareholding, personnel and business ties. The analysis shows that, in the case of banks, each of the types of relationships analyzed is more likely to occur or to occur in greater magnitude if other such relationships are present. This is so even after the effects of regional proximity and company and institution size are controlled for. The same patterns of intercorrelation were not observed among other institutional types.

The Study cannot attribute causality to the observed intercorrelations among shareholding, personnel and business relationships, nor can it evaluate fully their economic significance. The data do show, however, that the likelihood that these functional interrelationships between banks and companies occur entirely by chance is extremely remote.

[91] In the case of banks, the proportion of variation explained by the set of independent variables ranges from 6 percent to 23 percent.

TABLE XV-26

Institutional and Corporate Policies on Personnel Interlocks

	Encourages Its		Permits Its		Discourages But Permits Its		Forbids Its		None	
	Off.	Dir.	Off.	Dir.	Off.	Dir.	Off.	Dir.	Off.	Dir.
Bank Trusts	1	1	25	21	17	4	2	–	4	23
Investment Adviser	2	2	15	21	28	22	16	9	15	22
Life Insurance	–	–	14	15	8	1	1	–	3	10
P&L Insurance	–	–	8	7	6	3	–	–	7	11
Corp. Empl. Benefit	–	–	3	3	1	2	2	1	7	7
Foundations	1	1	3	1	1	1	1	–	4	7
College Endowment	–	–	3	4	2	1	–	–	14	14
Total (214)	4	4	71	72	63	34	22	10	54	94
Companies (312)	12	16	153	141	26	8	11	3	110	144

TABLE XV-27

PERSONNEL RELATIONSHIPS BETWEEN INSTITUTIONS AND ALL LIST A COMPANIES

(Whether or not stockholdings exist by the institution in the company)

Institution Type	Institutional Relationship: Dir.	Off.	Aff.	Dir.	Off.	Aff.	Dir.-Off.-Aff.	
	Company Relationship: Director			Officer			Ex. Com.	Fin. Com.
Banks Trust Departments [49]	494	65	4	122	2	0	122	49
Investment Advisers [76]	168	2	56	13	0	9	21	15
Property & Liability Insurance [21]	115	10	2	20	0	1	34	18
Life Insurance Companies [26]	211	4	5	30	1	1	81	30
Corporate Empl. Benefit Plans [13]	33	5	0	10	1	0	7	3
Foundations [10]	24	0	0	5	0	0	6	5
College Endowments [20]	80	6	1	10	1	0	7	13

TABLE XV-28

PERSONNEL RELATIONSHIPS BETWEEN INSTITUTIONS AND LIST A PORTFOLIO COMPANIES

Institution Type	Inst. Relationship / Co. Relationship: Dir.	Off.	Aff.	Dir.	Off.	Aff.	Dir.	Off.	Aff.	Dir.-Off.-Aff.	
	Director			Officer			Empl. Plan Trst.			Ex.Com.	Fin.Com.
Banks (Trust Depts.) [49]											
Instances of Ties	420	42	3	109	2	0	21	1	0	109	46
No. of Portfolio Cos.	196	40	3	84	2	0		(N.A.)		78	30
Investment Advisers [76]											
Instances of Ties	77	1	23	5	0	8	5	1	0	14	8
No. of Portfolio Cos.	67	1	23	5	0	8		(N.A.)		14	7
Property & Liability Ins. [21]											
Instances of Ties	36	7	2	9	0	1	3	0	0	13	4
No. of Portfolio Cos.	34	7	2	9	0	1		(N.A.)		13	4
Life Insurance Companies [26]											
Instances of Ties	62	3	2	9	1	1	5	0	0	29	10
No. of Portfolio Cos.	50	3	2	8	1	1		(N.A.)		24	9
Corp. Employee Benefit [13]											
Instances of Ties	14	2	0	4	0	0	1	0	0	3	2
No. of Portfolio Cos.	14	2	0	4	0	0		(N.A.)		3	2
Foundations [10]											
Instances of Ties	2	0	0	1	0	0	0	0	0	2	0
No. of Portfolio Cos.	2	0	0	1	0	0	–	–	–	2	0
College Endowments [20]											
Instances of Ties	28	4	0	5	0	0	1	0	0	1	5
No. of Portfolio Cos.	26	4	0	5	0	0		(N.A.)		1	4

N.A. indicates not available.

TABLE XV-29

MULTIPLE DIRECTOR INTERLOCKS BETWEEN INSTITUTIONS AND PORTFOLIO COMPANIES

Institution Type	Number of Ties							
	1	2	3	4	5	6	7 or more	Total
Banks (Trust Departments) [196 cos.]	313	74	25	4	2	0	2	420
Investment Advisers [67 cos.]	72	4	0	0	0	0	1	77
Property & Liability Ins. [34 cos.]	25	7	3	0	0	0	1	36
Life Insurance Cos. [50 cos.]	52	5	2	1	1	0	1	62
Corp. Employee Benefit [14 cos.]	9	2	2	0	1	0	0	14
Foundations [2 cos.]	2	0	0	0	0	0	0	2
College Endowments [26 cos.]	24	3	1	0	0	0	0	28
TOTAL								639

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TABLE IV-30

NUMBER OF RELATIONSHIPS BETWEEN INSTITUTIONS AND ALL I-64 COMPANIES

	Shareholdings	Creditor	Depository	Employee Ben. Manager
Banks (49)	5324	1581	2133	285
Investment Adv. (69)	2748	67	0	45
P & L Insurance (21)	640	43	0	0
Life Insurance (22)	598	506	0	96

TABLE XV-31

NUMBER OF RELATIONSHIPS BETWEEN INSTITUTIONS AND I-64 PORTFOLIO COMPANIES

	Shareholdings	Creditor	Depository	Employee Ben. Manager
Banks (49)	5324	1246	1598	240
Investment Adv. (69)	2748	44	0	25
P & L Insurance (21)	640	11	0	0
Life Insurance (22)	598	115	0	29

TABLE XV-32

CREDITOR RELATIONSHIPS BETWEEN INSTITUTIONS AND I-64 COMPANIES

(Numbers of Institutions Having Creditor Relationships With Specified Range of Number of Companies)

Number of Companies:		0	1-9	10-19	20-29	30-49	50-89	89-107	Total
Banks	Loan Regardless of Stock	1	8	11	9	10	8	2	49
	Stock and Loan	1	13	14	6	8	7	0	49
Investment Adv.	Loan Regardless of Stock	45	24	0	0	0	0	0	69
	Stock and Loan	48	20	0	0	0	0	0	68 1/
P & L Insurance	Loan Regardless of Stock	8	12	1	0	0	0	0	21
	Stock and Loan	13	8	0	0	0	0	0	21
Life Insurance	Loan Regardless of Stock	0	6	5	3	7	1 2/	0	22
	Stock and Loan	6	11	4	1	0	0	0	22

1/One of the investment advisers held no shares in any I-64 company, but had a creditor relationship with one such company.

2/The life insurance company with the largest number of creditor relationships with I-64 companies had such relationships with 56 companies.

TABLE XV-33

DEPOSITORY RELATIONSHIPS BETWEEN BANKS AND I-64 COMPANIES

(Numbers of Banks Having Depository Relationships With Specified Range of Number of Companies)

Number of Companies:	0	1-9	10-19	20-29	30-49	50-89	89-134	Total
Deposits Regardless of Stock	2	3	6	10	11	11	6	49
Stock and Deposits	2	8	10	10	8	9	2 1/	49

1/The bank with the largest number of depository relationships with I-64 portfolio companies had such relationships with 108 companies.

TABLE XV-34

EMPLOYEE BENEFIT PLAN MANAGER RELATIONSHIPS BETWEEN INSTITUTIONS AND I-64 COMPANIES

(Numbers of Institutions Managing Employee Benefit Plans of Specified Range of Number of Companies)

Number of Companies:		0	1-4	5-9	10-14	15-34	Total
Banks	Manager Regardless of Stock	8	22	10	4	5	49
	Stock and Manager	12	20	9	4	4[1]	49
Investment Adv.	Manager Regardless of Stock	50	16	3	0	0	69
	Stock and Manager	57	10	1	0	0	68[2]
P & L Insurance	Manager Regardless of Stock	21	0	0	0	0	21
	Stock and Manager	21	0	0	0	0	21
Life Insurance	Manager Regardless of Stock	5	9	4	3	1[3]	22
	Stock and Manager	11	9	2	0	0	22

1/The bank with the largest number of manager relationships with I-64 portfolio companies had such relationships with 30 such companies.
2/One of the investment advisers held no shares in any I-64 company, but had manager relationships with four such companies.
3/The life insurance company with the largest number of manager relationships with I-64 companies had such relationships with 15 companies.

TABLE XV-35

SHAREHOLDING RELATIONSHIPS BETWEEN INSTITUTIONS AND I-64 COMPANIES

(Numbers of Institutions Having Shareholdings in Specified Range of Number of Companies)

Number of Companies:	0	1-9	10-29	30-69	70-99	100-129	130-172	Total
Banks	0	0	0	5	15	14	15[1/]	49
Investment Adv.	1[2/]	6	25	26	7	2	2	69
P & L Insurance	0	1	11	9[3/]	0	0	0	21
Life Insurance	0	2	14	6[4/]	0	0	0	22

1/The bank with the largest number of shareholding relationships held shares in 165 I-64 companies.
2/This investment adviser had employee benefit plan manager relationships with four I-64 companies and a creditor relationship with one I-64 company.
3/The property and liability insurance company with the largest number of shareholding relationships held shares in 46 I-64 companies.
4/The life insurance company with the largest number of shareholding relationships held shares in 52 I-64 companies.

TABLE XV-36

Sample Mean Values and Summary Statistics
for Variables Employed in Analyses of Interdependence
Between Institutional Investors and Corporate Issuers

Mean Values

	Banks	P & L	Life Ins.	IA's
Personnel Ties (0,1)	.0490	.0923	.1003	.0298
Plan Manager (0,1)	.0477	0.0	.0891	.0149
Stock/Outstanding	.0039	.0022	.0017	.0060
Stock/Portfolio	.0033	.0105	.0061	.0062
Loans/Outstanding	.0164	.0004	.0336	.0006
Demand Deposits/Outstanding	.0257	0.0	0.0	0.0
Region (0,1)	.1345	.1622	.1421	.1623
Company Size (Log-Outstanding)	20.11	21.27	20.58	20.56
Institution Size (Log-Assets)	21.92	20.74	22.41	20.83

Summary Statistics

No. of Institutions	50	21	26	70
No. of Companies	288	288	288	288
Including Null Observations*	14,400	6,048	7,488	20,163
Without Null Observations	6,070	747	1,125	3,040
Useable Observations	5,979	715	1,077	3,025
Percent of Companies "known"	41.5	11.8	14.4	15.0
Average No. of Companies "known"	120	34	41	43

* Calculated as the product of corresponding elements from the two preceeding rows. Thus, 50 bank trust departments times 288 securities equals 14,400 potential bank-security observations. Similarly, 21 property and liability insurance companies times 288 securities equals 6,048 potential property and liability - security observations, etc.

TABLE XV-37

t-Ratios, Simple Pairwise Regression Equations

	Banks	P&L	Life Ins.	IA's
Stock/O; Personnel	14.4	0.2	1.7	1.5
Stock/O; Manager	14.4	---	1.1	0.3
Stock/O; Region	12.9	0.1	1.7	2.9
Stock/O; Loans/O	9.6	1.0	1.0	0.2
Stock/O; Dem Dep/O	8.6	---	---	---
Loans/O; Dem Dep/O	33.5	---	---	---

TABLE XV-38

MULTIVARIATE REGRESSION ANALYSES

Dependent Variable: Stock/Portfolio

	Banks		P & L		Life Ins.		IA's	
	Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t
Constant	-.0504	-	-.0936	-	-.0418	-	-.0139	-
Personnel	.0030	4.9	.0003	0.1	-.0013	1.3	.0020	1.9
Manager	.0017	2.7	-	-	-.0020	2.1	-.0002	0.1
Loans/O	.0040	2.3	.0966	0.6	.0055	1.8	-.0032	0.3
Dem. Dep/O	.0017	1.4	-	-	-	-	-	-
Region	.0029	7.4	.0037	2.6	.0021	2.5	.0004	0.9
Co. Size	.0030	40.1	.0047	14.3	.0030	19.1	.0025	24.2
Inst. Size	-.0003	2.1	.0002	0.2	-.0006	2.2	-.0015	9.6
R^2	.23		.24		.28		.20	

TABLE XV-39

MULTIVARIATE REGRESSION ANALYSES

Dependent Variable: Stock/Outstanding

	Banks		P & L		Life Ins.		IA's	
	Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t
Constant	-.0492	-	-.0072	-	.0147	-	.0239	-
Personnel	.0067	9.6	-.0017	1.9	.0011	1.2	-.0034	2.6
Manager	.0057	8.0	-	-	-.0011	1.2	-.0015	0.9
Loans/O	.0086	4.2	-.0341	0.5	.0003	0.1	-.0030	0.3
Dem. Dep./O	.0035	2.6	-	-	-	-	-	-
Region	.0023	5.1	.0008	1.1	.0012	1.4	-.0005	0.8
Co. Size	.0001	1.2	-.0014	8.7	-.0005	3.4	-.0022	17.9
Inst. Size	.0023	11.7	.0019	3.8	-.0001	0.4	.0013	7.0
R^2	.09		.11		.02		.12	

TABLE XV-40

MULTIVARIATE REGRESSION ANALYSES

Dependent Variable: Personnel Ties

	Banks		P & L		Life Ins.		IA's	
	Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t
Constant	-.1398	-	.5027	-	-.6404	-	.3423	-
Manager	.1328	10.1	-	-	-.0465	1.5	.0110	0.4
Stock/O	2.1101	8.6	-3.1050	2.0	2.0275	1.9	-.8702	3.2
Stock/P	.7593	2.7	.4648	0.6	-2.0793	2.0	.8235	2.6
Loans/O	.0215	0.6	-7.2953	2.4	-.2810	3.0	-.0431	0.3
Dem. Dep/O	.1279	5.1	-	-	-	-	-	-
Region	.1021	12.4	.1885	6.7	.2571	10.2	.0500	6.0
Co. Size	.0065	3.6	-.0453	5.8	.0009	0.2	-.0124	6.2
Inst. Size	.0011	0.3	.0254	1.3	.0316	3.5	-.0031	1.2
R^2	.10		.11		.12		.02	

TABLE XV-41

MULTIVARIATE REGRESSION ANALYSES

Dependent Variable: Manager

	Banks		P & L		Life Ins.		IA's	
	Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t
Constant	-.9438	-	-	-	-.7946	-	-.1020	-
Personnel	.1272	10.1	-	-	-.0459	1.5	.0057	0.4
Stock/O	1.8116	7.6	-	-	-.3508	0.3	-.1688	0.9
Stock/P	.2205	0.8	-	-	-1.7874	1.7	.0270	0.1
Loans/O	.1470	4.0	-	-	-.1980	2.1	-.0287	0.3
Dem. Dep/O	.0700	2.9	-	-	-	-	-	-
Region	.0863	10.6	-	-	-.0163	0.6	.0104	1.7
Co. Size	.0112	6.3	-	-	-.0052	0.9	-.0008	0.6
Inst. Size	.0336	9.5	-	-	.0453	5.1	.0064	3.3
R^2	.11				.03		.005	

TABLE XV-42

MULTIVARIATE REGRESSION ANALYSES

Dependent Variable: Loans/Outstanding

	Banks		P&L		Life Ins.		IA's	
	Coeff.	t	Coeff.	t	Coeff.	t	Coeff.	t
Constant	.0083	-	.0116	-	-.2470	-	-.0004	-
Personnel	.0121	2.6	-.0011	2.4	-.0294	3.0	-.0006	0.3
Manager	.0258	5.4	--	-	-.0210	2.1	-.0008	0.3
Stock/O	.4417	4.9	-.0124	0.6	-.2521	0.7	-.0059	0.2
Stock/P	.1786	1.7	.0074	0.8	.6546	1.9	-.0103	0.3
Region	.0246	8.1	.0006	1.7	-.0049	0.6	-.0005	0.6
Co. Size	-.0071	10.8	-.0004	4.5	-.0181	9.8	-.0002	0.7
Inst. Size	.0065	4.9	-.0001	0.3	.0292	10.5	.0002	0.7
R^2	.07		.04		.19		.001	

TABLE XV-43

MULTIVARIATE REGRESSION ANALYSES

Dependent Variable: Dem. Dep./Outstanding

	Banks			
	(without loans)		(with loans)	
	Coeff.	t	Coeff.	t
Constant	-.0143	-	-.0188	-
Personnel	.0406	5.7	.0341	5.1
Manager	.0334	4.6	.0195	2.9
Stock/O	.5330	3.9	.2941	2.3
Stock/P	.2176	1.4	.1210	0.8
Region	.0290	6.3	.0157	3.6
Co. Size	-.0091	9.2	-.0053	5.7
Inst. Size	.0097	4.8	.0062	3.3
Loans/O	--	-	.5409	29.6
R^2	.06		.18	

E. INSTITUTIONAL INVOLVEMENT IN CORPORATE DECISION-MAKING

1. Introduction

The fact that institutions may have the economic power to control or influence corporate policy or decisions because of their shareholding or business relationships with companies does not necessarily imply that the power will, in fact, be exercised. At the same time, even in the absence of any actual economic power, the sophistication of institutions and their ability to respond to corporate information and events may enable them to exercise whatever influence they have more effectively than other shareholders.

As we have seen, equity holdings are not the only type of relationship that institutions may have with companies. The shareholder relationship is, however, an important legally recognized medium for institutional access to corporate power centers. In this section of the chapter, the manner in which institutions exercise—or refrain from exercising—their rights as shareholders will be analyzed, as well as the extent to which institutions seek a voice in corporate affairs outside the context of formal shareholder prerogatives. This analysis will provide a basis for assessing the validity of the existing distribution of corporate power in light of institutional involvement.

2. Institutional Voting

Although the range of corporate matters submitted to shareholders for their approval is relatively narrow, the types of matters often involve fundamental questions of corporate policy and direction. Thus, for example, when management requests shareholder approval of an amendment to the charter providing for a substantial increase in authorized securities in order to consummate future corporate acquisitions that have not yet even been conceived, the beneficial owners of the company are confronted with a decision of potentially far-reaching impact. First, approval of the proposal may mean a further delegation to management of the power to negotiate and consummate acquisitions without additional shareholder approval (unless the acquisition takes the form of a statutory merger or is otherwise subject to shareholder approval). Second, the authorized increase in securities may ultimately dilute the interests of the existing shareholders in their company.

Although the proposal may be critical, shareholders generally have no opportunity to amend it in any way. The Commission's Proxy Rule 14a–8 explicitly permits exclusion of shareholder counter-proposals to management proposals as well as alternative slates of directors. Thus, the shareholder is usually faced with a yes or no decision, unless he is willing to undertake the burden of his own proxy solicitation.

In spite of the inflexibility of shareholder voting mechanisms, the vote is the most tangible manifestation of shareholder power. It is also an indispensable ingredient of corporate decision-making. Complete apathy on the part of shareholders to the point of abstention from corporate voting would paralyze the mechanisms of corporate power: management would be unable to muster a quorum at annual meetings and the necessary majority or higher percentage of outstanding shares to approve charter amendments, mergers and similar matters. Thus, there is more than public relations involved in management's solicitous attitude toward its constituency and in its entreaties to shareholders that they promptly sign and return their proxies.

As the analysis in section C of company concentration has indicated, institutions often manage holdings that represent substantial portions of a company's outstanding shares. They also have sole or partial voting authority over substantial amounts of corporate shares. To the extent that institutions, individually or collectively, hold and can vote just over one-third of a company's outstanding shares—and this is often the case—they have the power to veto critical matters requiring a two-thirds shareholder vote simply by withholding their vote. If institutional shareholders wished to do so, they could collectively elect a substantial number of the directors of companies (having cumulative voting) in which they hold large positions. To the extent that an institution holds a large percentage of a company's outstanding shares, it may be able more readily to mobilize the additional shares needed to approve or disapprove a corporate proposal. Thus, institutions as a group appear to have substantial power which might be exercised through voting.

a. The data

The Study obtained data on institutional voting policies and practices from among the 215 large institutions receiving Form I–12. These respondents are identified in Supplementary Volume II. Responses were generally based on voting during the period between January 1, 1967 and September 30, 1969. Institutions were instructed to answer with respect to all companies whose shares they had sole or partial authority to vote, regardless of whether those companies appeared on List A or any other list of sample companies.

Many of the questions in I–12 applicable to this aspect of the Study called for narrative responses that could not be readily quantified. In addition, many institutions (in some cases, more than half) did not respond to particular questions calling for narrative responses, either because they considered the question inapplicable to their operations or because they had not formulated any policy or maintained records of any voting practices. (This was the case to an even greater extent for questions involving institutional participation in corporate decision-making, discussed later in this chapter.)

b. Institutional policies

It is obviously not possible to characterize institutional voting policies in terms of whether those policies are fundamentally designed to serve institutional as opposed to corporate interests. No institution would be likely to admit that it has a policy of voting solely for the purpose of advancing its own objectives without regard to the welfare of the corporation in which it is a shareholder. On the other hand, since institutions do have a significant stake in many portfolio companies—and almost always hold more than just a few shares in any portfolio company—we might expect that institutions would, as a matter of policy if not of practice, attempt to make some independent judgment as to the merits of matters submitted to them as shareholders.

In an effort to determine whether any institutions adhered to a policy of complete passivity, the Study asked institutional respondents to indicate any policy of voting in blank or with management on all matters. Table XV–44 indicates that a sizable number of institutions do have such a policy: 20 percent of all investment advisers in the sample; 43 percent of all property and liability insurance companies, 31 percent of all life insurance companies and 46 percent of all corporate employee benefit plans. Foundations and college endowments show automatic management support among 50 percent and 40 percent respectively of their samples. Even among bank trust departments, which are presumably required to adhere to the American Bankers Association policy guidelines specifying independent judgment on voting, 18 percent of the respondents—or nine of the fifty largest banks in the country—have a policy of always supporting management.

Automatic support for management is not by any means tantamount to non-involvement. Institutions that consistently vote with management may represent an important segment of the shareholder constituency that management can count upon regardless of other shareholder pressures. To that extent these institutions are "safe" votes that may well mean the difference between the success and failure of a corporate proposal.

c. Institutional practices

(*1*) *Decision-making procedures.*—Table XV–45 shows that a number of institutions have specific procedures for distinguishing between routine and non-routine proxy matters. This was particularly the case for bank trusts, most of which (34 of 49) recognize that certain matters submitted for their consideration as shareholders (or representatives of shareholders) involve fundamental policy questions requiring special attention. However, among other institutional types, less than half of the respondents had any specified procedure.

Narrative responses to questions presented by the Study indicate that most institutions do have some more or less formal procedure for processing proxy materials and determining whether and how to vote the institution's shares. Most bank trust departments initially refer proxy materials to industry specialists whose recommendations are then reviewed by the bank's trust investment committee or similar body. This committee may establish a policy of voting against certain matters, such as proposals to eliminate preemptive rights.

Investment advisers less frequently employ such formal review procedures; often, the decision is delegated to the portfolio manager who has investment discretion over the shares. Insurance companies usually assign proxy materials to a member of their investment department for initial review, subject to approval by a senior officer or investment committee, particularly where the matter is non-routine. Many institutions, particularly foundations and college endowments, seek the recommendations or advice of banks serving as custodian or investment adviser.

Where the institution has only partial voting authority or none at all, it will ordinarily have some procedure for recommending action to the beneficial owner, although it is often provided that the institution may vote on routine matters without prior consultation. What constitutes a "routine" matter will vary and may itself be within the institution's discretion to determine. Routine matters may be limited to the uncon-

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tested election of directors and appointment of auditors—the two matters that most frequently appear in proxies. In at least one case, however, "routine" was defined to include every matter that was not contested.

It appears that institutions rarely vote in person at meetings, although banks indicate some tendency to do so in the case of closely-held corporations.

(2) *Abstention*.—The Study found that some institutions follow a practice of deliberately abstaining on certain matters submitted to them for their vote. Deliberate abstention indicates that the institution considered the matter to be voted upon and reached a decision not to vote; it excludes instances in which failure to vote resulted from oversight or disregard for returning proxies or casting votes

Among all institutions in the sample, 4 banks and 4 investment advisers indicated that they followed the practice of frequent deliberate abstentions. Analysis of voting data for the period between January 1, 1967 and September 30, 1969 revealed 262 instances of deliberate abstentions by 48 institutions, as follows:

Bank Trusts	183
Investment Advisers	60
Insurance Companies	14
Employee Benefit Plans	5

Almost three-quarters of these abstentions were by 25 banks. The median number of shares as to which such banks determined to abstain was 3,600.

An abstention may indicate the equivalent of a negative note, particularly if the votes are necessary for a quorum, or if an affirmative vote of a specified percentage of outstanding shares is required. Even where the number of shares not voted is not enough to cause any actual discomfort to corporate management, it may evidence institutional dissatisfaction in a subtle, yet unmistakable, manner that will be apparent to management. Another reason for abstention, although less prevalent, is that the matter involves a transaction to which the institution itself is a party; abstention would tend to eliminate any claim of conflict of interest.

Although the types of matters as to which institutions abstained were quite broad, covering almost every conceivable shareholder decision, well over half (159) of the abstentions occurred with respect to four areas:

Proposals to Abolish Preemptive Rights	59
Proxy Contests	57
Authorization of Merger	23
Authorization of Acquisition by Company	20

The types of proposals as to which abstention occurred most frequently suggest different explanations: consistent with the evidence on negative voting, discussed below, abstention on proposals to abolish preemptive rights is probably a negative reaction, tempered by the realization that the company may need additional flexibility in its financing program that is precluded by the necessity of first offering new shares to existing holders. Abstention as to the other matters may simply represent a conscious decision by institutions not to "get involved" in controversial, albeit major, corporate transactions and power struggles.

(3) *Negative voting.*—A negative vote on a matter submitted by management indicates at least that the institutional shareholder is opposed to management's views on that particular matter; it does not necessarily demonstrate a basic disagreement with management about corporate policy in general. As previously noted, some institutions have a policy of voting against certain types of proposals—such as those to diminish or abolish preemptive rights—regardless of the particular company making the proposal.

Table XV–46 summarizes the instances of negative institutional voting among the 215 institutions responding to Form I–12. The table shows the number of institutions voting negatively during the period between January 1, 1967 and September 30, 1969; the number of instances of such voting; the median number of shares voted negatively and the number of companies whose proposals were voted against.

Among institutional types, bank trust departments were by far the most frequent dissenters, both in number of banks (28 or 57 percent of I–12 banks) and in number of instances (351 out of a total of 584 negative votes by all I–12 institutions). At the same time, the median number of shares voted against management proposals by banks was relatively small—only 6,300 shares. A far greater number of shares was voted negatively by investment advisers and insurance companies. Since banks frequently have only partial voting authority, it may be that they vote some of their shares negatively while voting others in favor of management on particular matters. The relative frequency with which banks—as opposed to other institutional types—vote against management may also be explained by the American Bankers Association guidelines requiring independent evaluation of proxy matters. It appears that banks have somewhat more regularized procedures for considering such matters. As Table XV–45 shows, banks, more so than other institutions, have a procedure for distinguishing routine from non-routine proxy matters. The nature of the banks' fiduciary relationship with beneficiaries whose funds they manage as well as their tendency to hold shares for relatively long periods may dictate a policy of greater involvement at least in proxy matters and hence a greater number of dissensions.

Although 57 percent of the bank trust departments voted at least once against management, very few other institutional types did so. As Table XV–44 demonstrated, many institutions, including banks, have a policy that tends to preclude such voting.

The number of companies experiencing negative institutional votes, when compared to the instances of such votes, indicates that institutions did not concentrate their dissensions in the same companies. Moreover, relatively few portfolio companies experienced negative voting by institutions.

When asked to explain the relative rarity of negative voting, some institutions expressed the view that:

(1) Negative voting is pointless since management generally has the votes it needs;

(2) Negative voting requires critical and time-consuming evaluation of proxy materials and, in some cases, persuasive argument to a reviewing investment committee; and

(3) If the matter is important enough, it may be easier to dispose of the shares.

Unwilling to employ the necessary resources to evaluate matters submitted for their vote, institutions thus help to make managerial dominance of the proxy machinery a self-fulfilling prophecy. Although institutions, like other shareholders, may employ the proxy mechanisms to place their own proposals before fellow shareholders under Commission Rule 14a-8, only one bank and one investment adviser reported that they had done so between January 1, 1964 and September 30, 1969.

A few institutions expressed more interest in exercising the power of the vote. They stated their belief that even if negative voting did not result in the defeat of a management proposal, it might have a broader impact in terms of confining managerial discretion within reasonable bounds. If institutions were to express themselves, through voting, as opposed to a particular transaction or proposal, management might be more reluctant to go through with the deal or to propose similar ventures in the future. A negative vote, particularly one involving a large block of shares, might also lead management to seek institutional views in advance of future proposals to shareholders. Thus, negative voting may communicate institutional dissatisfaction to which management may be sensitive.

Although negative voting occurred with greater frequency (584 instances) than deliberate abstentions (262 instances), the types of matters generating most negative votes were not dissimilar from those as to which institutions abstained. Negative votes were cast on a broad spectrum of corporate matters, but 68 percent of such votes occurred in the following areas:

Proposals to abolish preemptive rights	196
Proposals to remove or reduce existing limitations on preemptive rights	17
Articles or by-law changes to increase percentage of shareholder votes needed to approve proposal	73
Other articles or by-law changes	19
Authorization to increase existing class of common stock	19
Authorization to create new class of preferred stock	17
Authorize acquisition by portfolio company	17
Authorize acquisition of portfolio company	9
Initiate plan to grant stock options, warrants or rights	31
Total	398

As in the case of abstentions, institutions expressed opposition most frequently to proposals eliminating preemptive rights. They explained that shares offered to existing security holders pursuant to such rights are usually priced below the market and do not require the payment of commissions. There is no immediate advantage to any shareholder in waiving these rights, although the company may benefit over the long term.

Article amendments to increase the percentage of shareholder votes needed to approve a proposal are almost always put forward by management as a defensive mechanism to ward off takeover attempts.[92] If an insurgent group is doing the proposing, it is to management's ad-

[92] An increase in the required percentage of shareholders votes might otherwise increase institutional power to the extent that institutions with large holdings might be able to veto corporate proposals.

vantage that the percentage of shares needed to approve such proposals be high. Institutions favoring the insurgent group would vote against these defensive amendments.

Institutions oppose management stock option plans either because of the excessively liberal terms of the options, the potential dilutive effects in the future or because of general dissatisfaction with management. They oppose authorizations of additional securities because of the dilutive impact of such authorizations on their equity interests and, in some cases, because the purpose for which the new securities will be used is unclear or appears inappropriate.

It is surprising that institutions reported opposing acquisitions by negative voting in only 26 instances; this is a miniscule fraction of such transactions. Institutions generally expressed opposition to terms of the transactions rather than to the acquisition itself.

In general, negative voting, even when considered as supplemented by deliberate abstentions, seems to be a relatively infrequent phenomenon having little discernible impact on portfolio companies.

3. Institutional Participation and Consultation

As described earlier, the prevailing regulatory framework conceives of the shareholder's role in corporate affairs as that of an absentee owner who receives periodic reports about the operations of the corporate household and is called upon to authorize or ratify the major decisions of his resident managers and to reconfirm their employment. He may on occasion be subject to the blandishments of persons seeking to supplant the present managers, but his involvement in managerial decisions is otherwise generally passive.

The institutional shareholder, however, may have a significant stake in corporate affairs, particularly if its interest is large or relatively illiquid and not susceptible of ready disposition. There may also be a greater tendency for an institution to bring its expertise and judgment to bear on corporate matters if tangible benefits to itself and its beneficiaries can be foreseen.

The institutions responding to Study questionnaires indicated that the vote is an instrument of limited efficacy in the art of corporate persuasion and power: by the time the decision-making process has reached the stage of shareholder voting, it is ordinarily too late for institutions to exercise decisive influence. The Study sought to determine whether and how institutions involve themselves in corporate affairs outside the formal context of shareholder voting.

Institutional "participation" is defined to include any contacts between representatives of the institution and the portfolio company, regardless of by whom initiated, in which the institution expresses its views as to what corporate management should do. It does not include ordinary contacts between securities analysts and companies or contacts by common directors. "Consultation" refers to these contacts from the company's perspective. Both terms exclude views expressed in the institution's capacity as a creditor or other non-shareholder role.

a. The data

The Study obtained data on institutional participation from among the 215 institutions receiving Form I-12; data on company consultation was obtained from among 312 companies receiving Form I-64. Responses were generally based on participation and consultation occurring between January 1, 1968 and September 30, 1969. Except in the case of acquisitions (defined to include any acquisition of corporate control, whether by purchase of stock or assets or otherwise, and whether or not involving a statutory merger or consolidation), institutions were instructed to answer with respect to *all* companies whose shares they held (regardless of voting authority). Companies were instructed to answer with respect to all institutional shareholders whom they may have consulted.

Institutional participation in acquisitions refers only to companies in List Q, reproduced in Supplementary Volume II, and includes the institution's involvement as shareholder or by providing advice or financial or other assistance either to the management of the portfolio company or to some other person or firm engaging in an acquisition effort involving the company. Excluded are instances where the sole involvement is that of debt holder and assuring the continued security of the debt.

Responses were not required with respect to portfolio companies in which the institution held less than $25,000 in common stock or companies whose stock is not publicly traded.

As in the case of institutional voting, many of the questions required narrative responses and many respondents did not answer all questions. Well over half of the institutional respondents did not respond to questions asking for views as to the appropriate type of institutional participation in portfolio company affairs, terming these questions inapplicable or simply leaving them blank. Respondents were given the option of responding anonymously to these policy-oriented questions; only five did so.

The Study staff also conducted interviews and discussions with both institutional and corporate managers.

b. Institutional policies and views

As indicated in Table XV-47, about 40 percent of the institutions responding to Form I-12 indicated they had a policy against participation in corporate matters other than acquisitions. It cannot be assumed that the remaining 60 percent favored such involvement since well over one-half of the respondents failed to answer the questions pertaining to institutional policies on participation. Failure to respond probably indicates that the respondent had no policy on the subiect.

Table XV-48, "Participation: Practices of Institutions," shows that an institution having no policy on participation is in fact likely not to participate as a matter of institutional practice. For example, 84 percent of all respondents indicated they did not participate even once in portfolio company decisions concerning non-acquisition matters during the Study period. Of this group, only 48 percent had corresponding policies against their involvement.

The views of different types of institutions toward institutional involvement in portfolio company affairs appear to be shaped by several common concerns. Form I–12 solicited general comments on involvement, seeking expressions of the institutions' viewpoints in light of public interest considerations.

The following comment from a bank is typical of most received:

> We believe that our responsibility as an investor requires us to vote those shares for which we have investment authority, and we therefore almost never abstain from voting. At the same time, we believe that in most cases our involvement in portfolio company affairs should be limited to voting our shares. Our usual policy with respect to voting shares in portfolio companies is to return signed blank proxies to the companies and let management do the managing. As indicated in our answers to previous questions, we will, if we deem it best to do so, vote against management. However, we do not believe it is generally our province to participate actively in the management of portfolio companies in those areas where we do not agree with management proposals; and if we find ourselves disagreeing often or strongly with such proposals, we are most likely to eliminate the shares of the company from our account portfolios, rather than fight management's policies.
>
> We do not consider this in any respect an abdication of responsibility. On the contrary, we owe our first responsibility to our customers, and we have found our policy as described above to be the most reasonable and most economical method of providing investment management for them.

Another bank stated that—

> The [institutional] stockholder must choose whether to participate in a fight to oust management or whether to quietly liquidate the holdings and employ the funds elsewhere. Usually, withdrawal seems more practical because of the expense of a proxy fight, the uncertainty of success in such action, and the prolonged period sometimes required before new management can produce results. Also, quite often the disappointing results are the product of conditions within the industry and are beyond the control of management.

Frequently, institutions cited possible conflicts of interest raised by participation in portfolio company affairs. Institutions are aware of conflicting responsibilities presented by their dual role as manager of their own beneficiaries' investments and as shareholders in portfolio companies. A conflict may also arise where the institution has a business as well as shareholder relationship with portfolio companies.[93] Speaking to the first possible conflict, an investment adviser stated:

> An investment adviser with many clients cannot accept portfolio company management responsibilities without creating a difficult conflict situation . . . Banking and investment banking functions require involvement and allegiance to the company as that firm must advise, criticize and aid management in continuing problems of finance, personnel, new ventures and affiliations. The investment adviser has a different set of responsibilities: measuring risk and opportunity relative to each other and to all other possible investments in light of the situation of the investment advisory client. A firm which is both the adviser to management and the adviser to investor-shareholders must separate those functions with great sensitivity and skill or it will fail both classes of client.

Another investment adviser noted:

> It seems proper for an institution that is receiving fees for managing money to stick to managing money, rather than attempt to manage or to influence the management of companies in which it will always be operating from a position

[93] See section D of this chapter for discussion of the extent of such relationships.

of ignorance. This is truer of such an institution than of an individual—who is not being paid to manage his money—or even of a non-profit corporation or trust which may have other purposes than mere portfolio management. If we take time out from our own job to allow sufficient expertise to be able to give informed opinions on how portfolio companies should run their various business, we would not be doing what our clients are paying us to do, and therefore we would be derelict in that very "fiduciary duty" that the SEC has spent so much time telling us we owe our clients.

One institution responding anonymously pointed out that the potential for conflicts of interest is particularly significant where the institution is also associated with the portfolio company in a capacity other than as a shareholder.

We believe that some of the more difficult problems arising from institutional ownership of common stocks arise when there are relationships between the institution and the portfolio company other than the ownership of the common stock itself. For example, where a bank is a lender, a depository, and an investor in the common stock of a portfolio company, involvement in management decisions of the portfolio company is, on the one hand, almost inevitable (arising from the bank's lending relationship) but questions can arise as to whether such involvement reflects the viewpoint of the lender or the common stockholder. Another example is where an investment banking firm having a relationship with a company finds itself in the role of a large common stock investor in that company, whether as a conduit for others or for its own account. We do not suggest that the answer lies in disenfranchising the commercial bank or the investment banker. We simply identify the situation of dual relationships as one deserving of primary attention.

Another area of concern is the possible use of institutional assets as a resource of investment banking firms interested in the promotion of mergers and other acquisitions. We do not allege that this is happening, but the possibility of abuse seems clearly to be there.

In spite of these and other potential problems we do not believe that institutional investors should be precluded from voting the stock which they hold (usually in a conduit capacity) nor would it be at all practical to require that a mutual fund, for example, be required to obtain instructions from its shareholders as to how to vote stock of portfolio companies held by the fund.

A number of respondents recognized that considerations of possible conflicts did not affect their duty to exercise customary responsibilities as shareholders of the portfolio company. One said:

As should all shareholders, institutional investors should exercise their voting rights and not shirk the responsibility. Institutional investors are in a better position than most other shareholders to evaluate a company's proposals in light of its operation.

Some institutions foresaw instances where even more intimate involvement might be appropriate:

If . . . an institutional investor finds himself locked into a position, for whatever reason, where he considers the management is failing to meet its responsibilities, then he has a duty, as both a shareholder and a fiduciary, to do whatever he can properly to induce the management to improve its handling of the company.

It is believed that most involvements in portfolio company affairs should be limited to the voting of shares. However, this is the point of view of a relatively small holder of shares in a given situation. From the standpoint of the public interest, generally there seems to us to be no reason why there should not be "participation" in corporate affairs, wholly aside from the voting of shares, where the interest is substantial or where the issues at stake seem to call for action. It is granted that in all cases it is not possible to resolve, as an investor, things of this nature through the sale or reduction of holdings.

Certainly investment companies with objectives of aiding small companies in their financing would have an interest as well as an obligation to involve themselves with management problems of their portfolio companies.

[I]f we found ourselves in a position with respect to a substantial interest in a portfolio company's stock where a management decision would unquestionably diminish the value of our stock, we would make our voice heard and take whatever action seemed appropriate to protect our trust.

Finally, a few respondents saw only functional limitations on the scope of their proper participation in the business affairs of portfolio companies.

Institutional investors should limit their involvement in portfolio company affairs to matters such as types of financing, dividends and distributions, plans to grant stock options, warrants or rights and other management compensation plans. In certain instances the institutional investors should also be involved in accounting policies and reorganizations.

Nearly all those responding expressed the belief that existing fiduciary principles were sufficient to protect their own beneficiaries as well as other corporate shareholders against the possibilities of abuse stemming from institutional participation in portfolio company affairs. Some preferred to rely upon industry self-regulation and stated that the relationships between institutions and portfolio companies were so "individualistic" that government regulation was not appropriate or desirable.

At this time, it would appear inappropriate for governmental or industry regulatory bodies to attempt to regulate the relationships between institutional investors and portfolio companies. The market place now contains a large number of investment companies and other institutional investors, many with differing philosophies, differing investment objectives and differing restrictions. It is appropriate that each institution be permitted to define its relationship with its portfolio companies in accordance with its own investment philosophy. Such an unstructured approach to the relationship between institutional investors and portfolio companies will, in turn, allow the individual investor to continue to select his investment vehicles from this broad spectrum of investment policies. If experience should then reveal that one policy on portfolio company relationships tends to yield superior investment results as opposed to another such policy, it may be assumed that the market place will dictate the relationship which should be maintained.

c. Institutional practices

As indicated by Table XV–47, a fairly large number of institutions have a policy of refraining from participation in general corporate matters other than acquisitions. It is appropriate, therefore, to examine separately participation in general corporate matters and participation in acquisitions.

(*1*) *General corporate matters.*— Table XV–48 (part 1) shows that relatively few institutions (34 out of 215) participated in general corporate matters. Investment advisers participated to a somewhat greater extent than other institutions. Even fewer institutions (10) reported that their efforts had some impact. This does not necessarily mean that the participation produced the desired result, but only that the institution was satisfied that participation had been fruitful and affected the outcome. Several institutions (13) indicated that their participation was limited to company-initiated matters where the company specifically requested assistance or advice.

Table XV-49 indicates instances of participation for each institutional type in various corporate matters. While the numbers are generally quite small, institutions have expressed their views on a wide range of subjects. They appear to be most interested in financing plans and, perhaps surprisingly, have even taken a position on accounting policy (14 institutions).

As has been seen, institutions explain their lack of participation in general corporate matters as a function of several factors:

(1) Institutions are investment managers, not corporate managers, and are content to leave corporate business to those primarily responsible for its conduct. They do not wish to be burdened with these matters—even if they are matters that are ultimately proper subjects for shareholder action. If the institution is dissatisfied with management's performance, it will dispose of the company's securities.

(2) Institutions do not wish to risk incurring any liabilities or burdens that may result from participation. For example, participation may identify an institution as a control person, thereby possibly subjecting its holdings to the registration requirements of the Securities Act upon resale. Participation may also afford the institution access to inside information that may inhibit its trading in the company's shares.

(3) Participation, particularly in a matter of marginal importance, may antagonize corporate management without any direct benefit to the institution. Management may retaliate by refusing to furnish statistical and other data helpful for investment analysis by the institution.

(4) Some institutions feel that uninvited participation would be ineffectual; if management refused to cooperate, the only recourse would be to vote against any proposal submitted to the institution as a shareholder or to dispose of the company's shares. Effective participation requires a willingness on the part of corporate management to be persuaded by sound arguments.

(5) A number of institutions appear to believe that participation may be illegal or unethical, without being able to articulate the precise basis of this belief. The concern may be political; that laws may be enacted or regulation imposed out of fear of financial power that would inhibit their existing relative investment freedom. This may explain the reluctance of many institutions to respond to narrative questions presented in Study questionnaires. Institutions are particularly sensitive to questions concerning joint participation by a group of institutions with common objectives. Existing antitrust laws and the 1968 tender offer provisions in the Exchange Act appear to have the effect of impeding frank discussion of concerted action by institutions, if not of precluding such action.

Notwithstanding the relatively small amount of participation reported by institutions, such participation can be significant in certain circumstances.

(1) Institutions indicate that their views may be sought by management, in which case participation will have some effect.

(2) Management is likely to be influenced by institutional participation when it is widespread or reflects a generally negative shareholder response to an impending transaction. These circumstances are most likely to occur, however, in the case of acquisitions rather than general corporate matters.

(3) Small or medium-sized companies are generally more receptive to institutional participation than are large companies. This is particularly so when the institution holds a substantial amount of the company's outstanding shares, or when the company is desirous of encouraging institutional interest in its securities.

(4) Institutions that have business relationships (for example, as creditors) with companies indicate that they may be able to exert more influence as shareholders because of such ties. However, some institutions are aware of the conflicts of interest such relationships may create.[94]

(5) An institution that is "locked in" to its holdings—because the shares are restricted, the amount of shares is very large or the shares are required to be held (for example, company shares placed in trust by a former officer of the company)—may be more highly motivated to participate in corporate affairs. For example, one bank stated that it might prefer to exert its influence over a portfolio company in which it had a substantial holding rather than to engage in a costly sale of the shares and a purchase of a comparable alternative investment. One insurance company stated that it would exert influence rather than sell its holdings if the disposition would result in a large capital gains tax. One investment adviser stated that it would more likely become involved in corporate decision-making if the value of the company's stock was well below the institution's purchase price and if participation might result in a favorable impact on the stock's price.

(6) In some cases, institutional shareholders or beneficiaries may request institutional participation in corporate affairs. This has happened only infrequently in the past, but the recent concern about corporate and institutional social responsibility has generated demands by some beneficiaries that their institutions take a more active role in corporate decisions that may have social consequences.[95]

At the 1970 annual meeting of General Motors Corp., two shareholder proposals included in the company's proxy and proxy statement pursuant to Commission Rule 14a–8 were indirectly related to corporate policies regarding air pollution, automotive safety and equal opportunity employment. While only a few institutional shareholders voted for these proposals, at least 35 (primarily foundations and college endowments) wrote to the company to express concern about the underlying issues presented. The letters, copies of which were examined by the Study, often reflected a response to views expressed by institutional beneficiaries or putative beneficiaries—mutual fund shareholders and college faculty members and students.

(2) *Acquisitions.*—Table XV–48 (part 2) shows the number of institutions, by type, indicating that they participated in acquisition

[94] See section D of this chapter for discussion of the extent of such relationships.

[95] See P. Landau, *Do Institutional Investors Have a Social Responsibility?*, 4 Institutional Investor, No. 7, p. 25 (July 1970).

matters during the period between January 1, 1968 and September 30, 1969. The table also shows the institutions' appraisal of the success of their efforts. Only 26 institutions reported participation, of which 12 stated that their participation had some impact on the outcome of the transaction or proposal.

These numbers appear inconsistent with narrative responses to Form I–12 and with interviews conducted by the Study staff. In the year 1969 alone, there were 4,550 acquisitions in the United States.[96] Although the Study inquired only about participation in acquisitions involving the 109 companies on List Q, many of these companies were part of acquisition efforts in which institutions were widely believed to be involved to some extent. The findings in section F of this chapter, dealing with transfers of corporate control, also suggest that the Study's quantitative data understate the extent of institutional participation in acquisitions.[97]

As indicated in Table XV–47, many institutions indicated that they had a policy of non-participation in matters other than acquisitions. While it does not follow that these same institutions had an affirmative policy of participating in acquisition matters, it is evident from their narrative responses as well as interviews that institutions often find it desirable to intercede in such matters. The Study's quantified data on the extent of participation is therefore probably unsound.

The Study found that some institutions participate in acquisition efforts in several ways:

(1) Institutions may advise the company on potential acquisition opportunities.

(2) Institutions may provide financial assistance to the acquiring portfolio company by making loans or participating in private placements to enable the company to acquire the target company's shares.

(3) Institutions may have a veto over acquisitions by portfolio companies because of an existing loan relationship; many long-term loan agreements provide that acquisitions may not be made without the institution's approval.

(4) Institutions may support a takeover effort by purchasing shares of the target company and tendering them to the acquiring company—or holding the shares until such time as the acquiring company is able to purchase them. Where an exchange offer is involved, the institution may assist the acquiring company by holding or purchasing additional shares of that company's stock; this may have the effect of stabilizing or increasing the price of securities being offered to tendering shareholders of the target company. The institution may also sell the shares of companies competing for the target's shares.

These tactics are discussed in detail in section F of this chapter.

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[96] Federal Trade Commission, *Current Trends in Merger Activity, 1969,* Statistical Report No. 6, p. 1 (March 1970).

[97] It seems likely that institutions responding to Form I–12 construed the definition of "participation" more narrowly than was intended by the questionnaire.

d. Company consultation

Of the 312 companies responding to Form I–64, only 75 reported having consulted with institutions. Table 15–49 indicates the matters with respect to which consultation occurred. As in the case of institutional participation in general corporate matters, companies indicated consultation most frequently on financing plans. In addition, 38 companies reported that they had consulted with institutions on acquisition matters. In view of the fact that the I–64 companies were not all involved in acquisitions, the number appears more accurate than the smaller number of participations reported by institutions.

The data show relatively little consultation by companies, with only 24 percent of all I–64 companies reporting having engaged in consultation, more than half of which consulted with respect to acquisitions.

4. Conclusion

The Study found that institutions as a group have a record of voting involvement that displays relatively little opposition to management. At the same time, the extent of their informal participation in corporate affairs remains largely unknown: institutions concede that they may find it desirable or necessary to interject their views into the corporate decision-making process, but report relatively few instances in which they did so.

At a time when institutional growth and its implications are under Congressional as well as general government scrutiny, it must be anticipated that many institutions may attempt to project a rather low profile of involvement in corporate affairs. The Study recognized that its inquiries into these matters might generate defensive responses reflecting sensitivity to the underlying policy implications; in fact, well over half of all institutional respondents did not respond to specific policy questions asking them to set forth their own views about the appropriate role of institutions as shareholders.

The failure to respond to these questions may be explained by apathy and indifference or by a desire to avoid any conspicuous association with the processes of corporate decision-making. In either case, it appears that institutions, including those which did respond fully, are acutely aware of the existing lack of guidelines governing their shareholding, personnel and business relationships with portfolio companies and apprehensive of indicating courses of conduct on their part that might be deemed inappropriate by the Commission or the Congress. Although, as has been noted, there are no general legal prohibitions on the exercise of shareholder prerogatives by institutions, the concern that such prohibitions exist or may be imposed appears to limit the likelihood of intensive institutional intervention in portfolio company decison-making, at least where the need for such intervention is unclear and the benefits uncertain.

TABLE XV-44

VOTING: POLICIES OF INSTITUTIONS

	Total Respon-dents	Institutions Indicating a Policy of Voting in Blank or with Management on All Matters.	
		Number of Respondents	Percentage of this type of Respondent
Bank Trusts	49	9	18%
Investment Advisers	76	15	20%
Property and Liability Ins.	21	9	43%
Life Insurance	26	8	31%
Corporate Employee Benefit Plans	13	6	46%
Foundations	10	5	50%
College Endowments	20	8	40%
TOTAL	215		

TABLE IV-45

VOTING: DECISION-MAKING PROCEDURES

	Institutions indicating procedure for distinguishing between routine and non-routine proxy matters.
Bank Trusts	34
Inv. Advisers	22
Prop. & L. Ins.	9
Life Insurance	11
Employee Ben.Pln.	5
Foundations	3
Endowments	6
TOTAL	90

TABLE XV-46

VOTING PRACTICES ON INSTITUTIONS

	Total Respondents	Institutions Voting Against Management at Least Once During the Study Period				
		Number of Institutions	Percentage of this type of Respondent	Number of Instances	Median Shares Voted (Approx.)	Number of Companies
Bank Trusts	49	28	57%	351	6,300	238
Investment Advisers	76	15	20%	143	67,000	103
Property and Liability Ins.	21	4	19%	17	27,000	16
Life Insurance	26	10	38%	62	75,000	36
Corporate Employee Benefit Plans	13	1	8%	10	113,000	9
Foundations	10	-	-	-	-	-
College Endowments	20	1	5%	1	17,000	1
TOTAL	215	59		584		403

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TABLE XV-47

PARTICIPATION: POLICIES OF INSTITUTIONS

	Total Respondents	Institutions Indicating Policy of Non-participation in Matters other than Acquisitions: Number of Institutions	Institutions Indicating Policy of Non-participation in Matters other than Acquisitions: Percentage of this type of Respondent	Percentage of Respondents who in fact did not participate in matters other than acquisitions.
Bank Trust	49	27	55%	68%
Investment Advisers	76	19	25%	32%
Property and Liability Ins.	21	10	48%	53%
Life Insurance	26	14	54%	67%
Corporate Employee Benefit Plans	13	4	31%	31%
Foundations	10	5	50%	50%
College Endowments	20	7	35%	39%
TOTAL	215	86	40%	48%

TABLE IV-48 (Part 1)

PARTICIPATION: PRACTICES OF INSTITUTIONS

	Participation in General Corporate Matters				Participation limited to Company-Initiated Matters	
	Institutions that participated at least once during the study period.	Non-Participants	Institutions that indicated their participation had an impact on general corporate matters	Number of such instances having an impact.	Number of Institutions	Number of Instances
Bank Trusts	9	40	2	3	6	10
Investment Advisers	16	60	6	14	3	9
Property and Liability Ins.	2	19	1	2	2	4
Life Insurance	5	21	1	1	2	6
Corporate Employee Benefit Plans	-	13	-	-	-	-
Foundations	-	10	-	-	-	-
College Endowments	2	18	-	-	-	-
TOTAL	34	181	10	20	13	29

TABLE XV-48 (Part 2)

PARTICIPATION: PRACTICES OF INSTITUTIONS

		Participation in Acquisition Matters			
	Total Respondents	Institutions that Participated at least once during study period.	Non-Participants	Institutions that indicated their participation had an impact on the acquisition effort	Number of such instances having an impact.
Bank Trusts	49	7	42	5	14
Investment Advisers	76	13	63	3	9
Property and Liability Ins.	21	1	20	1	2
Life Insurance	26	4	22	3	3
Corporate Employee Benefit Plans	13	-	13	-	-
Foundations	10	-	10	-	-
College Endowments	20	1	19	-	-
TOTAL	215	26	189	12	28

TABLE IV-49

INSTITUTIONAL PARTICIPATION AND COMPANY CONSULTATION

Matters in Which Institutions Participated or Portfolio Companies Consulted	Number of Institutions By Type Participating in All Corporate Matters: Total No.	Total % of All Participants	Banks No.	Inv. Adv. No.	P&L Ins. No.	Life Ins. No.	Empl. Ben. No.	Fdn. No.	Col. End. No.	Portfolio Companies Which Consulted With Institutions on All Corporate Matters: No.	% of All Cos. Consulting
a. Reorganization	7	13%	0	6	0	1	0	0	0	10	13%
b. Types of Financing	22	42%	3	12	1	5	0	0	1	32	43%
c. Terms of Financing	16	31%	1	9	1	4	0	0	1	27	36%
d. Participants in Financing	12	23%	1	5	2	3	0	0	1	21	28%
e. Dividends and Distributions	12	23%	3	5	1	3	0	0	0	15	20%
f. Accounting Policy	14	27%	1	9	0	4	0	0	0	13	17%
g. Operations	13	25%	0	8	0	5	0	0	0	19	25%
h. Advertising & Other Mmgt. Pol.	5	10%	0	3	0	2	0	0	0	10	13%
i. Plans to Grant Stock Opt., Warrants or Rights	10	19%	1	5	1	3	0	0	0	8	11%
j. Other Mngt. Compensation Plans	8	15%	0	4	0	4	0	0	0	5	7%
k. Indemnification	4	8%	0	2	0	2	0	0	0	4	5%
l. Selection of Dir. and Officers	14	27%	3	9	0	2	0	0	0	5	7%
m. Classification of Boards of Dirs.	3	6%	1	0	0	2	0	0	0	0	--
n. Preemptive Rights	10	19%	3	3	1	2	0	0	1	4	5%
o. Cumulative Voting	6	12%	1	3	0	2	0	0	0	1	1%
p. Other Changes in Articles or By-Laws of Company	9	17%	3	3	0	3	0	0	0	4	5%
q. Acquisitions	26	42%	7	13	1	4	0	0	1	38	51%
Total No. of Individual Institutions Participating	52		15	22	4	8	0	0	3		
Percentage of Total Respondents	24%										
Total No. of Individual Portfolio Companies Consulting										75	
Percentage of Total Portfolio Company Respondents										24%	

F. INSTITUTIONAL INVOLVEMENT IN TRANSFERS OF CORPORATE CONTROL

1. Introduction

The late 1960's saw an upsurge in transfers of corporate control. In some cases, the transfer was attempted by a group of dissident shareholders, working from within the corporate structure to supplant existing management. More often, transfers took the form of an acquisition of a controlling interest in the company by another company. While transfers may result from an agreement or understanding between the so-called "target" company management and the acquiring company, those that have generated the most controversy have involved a spirited contest involving the target and one or more bidders.

Where management proposes a merger with another company, the shareholders may or may not examine the proxy statement and make an independent decision on the merits of the transaction. As long as management is assured of the necessary shareholder approval, it need not make any special attempt to convince its constituency that the merger is in their best interests. Even if the merger proposal is defeated, management would not ordinarily fear the loss of its preeminent power over corporate affairs.

On the other hand, transfers of control occurring in the face of management opposition necessarily rely for their success on the accession of corporate shareholders to the offers made directly to them by the acquiring company. Such transfer bids call for dispositive action on the part of every shareholder, while threatening the position of existing management in the structure of corporate power.

A shareholder receiving a merger proxy is asked to vote on whether a particular transaction will be in the interests of the corporation as well as his own interests. The shareholder is, of course, concerned with the impact of the proposed merger on the investment value of his shares. Presumably, however, he will view the transaction in the context of his continuing ownership interest in the company, and, as in the case of similar corporate proposals, will be inclined to reaffirm his continuing confidence in management by approving the transaction.[98]

A shareholder receiving an offer from an acquiring company is given the opportunity to relinquish his ownership interest in exchange for cash or securities (frequently other than common stock) that are usually valued in excess of the previously prevailing worth of his investment. Such an offer requires the shareholder to make what is not a shareholder decision, but essentially an investment decision. If the offer is accepted, the shareholder will receive either cash, which he may then invest in another medium, or the securities of an entirely different corporate entity—albeit one which may ultimately include the target company.

As institutions have become major investors in corporate equities, their role in transfers of corporate control has become the subject of public concern. The concern is not so much that financial managers will, in the exercise of their investment function, tender or sell corporate securities to the highest bidder; indeed, their fiduciary respon-

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98 The same kind of shareholder interest would be involved in an exchange offer made with the concurrence of management

sibilities might compel that result. Rather, the concern is expressed that institutions may improperly facilitate—and even initiate—transfers of control in order to obtain short-term advantages to themselves, while disregarding both the interests of their own beneficiaries and those of other corporate shareholders.

The Study sought to determine to what extent institutions become involved in transfers of control and the consequences of any such involvement. Recognizing that an analysis of a large number of such transfers would be impracticable and that statistical data could not be readily obtained on such matters, the Study conducted a series of case studies, designed to examine in detail the operational facts and circumstances surrounding some of the more controversial corporate transfers.

Case studies for nine transfer situations were prepared by the Study staff. The patterns of conduct that emerge from analysis of the studies will be the focus of this section of the chapter.

2. Reasons for Institutional Involvement

As seen in section E, some institutions feel that, because of the immediate investment impact of takeover situations, they have a responsibility to participate in major corporate decisions involving acquisitions or transfers of control. As shareholders in portfolio companies, such institutions may consult directly with corporate management about proposed mergers or acquisitions; and, presumably, they will at least exercise independent judgment in casting their vote on such matters if they are submitted for shareholder approval.

Additional considerations may impel institutional involvement in a contested transfer situation where control is or may be sought through a direct offer to the target company's shareholders. In some cases, the impetus may be the opportunity for the institutional financial manager to obtain personal rewards and benefits apart from the interests of its beneficiaries. In other cases, there may be a congruity of interests between the financial manager and its beneficiaries. In all cases, there exists the possibility that the interests of the manager and its beneficiaries may conflict with the investment objectives and shareholder prerogatives of other corporate investors.

a. Liquidity

An institution holding a large block of a company's outstanding shares may find it difficult to dispose of the block through ordinary market sales. If market-makers are unable to handle the block and the institution has a pressing need for cash—for example, a mutual fund in a net redemption status—the institution may attempt to find a potential acquiring company to purchase the shares as a prelude to a takeover effort by that company for the rest of the portfolio company's shares (*see Home Insurance* case study).

b. Performance

A transfer of control may present opportunities for short-term profit to institutions. Such opportunities are especially attractive to investment companies whose shares are sold at net asset value: if portfolio securities increase in value or can be liquidated for capital gains, the value of fund shares will increase. The realization of substantial gains in portfolio performance may benefit institutional beneficiaries (if the methods utilized to obtain such gains are consistent with the beneficiaries' investment goals and policies) and may also benefit institutional financial managers, through the receipt of advisory fees and attraction of additional savings for management.

A bid for control usually results in an increase in the price of the target company's securities; if the institution can purchase such securities before they have reached the peak price, it may be reasonably assured of ready disposition at a profit by selling the securities or tendering them to the bidding company (*see, e.g.*, *Reliance Insurance* case study).

c. Special benefits

An institution with substantial holdings of a target's shares—or the financial ability to acquire such holdings—may be able to negotiate better terms than those available to the ordinary investor or to elicit other favored treatment. The institution or its financial manager may be given a special price, opportunity or inducement that is not made equally available to all shareholders of the target company. These benefits may constitute a "premium" for the attribute of potential corporate control that may be carried by the institution's shares.[99]

(1) The institution may receive advance notice or information that a takeover bid is contemplated. The purpose of such notice would be to enable the institution to acquire the target's shares in anticipation of the price rise that would accompany public announcement of the bid. In return for such information, the institution would be expected to tender the target's shares to the acquiring company (*see, e.g.*, *Reliance Insurance* case study).

(2) The institution may be induced to sell the target's shares to the acquiring company on the assurance of future contingent benefits—for example, the right to receive any higher price later offered publicly for the target's shares in a cash tender or securities exchange offer; the right to participate in any profits realized by the acquiring company on any subsequent disposition of the shares; the right to "put" (*i.e.*, sell back) any acquiring company securities received in exchange for the target's shares or the right to have such securities registered under the Securities Act for subsequent resale (*see, e.g.*, *Home Insurance* case study).

(3) The institution may be given the opportunity to participate in a financing by the acquiring company for the purpose of facilitating the contemplated transfer. For example, a bank may lend money to the acquiring company to enable it to acquire a large block of the target's shares for cash or to make a cash tender offer; institutions may purchase the acquiring company's securities in a non-public offering, the proceeds of which would be used to finance the transfer effort.

Where the institution already has advantageous business relationships with the acquiring company, as a creditor, depository or employee

[99] Compare *Perlman* v. *Feldmann*, 219 F. 2d 173 (2d Cir. 1955), where the court held that the defendant insiders must account to the other shareholders of the company for the "unusual profit" realized upon sale of their shares to an acquiring company. The court noted that the price of the shares included a "bonus" because of the power they carried to control the allocation of the company's products, and that the insiders had a fiduciary duty to the corporation (and its shareholders as beneficiaries). *See also Securities and Exchange Commission* v. *Parvin Dohrmann Co.*, SEC Litigation Release No. 4848 (December 15, 1970).

plan trustee, it may find it difficult to resist involvement in the transfer effort. Furthermore, the transfer effort may generate additional business for the institution: a bank holding a substantial equity position in the target or serving as commercial lender for the acquiring company may be named exchange offer agent or trustee and transfer agent for securities to be issued pursuant to the offer (*see*, *e.g.*, *Great American* case study).[100]

(4) The institutional financial manager may be induced to cause the institution to purchase the target's securities and tender them to the acquiring company pursuant to a public tender or exchange offer by assurances of future benefits to the manager if the offer is successful—for example, management of the target company's own investment portfolio (*see*, *e.g.*, *Great American* case study).

In some cases, the receipt of special benefits or information may compromise the interests of other corporate shareholders or the institution's own beneficiaries.

d. Self-fulfilling prophecy

To some extent, it appears that the phenomenon of corporate transfers and the role of institutional investors in such transfers is the product of a market psychology of self-fulfilling prophecy.

—A broker-dealer may recommend purchase of a company's stock as a desirable investment vehicle for institutional clients. The institutions buy, but the stock declines in price. Charging that the decline is a result of poor management, the broker may then attempt to find an acquiring company whose bid for control will restore and even enhance the price of the target's stock. The bid is made; the price rises and the broker's institutional customers profit (*see United Fruit* case study).

—A small company in a "glamour" industry whose stock enjoys a high price-earnings ratio may decide to make a bid for control of a larger company with assertedly less "aggressive" management whose stock has been selling at a low multiple or below book value. The acquiring company's aggressiveness in seeking control may sustain the judgment of institutions that the securities being offered in exchange for the target's securities are not overvalued—and may be disposed of subsequently at a profit. It may be reasoned that a pooling of the earnings of the two entities (where made possible under generally accepted accounting principles) will result in higher per share earnings for the acquiring company and that the pre-existing price-earnings multiple will be applied to the combined entity.

Institutional investors, like other investors, may tender to the acquiring company to obtain the more desirable investment medium. The apparent momentum of the bid for control may convince them that the only alternatives are to tender or to sell their holdings (*see*, *e.g.*, *Reliance Insurance* case study).

3. Case Studies of Institutional Involvement

Set forth below are summaries of the studies of institutional involvement in transfers of corporate control conducted by the Study's staff. The studies are based on interviews, testimony and documentary mate-

[100] Section D of this chapter indicates the extent of business relationships between institutions and portfolio companies.

rials obtained by the Study from the institutions, broker-dealers, companies and individuals involved. The *Armour* case study is based on an investigation conducted by the Commission's Division of Trading and Markets pursuant to Section 21(a) of the Securities Exchange Act. The Commission itself has made no findings or conclusions with respect to the facts in any case. The names of specific institutions are omitted.

In three of the case studies, data were collected on trading and tendering activities by institutions. These data indicate that relatively few institutions accounted for the bulk of institutional tendering in each case. Furthermore, the Study found that several institutions or institutional complexes were significantly involved in each of these three contested transfer bids.

a. Brunswick-Union Tank

On March 6, 1969, the managements of Brunswick Corp. ("Brunswick") and Union Tank Car Corporation ("Union Tank") announced their intention to submit to the shareholders of their respective companies a proposal for consolidation of the companies. The proposal was hailed by the managements of the two companies as a "merger of equals"; it came at a time when takeover bids and exchange offers were frequent occurrences in the market. The managements favored the merger because each was concerned that its company was vulnerable to takeover by other parties.

To the surprise of the managements, the immediate reaction of institutional shareholders to the announced combination was unfavorable. The institutional holders of Brunswick and the brokers who followed both companies questioned the financial and operational soundness of the proposal. They expressed their doubts among themselves and to the managements of the companies. The opposition voiced by institutional holders of Brunswick was particularly strong. In reaction to this opposition, the management of Brunswick solicited the support of institutional shareholders for the merger, but was unsuccessful.

With opposition to the proposed merger mounting, the proposed combination was called off on April 1. The reason given for abandonment of the proposal was that it was opposed by institutional shareholders of Brunswick.

Brunswick stock had become a favored investment of risk-oriented institutional investors, including nine registered investment companies, two hedge funds, one off-shore fund, one life insurance company and one bank. These fourteen institutions together held about 14.6 percent of Brunswick's outstanding shares. Six of the investment companies were part of two fund complexes, one of which held 6.1 percent of Brunswick's common stock.

Two brokers played key roles in evaluating the prospective merger and marshalling institutional opposition to its consummation. One of the brokers argued against the proposed merger to Brunswick management, predicting that institutional shareholders of Brunswick would oppose the merger. The other broker's reaction to the merger was also negative. As soon as he learned of the proposal, he called mutual funds holding Brunswick stock to express his views and obtain any reaction.

An officer of Brunswick noted in a memorandum that the first broker "has definite doubts as to wisdom of this move. Has talked to . . . [4 mutual funds]. All expressed consternation. [One fund] taking active part in calling other funds and creating opposition. [One broker] bought [shares] . . . for internal hedge fund. They don't understand why. Don't think the deal is in best interest of shareholders."

Both brokers continued to generate opposition among funds holding Brunswick stock during the period after the merger proposal was announced.

In addition to expressing dissatisfaction through brokers, institutional shareholders of Brunswick registered their opposition directly with management. These shareholders opposed the merger for the same reasons they bought Brunswick—the company had turned around and was registering dramatic earnings improvement. Projected per share earnings for 1969 for the combined companies were $1.00; Brunswick alone was expected to earn $1.05 per share.

Opposition was expressed most strongly by investment companies. One fund complex bought 1,264,800 shares of Brunswick between August 1968 and the March 6, 1969 announcement, and 40,200 shares during the pendency of the merger discussions.[101] The 1,305,000 shares was the largest block and totaled 6.1 percent of the outstanding stock. The complex bought because of a research report by its analyst, who observed that support by the complex could generate enthusiasm for the stock by other funds. The complex managers concluded that the merger would hurt their position because Brunswick by itself was a more speculative investment but had higher growth potential. They called management and announced that "their 24-hour look leads them to inform [Brunswick] that they will oppose the deal." They later told management they would vote against the deal if it was proposed to shareholders.

After the merger announcement, an analyst for another fund complex called an officer of Brunswick to express displeasure, and indicated that he had learned from the two brokers that other funds were unhappy. He listed the funds in an internal memo, adding: "It appears that all of these groups are strongly opposed to the merger. Most of us have made our feelings known to the company and the company has replied the deal is far from certain."

A representative of a hedge fund and an off-shore fund, together holding 370,000 shares of Brunswick purchased shortly before the merger announcement, advised an officer of the company that the funds would "oppose vehemently and vote against the combination." He stated that normally he would sell out when he opposed management but that this would have produced a loss in this case. He also told management that the proposed merger invited takeover bids and that he would respond to a higher bid by a third party.

In at least two instances, institutional holders of Brunswick expressed dissatisfaction to each other. The hedge fund referred to above obtained the reaction of the fund complex with the largest holdings of Brunswick. This complex also gave its views to another fund.

Brunswick management attempted to convince the opposition at a special meeting with institutions arranged for this purpose. Although

[101] Three other mutual funds purchased an additional 188,800 shares between the merger announcement and the withdrawal of the merger proposal.

the company's spokesman "did a good job selling the company he made a poor case for the merger" according to those present at the meeting. A private meeting with the fund complex holding the largest block failed to produce a more favorable reaction. However, a meeting with another fund complex did result in a concession—the fund agreed to vote for the merger as long as management continued to support it.

A tally by management showed that over 20 percent of Brunswick shares were opposed to the merger. Since the proposal required a two-thirds shareholder vote and at least the usual number of abstentions were contemplated, management realized that the merger could not assuredly be expected to be approved. Negotiations were formally terminated on April 1, 1969.

b. Bath Industries, Inc.

During the latter part of 1969, Bath was the subject of an attempt by a group of its shareholders to take control of the company. The group was headed by a director of Bath, and included several institutional holders:

an American banking affiliate of a British merchant bank;
a registered closed-end investment company;
an off-shore investment company; and
two investment advisers, one of which advised a family trust.

The director became increasingly dissatisfied with the corporate policies and decisions undertaken at the direction of Bath's president, and ultimately determined to attempt to remove the president and replace him with another chief executive. On the director's initiative, a meeting was held on April 14, 1969, attended by Bath's president, the president of the closed-end fund, the president of the family trust adviser and other representatives of management. The director's purpose in suggesting the meeting was to persuade the fund and the trust to purchase Bath shares held by its president. While no offer was made to purchase the shares, the members of the group suggested to Bath's management that fundamental changes in the company's business structure be effected.

The dissident director subsequently contacted executive recruiting agencies and spoke to at least one member of the group about finding a replacement for Bath's president. After the head of a Bath operating division resigned, the director and other members of the group blamed the resignation on Bath's president. The president was later questioned about the resignation at a meeting of institutional investors held on July 14, 1969; a number of those present expressed displeasure. After the meeting, two mutual fund complexes and one bank trust department disposed of Bath holdings, which were purchased in the market by members of the insurgent group.

At a meeting of the Bath board on July 15, 1969, the director attempted to remove the president, but his motion was defeated by a vote of 12 to 2. The only supporting vote was that of the director's attorney, who was also a member of the board. During July, the price of Bath stock declined, and three mutual fund managers in the same complex recommended disposition of their funds' holdings. The president of the closed-end fund supporting the director offered to buy the holdings of these funds in a private transaction, but the funds instead sold on the market through a block positioning firm. Several other institutions, including a bank, also disposed of Bath holdings during the latter part of July.

While the above-mentioned institutions were selling, members of the dissident group were purchasing Bath stock, on some days accounting for almost all of the purchases of the stock. The institutions in the group stated that they were not in contact with one another, but were independently interested in cleaning up "overhanging" blocks in the market.

During August 1969, various members of the group discussed their common interests in Bath. Two members of the group contacted a mutual fund complex holding a large block of Bath stock to elicit its support in the event of a vote against management. The complex expressed support for the insurgents and dissatisfaction with existing management.

On September 9, 1969, the dissident director hosted a dinner for members of the group to introduce his candidate for chief executive of Bath. Prior to the dinner, members of the group compiled a list of opposing shareholders; the list included the mutual fund complex referred to above. The plan was to confront Bath's president with the list as evidence that the insurgent group could win a proxy contest if necessary. At a meeting of the Bath board on September 10, 1969, the list was submitted to the president. The president retained the list, assertedly for the purpose of verifying its contents, and the board meeting was adjourned.

The president then contacted the mutual fund complex, which apparently held the balance of power. The complex decided to support the president. Bath then filed a lawsuit against the director and the other members of the insurgent group, alleging that the defendants had acted as a "group" within the meaning of Section 13(d) of the Securities Exchange Act, but had failed to file the required report with the Commission when they acquired over 10 percent of Bath's outstanding shares. (Under recent amendments, the report must be filed when over 5 percent ownership exists.)

The district court granted a temporary restraining order and, after an evidentiary hearing, it enjoined all defendants—except the closed-end fund, its president and the off-shore fund—from proceeding with any plan to remove Bath's president or call a special shareholders' meeting until they had complied with Section 13(d).[102] The defendants not enjoined had previously made offers of settlement in the proceeding which were accepted by the company. The remaining defendants have since settled the case on different terms.

c. Home Insurance Co.

An Institution's Dilemma.—In late 1967, an investment company which had formerly limited itself to investing solely in insurance company stocks, modified its investment policy (upon appropriate shareholder approval) in order to permit up to 40 percent of its portfolio to be invested in non-insurance stocks. The fund's manager, who had just assumed this position, was confronted with the necessity

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[102] *See Bath Industries* v. *Blot*, 305 F. Supp. 526 (E.D. Wis. 1969), *remanded*, 427 F. 2d 97 (7th Cir. 1970).

of diversifying a portfolio comprised of large blocks of relatively illiquid insurance stocks.

With the assistance of a securities analyst associated with a broker-dealer, the fund manager analyzed the problem. The securities analyst believed that property and liability insurance companies were desirable investments, concluding that the earnings of such companies could be increased through more aggressive management of their investment portfolios. To the extent that these companies were not willing or able to undertake such management themselves, they presented attractive acquisition targets.

The fund manager, while agreeing with this thesis, felt that there would have to be a dramatic event—such as an acquisition of an insurance company by a non-financial enterprise—before the market's demand for insurance stocks could be fully realized. In the absence of such demand, the fund found it difficult to dispose of insurance stocks in its portfolio. Shortly after joining the fund, the fund manager unsuccessfully attempted to dispose of a large block of insurance stock through more or less traditional media; the market-maker was unable to handle the block.

The fund's problem was exacerbated by two factors: First, it was a matter of public record that the fund had adopted an investment policy that permitted it to dispose of large blocks of insurance stocks; bids for certain such stocks dropped in anticipation of substantial sales by the fund. Second, redemptions of the fund's shares were in excess of sales; thus, it became mandatory for the fund to liquidate positions in order to meet redemptions. The fund manager concluded that "80% of the . . . [portfolio] was relatively illiquid as far as immediate marketability was concerned," and that "traditional market-makers did not have the financial strength to basically make realistic markets sufficient in size to handle the distribution problems of the . . . Fund."

Various "non-traditional" approaches were utilized: (1) unregistered private secondary offerings, (2) sales through block positioning brokers and (3) sales to the issuers of the stock in exchange for cash or for securities held in the issuer's investment portfolio. The most radical and potentially most successful approach was to sell large blocks to non-financial corporations in order to induce or facilitate a takeover of the portfolio company. This method not only enabled the fund to dispose of illiquid securities, but also created the possibility of enhancing the market value of the remaining insurance stocks in the fund's portfolio. As the fund manager reasoned, if any industry (here, property and liability insurance) became desirable "from a market point of view because of an acquisition potential," the market would attribute additional value to the securities of the industry.

Thus, the fund "did not discourage any inquiries . . . as to the possible purchase or acquisition of an insurance stock" it held.

Selection of Target/Initial Purchase.—The securities analyst who had consulted with the fund manager contacted Northwest Industries, Inc. ("Northwest") in April 1968 to suggest that it purchase a large block of Home Insurance Co. ("Home") representing slightly under 10 percent of outstanding shares. The block was held by the fund, which received the bid through the analyst and claimed to be unaware of the identity of the bidder until the actual sale.

The fund manager believed that the bidder intended to make an exchange or cash tender offer for additional Home stock. The manager had been informed by the analyst that the bidder was "very substantial." Recognizing that sale of the block would probably be the first step in an attempted transfer of control, the fund manager decided that the fund's "block was only for sale if it carried a very sizeable premium or some on-going value." In effect, the fund insisted upon and obtained "most favored shareholder" treatment from Northwest.

As a condition of the block sale, the fund was given the right to receive the difference between the block sale price and any higher price subsequently offered to other shareholders of Home through a cash tender offer. If Northwest were to make a securities exchange offer subsequently, the fund would have the right to repay the cash price it had received and accept instead any higher valued package of securities offered to the other shareholders.

This provision gave the fund a riskless opportunity to profit from any increase in the value of securities it had already sold in the event of a subsequent tender offer. The provision became a standard feature of transactions by the fund in large blocks of target company stocks. In some cases, the fund was able to obtain even more favored treatment; for example, the right to share in any profits realized from the resale of the block by the original bidder to a third party, the right to receive a portion of any prevailing higher market value at a later date, or the right to require the bidder to repurchase its own securities issued in exchange for the target's shares.

The agreement for the sale of the Home block was consummated on May 7, 1968. On May 22, 1968 Northwest announced its purchase of the block and also announced a proposed exchange offer for the balance of outstanding Home shares.

Transfer of Control to City Investing.—On June 19, 1968, City Investing, Inc. ("City") announced a competing bid for Home. When Home's management expressed preference for the City bid, Northwest decided to drop out of contention and formally withdrew on June 27. Its withdrawal permitted it to realize a quick profit through the sale of its block of Home stock to City at a price ($60 per share) almost double the original price of the block ($30.25 per share). The agreement of sale with City was approved by Northwest's board of directors on July 3, 1968.

Lacking the available cash to purchase the entire Northwest block, on July 12 City arranged through two broker-dealers to sell most of the block to various institutional investors. The institutions would tender this stock to City pursuant to its exchange offer for the package of securities comprising the exchange offer, which was altered from the original package at the request of such institutions and was to be valued at a price not less than the cash price of the Home shares purchased by the institutions.

In addition, the institutions were given the option for a period of one year or upon the expiration of the exchange offer, whichever occurred first, of tendering for the cash purchase price (payable in City common stock) any Home shares they held which were purchased from Northwest. City securities delivered to the institutions were to be included in the City registration statement covering the exchange offer.

City's obligation to acquire the Home shares from the institutions was subject to the condition that the institutions would not have purchased or sold any City stock during the five days before the institutions tendered Home shares to City. The five day period, used to calculate the exchange ratio based on closing prices of City common shares, was changed three times at the request of the institutions to enable their acquisition of a larger amount of City shares under the agreement.

The institutions purchasing Home stock included five registered investment companies, six bank trust companies (for managed accounts), an unregistered hedge fund and two insurance companies. Three of the banks and the hedge fund had in late 1967 purchased City securities in a private offering in order to enable City to refinance a cash tender offer for another company.

Purchases Outside the Exchange Offer.—City's exchange offer registration statement became effective on August 2, 1968. Under the exchange offer, tendering shareholders received securities valued on that date at $53.71 for each Home share tendered. However, institutions whose tenders were covered by the special agreement with City received the equivalent of $60 per Home share tendered. Thus, institutional shareholders received a premium for having served as conduits in moving the decisive block of Home stock from Northwest to City.

d. Great American Holding Corp.

The Target.—Great American Holding Corp. ("GAH") was the parent of Great American Insurance Co., a property and liability insurer. As of June 30, 1968, GAH had about $664 million in assets, 6.2 million outstanding shares and reported losses for the year then ended of about $4 million.

The Bidders.—National General Corp. ("NGC") was a conglomerate which was engaged in various entertainment and leisure time enterprises in 1968. As of March 31, 1968, NGC had assets of $195 million and 3.6 million outstanding shares.

AMK Corporation ("AMK") was principally a meat packing company in 1968. As of May 31, 1968, AMK had assets of $178.3 million and 2.2 million outstanding shares.

NGC Publicity Campaign.—In 1967, NGC embarked upon an acquisition program. In early 1968, it acquired a book publishing company and later in the year attempted to acquire a motion picture company. In an effort to develop institutional interest in its stock, NGC employed a public relations consultant who generated press announcements and also began meeting with institutional managers and broker-dealers.

Several brokers became interested in the stock and recommended it to institutional and other clients. NGC made projections of greatly increased earnings in private meetings with institutional managers. A number of fund managers indicated that the company was attributing prospective acquisitions—an "acquisition factor"—to its earnings projections.

During the second quarter of 1968, NGC met with at least eight investment advisers for investment companies, one of which was an off-shore fund. In contrast to relatively small institutional purchases of NGC stock in the first quarter of 1968, these funds made market purchases of a total of 693,800 shares during the second quarter, constituting 18.2 percent of all outstanding shares. During this period, the price of NGC stock rose from $25 to $60. The institutional purchasers were aware of NGC's desire to acquire other companies and of its projections that such acquisitions would greatly enhance per share earnings.

Selection of Target.—Since August 1967, a broker-dealer specializing in institutional business had been urging some of its clients to purchase the securities of property and liability insurance companies on the basis of a research study prepared by one of its financial analysts. The report espoused the thesis that these companies were not making optimal use of liquid assets in excess of the legally required surplus. It was suggested that these companies form parent holding companies which would be able to use this "redundant capital" to expand into related financial services without state insurance law restrictions. It was also indicated that these companies were acquisition targets for non-financial companies which could utilize their liquid assets.

The report pointed out that insurance company shares often sold below book value and that the management of such companies seldom held a substantial percentage of outstanding shares. GAH was listed as one such company.

On May 13, 1968, the president of NGC met with the broker-dealer and discussed the possibility of acquiring control of GAH. On May 28, 1968, when the market price of GAH was about $38 per share, the NGC executive committee authorized the purchase of up to 500,000 shares of GAH at up to $55 per share. The target had been selected.

Financing Initial Purchase.—In order to obtain sufficient funds to purchase the GAH shares, NGC sold 440,000 NGC common stock purchase warrants to various individuals and institutions in an assertedly non-public offering. Two registered mutual funds and one off-shore fund purchased a total of 300,000 warrants; these same funds after the first quarter of 1968 became substantial holders of NGC common stock.

The exercise price of the warrants was a substantial discount from the market price of NGC stock and the warrants carried immediate registration rights. NGC also agreed to obtain listing of the warrants on the American Stock Exchange, where warrants of the same class were already trading. The sale of the warrants raised $9.5 million. The purchasers denied they were informed of the specific purpose of the placement; they were told that the proceeds would be used for general corporate purposes or for acquisitions. A number of the purchasers stated that they were aware that the proceeds would be used for an acquisition, although they claimed ignorance of the target's identity.

In June 1968, NGC stepped up its efforts to interest institutions in its stock; it referred to an imminent acquisition that would add significantly to NGC's earnings.

Market Purchases/Defensive Tactics.—On June 3, 1968, the broker which had originally interested NGC in acquiring GAH began making purchases of GAH on behalf of NGC through a nominee account. By June 11, 403,700 shares had been accumulated, representing 7% of outstanding shares. The total cost of these purchases was $20 million.

GAH realized at this time that it was a target and had instructed its investment banker to find a more acceptable acquirer. Its investment banker did suggest a company, and on June 7, 1968, that company purchased a 296,000 share block of GAH from a bank having a common director on the GAH board. However, the investment banker was not able to put together another large block for purchase by the "acceptable" acquirer (offered by two insurance companies and a mutual fund) at a price it was willing to pay, and the company dropped out of contention on June 10.

On the same day, NGC's broker-dealer proposed a block purchase by NGC. In view of NGC's temporary lack of cash, the block was to be purchased on a "21-day delivery buyer's option." NGC expected to receive adequate cash from the sale of one of its subsidiaries on July 1. The broker-dealer arranged to purchase 145,000 shares of GAH from an insurance company and the 296,000 shares held by the "acceptable" acquiring company which was dropping out of contention. The transaction was consummated on June 11. Of this 441,000 share block, NGC purchased 266,000 shares and the remainder were sold to other clients of the broker-dealer, including an institutional holder of NGC which had participated in the NGC private placement to finance initial purchases of GAH.

At the request of the New York Stock Exchange, NGC announced its acquisition of the block on June 12, 1968. The exchange later found that the 21-day delivery option constituted a violation of Regulation T of the Federal Reserve Board; on October 15, 1968, the Exchange fined and censured the broker-dealer which had effected the transaction.

Exchange Offer.—Between June 12 and June 25, 1968, NGC unsuccessfully attempted to negotiate a friendly combination with GAH. On June 25, the NGC executive committee authorized an exchange offer for GAH shares. The exchange offer package, consisting of convertible debentures and common stock warrants, was valued at $400.2 million. The offer was announced on June 26; the registration statement covering the offer was filed with the Commission on August 8 and became effective on September 19, 1968, NGC shareholders having authorized the securities to be issued on September 10, 1968.

During June, several mutual funds, including earlier purchasers, purchased additional NGC shares, while also purchasing large positions in GAH. Three mutual fund complexes and one off-shore fund complex were particularly active.

Contest With AMK.—After preliminary negotiations between AMK and GAH beginning June 6, 1968, AMK issued a press release on June 27, the day after NGC's announced exchange offer, stating that friendly discussions with GAH were being held and that consideration was being given to a formal proposal by AMK. On July 10, at the suggestion of GAH, AMK submitted a proposal for merger. On July 16, NGC improved its proposed exchange offer package, but AMK stock reached a new high, purportedly on the market's expectation that it would combine with GAH.

On July 24, 1968, having received NGC's revised offer, GAH announced an agreement in principle to merge with AMK. Some of NGC's allies began circulating rumors that a key executive of AMK was seriously ill and that certain funds were "dumping" AMK stock. While most institutions stated that they were not influenced by these rumors, by August 8, the filing date of NGC's exchange offer registration statement, AMK stock had dropped substantially. A total of 471,200 AMK shares were sold by six mutual funds during the third quarter of 1968, including one which had participated in the NGC private placement. On the date NGC's registration statement was declared effective, two funds sold 154,000 AMK shares after a visit by NGC's chief executive.

In the registration statement, a bank holding 5 percent of GAH shares for managed accounts was named exchange offer agent, although NGC had no previous connections with the bank. The bank subsequently tendered half of these shares to NGC and sold the balance in the market near the termination of the NGC exchange offer when it was reasonably certain that such shares would be tendered to NGC because of the activity of arbitrageurs. Several mutual funds and one off-shore fund began acquiring substantial amounts of GAH. The price of NGC stock dropped after AMK entered the contest.

On September 3, 1968, NGC revised its offer by lowering the conversion price of the debentures and exercise price of the warrants. The next day GAH restated its intention to merge with AMK. NGC's shareholders approved the authorization of securities for the exchange offer on September 10, while GAH mailed notice of a special shareholders meeting to be held on October 8 to approve the AMK merger.

On September 18, the broker-dealer assisting NGC agreed to accept a finders fee of $250,000 regardless of the success of the exchange offer instead of the previously agreed $1 million contingency fee if the offer was successful.

NGC Inducements—GAH Portfolio.—After AMK announced its interest in GAH, NGC advised several institutional managers that it was not satisfied with the manner in which GAH's investment portfolio was being managed and stated that if NGC was successful in acquiring GAH, favorable consideration would be given to parceling out the portfolio for management by other institutional managers based on their cooperation with NGC with respect to the tender offer. One investment partnership manager stated that NGC had repeatedly attempted to induce him to purchase GAH stock and tender it to NGC by promising management of a portion of the insurance company's portfolio.

When NGC's exchange offer did prove successful, NGC initially made good on its assurances, selecting five investment advisers that had been helpful to NGC during the offer to manage a total of $65 million of the GAH portfolio. In general, the institutions managed by such advisers had been large purchasers of NGC and GAH stock, tendering the latter to NGC, and at least one had also been a large seller of AMK. NGC later assumed management of these portions of the GAH portfolio itself through a subsidiary. Only two of the five advisers actually managed portions of the portfolio for a short time.

Solicitation of Tenders.—After NGC's registration statement became effective, on September 19, 1968, NGC and a dealer-manager for the offer visited institutions to solicit tenders and to discuss the management of the GAH portfolio. AMK and GAH officials urged GAH holders to vote for the merger with AMK.

On September 26, AMK and NGC improved their offers. NGC discussed the merits of its package with several institutional managers before publicly announcing revisions. An off-shore fund helped to stabilize the value of the NGC exchange offer package by purchasing the securities offered in the "when issued" market. This made it more profitable for arbitrageurs and other investors to tender to NGC.

GAH brought suit against NGC, its investment bankers and a number of other brokers and investment companies, alleging fraudulent statements in NGC's exchange offer prospectus and press releases, violations of Regulation T, manipulation of NGC and AMK stock through institutional purchases and "downside stabilization" of GAH stock through critically-timed sales.

On October 4, 1968, the NGC exchange offer expired. The previous day, a mutual fund holding over 5 percent of GAH, which was unable to tender to NGC because of an Investment Company Act affiliation problem, sold on the open market. A substantial portion of this stock was purchased by institutions "allied" with NGC, including one mutual fund which increased its position to 447,800 (about 7 percent of outstanding) GAH shares. These shares were tendered to NGC. An aggregate of over 4.2 million shares were tendered to NGC, or about 69 percent of GAH's outstanding shares.

One off-shore fund complex tendered 9.69 percent of all shares tendered; another registered fund complex (selected to manage $25 million of GAH's portfolio) tendered 11.25 percent and the bank serving as exchange offer agent tendered 3.89 percent. Many of the institutions tendering had been "allies" of NGC since their initial purchase of warrants to enable NGC to buy its first block of GAH. Six investment companies and complexes, excluding the off-shore complex, and the bank aiding NGC tendered about 28 percent of all shares tendered and about 20 percent of the total GAH shares outstanding.

Post Exchange Offer.—On October 22, 1968, GAH publicly announced that their shareholders (including NGC) had defeated the AMK-GAH merger proposal; on November 14, GAH dismissed its lawsuit against NGC. During this period, competition for management of the GAH investment portfolio increased.

On November 14, NGC announced its intention to renew its exchange offer using the same package to acquire the remaining shares of GAH. The new offer became effective on January 10, 1969. The offer expired on February 5, at which time NGC owned about 94 percent of GAH shares. Two days later, on February 7, at the initiative of NGC, Great American Insurance Co., the operating subsidiary of GAH, paid an upstream dividend to GAH comprised of $173 million in securities from its portfolio.

On February 25, 1969, GAH was merged into NGC. NGC sold some of the securities GAH had received from its subsidiary and used $25 million of the proceeds to reacquire common stock and some of its debentures issued in the exchange offer. Some of the debentures were purchased from allied funds in market or private transactions. By this time, the debentures were selling at a discount. Thus, NGC was able to draw upon the resources of the acquired target to reduce the original cost of acquiring it.

Tendering by Institutions.—Table XV-50 indicates the extent of institutional activity in tendering GAH stock. Of all shares tendered, 39.84 percent were tendered by the institutions surveyed, including about 30 percent by 32 registered investment companies. Six investment companies or complexes and one bank tendered about 28 percent of all shares tendered.

TABLE XV-50

TENDERS OF GREAT AMERICAN HOLDING

Total Outstanding Shares:	6,157,141
Total Common Shares Held by Responding Institutions as of 5/12/68:	
30 Banks:	758,028
11 Investment Companies:	780,392
1 Insurance Company:	130,200
5 Other: 1/	43,118
Total:	1,711,538 (27.79%)
Total Shares Tendered: 2/	4,244,269
Total Shares Tendered by Responding Institutions:	1,690,960 (39.84% of all shares tendered)
18 Banks:	282,620 (6.65 of shares tendered)
32 Registered Investment Companies:	1,295,700 (30.52% of shares tendered) 3/
1 Insurance Company:	25,000 (0.58% of shares tendered) 4/
3 Other:	87,640 (2.06% of shares tendered) 5/

1/ Two investment advisers, two college endowment funds and one self-administered pension fund.

2/ The above total reflects the number of shares tendered pursuant to the first tender offer (9/19/68-10/4/68). A total of 213,578 shares was tendered during the second tender offer (1/10/69-2/5/69) by responding institutions as follows:

Banks:	41,478
Inv. Co's.:	148,300
Ins. Co's.:	0
Other:	23,800

3/ Six registered investment companies and one bank tendered about 28% of all shares tendered.

4/ A separate account of an insurance company tendered the subject shares. For purposes of the above calculations, the separate account was treated as an insurance company.

5/ One college endowment fund, one private hedge fund and one investment adviser.

e. Reliance Insurance Co.

Selection of Target.—As noted in the Great American Holding Corp. case study, a broker-dealer having a large institutional clientele prepared a report on the insurance industry in 1967. The report posited the thesis that property and liability insurance companies were desirable targets for acquisition by non-financial corporations because such insurance companies were not fully utilizing surplus capital in excess of required legal reserves. If such capital could be freed for employment in non-insurance enterprises outside the control of insurance regulatory agencies, the value of such insurance stocks would increase substantially.

This thesis had the corollary conclusion that insurance stocks presented an excellent opportunity for short-term investment by institutions—provided that non-financial corporations could be induced to attempt takeovers of property and liability insurers.

The broker-dealer circulated its report among various potential acquiring companies as well as among the insurance companies named in the report. Discussions were held with Reliance Insurance Co. ("Reliance"), one of the named insurers, but Reliance's management was opposed to any voluntary merger with another company. Undeterred, the broker continued to seek a partner for Reliance.

Leasco Data Processing Equipment Corp. ("Leasco"), a computer leasing company whose securities were valued at a high price-earnings multiple then enjoyed by this "glamour" industry, was a much smaller company than Reliance. After receiving a copy of the broker's report in November 1967, Leasco held discussions with the broker to learn about the property and liability insurance industry and to consider possible targets. The broker suggested several such targets, including Great American Holding Corp. and Reliance.

In January 1968, the broker advised Leasco that its clients held 600,000 shares of Reliance and that it could obtain an additional 2 million shares of Reliance's 4.7 million outstanding shares "for the right price." The broker also listed its compensation demands in the event that Leasco determined to seek acquisition of Reliance: (1) a finder's fee of $750,000; (2) assurances of an "immediate substantial commitment of cash" by Leasco for Reliance stock; (3) execution of all purchases of Reliance stock through the broker; (4) participation as dealer-manager in any tender or exchange offer; (5) a future relationship as Leasco's lead investment banker and (6) representation on the board of either Reliance or Leasco. Leasco was astonished at the extent of these demands.

During the first quarter of 1968, the broker strongly recommended purchase of Reliance stock by its institutional clients. The stock was then selling at a substantial discount from book value, a situation which the broker anticipated would radically change if Leasco could be induced to make an acquisition attempt.

Leasco remained uncertain about committing itself to such an attempt. However, the company had been considering acquisition of some type of financial institution. The broker sensed indecision and attempted to persuade Leasco through several discussions; an "expert consultant" (a mutual fund manager who later became president of the broker's investment advisory subsidiary and whose fund owned

3.2 percent of the outstanding Reliance stock and subsequently purchased additional shares at the broker's request) was retained by the broker to convince Leasco that the acquisition of Reliance would not tarnish Leasco's attractiveness to mutual fund managers. Leasco realized the importance of continued acceptability of its stock to fund managers as a means of maintaining its high price-earnings multiple, without which any acquisition program would have been more difficult. Its own investment banker advised against the acquisition of Reliance.

Initial Purchases.—Leasco acceded to the urging of the broker on March 13, 1968, at which time the decision was made to take a relatively small position in Reliance. An account was opened with the broker under a code number; Leasco assigned a code name to Reliance for internal purposes. From March 13 through April 2, 1968, Leasco purchased 132.600 shares of Reliance, or about 3 percent of outstanding shares, through the broker (which received commissions of $47,000). Leasco termed these purchases "investments."

The broker was disappointed with the size of the purchases. It was also concerned that Leasco agree to its compensation demands. Ultimately, the only form of compensation agreed upon was the $750,000 finder's fee. Leasco's hesitancy in proceeding with a takeover effort and its refusal to meet the broker's compensation demands resulted in strained relationships.

On April 3, 1968, Leasco advised the broker that it had terminated purchases of Reliance stock and would make no decision regarding future acquisition plans until after it had completed a contemplated public offering of common stock and warrants through another underwriter. The registration statement covering this offering was filed with the Commission on May 10 and became effective on June 4, 1968.

Anticipatory Institutional Purchases.—As it became apparent to the broker that Leasco was moving in the direction of a takeover attempt—even though the movement had been slowed by a pending registration statement—the broker stepped up its efforts to persuade institutional investors to buy Reliance stock in anticipation of such a takeover. The institutions would benefit by such purchases since a takeover effort would almost certainly boost the price of Reliance shares; Leasco would benefit since large blocks of Reliance would be posited in friendly hands more or less under the control of the broker. The broker would benefit by enhancing its image with institutions and other prospective acquiring companies, and it would reap more direct financial rewards through commissions, tender solicitation fees and finder's fees. These sources of revenue ultimately produced $1.3 million for the broker in this case.

Thus, on April 9, 1968, the manager of a large mutual fund whose investment policy contemplated long-term growth began a buying program in Reliance stock based upon information furnished by the broker to the effect that Reliance would be the subject of a Leasco takeover attempt. Ordinary public investors had no access to this information. From April 10 to May 28, 1968, the fund purchased 200,000 shares of Reliance through the broker. The information was conveyed to other funds in the same complex and they too purchased Reliance shares. Leasco did not publicly announce its acquisition of an "investment" in 3 percent of Reliance's shares until May 24, 1968.

The same type of anticipatory purchases were made by other institutions, primarily mutual funds. Most of the shares acquired in these purchases were later tendered to Leasco pursuant to its subsequent exchange offer. During the first six months of 1968, the broker's customers purchased a total of 1.2 million shares of Reliance, representing about 26 percent of outstanding shares. Reliance stock rose from 35⅛ on January 2, 1968 to 59⅞ on June 21, 1968, the day before Leasco publicly announced an exchange offer seeking control of Reliance.

Although no individual institution purchased more than 10% of Reliance's outstanding shares (which might have subjected the institution to the then existing reporting requirements of the Securities Exchange Act), all of the institutions acted on the same information of an impending takeover attempt and with the same expectation of a tender or exchange offer that would allow them to dispose of their holdings to an acquiring company at a substantial profit.

Leasco's indecision made it mandatory for the broker to keep any large blocks of Reliance from falling into unfriendly hands or from depressing the market until Leasco announced a takeover offer. Thus, when a mutual fund which invested heavily in insurance stocks found it necessary to dispose of 404,000 shares of Reliance on May 16, 1968, the broker first offered the block to Leasco. After Leasco declined to purchase the block, the broker placed it within three hours with institutional and some individual clients. Two mutual funds took 300,000 of the shares.

Leasco's public announcement of its 3 percent holdings of Reliance on May 24, 1968 came in response to a comment by a Commission staff member who was reviewing Leasco's registration statement covering an unrelated public offering of securities. The registration statement had merely disclosed a holding of an "unrelated financial company." However, the identity of the company was being disseminated by the broker assisting Leasco in the Reliance takeover.

On June 11, 1968, the broker expressed disappointment at Leasco's continuing indecision, threatening to "take the deal elsewhere" and complaining about its inability to keep mutual funds "informed."

Exchange Offer.—Leasco met with Reliance's management on June 17, 1968 to discuss a friendly combination of the two companies. After the meeting, at Reliance's suggestion, Leasco submitted a formal proposal for consideration of the Reliance board of directors. The proposal was promptly rejected, and on June 21, 1968, Leasco publicly announced a proposed exchange offer for Reliance stock. The exchange offer package was originally comprised of Leasco common stock warrants and convertible debentures; the debentures were subsequently replaced in the package by convertible preferred stock in order to qualify for pooling of interest accounting treatment.[103]

By the time the exchange offer became effective in late August, institutional clients of the broker which had originally suggested the takeover held substantial blocks of Reliance: six mutual funds or fund complexes held 1,184,000 shares or about 25 percent of outstanding

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[103] Such treatment is no longer permissible for convertible preferred stock under recently promulgated accounting rules of the American Institute of Certified Public Accountants. *See* AICPA Accounting Principles Board Opinion No. 16 (August 1970) ; *see also* note 104, below.

Reliance stock. All of these funds tendered their shares to Leasco when the exchange offer became effective.

Reliance at first vigorously resisted Leasco's offer. Its management approached several companies in an attempt to arrange a defensive merger. One company made an offer in late July for Reliance, which Reliance's management termed "acceptable." The deal was never consumated because of Leasco's success, which ultimately resulted in capitulation by Reliance's management.

Reliance also sought to enjoin Leasco and its broker adviser from proceeding with the exchange offer. The suit was later discontinued, and Reliance's management has since stated that it "could not prove the conspiracy" alleged.

On August 1, 1968, Leasco revised its offer and assured Reliance's senior management of five-year employment contracts if the exchange offer was successful. Management dropped its opposition to the offer on the understanding that Leasco would not exercise full managerial control over Reliance for five years.

Since Leasco's exchange offer was not yet effective, the company was prohibited by the Securities Act from making written representations about the offer except through the statutory prospectus. However, oral offers were not precluded, and Leasco attempted to obtain direct support from mutual funds for its offer. Leasco's officers met in July and early August with mutual fund managers or groups of fund managers; at least ten funds or fund complexes participated in these meetings. Although none of the funds admitted that they had been specifically asked for support, substantially all bought either Leasco or Reliance stock or both after the meetings or tendered their previous holdings of Reliance after the exchange offer became effective.

Special Shareholder Group.—During the latter part of July, Leasco noted that about 14 percent of Reliance's outstanding common stock, on a fully converted basis, was held by a small group of Class A common shareholders, consisting of three Reliance directors, their families, family trusts and a family-controlled corporation. The shares were convertible into common stock on the basis of 10 shares of common for each share of Class A, upon the approval of the Reliance board of directors. Leasco negotiated with these Class A shareholders to purchase their shares, recognizing that while the Reliance board would not approve any conversion of the shares, their purchase by Leasco would eliminate the possibility that the shares could be used defensively by Reliance.

The Class A shareholders wanted cash for their shares. But Leasco did not want a cash transaction for two reasons: first, Leasco did not have the $57 million in cash necessary to make the purchase. Second, the payment of cash might prohibit the use of pooling of interest accounting treatment.[104]

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[104] Under pooling of interest accounting, the combination of two companies is treated as though the companies had always been united: thus, assets of the two companies are combined at their book value, retained earnings are combined and, with proper disclosures, the acquiring company may report earnings to include the earnings of any company acquired during the fiscal year. Under purchase accounting, the assets of the acquired company are accounted for by the acquiring company on the basis of fair market value at the date of acquisition. In purchase transactions controlled by AICPA Accounting Principles Board Opinion Nos. 16 and 17 (August 1970), any excess of the purchase price over the fair market value of the tangible assets acquired is charged to an intangible, such as goodwill, and amortized against earnings over some specified period. Earnings of the acquired company are reflected only from the date of acquisition.

These problems were supposedly eased by an agreement reached on July 23, 1968 under which the Class A shareholders would tender their stock to Leasco, receiving Leasco securities, and Leasco would find buyers to pay cash for the Leasco securities received by the tendering shareholders. Leasco put together a group of about 20 institutions, including banks, insurance companies, mutual funds and unregistered investment partnerships, to purchase the Leasco securities from the Class A shareholders. Bank trust departments accounted for about half of the purchases. It was decided to structure the deal in this manner rather than to have the 20 institutions buy the Reliance stock directly from the Class A shareholders and tender it to Leasco because of possible liabilities for short-swing profits under Section 16(b) of the Securities Exchange Act and also in order to avoid immediate taxable gains to the institutions.

In order to induce the institutions to buy the Leasco securities, Leasco undertook to provide them an annual return of approximately 15 percent (*i.e.*, a $2.20 dividend on Leasco preferred and 75 cents per month for each Leasco unit held for one year) and also gave them a put option under which they could sell the Leasco securities to the company after a year at a "guaranteed price" in excess of the purchase price. The institutions could, in the alternative, participate in a registered secondary offering of the Leasco securities, for which Leasco would pay all expenses or find purchasers for the securities. Any profits realized upon resale in excess of the "guaranteed price" were to be divided between Leasco and the institutions under a specified formula. Leasco characterized these institutions in the exchange offer prospectus as "underwriters" since they were facilitating a distribution of Leasco securities.

These arrangements gave Leasco what it wanted—removal of the last possible pocket of resistance to its takeover effort—while conferring substantial benefits on both the Reliance Class A shareholders, who received cash for their shares, and on the institutions participating in the take-out agreement.[105] Similar advantages were not made available to other Reliance shareholders who tendered their stock in exchange for Leasco securities and had no assurance as to what the securities they received would be worth in the future.

Tendering by Institutions.—Table XV–51 indicates that 28 investment companies tendered 28.66 percent of all Reliance shares tendered, while all institutions surveyed accounted for 32.05 percent of all shares tendered. Six investment companies (or complexes) alone tendered almost 26 percent of all shares tendered.

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[105] The arrangements imposed considerable burdens on Leasco. At the request of certain banks participating in the agreement, Leasco deferred a registered secondary offering of the institutions' shares. The price of Leasco shares later dropped, and Leasco was required to refinance its take-out agreement by substituting other institutions, including pension funds, and by borrowings from seven banks. The borrowings were secured by 62% of outstanding Reliance shares. Two of the banks had participated in the take-out agreement.

TABLE XV-51

TENDERS OF RELIANCE

Total Shares Outstanding: ($5 par common)	4,713,220
Total $5 par common Shares of Reliance Held by Responding Institutions as of 12/31/67:	
29 Banks:	511,660
17 Registered Investment Companies:	574,744
2 Insurance Companies:	39,700
4 Others: 1/	23,288
Total:	1,149,332 (24.38%)
Total Shares ($5 par common) Tendered to Leasco:	4,571,823
Total Shares ($5 par common) Tendered to Leasco by Responding Institutions:	1,465,365 (32.05% of shares tendered)
22 Banks:	138,465 (3.02% of shares tendered)
28 Registered Investment Companies: 2/	1,310,500 (28.66% of shares tendered)
0 Insurance Companies:	-0- (0% of shares tendered)
2 Others 3/	16,400 (0.35% of shares tendered)

1/ One hedge fund and three investment advisers.

2/ Note: Six Investment Companies or Complexes tendered 1,184,300 shares (25.9 %) of all shares tendered.

3/ Two investment advisers.

f. United Fruit Co.

Selection of Target.—In May 1967, a broker-dealer firm with a substantial institutional clientele began recommending the purchase of United Fruit stock to its customers and purchasing such stock for discretionary accounts. The recommendation, which was based on a general analysis of the company's business and management, resulted in substantial institutional purchases of United.

In early 1968 the price of United stock increased, but later in the year it began to decline as higher earnings failed to materialize. The broker had suggested several possible acquisition opportunities to United, but United had not responded favorably. In September 1968, the broker notified United that it intended to give its clients a negative report about United; at the same time, the broker offered United a large block of its own shares. When United declined to accept the offer, the broker determined that the most feasible way of taking its institutional and other clients out of United stock was to interest another company in acquiring United. The broker sought to expand its acquisition consultation and assistance services.

On September 19, 1968, the broker met with the management of AMK Corp. to submit a proposal for the acquisition by AMK of a block of United representing about 9½ percent of outstanding shares. This was to be followed by an exchange offer for United's remaining shares and, ultimately, the merger of United into AMK. AMK indicated interest in the plan and the broker pressed for an early decision, particularly because of rumors to the effect that Zapata Norness Co. was preparing its own exchange offer for United.

A few days later, AMK informed the broker that it would purchase 9½ percent of United (thereby avoiding reporting of its holdings under the then existing requirements of the Securities Exchange Act), but that the block would have to be close to 10 percent; AMK did not want only 2 or 3 percent of the company.

Initial Purchase/Most Favored Shareholder Clause.—The broker contacted institutional clients, stating that a "corporate buyer" was prepared to pay a premium over the then prevailing market price for United stock. AMK also agreed to a most favored shareholder proviso—if, in the future, AMK made a cash tender offer for United stock, the institutions selling the initial block to AMK would be entitled to receive the difference between the sale price of the initial block and any higher price offered for the other shares; if AMK made a securities exchange offer, the institutions would be entitled to repay the initial purchase price and instead take any higher valued package of securities.

In spite of these favorable terms, several institutions balked at disposing of their United shares. The broker exerted persistent persuasion on certain large institutional holders of United to sell at least part of their holdings. One mutual fund which held about 4 percent of outstanding United shares agreed to sell half of its holdings to AMK after considerable internal dispute. In other cases, the broker advised institutional clients to retain part of their United holdings. The sellers included seven mutual funds (474,000 shares), a life insurance company (106,600 shares) and a foundation (15,600 shares). Other customers of the broker, including pension funds and profit sharing trusts, sold about 135,000 shares. Two of the selling mutual funds were managed by the broker. Three mutual funds or fund complexes refused to sell.

The transaction was crossed on the New York Stock Exchange on September 24, 1968, at a price 10 percent above the previous closing price.

Financing Initial Purchase.—The purchase of the initial block was financed by a loan of $35 million from seven banks. The lending group was put together by AMK's principal commercial banker, which later acted as warrant agent and trustee for the debentures included in AMK's exchange offer. The loan was made for the specific purpose of purchasing United stock; although the loan was unsecured, AMK's banker retained custody of the stock until the exchange offer became effective in January 1969 and repayment was assured by exercise of the most favored shareholder option.

The loan carried the condition that AMK could proceed with an exchange offer only if agreeable to United's management. The exchange offer prospectus stated that AMK intended to repay the loan with the funds it expected to receive from the exercise of the most favored shareholder proviso; since the exchange offer package was valued at a higher price than the price which the institutions selling the initial block had received, it was anticipated that the institutions would elect to repay the original price and take the securities instead.

Competing Exchange Offers/Anticipatory Purchases and Sales.—On September 27, 1968, Zapata announced its exchange offer for United stock. This offer was publicly opposed by United's management. At management's urging, Dillingham Corp. announced an exchange offer for United on September 30, 1968. This offer was later withdrawn on October 22, 1968. United then sought to merge with Textron Corp., announcing a merger proposal on November 4, 1968. However, the investment community reacted adversely to the proposed merger; a number of institutions, believing that Textron was paying too much for United, sold their holdings of Textron.

Weighing the competing offers of AMK and Zapata and apparently realizing that some takeover was inevitable, United's management elected to support AMK's offer. The AMK exchange offer was publicly announced on December 4, 1968 and Textron withdrew its merger proposal five days later without regret.

During the period of offers and counter-offers, the price of United stock climbed steadily upward. At the same time, the broker which had devised the AMK takeover plan was soliciting anticipatory purchases of United by institutions and anticipatory sales of Zapata. The sales would depress the value of the Zapata exchange offer package, thereby increasing the attractiveness of the competing AMK bid.

Thus, for example, one mutual fund complex, which was a client of the broker, was induced to sell 100,000 shares of Zapata almost simultaneously with the announcement of the AMK exchange offer, despite purchase recommendations by the fund's analysts. One life insurance company, which had participated in the sale of the initial United block to AMK, sold 20,000 shares of Zapata common stock on November 1, 1968 through another broker serving as dealer-manager for the exchange offer. The proceeds were invested in Zapata debentures, and the debentures were sold after AMK's exchange offer proved successful.

Just prior to the effectiveness of Zapata's exchange offer on January 9, 1969 and of AMK's exchange offer on January 10, another mutual fund sold 20,000 shares of Zapata. Two hedge funds effected short sales of Zapata stock at about the same time.

Anticipatory purchases by institutions were made by institutions that had participated in the original block sale of United stock to AMK in September 1968.[106] Since the exchange offer package was valued in excess of the price those institutions had received, they had an incentive both to exercise the most favored shareholder option—repaying the original price and taking the exchange package—and to purchase and tender additional United shares in order to ensure the success of the AMK offer. AMK's management characterized these institutions in early discussions with United's management designed to secure United's support, as "locked in" to AMK. It will be recalled that several of the institutions had retained part of their United holdings.

As an officer of United explained to other members of management, the institutions were "so economically tied up that they could not afford not to [support] the AMK deal . . . [They are] going to be darned sure to do everything they can to make the AMK offer succeed. And which means not only tendering the additional shares that they have for the deal . . . but some of them actually went out and started buying shares again in order to have them on hand to insure the success of the AMK deal."

In oral and written solicitations by the initiating broker, it was pointed out that the "value" of the most favored shareholder option would be "enhanced" if additional United shares were tendered to AMK. The written solicitations were reviewed by the dealer-manager for AMK's exchange offer. While AMK's exchange offer prospectus stated that all shares tendered would be accepted, the impression was conveyed that the AMK securities received might not be worth as much if the offer failed to achieve a transfer of control. Thus, several institutions purchased additional United shares and tendered them, as well as shares they had previously held, to AMK.

Zapata Efforts—Special Offering.—Zapata and its broker-dealer adviser attempted to purchase AMK's block of United on January 3, 1969. When AMK declined the offer, deciding to continue with its own efforts, Zapata's broker realized that it was imperative for Zapata to obtain an initial block on its own initiative. Arbitrage houses held substantial amounts of United stock, and both Zapata and AMK attempted to win the allegiance of these brokers.[107] Zapata's broker received indications from the arbitrageurs that they would sell to the highest bidder, but that absent any price difference, they would tender to AMK. This made it even more critical for Zapata to pick up a large block of United on its own.

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[106] Such purchases were also facilitated by the bank acting as AMK's exchange offer agent, which also administered United's pension trust. Two days before the effective date of AMK's exchange offer, the bank sold a large block of United shares held by the trust on the market. The shares were purchased by a mutual fund which later tendered them to AMK.

[107] On January 22, 1969, seven arbitrage houses held about 6.7% of the outstanding shares of United, and by March 4 (before issuance of the AMK exchange offer securities) they held about 12% of such shares.

Zapata's broker proposed that an effort be made to solicit institutions to purchase United stock from arbitrageurs and tender in exchange for Zapata common shares separate and apart from the Zapata public exchange offer. The exchange would place a premium on United stock and the institutions would also have the option of taking the exchange offer package of securities if they wished to do so. In addition, the institutions were to be given a put option, permitting them to sell their United stock to Zapata for cash (at a premium price) in the event that Zapata was unable to list the Zapata common stock on the New York Stock Exchange. Zapata would also agree to register under the Securities Act the shares given to the institutions in exchange for United stock.

Even before the proposal was finalized, the broker attempted to obtain indications of interest from institutions. However, the deal collapsed when legal counsel advised Zapata that the New York Stock Exchange would not list common stock given to institutions under a special arrangement of the type contemplated.

AMK's Solicitation.—On January 17, 1969, one week after AMK's exchange offer registration statement had become effective, AMK contacted several institutions to solicit tenders of United stock. One mutual fund and one off-shore fund were particularly sought after as allies. AMK indicated that a block of United stock might be available for purchase by these institutions. AMK consulted with its dealer-manager on strategy, emphasizing the importance of keeping large blocks out of the hands of Zapata.

On January 20, 1969, a broker-dealer with a substantial arbitrage business called AMK to advise that a block of 370,000 United shares was available. AMK had been in frequent contact with arbitrageurs and believed that their cooperation was essential to success. After receiving the call, an officer of AMK called the manager of the mutual fund referred to above to determine whether this fund would be interested in buying the block. The manager indicated willingness to take 350,000 shares. The AMK official then called the dealer-manager for its exchange offer; the dealer-manager confirmed and executed the sale the same morning on the New York Stock Exchange.

A short time later in the day, the fund manager realized that the purchase had created a two-fold problem: first, the fund did not have sufficient cash to buy the block; second, the shares in the block, when added to the fund's existing holdings of United, represented more than 5 percent of United's outstanding shares, thereby constituting the fund an "affiliate" of United under the Investment Company Act and requiring Commission approval under the Act for any tender to AMK, which was also an "affiliate" of United because of its 9½ percent shareholdings. The fund manager promptly called the dealer-manager, who was upset but promised to solve the problem. The fund manager stated that he could still buy 250,000 shares. This left 120,000 shares (out of the original 370,000) to be quickly placed.

The dealer-manager called the AMK official, who in turn contacted the off-shore fund referred to above. The off-shore fund agreed to buy 80,000 shares, and the order was executed through the dealer-manager. At the request of the dealer-manager, another arbitrage house bought 30,000 shares. The 10,000 shares of the original 370,000-share block not covered by these sales were purchased by a mutual fund client of the broker which had originally initiated AMK's interest in the acquisition of United. All of these shares were tendered to AMK.

At AMK's shareholders meeting on January 21, 1969, AMK announced that it had already received assurances that 40 percent of United's stock would be tendered to it. On January 27, Zapata withdrew its exchange offer, giving those shareholders who had already tendered the right to withdraw their shares and selling the remainder of its United shares to AMK. AMK and United subsequently merged.

Post-Exchange Offer Period.—Several of the institutions participating in the original block sale to AMK and in later anticipatory purchases disposed of their AMK securities within a short period after the expiration of the exchange offer. Sales were made both through the broker which had initiated the takeover effort and through AMK's dealer-manager. While there were no formal take-out agreements, the dealer-manager stated that it felt a greater propensity to block position sales of AMK securities where the firm had induced clients to tender.

Tendering by Institutions.—Table XV–52 indicates that 36 investment companies tendered to AMK 36.83 percent of all United shares tendered, while all institutions surveyed accounted for 46.39 percent of shares tendered. Six investment companies (or complexes) tendered almost 28 percent of all shares tendered.

TABLE XV-52

TENDERS OF UNITED FRUIT

Total Common Shares Outstanding:		7,834,347
Total Common Shares Held By Responding Institutions as of 9/24/68:		
26 Banks:		233,448
23 Investment Companies:		1,690,600
7 Insurance Companies:		268,600
5 Other 1/		416,153
		2,608,801 (33.29%)
Total Common Shares Tendered to AMK:		6,442,556
Total Common Shares Tendered to AMK by Responding Institutions:		2,988,751 (46.39% of all shares tendered)2/
15 Banks:	87,561	(1.35% of shares tendered)
36 Registered Investment Companies (excluding insurance company separate accounts)	2,373,300	(36.83% of shares tendered)3/
5 Insurance Companies: (including separate accounts as part of one life company)	203,700	(3.16% of shares tendered)
8 Other:	324,190	(5.03% of shares tendered)4/

1/ Four investment advisers and one university endowment fund.

2/ Twelve registered investment companies and/or investment company complexes, one insurance company complex, one investment adviser and one private hedge fund tendered 2,566,900 shares, or 39.9% of all shares tendered.

3/ Six registered investment companies and/or complexes tendered 1,799,500 shares, or 27.9% of all shares tendered.

4/ Includes six investment advisers, one private hedge fund and one university endowment fund.

g. Armour and Co.

Purchases by Gulf & Western.—In the fall of 1967, Gulf & Western Industries ("G&W") (a conglomerate), without any public announcement, began to purchase the common stock of Armour and Co. (a major food processor). The purchases were effected on the market through a broker-dealer with a large institutional clientele. By January 1968, G&W had accumulated 750,000 shares, or about 9.9 percent of Armour's outstanding shares, purchased at a cost of over $26.7 million.

G&W proposed in January 1968 to merge the two companies. However, the Justice Department challenged the proposed merger as anticompetitive. G&W decided to withdraw its proposal and to dispose of its Armour shares—hopefully at a substantial profit. It offered the shares to Armour, reasoning that Armour was in a vulnerable position for a takeover bid, at $60 per share.

Armour Bid For Own Shares.—Instead of accepting the G&W offer of Armour shares, Armour announced, in June 1968, a proposal to acquire its own shares by a public cash tender offer. The offer for 1.5 million shares at $50 per share was made on August 1. G&W was not surprised that the offer was made, but was disappointed at the price. In addition, G&W realized that the offer, by reducing the number of outstanding Armour shares, would have the effect of making G&W a statutory insider because its 750,000 shares would amount to over 10 percent of outstanding shares after the offer. The offer thus forced G&W to find another buyer if it was to sell above $50 and avoid possible short-swing profits liabilities under Section 16(b) of the Securities Exchange Act.

Initial Purchase by General Host.—General Host Corporation ("Host"), a relatively small company in the food industry, learned of the availability of the Armour block from G&W and a broker-dealer and decided to attempt to purchase it. Under agreement of August 6, 1968, Host purchased 150,000 shares of Armour from G&W at $56 per share, the purchase price to be payable in two installments of $4.2 million each at the signing of the agreement and at the closing on August 16. G&W also granted Host a 90-day option to purchase the remaining 600,000 shares of Armour at $60 per share plus a ten-year warrant to purchase 175,000 shares of Host common stock at $30 per share.[108]

Financing of Initial Purchase.—In order to finance the initial purchase of 150,000 shares, Host needed to borrow $6.9 million (the remainder being available from internal sources). Bank loans by Host's commercial banker were quickly arranged. Since the total amount of the loans, when added to existing loans, would have exceeded the bank's legal lending limit to Host, the bank arranged to have another bank lend $5.9 million on an "unsecured" basis. A loan secured by the Armour stock would have been impermissible under Federal Reserve Board Regulation U because the value of the stock was less than that required for such collateralized loans.

Although the loans were termed "unsecured," various contractual arrangements gave the banks effective control over the Armour stock for purposes of repayment.

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[108] Host stock closed at $34 per share on August 6, 1968.

Financing of Supplementary Purchases.—Additional financing was needed to enable exercise of the option to purchase the remaining 600,000 Armour shares from G&W and to repay the bank loans used to purchase the initial block. Host's two broker-dealer advisers arranged for a private offering to institutions and others of $47.4 million in 20-year subordinated notes, convertible into Host common stock at $27 per share. Although the use of proceeds was not originally restricted to the purchase of Armour stock, this restriction was later added upon the insistence of several institutions which believed that the notes would not otherwise be a desirable investment.

Among the purchasers of the notes were:

8 investment companies ($15.8 million in notes)
4 foreign banks ($7 million)
5 hedge funds ($4.1 million)
2 broker-dealers ($3 million)
1 off-shore fund ($2.5 million)
1 U.S. bank ($2 million)[109]
1 life insurance company ($1.5 million)

Purchases of $1.5 million in Host notes were also made by two officers of Host, financed by Host's commercial banker.

Disclosure of Host Purchases.—Host disclosed its over 10 percent holdings of Armour pursuant to Section 13(d) of the Securities Exchange Act on September 11, 1968. Host first responded to Item 4 of Schedule 13D, requesting information about the purpose of the transaction, with the words: "Not Applicable." After the Commission's staff advised Host that a definitive answer was required, Host amended the Schedule on October 16, as follows:

> Item 4. *Purpose of Transaction*
> General Host Corporation has purchased the 150,000 shares of Armour Common Stock and acquired the option to purchase an additional 600,000 of such shares because it considers such purchases to be a good investment. General Host Corporation may, depending on future analysis and developments, increase its investment in Armour and Company. General Host Corporation, however, has not entered into any arrangement to obtain the financial resources which would be required for General Host Corporation to substantially increase its investment in Armour beyond the above-mentioned 750,000 shares.

"Confidential Report on Armour and Company."—By the end of September 1968, the management of Host had completed most of its "Confidential Report on Armour and Company." The report included chapters on Armour's management, business, labor relations, financial history and other matters, and concluded with a chapter entitled "Investment Strategy." This chapter discussed six phases of a possible transfer bid for Armour.

The first phase was the acquisition of the initial 150,000 shares from G&W and the arrangement for the note placement. The second phase of the strategy centered around the exercise of the 600,000 share option. The third phase of the strategy involved increasing Host's ownership interest to between 20 and 25 percent of the outstanding shares, through open market purchases or a tender offer. The fourth phase of the strategy contemplated an increase in Host's ownership to the point of "virtually absolute control—probably somewhere between 40%–51%."

[109] The bank purchased for three corporate pension and profit-sharing trusts and one commingled fund for similar trusts.

According to the report, once Host gained control of Armour, several options were available: (1) a downstream merger of Host into Armour; (2) a merger of Armour into a newly created subsidiary of Host; (3) the acquisition of an 80 percent ownership interest in Armour; or (4) some other type of reorganization involving the sale of assets and the reduction of Host's debt.

The fifth phase of the strategy was thus to consummate some business combination between Host and Armour, and the sixth phase was the "successful integration of Armour and Company into the General Host family."

Host took precautions to prevent the report from falling into the hands of outsiders, but a copy was given to its bankers in connection with the financing of subsequent open market purchases of Armour stock (phase three of the strategy).

The strategy followed by Host did, in fact, closely parallel that set forth in the report through the first four phases. Host's failure to consummate the final stages of the strategy was due to circumstances which could not have been foreseen in the summer and fall of 1968 when the report was written.

The report did discuss the possibility of a disposition of Host's holdings of Armour stock in the event that it proved impossible to consummate the next successive phase of its transfer bid.

Rejection of Transfer Bid by Armour.—From the outset, Armour's management made it clear that it rejected any attempted transfer bid by Host. The chief executive of Armour refused to meet with Host officials and publicly opposed the bid.

Market Purchases—Financing.—On October 21, 1968, Host requested its commercial banker and the other bank that had participated in the earlier financing to arrange a $20 million loan to finance market purchases of Armour stock, the objective being to increase Host's holdings to 20 percent of outstanding shares. The first bank again faced legal lending limitations; these were resolved by bringing in a third bank to participate in the financing.

All three banks were given copies of the "Confidential Report" and were aware of Host's ultimate objectives. The loans were conditioned on the requirement of compensating balances by Host and on the understanding that the banks would become commercial bankers for Armour if the transfer bid was successful. The banks required the loans to be repaid immediately if Host was not able to consummate a combination with Armour.[110]

The financing was arranged in the face of defensive efforts by Armour's management to block loans by banks throughout the country with which it did business or which hoped for commercial banking relationships with Armour. Armour officials contacted bankers by telephone and letter, stressing the obstacles that lay in Host's path and Armour's continuing opposition to any takeover.

Conditioning Market for Host Securities.—In the months preceding Host's public transfer bid, the market in its own securities was

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[110] The Armour stock acquired with the proceeds of the loans was deposited in a custody account with one of the banks. There was no lien agreement with respect to the stock, but the banks had a right of set-off as to all property in their possession.

bolstered by the distribution of two research reports on October 22 and November 25, 1968 by an investment adviser and a broker-dealer. These reports stimulated purchases of Host stock by institutions. Both reports were reviewed by Host officials, and one of the reports reflected Host's view that an existing antitrust decree prohibiting Armour from merging with another company in the food industry would not preclude the transfer bid.

An officer of Host also spoke at a luncheon for institutional investors, sponsored by the broker-dealer which had prepared one of the reports. After the luncheon, one mutual fund manager stated that "it seemed more than casually implied that they were going to go after Armour."

The price of Host stock rose from $39 on December 5 to $44 on December 13, 1968, at which time Host announced that it was "considering the possibility" of making an exchange offer. During this period, the clients of the broker-dealer referred to above accounted for about one-third of the purchases of Host stock on the New York Stock Exchange.

Anticipatory Purchases of Armour and Host Securities.—Large amounts of both Armour and Host securities were traded by institutions, particularly mutual funds, during the last quarter of 1968 and the period in January 1969 prior to the effectiveness of Host's exchange offer. The funds accounted for purchases of 405,100 shares and sales of 351,400 shares of Armour common stock; they accounted for purchases of 239,700 shares and sales of 102,400 shares of Host common stock.

Most shares were purchased on the recommendation of Host's two broker-dealer advisers. Some of the institutional purchasers had previously purchased Host's notes in the private placement used to finance its initial acquisition of Armour shares from G&W.

Armour's Proposal for Defensive Merger.—Armour announced on December 12, 1968 that it planned to make an exchange offer for Williams Brothers Co. The transaction was never consummated, and Armour's chief executive officer subsequently stated that the purpose of the announcement was to "get out in the open" Host's intent to take control of Armour. The terms of the proposed acquisition would have involved the issuance of enough Armour shares to make it difficult for Host to acquire a controlling block, reducing Host's holdings to about 10 percent of outstanding shares.

Exchange Offer.—On December 5, 1968, Host filed an amendment to its Schedule 13D (previously filed under Section 13(d) of the Securities Exchange Act) in order to reflect its purchases of a total of 250,000 shares of Armour stock during November. Host characterized the purpose of the purchases as designed "to increase its investment" in Armour. However, after the announcement on December 12 of the Williams Brothers deal, Host changed its official posture. Another amendment to its Schedule 13D, filed on December 13, stated:

> *Item 4. Purpose of Transaction*
> General is considering the possibility of obtaining control of Armour and Company through acquisition of additional stock by means of an offer made generally to Armour stockholders.

The terms of the exchange offer were submitted to the Host board of directors on December 16 and approved. No announcement of this fact occurred until December 23.

The registration statement covering the offer was filed on December 30, 1968.

Valuation of the Exchange Offer.—Armour was approximately ten times the size of Host. Thus, attractive valuation of the offer was crucial to Host's success. Three bases for evaluating the offer existed. By far the most important was market value, particularly in view of the subsequent competing cash tender offer of the Greyhound Corporation, which set a standard cash value for the Armour shares during the period January 27 through February 13, 1969.

The other two bases for evaluation were set forth in the registration statement:

First, the income received by an Armour stockholder would be increased from $1.60 in the form of dividends on Armour stock, to $4.20 in the form of interest on Host debentures. Second, instead of owning a share having a book value of approximately $41, the former Armour shareholder would have a debenture with a face value of $60 and 1½ warrants, affording the former Armour shareholder "the opportunity to participate in any possible future increases in the market value of General Host's stock."

Defensive Litigation—Antitrust Decree.—On January 27, 1969, Armour brought suit against Host in an effort to obtain an order temporarily restraining the making of the Host offer. The motion was denied, but the litigation continued.

Throughout the entire takeover period, Armour publicized its belief that a takeover by Host would be illegal under the terms of the antitrust consent decree entered in 1920 against major meatpacking companies, including Armour. The decree prohibited certain mergers of such companies within the same industry. Armour's views were buttressed by, and Armour made widespread use of, opinions from four of the country's most prestigious law firms. Armour statements citing these opinions were released to the press and mailed to Host and to banks, other financial institutions and brokers throughout the country. Armour relied on the Department of Justice as its ultimate line of defense against the transfer bid. However, the Department was unsuccessful in convincing the courts that the bid should be blocked.

Armour also tried to convince the state securities authorities in Illinois, Wisconsin, Kentucky and California to prohibit the Host offer in those states. It met with success in Illinois and Wisconsin, partial success in Kentucky, and failure in California. These efforts did not help Armour materially.

Greyhound Tender Offer—Initial Consideration and Financing.—At the same time Gulf & Western was acquiring its holdings in Armour, the Greyhound Corporation (a large company with interests in transportation and food, among other things) was starting to consider Armour as a possible acquisition. However, Greyhound did not have discussions with Armour's management or otherwise pursue its interest actively until after the Host offer was announced and there were indications from Armour that it would be receptive to another bidder. A member of Greyhound's executive committee who was also a close friend of Armour's chairman received indications from Armour's management that it would favor a competing bid.

The Greyhound board of directors met on January 27, 1969 to consider making a cash tender offer for Armour common stock. The minutes of the Board meeting reflect that a very thorough review was made of the whole situation. The proposal to seek 2.5 million shares (about 40 percent of outstanding) at $65 per share was approved and publicly announced.

The financing for the offer was obtained from bank sources. Preexisting credit agreements supplied $75 million; $42.5 million was borrowed from one of Armour's commercial bankers (which had previously also been a Greyhound creditor); and the remaining $47.5 million was loaned by a number of New York banks.

Greyhound conditioned the making of the offer on the tender of about 500,000 Armour shares controlled by Armour's chairman. This was felt to be essential both to give Greyhound an initial block of Armour and to show that Armour's management supported the Greyhound offer. Armour's chairman agreed to the proposal.

Disclosure of Greyhound Purchases.—In its Schedule 13D filing with the Commission on January 27, 1969, Greyhound stated it was purchasing for "investment." The schedule was amended, after staff comment, to reflect an intent to obtain control of Armour:

> Greyhound Food Management, Inc. is purchasing the Armour and Company shares as an investment with a view to control. Depending upon the number of shares acquired pursuant to the Offer, it may or may not obtain control of Armour and Company.

Block Purchase by Greyhound/Higher Competing Offers.—On January 30, 1969, a broker-dealer acting for Greyhound arranged with an arbitrage house and another broker-dealer to purchase two blocks totalling 500,000 shares of Armour at $70 per share. The transactions were executed on the Pacific Coast and Midwest Stock Exchanges, and one of the selling brokers had to sell short to complete the trade. An hour after the trades, and two minutes before the close of the New York Stock Exchange, news was carried on the broad tape of the trades and of an increase in Greyhound's cash tender offer price from $65 to $70 per share. Before this public announcement, the broker was able to cover its short position by purchases on the New York Stock Exchange at less than $70 per share.

During the first three days of its public tender at $65, virtually the only stock Greyhound received was the nearly 500,000 shares tendered by Armour management. In part, this was due to the fact that many stockholders, particularly institutions, do not act until the last few days of an offer period. Mainly, however, it was due to the fact that the market price of Armour rose from the pre-tender price of $59 per share to close at $67½ on January 29. The price rise was caused by heavy buying, especially by customers of the broker-dealer-arbitrage house that participated in the January 30 block sale to Greyhound.

Many buyers of Armour stock anticipated that the terms of the offers would escalate with the conflict. Thus, Host announced on January 28 that it was considering increasing the value of its package, and at the opening of the market on January 29, the new terms were revealed: the number of warrants to be offered was increased, while the warrant exercise price was lowered.

Greyhound realized the necessity for revising its offer, but was willing to do so only if it could be assured of obtaining a significant number of shares. After purchasing 500,000 shares of Armour at what was then a $5 premium, Greyhound on January 30 raised its cash tender to the $70 per share price. Under Section 14(d) of the Exchange Act the new price became applicable to all previously tendered shares as well.

Results of Greyhound Bid.—By the weekend of February 8, 1969, Greyhound counted tenders for 1.6 million shares of Armour. The tender offer was due to expire on February 10. Greyhound decided to increase the tender offer price to $72 per share and to accept any and all shares tendered, dropping the previous 2.5 million share limitation.[111] This action produced the tender of 240,000 shares from three mutual funds—the only shares tendered by mutual funds to Greyhound during the course of its offer. The funds had been friendly to Armour's management, but had been unwilling to tender to Greyhound at a price lower than the market price.

The possibility of the increase was discussed with one of the fund complexes the day before the increase was publicly announced, and the funds agreed during the discussion to tender their Armour shares to Greyhound at the increased price.

By the end of the tender offer period, extended to February 13, 1969, Greyhound had acquired 2 million shares of Armour stock and $4.3 million in Armour convertible debentures, at a total cost of approximately $152.4 million. Greyhound thus became a one-third owner of Armour, but fell short of the 40 percent goal it hoped would have blocked Host's efforts.

Solicitation of Tenders by General Host.—Host's registration statement became effective on January 30, 1969. Solicitation of tenders was the primary responsibility of the two broker-dealer advisers which had assisted Host from the outset of its transfer bid and were now also dealer-managers of the offer. Host's management also contacted mutual funds to solicit tenders.

Institutions were solicited to purchase Armour shares and tender to Host. This would not only keep shares out of Greyhound's hands, but would also tend to keep the price of Armour stock above the Greyhound cash tender price. Thus, for example, at the urging of one of the broker-dealers, the manager of one mutual fund purchased 100,000 shares of Armour on February 5 and 50,000 shares on February 11 and 12, tendering all shares to Host. After learning from the broker-dealer that Host was "reasonably sure we are going to get control," and was close to its goal, the fund manager recommended buying an additional 50,000 shares of Armour to tender to Host. He thought that this "additional purchase was sort of insurance . . . It would move to assure the investment, so to speak."

In one case, a large mutual fund already holding Armour shares agreed to tender to Host only after being assured of a ready disposition of the warrants comprising part of the exchange package. One of the dealer-managers of the offer arranged for a sale of the warrants through an arbitrage house.

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[111] Armour stock had closed at $72 per share on February 7, 1969.

The three mutual funds which ultimately tendered to Greyhound were a special target of solicitation efforts by Host. Host attempted to dissuade Armour shareholders from tendering to Greyhound or to induce them to revoke such tenders.

Among the most important instances of institutional facilitation of the Host exchange offer were the following:

—On January 31, 1969, a property and liability insurance company (which itself had become a subsidiary of a conglomerate as a result of a successful transfer bid) purchased 231,400 shares of Armour stock through one of the dealer-managers. All but12,500 of these shares were purchased at prices above the Greyhound tender price. On February 7, the company purchased an additional 93,500 shares through the same broker and at prices in excess of Greyhound's offer. All of these shares, amounting to 5 percent of Armour's outstanding stock, were tendered to Host in exchange for $20 million in Host debentures and warrants to purchase 25 percent of Host common stock. An investment partnership comprised of officers of the insurance company's parent had previously purchased $1 million of Host notes in the private placement that initiated the transfer bid. These officers thus may have had a personal stake in the success of the bid.

—One off-shore fund complex not only purchased Armour shares to tender to Host, but also agreed to purchase the Host warrants comprising the exchange offer package that other institutions wanted to dispose of. This helped to maintain the value of the package, while facilitating tenders by other institutions. One fund in the off-shore complex ultimately became the owner of warrants which, if exercised, would have given it 25 percent of Host's outstanding shares.

—A registered investment company complex, which had participated in the initial Host note financing, was also instrumental in purchasing and tendering Armour shares. It ultimately held warrants which, if exercised, would have given it over 10 percent of Host's outstanding shares.

Post-Transfer Bid Conduct.—Although Host obtained a majority of Armour's shares, it had neither enough shares (two-thirds) to effect a statutory merger nor enough (80 percent) to file consolidated tax returns. In addition, Armour's by-law provisions for staggered director terms precluded control of the board of directors until 1971. The debt which Host had incurred in the transfer bid could not be serviced by the dividend income it would receive from Armour stock. The New York Stock Exchange denied listing of the Host debentures because it appeared that Host might not be able to meet debt service requirements.

Host needed Greyhound's stock to effect a merger with Armour. However, Greyhound refused to sell or grant Host an option. An interim agreement was arrived at among Armour, Greyhound and Host, permitting Greyhound two directors and Host four directors on the 17-man board. Even the combined attempts by Greyhound and Host to form an executive committee were defeated by Armour's other directors. Under a subsequent agreement, the chairman of Armour resigned and a six-man executive committee was formed, consisting of representatives from all three companies. Each group of representatives had a veto.

This situation proved intolerable for Host; it had no practical control over Armour, but all of the expense of servicing the debt used to acquire control. On October 27, 1969, Host capitulated, selling its Armour holdings to Greyhound for cash, promissory notes and Greyhound preferred stock and warrants. This package had a value of about $211 million, or $50 million less than the amount at which Host valued its Armour holdings for accounting purposes.

Many of the institutions receiving Host securities sold some or all of their holdings by June 30, 1969. Although some institutions and corporate investors purchased these securities, the bulk of them were purchased by individuals. The Host exchange package, valued at $74.65 on February 14, 1969, was worth about $50 on June 30, 1969 and $30 on February 13, 1970, one year after the exchange offer expired.

h. General Time Corporation

Selection of Target.—In 1967, Talley Industries, Inc. ("Talley") embarked on an acquisition program, invoking the assistance of a broker-dealer. One of the limited partners of the brokerage firm was an officer and director of Talley. The broker conducted discussions with the management of General Time Corporation ("General"), assertedly to determine whether General's stock was a good investment opportunity for the broker's clients. The broker apparently concluded that General was a "worthwhile investment" and purchased relatively small amounts of shares for its discretionary and other customer accounts.

On December 22, 1967, the broker suggested to Talley's president that he consider the possibility of acquiring General stock either as a personal investment or for Talley as a means of initiating a takeover effort for the company. The broker submitted to Talley a "Confidential Memo for Talley Industries" in which General was described.

Initial Purchases.—Beginning on December 26, 1967, Talley began to make market purchases of General stock. Prior to this time, Talley had not acquired securities of any company for investment purposes nor had it maintained any brokerage account for this purpose. Talley purchased 24,800 General shares on December 26 and 27, 1967, accounting for over half of NYSE volume in the stock on those days.

Solicitation of Anticipatory Purchases.—On December 29, 1967, Talley's president called the president of a registered open-end investment company (or "mutual fund") which held over 5 percent of Talley's outstanding shares. At this time, Talley had only about 1 percent of General's outstanding shares. However, Talley advised the mutual fund that it contemplated an acquisition of a "listed company" and asked whether the fund would consider buying such stock—apparently to assist Talley in acquiring a decisive block of General shares.

On January 3, 1968, at the request of Talley, its assisting broker met with the fund's officials to discuss the merits of the proposal. The fund indicated that it would purchase General shares provided that the price could be maintained at reasonably low levels. Both Talley and the fund agreed that purchases should be effected through the broker in order to prevent the possibility of their bidding separately for the same block of stock. Prior to this time, the fund had analyzed

General as a possible investment opportunity, but had concluded the stock was not "strong enough" to warrant purchase. The impending Talley bid convinced the fund manager that General "might be quite an attractive investment and had a very good chance of going up in price."

On January 5, 1968, the fund placed an order with the broker for purchase at the broker's discretion of up to 205,000 shares (later increased to 210,000 shares) of General stock. This represented the maximum possible commitment by the fund under its investment policy which restricted it from investing in more than 10 percent of the outstanding voting securities of any one company.

One other registered investment company and its broker also made anticipatory purchases based on information furnished by Talley's assisting broker that a transfer effort was contemplated or underway. During the first quarter of 1968, the investment company purchased 30,500 shares of General, constituting about 15 percent of the fund's investment assets at that time. The fund's broker purchased an additional 100,000 shares for its other customers. Another investment adviser purchased 43,500 shares for a number of its accounts in January 1968 after discussions with Talley's broker. In each of the above cases, part of the purchases were executed by the broker. The broker also made substantial purchases for its own clients—51,100 shares on January 12 alone.

Stabilizing Price of Target Shares.—In order to reduce any price impact on General stock during the period of anticipatory purchases, Talley curtailed its purchases of General during the period January 5 through February 15, 1968, when the mutual fund rendering primary assistance was acquiring its 210,000-share block. Talley also sold General shares during this period; overall, it purchased 35,000 shares and sold 50,000 shares. Most of Talley's purchases during the period occurred after the fund had acquired substantially all of its shares. At the same time, General shares sold by Talley were placed in friendly hands by the broker. At one point, the fund's manager suggested to the broker that if Talley and its allies "would quit buying altogether, the price would probably come down." Buying was suspended on two occasions, and the price of General shares declined, after which anticipatory purchases were resumed.

Throughout the period, Talley maintained close contact with the fund, reporting the numbers of General shares being acquired by itself and its allies.

Special Bid/Additional Market Purchases.—On February 19, 1968, Talley purchased 66,437 General shares through a special bid on the New York Stock Exchange. The special bid alerted General to the fact that it was the subject of a takeover effort. General's management met with Talley the same day, and news of Talley's identity as the bidder appeared on the broad tape, although this information was given to General in confidence.

Talley proposed a merger with General, claiming that it and its associates held about a third of outstanding shares. General first agreed to consider the proposal, but quickly determined to oppose it. Talley, which at that time held about 5½ percent of General's shares, then made additional market purchases, bringing its holdings to about 12½ percent by February 23, 1968. Talley's initial purchases of General stock had been at a price of about $25 per share; by the time of subsequent market purchases after public disclosure of the bid, Talley had to pay up to $43.50 per share. Talley also agreed to pay its broker a fee of $750,000, contingent upon consummation of a merger with General (in addition to the brokerage commissions on its purchases).

Defensive Tactics.—Talley's basic strategy was to oppose General management's director nominees at the forthcoming April shareholders meeting and to support its own nominees—through an "Independent Stockholders' Committee of General Time Corporation" whose proxy solicitation expenses were borne by Talley. One of the director nominees of the Committee was the president of a mutual fund (although not the primary fund) which made anticipatory purchases of General stock.

General attempted to block this strategy by defensive litigation and a defensive merger. Both efforts were unsuccessful. General first brought suit in federal court, alleging violations of the Investment Company Act and seeking to enjoin the voting of its stock by Talley and its allies. The case was dismissed on the grounds that General did not have standing to sue.[112] After the Talley group had filed proxy soliciting material, General again attempted to block its transfer effort by bringing suit in federal court, alleging that the proxy material was false and misleading and violative of Section 14 of the Securities Exchange Act. This suit, too, was unsuccessful.

On April 13, 1968, General announced an agreement in principle to merge with Seeburg Corporation, "contingent upon the continuation of General's present management." Both of the mutual funds that had made substantial anticipatory purchases of General stock announced shortly thereafter that they were opposed to the Seeburg merger proposal and would vote against it.

Commission Action/Outcome of Transfer Effort.—Since the mutual fund purchasing 210,000 shares of General also held over 5 percent of Talley's outstanding shares, Talley was an affiliated person of the fund under the Investment Company Act. To the extent that the purchases of General stock by Talley constituted "joint transactions" with the fund, such purchases required prior approval by the Commission under Section 17(d) of the Act and Rule 17d–1 thereunder. Approval is conditioned on a finding by the Commission under Rule 17d–1 that the participation by the investment company in the joint arrangement "is consistent with the provisions, policies and purposes of the Act. . . ."

The investment company in this case had made no application for prior approval of its purchases of General stock. However, on March 25, 1968, before Talley's proxy solicitation material was mailed, such an application was filed with the Commission. On April 19, 1968, the Commission found that there was a joint arrangement subject to Section 17(d) of the Act, that the requisite prior approval had not been sought, and that there was "no warrant for granting retroactive approval of the transactions effected in such violation of the Act." [113]

Undeterred, on April 21, 1968, the day before the scheduled meeting of General's shareholders, Talley issued a press release announcing

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[112] *General Time* v. *Talley Industries,* 283 F. Supp. 400 (S.D.N.Y. 1968), *affirmed,* 403 F. 2d 159 (2d Cir. 1968), *cert. denied,* 393 U.S. 1026 (1968).
[113] SEC Investment Company Act Release No. 5358.

plans for a merger with General after the contemplated election of the Talley slate of directors. Talley indicated that it would offer convertible preferred stock in exchange for General shares. The General shareholders meeting was adjourned to May 3, 1968 in order to permit the votes to be counted and certified. Preliminary indications pointed to a Talley victory, which would not have been possible without the support of the assisting fund.

On May 1, 1968, the Commission instituted an injunctive action in federal court seeking to enjoin the mutual fund and Talley from violations of the Investment Company Act and to compel the defendants to withdraw their votes cast at the shareholders meeting. Upon appeal from a decision of the district court dismissing the complaint, the court of appeals found that there had been a violation of Section 17(d) and Rule 17d-1, but declined to order the defendants to withdraw their votes.[114]

On December 2, 1968, it was determined that the Talley slate of directors had won by a vote of 979,235 shares to 882,159 shares for General's nominees. Talley and General were subsequently merged.

i. Collins Radio Co.

On March 24, 1969, Electronic Data Systems Corp. ("EDS"), a computer company with annual sales of $8 million, announced that it intended to acquire Collins Radio Co. ("Collins"), a large radio and communications company with annual sales of $440 million. A combination with Collins was viewed by EDS as a means of obtaining the benefits of Collins' technological, manufacturing and marketing capabilities. EDS planned to exchange its stock, selling at 250 times earnings, for 51 percent of the shares of Collins, then selling at ten times earnings.

Collins responded to EDS' proposed exchange offer by engaging in various defensive tactics. These included advising shareholders not to tender, writing letters to state securities authorities urging them not to authorize EDS' offer in their states and negotiating combinations with other companies. None of these efforts appeared to be having much success.

Collins did receive several offers from companies seeking to acquire it, but none of them matured into agreements. One potential acquiring company was blocked by opposition from the Justice Department, which suggested that a combination with Collins might be anticompetitive.

Both before and after announcement of the proposed exchange offer, EDS' investment banker and market-maker sought to keep large blocks of EDS off the market which might have depressed the market price of EDS stock and thereby jeopardized the exchange offer. These blocks were placed with institutional investors, several of which indicated that the investment banker was soliciting or inducing their purchases of EDS.

EDS and its investment banker also met with several major institutional holders of Collins' stock, including two banks, an investment adviser and a life insurance company. The expressed purpose of these contacts was to familiarize Collins institutional shareholders with EDS management. The two banks together held about 23 percent of

[114] *Securities and Exchange Commission* v. *Talley Industries*, 399 F. 2d 396 (2d Cir.), *cert. denied*, 393 U.S. 1015 (1968).

Collins' outstanding shares. One of the banks exercised sole voting authority over 60 percent of its holdings of Collins and partial voting authority over 16 percent; the other bank had sole voting authority over 92 percent of its holdings and partial voting authority over the remaining 8 percent. Both banks were also major creditors of Collins.

Even before EDS' announcement of the proposed exchange offer, negotiations had begun between Collins and the commercial departments of several banks, including the two banks referred to above, for the purpose of amending an existing revolving credit agreement to increase the amount of the credit lines. The credit agreement contained standard protective clauses, including a provision which gave the banks with a specified percentage of the loan commitment the option of requiring repayment of the loans in the event Collins merged or consolidated with another company.

In response to the announcement of the EDS exchange offer, several of the banks expressed concern that this provision did not encompass an exchange offer. The banks suggested and Collins agreed to a modification of the provision to provide that if 30 percent of the outstanding stock of Collins were owned or controlled, directly or indirectly, by any single shareholder, the loans would be repayable at the option of the holders of 25 percent of Collins' outstanding loans. This type of provision, directed to tender and exchange offers, was then unique within the banking industry.

On May 1, 1969, EDS withdrew its proposal, explaining that Collins had just notified it of the amendment to the credit agreement. Collins has subsequently expressed the view that a restrictive provision in a credit agreement would not prove completely effective in deterring potential takeovers: the acquiring company could refinance the target company's debt if necessary and, in any event, it is unlikely that the banks would actually call the loans, particularly if the company was not able to repay them.

The two banks holding 23 percent of Collins' outstanding shares were mainly instrumental in blocking the exchange offer. The trust departments of those banks, which had been approached by EDS for support, were opposed to the offer because of the disparity in the size and price-earnings multiples of the two companies. The commercial departments of the banks were also opposed to the offer for much the same reasons. While the banks stated that the loan repayment provision was primarily intended to protect the bank's creditor interests by providing for a review of Collins' debt service requirements after any major change in its corporate business or structure, they admitted that the provision would afford some measure of protection to managements of target companies

Both banks stated that the decisions of their trust and commercial departments were arrived at independently, and that the departments did not consult with each other.

j. Trading analyses

In the *Great American Holding Corp.*, *Reliance Insurance* and *United Fruit* case studies, the Study analyzed institutional trading, tendering and resales of securities received in these exchange offers. The initial data for such trading were derived from Form I–1 responses on monthly purchases and sales (discussed in Part Three) and, in the case of investment companies also from Form N-1Q, a quarterly report required to be filed by all registered investment companies under the Investment Company Act of 1940. Institutions indicating trading activity in any of the securities involved in these case studies also received special questionnaires requesting data on daily trading during the relevant periods. The data supplied were supported in some instances by examination of underlying documentation and records maintained by the institutions.

Tables XV-53, XV-54 and XV-55 indicate for each of the three case studies the target share holdings of particular types of institutions at the initiation of the transfer effort (in some cases subdivided according to the size of such holdings); purchases and sales of the target's shares during the pre-public exchange offer period beginning with the initiation of the transfer efforts as defined in the tables; purchases and sales of the target's shares during the period of the public exchange offer's effectiveness; the number of target shares tendered to the successful bidding company; and sales of the bidding company's securities received in exchange for target shares tendered. For purposes of comparison, the tables show sales of the new securities in units reflecting the exchange ratio. Resales are set forth for the periods ending one month after the effective date of the tender offer (which would include trading in the "when issued" market), six months after expiration of the offer, and one year after expiration, with an indication of holdings by the institutions at the end of one year. The six-month period may be significant since it indicates the point at which securities received through tendering could be disposed of at long-term capital gain tax rates.

Several conclusions emerge from these data, although it would be inappropriate to attempt to apply these conclusions to all transfer bids since the data are limited to the three cases analyzed and necessarily depend on the facts in each case.

(1) *Short-term trading.*—It appears that in each of the case studies, critical assistance to the bidding company occurred in the form of large purchases of target company shares by registered investment companies which held no such shares prior to the initiation of the transfer bid. These investment companies, as opposed to most other investment companies and most other institutions, were significant purchasers of target shares during the period before the tender offers became effective and either purchased additional shares during the effective period which, together with earlier acquisitions, they tendered to the successful bidding company, or sold the target's shares in the market at a profit during the effective period of the tender offer. Target shares sold by institutions during the exchange offer period are often purchased by arbitrageurs which tender to the bidding company for trading profits represented by the spread between the market price of the target shares and the greater value of the exchange offer package. Such shares are also purchased by institutions allied with the bidder which tender these shares.

Thus, although some institutions do not directly tender their shares, they nonetheless facilitate transfer bids by their short-term trading activity, purchasing large amounts of the target's shares during the transfer effort and selling those shares in the market during and usually shortly before the expiration of the exchange offer. Institutions may prefer market sales to direct tendering since they are assured of an immediate cash profit and do not have to bear the risk of holding bidding company securities offered in exchange for the target's shares. (The tax consequences here were the same since the tender offers analyzed were not tax-free exchanges.)

While in the *United Fruit* case, investment companies tendering a large number of target shares included mutual funds which had substantial positions in such shares before the initiation of the transfer bid, it will be recalled that one of the factors in the initiation of the bid was to enable institutional clients of a broker-dealer which had recommended purchase of United Fruit shares to dispose of those shares at a profit. Some of these pre-existing holders participated in the sale of the initial block of United to AMK and, because of the most favored shareholder proviso in that transaction, they had a particular interest in tendering the target's share and in "rescinding" the earlier cash sale transaction to accept the higher valued package of securities in the exchange offer. In addition, in a slight departure from the pattern exhibited generally, several investment companies previously holding moderate amounts of target shares purchased substantially during the pre-effective and effective period and tendered moderately heavy amounts.

In the *Great American* case, one large mutual fund holder of the target's shares, favorably inclined to the tender offer, disposed of its holdings through market sales the day before expiration of the tender offer because it was an "affiliate" of the bidding company under the Investment Company Act (both the fund and the bidder held over 5 percent of the target's shares) and a direct tender would have required a Commission exemptive order.

Registered investment companies were by far the most significant factor in short-term trading and tendering activity. By contrast, banks appear generally to have sold their holdings of target shares in a rising market for such shares rather than to have tendered them. The prices of the target shares increased substantially from initiation of the transfer efforts to the effective dates, and rose even higher during the effective periods of the exchange offers. Thus, the reason for market sales may have been the desire to obtain tangible realized gains. An exception was the bank which served as exchange offer agent in the *Great American* case; a large holder of the target's shares through its trust department, this bank tendered significant amounts of target shares to the bidding company.

Insurance companies followed a similar pattern as banks in the *Great American* and *Reliance* cases, possibly because the targets were other insurance companies. However, insurance companies tendered moderate amounts of the target's shares in the *United Fruit* case.

Other institutions, including investment advisers, hedge funds, university endowments and, in one instance, a self-administered pension fund, did not deviate significantly from the bank-insurance pattern and were net sellers. However, moderate amounts were tendered by investment advisers in *United Fruit*, the largest block by the broker-dealer which initiated the effort. Two large blocks were also tendered by hedge funds, one in *Great American* and one in *United Fruit*.

(2) *Disposition of securities received in exchange offers.*—In all three case studies, there was a similar pattern of disposition of the securities received in the exchange offers. Institutions as a group sold between roughly one-third and one-half of all securities received in the exchange offer within the first year. Substantial dispositions by institutions which had held no target shares at the initiation of the transfer effort would be indicative of short-term trading in the same manner that market sales by those institutions of target shares shortly before or after the effective date of the exchange offers would tend to show short-term interest.

In general, it appears that institutions have a somewhat greater tendency to dispose more quickly of the most volatile components of exchange offer packages, warrants. This was the case for investment companies with no holdings in the target prior to the transfer effort. Debt securities issued were apparently not considered more attractive than equity securities from the standpoint of long-term investment.

In *United Fruit*, investment companies with no prior target holdings disposed of almost all of the warrants received within one year after the expiration of the exchange offer. During the same period, they disposed of about half of the common stock received and over three-quarters of the debentures. Investment companies with large initial target shareholdings disposed of about half of the warrants, three-quarters of the common stock and less than one-quarter of the debentures within one year. In *Reliance*, investment companies with no prior target shares sold over two-thirds of the warrants received and about one-third of the convertible preferred shares received within one year. In *Great American*, investment companies with no prior target shares sold over one-third of the warrants and about the same amount of debentures within one year.

(3) *Participation by unregulated institutions.*—It appears that unregistered hedge funds and unregistered offshore funds have been significant participants in short-term trading and tendering activity in the contested transfer bids examined. As noted, two large blocks were tendered by hedge funds; the entire position in one instance and the bulk of the position in the other were accumulated during the effective periods. One off-shore fund complex, whose trades and tender activity are omitted from the tables, made substantial purchases of target and bidder shares in *Great American* and *United Fruit*. Purchases of the bidder's shares would tend to support the price of the bidder's stock. The complex tendered large amounts of shares and was also particularly active in the "when-issued" market in one case, purchasing securities in that market from institutions wishing to dispose of them and thus helping to maintain the price of the exchange offer package, to facilitate arbitrage transactions and to make tenders by others more attractive to them.

These unregistered institutions are not subject to the strictures of the Investment Company Act, such as the requirement of Commission approval of transactions involving affiliated persons, or the other restrictions imposed by state and federal regulatory bodies.

TABLE XV-53

GREAT AMERICAN TRADING, TENDER AND RESALE ANALYSIS

Institutional Category	Great American Holdings as of 5/12/68	Period 1 1/ 5/13-9/18/68		Period 2 2/ 9/19-10/4/68		Tenders	RESALE OF NEW NGC SECURITIES 3/ Effective date to 1 month after expiration		1-6 Months		6 months-1 year		Holdings after 1 year (10/4/69)	
		P	S	P	S		No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.
Investment Companies holding over 50,000 shares as of 5/12/68 (2)	683,740 (1 investment co. held 619,640 shares)	-0-	64,100	-0-	619,640	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Investment Companies holding between 10,000 and 50,000 shares as of 5/12/68 (4)	87,000	-0-	30,000	-0-	13,800	43,200	-0-	-0-	43,200	43,200	-0-	-0-	-0-	-0-

1/ From date target was suggested as acquisition candidate to acquiring company to date prior to effectiveness of National General's tender offer.

2/ From effective date of tender offer through expiration of first tender offer.

3/ Package consisted of 1.5 warrants and a $50 debenture.

GREAT AMERICAN TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	Great American Holdings as of 5/12/68	Period 1 1/ 5/13-9/18/68		Period 2 2/ 9/19-10/4/68		Tenders	RESALE OF NEW NGC SECURITIES 3/ Effective date to 1 month after expiration		1-6 Months		6 months-1 year		holdings after 1 year 10/4/69	
		P	S	2	S		No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.
Investment Companies holding less than 10,000 shares as of 5/12/68.(5)	9,652	14,200	18,900	-0-	4,952	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Investment Company holding no shares as of 5/12/68.(40)	-0-	1,052,550	203,800	412,380	53,130	1,218,000	60,000	33,000	180,600	208,740	205,100	211,960	838,967	764,300
Banks holding over 50,000 shares as of 5/12/68 (4)	599,824	500	102,514	6,554	231,068	273,296	-0-	-0-	50,000	30,000	129,600	4,914	12,591	205,410
Banks holding between 10,000 and 50,000 shares as of 5/12/68 (5)	99,996	-0-	34,514	-0-	59,608	3,320	-0-	-0-	3,000	3,000	-0-	-0-	-0-	15,032 (Banks with -0- to 50,000 holdings as of 5/12/68.)
Banks holding less than 10,000 as of 5/12/66 (21)	58,208	7,300	6,618	8,100	30,178	15,888	1,200	-0-	15,896	2,076	1,096	-0-		

GREAT AMERICAN TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	Great American Holdings as of 5/12/68	Period 1 1/ 5/13-9/18/68 P	Period 1 1/ 5/13-9/18/68 S	Period 2 2/ 9/19-10/4/68 P	Period 2 2/ 9/19-10/4/68 S	Tenders	RESALE OF NEW NGC SECURITIES 3/ — Effective date to 1 month after expiration: No. of 1.5 units of wts.	Effective date to 1 month after expiration: No. of $50 units of debs.	1-6 Months: No. of 1.5 units of wts.	1-6 Months: No. of $50 units of debs.	6 months-1 year: No. of 1.5 units of wts.	6 months-1 year: No. of $50 of debs.	Holdings after 1 year 10/4/69: No. of 1.5 units of wts.	Holdings after 1 year 10/4/69: No. of $50 units of debs.
Banks holding no shares as of 5/12/68 (2)	-0-	30,700	11,264	9,796	4,614	900	-0-	-0-	-0-	-0-	-0-	-0-		
Insurance Companies holding over 50,000 shares as of 5/12/68 (1)	130,200	-0-	130,200	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Insurance Companies with no holdings as of 5/12/68 (1)	-0-	-0-	-0-	25,000	-0-	25,000	-0-	-0-	-0-	-0-	25,000	25,000	-0-	-0-
Others holding between 10,000 and 50,000 as of 5/12/68 (2)	34,000	-0-	27,000	-0-	-0-	7,000	7,000	7,000	-0-	-0-	-0-	-0-	-0-	-0-
Others holding under 10,000 shares as of 5/12/68 (3)	9,118	3,000	11,998	2,400	80	640	-0-	-0-	-0-	-0-	-0-	640	640	-0-

GREAT AMERICAN TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	Great American Holdings as of 5/12/68	Period 1 1/ 5/13-9/18/68		Period 2 2/ 9/19-10/4/68		Tenders	RESALE OF NEW NGC SECURITIES 3/ Effective date to 1 month after expiration		1-6 Months		6 months-1 year		Holdings after 1 year 10/4/69	
		P	S	P	S		No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 units of debs.	No. of 1.5 units of wts.	No. of $50 unit of debs.
Others with no holding as of 5/12/68 (2)	-0-	160	-0-	82,000	2,000	80,000	80,000	80,000	-0-	-0-	-0-	-0-	-0-	-0-
Institutional Totals4/	1,711,738	1,108,410	640,908	546,230	1,019,070	1,667,244	148,200	120,000	292,696	287,016	360,796	242,514	852,198	984,742
Acquiring Company		403,700												
Total Tendered						3,607,478								
Total Outstanding	6,157,141												6,220,681 (as of 12/31/69	4,415,740 (as of 12/31/69)
Total Vol.5/			4,777,600		2,802,700									
Closing Market Prices (NYSE or AMEX) 7/		31	63½ (9/17/68)	68-3/8	79		36 6/ 31.5	52-3/4 49-15/16	33 18-5/16	50 37½	16-13/16 11-5/8	36¼ 26-3/4	11-5/8	26-3/4

4/ Includes Third Market transactions which were relatively minimal.
5/ Includes New York, Midwest and Pacific Coast round lot transactions; does not include Third Market volume.
6/ "When issued" listed trading commenced on October 24, 1968, although over-the-counter trading commenced on an earlier date.
7/ Where two prices are shown, first price indicates the beginning of the period and the second price indicates the end of the period.

TABLE XV-54

RELIANCE TRADING, TENDER AND RESALE ANALYSIS

Institutional Category	Reliance Holdings as of 12/31/67	Period 1 1/ 1/1-8/18/68		Period 2 2/ 8/19-11/1/68		Tenders	RESALE OF NEW LEASCO SECURITIES 3/ Effective date to 1 mo. after expiration		1-6 Months		6 Months-1 year		Holdings after 1 year 11/1/69	
		P	S	P	S		No. of 1.25 units of wts.	Conv. pfd.	No. of 1.25 units of wts.	Conv. pfd.	No. of 1.25 units wts.	Conv. pfd.	No. of 1.25 units of wts.	Conv. pfd.
Registered Investment Companies holding over 50,000 shares of Reliance as of 12/31/67. (2)	469,714	84,800	404,514	-0-	-0-	150,000	-0-	-0-	41,600	130,500	-0-	-0-	108,400	19,500
Registered Investment Companies holding between 10,000 and 50,000 Reliance as of 12/31/67. (4)	70,500	-0-	70,500	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Registered Investment Companies holding less than 10,000 shares of Reliance as of 12/31/67. (11)	34,530	270,500 (1 fund bought 235,000 5/68 & had sold out earlier holdings)	28,230	-0-	21,300	255,500	241,500	11,800	10,000	241,700	-0-	-0-	4,000	2,000

1/ Approximate beginning of interest in target to day before effective date of tender offer.

2/ Effective date of tender offer to termination of tender offer.

3/ The exchange ratio was 1 share of Leasco convertible preferred stock and ½ Leasco warrant for each share of Reliance common. All shares of Leasco warrants were adjusted to reflect 5 for 2 stock split on 2/13/69.

RELIANCE TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	Reliance Holdings as of 12/31/67	Period 1 1/ 1/1-8/18/68		Period 2 2/ 8/19-11/1/68		Tenders	RESALE OF NEW LEASCO SECURITIES 3/ Effective date to 1 month after expiration		1-6 Months		6 Months-1 year		Holdings 11/1/69 after 1 year	
		P	S	P	S		No. of 125 units of wts.	Conv. pfd.	No. of 125 units of wts.	Conv. pfd.	No. of 125 units of wts.	Conv. pfd.	No. of 125 units of wts.	Conv. pfd.
Registered Investment Companies holding no shares of Reliance as of 12/31/67. (29)	-0-	936,150	39,500	113,800	105,450	905,000	69,700	12,600	274,400	265,600	301,580	20,500	258,320	205,300
Banks holding over 50,000 shares of Reliance as of 12/31/67. (3)	337,213	285,210	285,119	500	34,060	52,744	-0-	2,537	32,400	3,900	0-	19,000	-0-	27,195
Banks holding between 10,000 and 50,000 shares of Reliance as of 12/31/67. (5)	133,779	-0-	79,541	-0-	2,674	51,564	12,200	200	20,060	15,772	142	20,000	82,022 (banks holding 0 to 50,000 Reliance on 12/31/67.)	44,861
Banks holding less than 10,000 shares of Reliance as of 12/31/67. (21)	40,668	11,400	16,101	14,100	15,910	34,157	2,280	2,400	1,123	280	2,488	2,208		

RELIANCE TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	Reliance Holdings as of 12/31/67	Period 1 1/ 1/1-8/18/68		Period 2 2/ 8/19-11/1/68		Tenders	RESALE OF NEW LEASCO SECURITIES 3/ — Effective date to 1 month after expiration 4/		1-6 months		6 Months-1 year		Holdings after 1 year 11/1/69	
		P	S	P	S		No. of 1.25 units of wts.	Conv. pfd.	No. of 1.25 units of wts.	Conv. pfd.	No. of 1.25 units of wts.	Conv. pfd.	No. of 1.25 units of wts.	Conv pfd.
Insurance Co's	39,700	9,500	43,100	-0-	6,100	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Others	23,228	151,238	91,646	8,100	74,520	16,400	2,500	1,000	-0-	300	-0-	600	4,900	5,500
Institutional Totals 5/	1,149,332	1,497,798	1,068,251	136,500	270,014	765,365	328,180	30,537	379,583	658,052	304,210	44,308	457,642	704,356
Acquiring Co.		132,600												
Total Tendered						4,571,820								
Total Outstanding	4,713,200												8/ 5,871,200	4,766,000
Total Volume 6/			6,034,600		1,583,300									
Market Prices 7/	35		35-1/8 66¼		68½ 88-1/8		8-7/8* 15	59-5/8 85	15¼* 11¼	84½ 68-1/8	10-7/8 7-7/8	67-1/8 50½		

4/ "when issued" trading began 9/17/68.
5/ Inlcuded certain third market trading which was minimal.
6/ Round lot transactions on AMEX.
7/ Closing prices-When two prices are shown, first price indicates the beginning of period and second price indicates the end of the period.
8/ Includes 145,000 warrants issued in connection with an offering on June 4, 1968.
* Adjusted for split 2/13/69.

TABLE IV-55

UNITED FRUIT TRADING, TENDER AND RESALE ANALYSIS

Institutional Category	United Fruit Holdings as of 9/24/68	Period 1 1/ 9/24-1/8/69		Period 2 2/ 1/9-2/4/69		Tenders	RESALE OF NEW AMK SECURITIES 3/ Effective date-1 Month after expiration			1-6 Months			6 Months-1 year			Holdings after 1 year (2/4/70)		
		P	S	P	S		No. of .55 units of com.	No. of 15 units of wts.	No. of $38 u. of deb.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 15 units of wts.	No. of $38units of debs.	No. of .55 units of com.	No. of 15units of wts.	No. of $38 units of debs.
Investment Company holders of over 50,000 shares as of 9/24/68. (7)	1,476,000	60,000	262,600 (+422800 subject to "rescission"	250,000	209,300	1,314,100 (including "rescinded" shares)	111,818	12,200	316	114,664	149,000	146,326	618,636	421,033	131,579	468,982	731,867	1,035,879
Investment Company holders of between 10,000 & 50,000 shares as of 9/24/68. (7)	180,900	128,500	42,200 (+49000 subject to "rescission")	103,600	-0-	367,800 (including "rescinded" shares)	16,400	132,266	-0-	90,500	95,033	67,268	-0-	-0-	77,631	260,900	140,500	222,900

1/ From date AMK bought 9% block of United Fruit through date before Zapata's registration statement and two days before AMK's registration statement were declared effective by the Commission.

2/ From date Zapata's registration statement was declared effective through date of expiration of AMK's tender offer.

3/ Package consisted of .55 share AMK common, 1.5 warrant and a $38 convertible debenture.

4/ Resales of AMK securities include sales of two registered investment companies managed by one of the indicated investment advisers; the two investment companies tendered 16,400 shares and their resales are treated both under "investment companies" and under "other" since they could not be differentiated from other resales by the investment adviser.

UNITED FRUIT TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	United Fruit Holdings as of 9/24/68	Period 1 1/ 9/24-1/8/69		Period 2 2/ 1/9-2/4/69		Tenders	RESALE OF NEW AMK SECURITIES 3/ — Effective date-1 Month after expiration			1-6 Months			6 Months-1 year			Holdings after 1 year (2/4/70)		
		P.	S	P	S		No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.
Investment Company holders of less than 10,000 shares as of 9/24/68. (9)	33,700	71,600(1)	93,200 (+3,200 subject to "re-scission")	-0-	2,900	9,200 (including "rescinded" shares)	3,200	3,200	3,156	545	6,000	-0-	-0-	-0-	-0-	5,435	-0-	6,042
Investment Companies with no holdings as of 9/24/68. (38)	-0-	881,900	167,300	183,600	157,300	682,200	126,973	110,200	192910	238,945	493,933	241,510	9,090	26,300	136,858	307,191	51,767	110,921
Banks (26)	233,488	39,750	149,019 (+ 15,600 subject to "re-scission")	19,400	22,560	87,561	600	-0-	-0-	3,284	4,359	4,192	24,020	21,502	19,781	59,658	61,700	63,587

UNITED FRUIT TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	United Fruit Holdings as 9/24/68	Period 1 [1/] 9/24-1/8/69		Period 2 [2/] 1/9-2/4/69		Tenders	RESALE OF NEW AMK SECURITIES [2/]: Effective date-1 Month after expiration			1-6 Months			6 Months-1 year			Holdings after 1 year (2/4/70)		
		P	S	P	S		No. of .55 units of common	No. of 1.5 units of wts.	No. of $38 uts of debs	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.
Insurance Companies (8)	268,600	10,400	61,000 (+106,600 subject to "rescission")	27,500	41,800	203,700 (including "rescinded" shares)	-0-	55,100	-0-	48,000	119,300	98,800	29,100	-0-	20,500	126,600	29,300	84,400
Other (5) [4/]	416,153	60,300	229,785 (+136,000 subject to "rescission")	88,300	23,753	324,190	79,833	246,111	104,511	194,133	77,979	163,000	-0-	100	12,395	50,225	-0-	44,287
Institutional Totals [5/]	2,608,801	1,252,450	1,005,104 (+733,200 subject to "rescission")	672,400	457,613	2,988,751	338,824	559,077	300895	690,071	945,604	747,412	680846	468,935	398,744	1,279,011	1015134	1,568,016
AMK-Acquiring Company	-0-	7,100 (+733200 subject to "rescission")																
Total Tendered						5,442,556												

5/ Includes Third Market transactions which were relatively minimal.

UNITED FRUIT TRADING, TENDER AND RESALE ANALYSIS (CONT'D.)

Institutional Category	United Fruit Holdings as of 9/24/68	Period 1 9/24-1/8/69		Period 2 1/9-2/4/69		Tenders	RESALE OF NEW AMK SECURITIES: Effective date-1 Month after expiration			1-6 Months			6 Months-1 Year			Holdings after 1 year (2/4/70)		
		P	S	P	S		No. of .55 units of common	No. of 1.5 units of wts.	No. of $38 units of deb	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.	No. of .55 units of com.	No. of 1.5 units of wts.	No. of $38 units of debs.
Total Outstanding	7,834,347															8/ 8,227,616 (not adjusted to units as of 12/31/69	6,699,942 as of 12/31/69	6,699,915 as of 12/31/69
Total Trading Volume 6/			6,236,400		2,804900													
Closing Market Prices (NYSE or AMEX)	9/	51-3/4	83	85½	80-3/4		24.475 7/	24	33.82	17.943	18.187	28.975	12.925	10.5	26.98			
		58½					18.0125	17.25	28.88	12.512	10.5	26.855	14.643	12	26.22	14.643	12	26.22

6/ Includes New York, Midwest, Pacific Coast and Boston Stock Exchange Round Lot Transactions; does not include Third Market Volume.
7/ "When issued" listed trading commenced on 1,28/69, although over-the-counter trading commenced on an earlier date.
8/ Not adjusted because of substantial amount of common stock issued and outstanding prior to issuance of new common stock pursuant to exchange offer; amount includes all common stock outstanding.
9/ Where two prices are shown, first price indicates the beginning of the period and the second price indicated the end of the period, except for the 9/24 Purchase column which indicates the open and close on that date respectively.

4. Institutional Involvement as Shareholders

While contested transfers of control initiated by or on behalf of acquiring companies present institutions with multifaceted opportunities for involvement, an attempted transfer within the existing corporate framework generally limits the institution's role to that of shareholder (although its interest may be investment-oriented as well). Where the transfer requires the approval of shareholders, such as a merger, institutional involvement may be limited to voting. As the case studies indicate, however, the institution may play a more active role in such matters.

a. *Opposition to contemplated transaction*

The *Brunswick-Union Tank* study demonstrates that institutional shareholders as a group may have the power to block a contemplated merger or other acquisition by a portfolio company even before the matter is submitted to all shareholders for their approval. Opposition in the Brunswick case apparently reflected the belief of many institutions that the merger was not in their best interests as shareholders or investors.

Brunswick was viewed by institutions as a fairly speculative investment with a prospect of high returns in the near future. A merger with Union Tank would, in the opinion of the institutions, diminish the immediate value of their Brunswick holdings even if management's projections of long-term corporate benefit were accurate.

It was not feasible for some of these institutions to dispose of their holdings; one fund manager stated that such a disposition would produce a loss. Other institutions felt that Brunswick and its management were basically sound; they simply opposed the merger and made their opposition known to management.

While the institutions did not enter into any formal agreement or understanding to vote against the merger or to voice jointly their disapproval of it in advance of any shareholder vote, it appears that a concerted effort was made to convince management that the proposed transaction should not be consummated. There is also evidence that institutions were aware of the efforts being made by other institutions, both directly and through two broker-dealers.

Although management attempted to persuade institutional holders of its stock that the merger was desirable, it was largely unsuccessful. With over 20% of Brunswick's outstanding shares apparently opposed to the proposal, management terminated discussions with Union Tank. Institutional participation had blocked the transaction.

b. *Attempt to replace existing management*

The *Bath Industries* case study is an example of an attempt by dissident shareholders, including institutions, to oust management by a display of power. In their efforts to demonstrate to management that they had enough votes to win a proxy contest if necessary, the insurgents both increased their own shareholdings by large market purchases (and attempted private purchases) and contacted other institutional shareholders to elicit support. Miscalculating the extent of their support, the insurgents were unable to force management's resignation.

Instead, they found themselves subjected to a standard defensive tactic—a lawsuit brought by the company to enjoin them from attempting to effect a transfer of control. The suit was successful because the insurgents had failed to file the required statement of stock ownership by the "group" under Section 13(d) of the Securities Exchange Act.

5. Institutional Involvement in Transfer Bids

The nature of institutional involvement in a contested transfer situation will depend on the type of institution and its reasons for participating. Thus, a bank with creditor ties may furnish financing to a bidding company. A mutual fund with short-term performance orientation is more likely to participate in trading and tendering activities. In some cases, the institution itself will be the bidder or target of a transfer bid.

It is not possible to describe a transfer pattern whose details prevail in every case. But the mechanisms of corporate transfer bids are identical in purpose, substantially similar in design and vary in execution only by reason of the inevitable uncertainty of success and the consequent need for adaptation.

a. Purpose of bid

All transfer bids have a common purpose: to acquire a sufficient number of shares of the target company to assume control—after which the target may be operated as a subsidiary or merged with the acquiring company. It is ordinarily essential that over 50 percent of the target's shares be acquired; even though less than 50 percent ownership may constitute practical control, it may invite competing transfer bids. More important, it is not possible to consolidate the financial statements of the target with those of the acquiring company without over 50 percent ownership or to employ the equity method in accounting for the bidder's investment absent approximately 50 percent ownership. If the acquiring company is seeking the target's earnings—in order to augment its own per share earnings—it must be able to consolidate for accounting purposes, or to account for its investment in the acquired company on the basis of its equity in the undistributed net income of such company.

Furthermore, if the acquiring company is seeking the tax benefits that may flow from consolidated tax returns, it must acquire at least 80 percent of the target's shares. This may enable the acquiring company to utilize any operating losses experienced by the target—to set those losses off against the acquiring company's operating gains—and to utilize any tax loss carry-forwards (losses experienced in earlier years that may be set off against gains in subsequent years).[115]

If the acquiring company issues debt securities in exchange for the target's shares, it may be confronted with serious liquidity problems unless it is able to make use of the target's flow of funds to retire, refinance or service the debt (see *Armour* case study). This ordinarily will require a statutory merger between the two entities; the acquiring company thus must be assured in most cases of the support of two-thirds of the target's shares entitled to vote on a merger. (In the *Great American* case study, the same objectives were achieved by an upstream dividend from the acquired company to the acquiring company.) Even

[115] See Sections 381 and 382 of the Internal Revenue Code of 1954.

if it has these shares, the *Armour* case study demonstrates that the skillful use of defensive tactics by the target's management may block the acquiring company from initiating the merger proposal or otherwise replacing management.

b. Planning for bid

Transfer bids do not simply happen; they are more or less carefully conceived and executed, at least after the initial decision has been made to acquire an initial block of the target's shares. In retrospect, it appears disingenuous for some bidders to characterize their initial forays into the arena of a corporate power contest, through purchases of the target's securities, as "investments" (*see Armour* case study). Where possible, bidders have refrained from characterizing their intentions at all until absolutely necessary.

The advantages of secrecy are obvious: public announcement of any intention to acquire a substantial position in a target company would almost certainly increase the market price of the target's shares, making a bid more costly. Disclosure would also enable the target's management to undertake defensive tactics, such as soliciting competing bids or adopting special by-laws or charter provisions designed to thwart transfers of control.

The primary requisite of any plan is flexibility. The bidder must be prepared to react almost instantly to a hostile reaction from the target's management, to competing bids and to various market factors such as the availability of large blocks of the target's stock and the attitude of major arbitrageurs.

While it does not appear typical, there are some cases where institutions may participate in planning (*see Home Insurance* and *General Time* case studies). Ordinarily, however, the institution is interested only in alleviating its own problem (*e.g.*, locked-in stock) or in capitalizing on the profit potential of a takeover bid; it is allied with the corporate bidder primarily for the purpose of advancing its own interests. Thus, some institutions—like other investors—appear to analyze transfer bids in terms of immediate self-interest considerations without regard to the desirability of the transfer from the standpoint of the corporate business and structure of the target company and the acquiring company.

c. Conditioning the market for the bidder's securities

Even before—and certainly after—it has been determined to seek control of a target company, the bidding company must generally ensure the market acceptability of its own securities. If cash purchases are to be made, the bidder may require financing. Commercial lenders such as banks would presumably be most interested in the actual ability of the bidding company to service the debt or would look to the shares acquired for repayment of the loan. But institutions purchasing the bidder's securities in a private offering, the proceeds of which would be used for cash purchases, would be concerned about the value of the securities they received (*see Great American* case study).

The importance of a strong market in the bidder's securities is even more critical where an exchange offer is to be made. In such case, shareholders of the target will be asked to surrender their interests in exchange for the securities of the bidder. The market value of the package of securities offered is often the paramount consideration in inducing shareholders to tender (*see United Fruit* and *Amour* case studies).

It is therefore not surprising that publicly announced transfer bids have been preceded by attempts on the part of potential bidders to develop an institutional following in their stock. Large institutional holdings may produce two results: First, the market price of the bidder's securities may be increased or held at high levels, particularly if the trading market in the bidder's securities is relatively thin; second, the institutions may develop a "locked-in" interest in a continued favorable valuation of the bidder's securities where the positions are not, as a practical matter, readily marketable. Such an interest may impel the institutional holders to support transfer bids, either to facilitate the development of a broader trading market (which would ease marketability of their locked-in positions), or to obtain the benefits of a higher valuation of securities that might flow from a successful acquisition effort, or both.

If the maintenance of a stable market in the bidder's securities is desirable in the pre-transfer period, it may be critical after the transfer effort has begun. During this period, efforts may be made by the bidder or its broker-dealer adviser to prevent large blocks of the bidder's stock being offered for sale from depressing the market value of the stock (*see Collins* case study). In some cases, the institutions participating in the financing of target share purchases may be given puts or registration rights (under the Securities Act) in the bidder's securities (*see Home Insurance* case study). These benefits tend to assure the institutions that they can dispose of the bidder's securities, while enabling the bidder to deter any precipitous decline in the price of those securities through uncontrolled market sales.

The techniques for promoting institutional interest in the bidder's securities are varied—they may involve press releases, briefings, discussions or other contacts and almost always require the allegiance of one or more broker-dealers which may have a prospective interest in any contemplated transfer bid (*see Great American* case study). Brokers not only benefit from the commissions generated by purchases of the bidder's stock, but they may also expect future compensation in the form of finder's fees, consultation fees, tender solicitation fees and business relationships with the bidder or prospective target.

Regardless of the particular form of persuasion utilized, its substance follows a familiar line of reasoning: a company with a high price-earnings ratio can generate an even higher price for its securities by acquiring the earnings of a company with a low ratio or by utilizing the cash, technology, markets or other resources of the target in a more effective manner. The cult of acquisition-mindedness, particularly as practiced by so-called conglomerates, may have achieved high price-earnings ratios for the bidder's stock initially; the consummation of acquisitions, it was argued, would solidify or improve the market's enthusiastic evaluation of corporate performance. As long as this thesis was generally accepted by investors, including institutions, the price of bidding company stocks remained high and transfers could be more readily effected.

The federal securities laws may apply in several ways to attempts by prospective bidders to condition the market in their own securities as a prelude to a public bid for control:

(1) Rule 10b-5 under the Securities Exchange Act prohibits false and misleading statements or omissions in connection with the purchase or sale of any security. The rule thus precludes any person from trading in securities of a company on the basis of material inside information. To the extent that certain institutional investors might have been given non-public information about the intention of a bidding company to embark upon a program of acquisitions, those investors might have violated Rule 10b-5 by purchasing the bidding company's stock in anticipation of the public announcement of such a program. This might be so, for instance, if the bidder was privately projecting earnings based on future acquisitions (*see Great American* case study).

(2) Section 5 of the Securities Act prohibits any company from offering its securities publicly unless a registration statement has been filed with the Commission. Attempts to precondition the market for securities to be publicly offered violate the Act—these attempts are commonly referred to as "gun-jumping." The reason for these restrictions is clear: public offerings of securities are required to be accompanied by the full and fair disclosures afforded by the statutory prospectus (and registration statement, of which the prospectus is part). An offer in advance of filing of the registration statement may encourage potential investors to make investment decisions before they are aware of all material facts about the company.

Where a company contemplates that it will make a bid for control of another company by offering to exchange its own securities for the securities of the target, it may not attempt to precondition the market for such an offering if the offering is required to be registered under the Securities Act.[116] Having considered or adopted a plan for a transfer bid, a company is not free to bolster the market for its own securities in order to facilitate the bid when it is made.

(3) Rule 10b-6 under the Securities Exchange Act generally prohibits a company (and any "underwriters" [117]) from purchasing its own securities when it is engaged in a distribution of its securities. The effect of such purchases would be to stabilize the market price of the securities being publicly offered. While certain types of stabilization are permitted under the Act and rules by issuers and underwriters, these transactions must be carried out within the strict limitations of applicable Commission rules.

A company bidding for control of another company through an exchange offer, as well as its broker-dealer advisers and assisting institutions, may violate Rule 10b-6 by purchasing or bidding for the acquiring company's securities in order to keep large blocks off the market and to maintain the price of such securities.

d. Selection of target company

The decision to bid for control of a particular target company may fail to reflect a deliberative study by the acquiring company of the economic and commercial merits of a business combination. Several

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[116] *See* SEC Securities Act Release Nos. 3844 (1957), 4697 (1964), 5009 (1969).
[117] The term "underwriter" includes any person facilitating or participating in a distribution of securities.

of the cases studied (e.g., *Great American*) suggest that bids may be based on technical market factors rather than the compatibility of the target with its prospective acquirer. It is thus perhaps inevitable that the most vigorous proponents of transfer bids were broker-dealers, which saw in such efforts abundant opportunities for quick trading profits by their institutional clients and large fees and commissions for themselves.

It would be inappropriate to conclude that all or even most transfer bids are without economic justification. At the same time, it appears that many transfer bids are made because they are practicable, although their justification is questionable. A bid for a small company that might benefit from combination with a larger enterprise may not be feasible because smaller companies are often closely held or management controls a substantial percentage of the outstanding shares; a combination with such a company would thus require the concurrence of its management. A bid for a large company in the same industry as the bidder or in a complementary industry may be susceptible of challenge by the Justice Department as violative of the antitrust laws (*see Collins* and *Armour* case studies). Thus, bids may be made for companies simply because it is feasible to obtain control of such companies and technical market factors make it seem relatively inexpensive to do so.

Although the Study found one case where an institution was directly instrumental in selecting a potential target because of the institution's own need to dispose of a large block of the target's stock (*Home Insurance*), targets are generally selected by a broker-dealer or by the acquiring company itself. In the *United Fruit* case study, a broker-dealer decided that the target should be acquired partially because it appeared to be the only feasible way of fulfilling the broker's prediction to its institutional clients that the price of the target's stock would increase.

In the *Collins Radio*, *Reliance Insurance* and *Armour* cases, the bidding company realized the possibility of acquiring control of a very much larger target through the use of its own highly valued securities. In the *Home Insurance* case, the bidder saw an opportunity to diversify its conglomerate activities at relatively low cost.

e. Initial purchase of target shares

The case studies indicate that once the bidding company has selected a target, it will often attempt to acquire a large initial block of the target's shares. Some of the bidding companies maintain that this initial purchase does not necessarily constitute an irrevocable commitment on their part to seek control of the target. Even if that is so, it would be disingenuous to suggest that a purchase of up to 10 percent of another company's stock is merely a routine "investment"—particularly when the purchase is financed in such a way as to make a further bid for control appear likely.

In general, the acquiring company will purchase an initial block that is large enough to give it a solid base from which to bid for control. At the same time, the bidder will take care to limit its purchase to an amount that will enable it to avoid the reporting requirements of Sections 16(a) and 13(d) of the Securities Exchange Act as well as the short-swing liability provisions of Section 16(b) of the Act, should the bidder ultimately decide to sell out to a competing bidder within six months of its original purchase (*Home Insurance* and *Armour* case studies). Section 16 is triggered by 10 percent ownership; while Section 13(d) now requires reporting of 5 percent ownership, the threshold figure was 10 percent until legislative amendments passed at the end of 1970.

The initial purchase may be effected in three ways: a large block of the target's stock may be available from an institutional or corporate holder desiring to dispose of the block (*Home Insurance; Armour*); a block may be assembled from among various institutions (*United Fruit*); or the bidder may make a series of market purchases, possibly through a nominee or code number account in order to maintain secrecy (*Reliance Insurance; General Time*). The market purchases may be solicited by the bidder's broker-dealer adviser.

The case studies indicate that institutions which are aware of the purpose of initial purchases of the target's stock and participate in such purchases, either by helping to finance them or by selling the target's stock they hold to the bidder, may demand and receive special conditions as part of the price for their assistance. Under a "most favored shareholder" proviso, some institutions have been able to extract an agreement from the bidder to pay them the difference between the purchase price of the initial block and any higher price subsequently offered to all shareholders of the target through a cash tender offer; in the event of a subsequent securities exchange offer, the institutions would have the right to repay the initial purchase price and instead take any higher valued package of securities (*see, e.g., Home Insurance* case study).

Other provisos might permit the institution to share in any profit realized by the bidder upon any subsequent resale of the initial block to a competing bidder or to "put" the bidder's shares at a specified price over a period of time.

f. Anticipatory purchases of target shares

Although the bidding company would typically refrain from any public announcement of its initial buying activity and of its intentions with respect to the target, institutional investors might be advised, either generally or specifically, that the target company's shares were being sought (*see General Time* case study). Broker-dealers participating in the transfer bid on behalf of the bidder might alert their institutional clients in order to enable them to make anticipatory purchases of the target's shares—purchases made on the basis of non-public information that a transfer bid was contemplated and might be expected to result in an increase in the price of the target's shares when announced.

Institutions which had participated in the purchase of the initial block might also have knowledge that a transfer bid was being or might be made. In some cases, institutions might be solicited by a broker assisting the bidder to make anticipatory purchases so as to help ensure the success of any subsequent tender or exchange offer. With the target's shares "locked up" in friendly hands, the bidding company could then make a public bid for control with some assurance of the outcome (*see, e.g., United Fruit* case study).

As previously noted, institutions holding the bidding company's shares might be more readily induced to assist in any transfer bid because of the adverse impact of an unsuccessful bid on the price of the bidder's shares. Where the institution participates in the financing of the initial purchase of the target's shares—for example, by purchasing the bidder's securities in a private offering for cash—the institution has a strong incentive to assist the transfer bid. The incentive will be reinforced by any special conditions that may have accompanied the initial purchase—for example, where the institution sold the target's shares to the bidder with the proviso that it receive any higher cash price or higher valued securities package that might be subsequently offered. By making anticipatory purchases of the target's shares, the institution may encourage the bidding company to go forward with its plans, thereby ensuring the receipt of the special benefits.

Anticipatory purchases may also occur even after a public tender or exchange offer has been announced. If the institution is being regularly advised by the broker-dealer coordinating the transfer bid or by the bidder of the status of the bid—its likelihood of success or the possibility that the bid price may be increased—the institution will be able to effect purchases at a price that does not yet reflect these facts.

As noted in the *General Time* case study, anticipatory purchases by registered investment companies may raise problems under the Investment Company Act if the investment company is also an "affiliate" (*e.g.*, 5 percent owner) of the bidding company. In such a case, any joint arrangements or transactions with the bidder to purchase the target's shares require advance approval of the Commission. Such advance approval would have the effect of making the existence of the transfer bid publicly known and would therefore tend to eliminate the advantages that flow from secrecy.[118]

g. Solicitation of tenders

As the case studies indicate, it is generally not possible for an acquiring company to obtain a sufficient percentage of the target's shares to achieve a transfer of control without making an offer to all of the target company's shareholders.[119] Such an offer may take the form of a cash tender offer, under which the shareholder tenders his shares and receives a specified cash payment, or a securities exchange offer, under which the shareholder tenders his shares and receives securities issued by the acquiring company.

Cash tender offers have the advantage of being readily comprehensible to the average investor; they are also considerably easier to make from the standpoint of compliance with the federal securities laws. Until the 1968 amendments to the Exchange Act, there were virtually no restrictions on cash offers. The amendments (and more recent amendments in 1970) require companies making offers which, if accepted, would make them owners of over 5 percent of the target's stock, to file specified information with the Commission. The information, including

[118] In *General Time*, disclosure of the joint transactions might also have revealed the attempts by the bidding company and the investment company to stabilize the price of the target's shares in order to minimize the cost of the transfer bid.

[119] The *General Time* case study is unusual in this respect; it represents a hybrid external transfer bid and internal shareholder proxy contest.

a statement of any intention or plan on the part of the bidder to acquire control, is also furnished to the target company.

Securities exchange offers require the filing of a registration statement under the Securities Act, unless the securities being offered are otherwise exempt from registration. (Under the 1970 amendments, these offers are also subject to the tender offer provisions of the Exchange Act.) The burden of preparing, reviewing, filing and revising disclosure documents and their processing by the Commission may be time-consuming, but exchange offers permit the acquiring company to bid for the target without any immediate expenditure of cash. The "packages" offered have ranged from common stock to warrants, various types of preferred stocks, convertible debentures and bonds—or, in many cases, combinations of these. The broker-dealer assisting the bidder will ordinarily assign a "value" to the package—although the value may be subject to debate by contesting bidders or the target's management.

Where the tender or exchange offer is resisted by the target company management or where there are competing offers, the key to success will generally lie in effective solicitation of tenders. Since institutions have the economic power to play a decisive role in such offers—by tendering shares they hold or purchasing additional shares and tendering them—solicitation efforts have been focused on institutional investors.[120]

Solicitation in the case of cash tender offers is facilitated to some extent by the absence of any restrictions on the dissemination of written material regarding the offer—as long as the material does not contain false and misleading statements or omissions. Securities exchange offers are, on the other hand, restricted by the Securities Act prohibitions on written solicitations outside the statutory prospectus during the period before the registration statement becomes effective. Oral solicitations—if accurate and complete—are permissible for both cash and securities offers after the appropriate disclosure documents—schedule and/or registration statement—have been filed with the Commission.

(1) *Alignment of "friendly" institutions.*—The acquiring company and its broker-dealer adviser (which by this time may be serving as dealer-manager for the tender or exchange offer) may attempt to form a group of institutional investors which will act as conduits in purchasing blocks of the target's shares and tendering them to the bidding company (*see, e.g.*, *United Fruit* and *Armour* case studies). Such a "group" is not bound by formal agreement; rather, its members participate in a common effort, coordinated by the broker-dealer, to facilitate the objectives of the public offer—the acquisition of a controlling percentage of the target's shares. (*But see General Time* case study where the bidding company and at least one mutual fund clearly acted together).

Some of the group's members may be drawn from among institutions that previously participated in the bidding company's initial purchase of the target's stock; others may have made anticipatory purchases of the target's shares on the basis of information about an im-

[120] This is vividly illustrated by the *Armour* case study, where one of the bidders had the support of only three institutions, while the other had broad institutional support.

pending transfer bid—they may feel some obligation to reciprocate by tendering through the broker who originally gave them this information.

While the membership of the group is usually unstructured and the members do not ordinarily meet with each other, information may be exchanged through the broker-dealer or in meetings or discussions with the bidding company's management (*see*, *e.g.*, *United Fruit* and *Reliance Insurance* case studies). If there is a competing offer, there may be a concerted effort to keep the target's shares from falling into the hands of the rival. Thus, in the *United Fruit* case study, the management of AMK and its broker-dealer adviser aggressively sought to secure the tender of a large block of United Fruit stock, even to the point of re-placing the block in the hands of allied institutions when the initial allied institutional purchaser found that it could not purchase the entire block.

Sections 13(d) and 14(d) of the Securities Exchange Act require disclosures by any "person" acquiring or proposing to acquire by tender offer ownership of over 5 percent of a company's securities (the figure was 10 percent during the periods covered by the case studies). The term "person" is defined to include any "partnership, limited partnership, syndicate, or other group" which acts as such "for the purpose of acquiring, holding, or disposing of securities of an issuer." It is possible that institutions, conscious of the concerted effort to purchase and tender shares of a target company, could constitute members of a "group" by participating in such an effort.[121]

(2) *Soliciting sales of competing bidder's shares.*—The case studies revealed some instances suggesting a solicitation by the bidding company's broker-dealer adviser of sales of a competing bidder's shares (*see United Fruit* case study). In other cases, such sales may occur independently because institutions believe that the competing bidder will be unsuccessful in its transfer efforts. The effect of such sales cannot be determined with precision, but the impact might be to adversely affect the price of the competing bidder's securities, thereby decreasing the value of its exchange offer package or imperiling its financing of a cash tender offer.

(3) *Special inducements.*—The bidding company and its broker-dealer may offer special terms to institutions or other large holders that facilitate the transfer bid by tendering (*see*, *e.g.*, *Reliance Insurance* case study). The financial manager may receive assurances of special benefits to it for the institution's cooperation. For example, where the target company has its own investment portfolio, the bidding company may imply that allied institutional financial managers will be given the opportunity to manage part of the portfolio if the bid for control is successful (*see Great American* case study).

Special inducements during the tender or exchange offer period—such as a premium price, registration rights under the Securities Act,

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[121] In the *Bath Industries* case (n. 31, above), the Court of Appeals, rejecting the District Court's interpretation of Section 13(d), held that disclosure would be required only if the members of the group together beneficially owned the required percentage (then 10 percent, now 5 percent) of the target company's outstanding shares and then agreed to pursue joint efforts to acquire additional shares. However, the statutory language refers to any "group" acting "for the purpose of acquiring, *holding*, or disposing of securities of an issuer" (emphasis added) and thus seems susceptible of a broader interpretation. *See* H.R. Rep. No. 1711, 90th Cong., 2d Sess. (1968).

stock exchange listing, buy-back agreements (or puts)—are now generally precluded under the Commission's Rule 10b–13, which prohibits purchases outside the terms of the public tender or exchange offer. The rule underscores one of the primary objectives of the 1968 amendments to the Securities Exchange Act—equal treatment of all tendering shareholders. It provides, in effect, that special treatment cannot be given to any shareholder "from the time such tender offer or exchange offer is publicly announced or otherwise made known by such person [the bidder] to holders of the security to be acquired until the expiration of the period . . . during which securities tendered pursuant to such tender offer or exchange offer may . . . be accepted or rejected . . ."

h. Financing of transfer bid

As the case studies demonstrate, virtually every transfer bid—even one primarily involving an exchange of the bidder's own securities—requires financing. Such financing may be provided on a conventional basis by bank lendings (*e.g., United Fruit; Armour*); it may also take the form of special arrangements with institutional investors that facilitate the transfer bid. Thus, institutions may purchase the bidder's securities in a private offering, the purpose of which is to raise enough money for the bidder to purchase an initial block of the target's shares (*e.g., Great American*). Where the bidder lacks the available resources to consummate immediate purchases of the target's shares, it may arrange for institutions to serve as conduits or "warehouses" (in industry jargon)—purchasing the shares and holding them for some specified period until the bidder is able to purchase the shares itself (*e.g., Home Insurance*).

These types of arrangements may create problems under the Federal Reserve Board regulations governing the extension of credit as well as under the tender and exchange offer provisions of the Exchange Act.

(1) *Federal Reserve Board Regulations.*—Regulations G, T and U are promulgated by the Federal Reserve Board in the exercise of its monetary policy-making responsibilities. The purpose of these regulations is to specify the terms and conditions under which credit may be extended by regulated banks, broker-dealers and other lenders in connection with the purchase of securities. Particular restrictions attach to loans that are collateralized by securities.

The case studies and recent litigated cases suggest that institutional investors participating in a transfer bid—as well as the bidder and its broker-dealer—may attempt to circumvent the Board's regulations. Thus, banks may make loans to bidding companies that are denominated "non-purpose" or "unsecured" when it seems apparent that the loan is made for the purpose of enabling the bidder to purchase the shares of a target company and that the bank will retain custody of those shares and look to them for repayment of the loan (*see Armour* and *United Fruit*).

The interpretation of the credit regulations is vested in the Board, which has generally interpreted its limitations on secured loans as not extending to situations where the bank merely retains custody of the securities and, in good faith, does not rely on the securities as collateral.

In the *Great American* case, the New York Stock Exchange found that a member broker-dealer had violated the Board's regulations by participating in an arrangement under which the target's securities were purchased on a "21-day delivery buyer's option." The option was found to have been an improper extension of credit to the bidding company which enabled it to purchase a block of the target's securities although it lacked the funds to do so.

A special problem arises in the case of loans made by foreign banks and broker-dealers. In one case involving a transfer bid, a district court has held that the Board's regulations do not extend to such persons.[122] It is doubtful that this decision can be relied upon as dispositive authority on the question; a pending appeal from the decision was dismissed after the tender offer succeeded. Congress recently amended Section 7 of the Securities Exchange Act to provide explicitly that the margin requirements apply to borrowers which are either United States persons or foreign persons controlled by United States persons.[123]

(2) *Tender offer requirements.*—In the case of *Securities and Exchange Commission* v. *Madison Square Garden*,[124] the Commission sought injunctive relief for alleged violations of the tender offer requirements of the Exchange Act as well as violations of Regulation T. The defendants consented to the entry of a permanent injunction against them without admitting the violations charged in the complaint.

The case involved a contest between two companies for control of Roosevelt Raceway, Inc. The complaint alleged that after one of the bidding companies had announced a cash tender offer, the other bidder issued a press release stating that it had reached an agreement with a broker-dealer under which the broker and certain of its institutional clients would purchase a large block of Roosevelt shares and hold them for a year, at which time they would have the right to require the bidder to purchase the shares at 120 percent of their cost. It was alleged that the purchases under this agreement caused the market price of Roosevelt stock to exceed the tender offer price, thereby defeating the offer.

The Commission charged that this conduct constituted a solicitation to the shareholders of Roosevelt to reject the tender offer, made without the filing of the disclosures required by Section 14(d) of the Securities Exchange Act; that the defendants together held over 10 percent of Roosevelt's shares and had acted as a "group" for the purposes of acquiring, holding and disposing of Roosevelt shares without the filing of the disclosures required by Section 13(d) of the Act; and that the broker, by entering into an agreement to hold Roosevelt shares for one year with a right to cause the bidder to purchase the shares, had extended and arranged for the extension of credit in violation of Regulation T.

Under the consent injunction, the defendants were enjoined from further violations of the specified provisions, and the agreement between the bidder, the broker and the institutions was declared null and void.

This case illustrates the problems that may be generated by any arrangement or understanding among a bidding company, its broker-

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[122] *Metro-Goldwyn-Mayer* v. *Transamerica Corp.*, 303 F. Supp. 1354 (S.D.N.Y. 1969).
[123] Pub. L. No. 91–508, § 301 (October 26, 1970).
[124] SEC Litigation Release No. 4598 (April 29, 1970).

dealer adviser and allied institutions to make anticipatory or other purchases of a target's shares under a proviso that the shares will be ultimately tendered or sold by the institutions to the bidder. In effect, such an arrangement makes the institutional investors mere conduits, or "warehouses," in the financing of a purchase of securities by the bidding company. The arrangement may run afoul of the credit regulations applicable to any persons which participate in such a scheme; it may also trigger the disclosure requirements of the Securities Exchange Act regarding joint accumulations of over 5 percent of the target's shares.

i. Defensive tactics

While bidding companies generally seek an amicable transfer of control from the target's management—usually after having acquired a substantial block of the target's shares—the effect of such an initial approach may well be tantamount to a declaration of war. Management has the most direct and immediate interests at stake in any transfer bid: shareholders may be asked to surrender their ownership interests in exchange for an apparently desirable cash price or package of securities; management faces the loss of its job.

A transfer bid inevitably reflects on the competence and vigor of existing management. The bid may be particularly humiliating when it comes from a relatively small company whose young, aggressive corporate managers control a company valued in the market at an extraordinary price-earnings ratio. The target's management may also genuinely believe that a combination with the bidding company is not in the best interests of the target's shareholders. The companies' businesses and corporate structures may appear incompatible and the takeover effort may seem to represent nothing more than a bid for assimilation of the target's earnings, cash and prestige. While the price being offered to the target's shareholders may seem attractive, the economic and financial basis of the proposed combination may be unsound.

The defensive tactics employed by the target's management will depend on (1) when it learns of the bid; (2) the nature of the bid; and (3) the likelihood of the bid's success. If the target's management foresees the possibility of a transfer bid, it may act defensively long before any actual bid materializes. If the bid is on its face inadequate, more advantageous arrangements might be made with another bidder; the very existence of competing bidders will tend to diminish the success of any one bidder and raise its costs. Even if the bid appears to be succeeding, the target's management may still be able to retain power, at least temporarily and possibly long enough to bargain for long-term benefits.

It is not possible to predict which defensive tactics may be utilized or the order in which they may be employed. The listing below reflects most of the methods found in the case studies.

(1) *Charter and by-laws amendments.*—In the wake of the series of transfer bids occurring in the late 1960's, a number of companies whose managements were apprehensive of such bids adopted amendments to their charter and by-laws designed to make transfers of control more difficult. These amendments were also adopted by companies directly confronted with transfer bids.

Charter amendments might include provisions to delegate additional authority to the company's board of directors, to increase the size of the board, to abolish cumulative voting and to increase the percentage of shareholder votes needed for quorum purposes or to approve a transaction, such as a merger. As indicated in section E of this chapter, institutional shareholders supporting the bidding company would tend to vote against these amendments. Some by-law changes can be made without any shareholder approval, and are therefore ideally suited for prompt defensive action. Changes might include staggered terms for directors, the creation of a special executive committee or special provisions for corporate decision-making. The *Armour* case study provides striking evidence of effective use of such tactics.

(2) *Counter-solicitation.*—Perhaps the most direct defensive action the target company's management may undertake is an appeal to the company's shareholders for loyalty. The shareholders may receive letters or other communications from the officers of the target, advising them not to tender their shares to a bidder whose domination of the company would, in management's views, impede its progress and stability. Shareholders may also be warned that any securities they receive in exchange for their present holdings in the target might be of dubious value, or that the terms of the offer are unacceptably low.

The problem with this type of defensive tactic is that most shareholders do not feel any special allegiance to the companies whose shares they own. This is perhaps even more so in the case of institutional shareholders where they are given a clear and relatively riskless opportunity to realize immediate profit.

The centralization of corporate power in management may thus have the ironic side-effect of making management more vulnerable to bids for control made by acquiring companies directly to the target's shareholders. Shareholders cannot be expected to accept uncritically the counter-solicitory propaganda of management to the effect that "their" company is in danger of being taken over by ruthless entrepreneurial opportunists because the shareholders do not—and cannot—realistically identify themselves as a vital part of the framework of corporate power under attack.

Where there is more than one bid for the target's shares, the target's management may determine to support one of the bidders (*see Armour* and *United Fruit* case studies). It may also ultimately decide to withdraw earlier objections and recommend acceptance of a bid to its shareholders.

Section 14(d)(4) of the Securities Exchange Act requires any solicitation or recommendation in connection with a tender offer to be accompanied by a filing with the Commission containing the same information that the bidding company must file. Thus, attempts by the target's management to generate support from institutions or other shareholders must be disclosed.

(3) *Purchase or sale of target's shares.*—Since the bidding company is generally seeking a specified percentage of the target's outstanding shares—or all such shares—the target's management may be able to defeat the bid by reducing the number of shares available for public purchase. As we have seen in the *Armour* case study, the target may begin a program to purchase its own shares, either by market pur-

chases or by a tender offer to all shareholders. Such purchases by the corporation may increase price levels, making acquisition by the bidder more expensive, and may dry up the sources of shares for ready sale to the bidder.

The Commission has promulgated for comment and has under consideration proposed Rule 13e-2, which would govern the terms and conditions under which a company may acquire its own shares. The rule is designed to prevent fraudulent, deceptive or manipulative practices in connection with such purchases.[125] Rule 10b-5 presently prohibits the target company from making false and misleading statements or omissions in connection with purchases of its shares.

While there appears to be an inclination to characterize such purchases as intended to supply the company with securities to be used in future acquisitions or for general corporate purposes, the antifraud provisions would be violated if the purchases were intended to block a transfer bid and the company stated that another purpose was intended.

The *Armour* case study also illustrates that the target company's management may seek to impede a transfer bid by issuing additional shares to friendly holders. If the acquisition of another company by the target for stock can be quickly arranged, the target may be able to issue enough shares to prevent the bidding company from obtaining a sufficiently large percentage of outstanding shares to achieve control.

Purchases and sales of the target's shares as a defensive tactic raise questions as to whether the target's management is compromising its fiduciary obligation to the company's shareholders. Even if the details and purpose of these transactions are fully disclosed, the target's management must still establish that the transactions were consummated for the benefit of the company and its shareholders.

(4) *Competing bids—defensive mergers.*—If the target's management believes that the transfer bid is succeeding or that some sort of business combination is inevitable, it may attempt to arrange an amicable combination with, acquisition of or acquisition by another company. This is a frequently observed phenomenon in the case studies (*see, e.g., Collins Radio*). In some cases, the target's management may encourage another bidder to enter the arena—not because it is hoped that the new bidder will be victorious, but because the presence of several bidders will diminish the chances of success of all of them (*see United Fruit* case study).

As in the case of transactions in the target's shares, the target company's management must not only disclose the circumstances and reasons for arranging amicable mergers or acquisitions, but must also be able to justify the transaction as properly within the exercise of its fiduciary responsibilities. Although the Commission's focus is on the full and fair disclosure of the transactions, and the Commission has no power to enforce the observance of corporate fiduciary responsibilities, it has been the Commission's experience that public disclosure may often serve to deter self-dealing or over-reaching by corporate insiders.

(5) *Soliciting sales of bidder's shares.*—The target company's man-

[125] Rule 13e-1 requires disclosure of such purchases during the tender offer period.

agement and allied institutions and broker-dealers may attempt to defeat a transfer bid by selling or soliciting sales of the bidding company's shares. To the extent that such sales have the effect of depressing the price of the shares, they make the bid more difficult. Such sales may constitute manipulative conduct prohibited by the antifraud provisions of the federal securities laws.[126]

(6) *Contract restrictions.*—The *Collins Radio* case study provides evidence of the effectiveness of certain types of contractual restrictions to which the target company may agree to bind itself in order to thwart a transfer bid. There, the banks advancing credit to the target company (two of which were also major holders of the target's shares) amended the credit agreement, with the concurrence of the target's management, to provide that any loans made would be immediately repayable at the option of the lenders if the target experienced a transfer of control. Previously, such agreements had provided for repayment only in the event of a statutory merger, and thus did not cover changes of control resulting from tender or exchange offers.

It is understandable that institutional lenders would want full protection in the event of major corporate transactions that might adversely affect the ability of the target company to service its debt. However, where the purpose is primarily to preserve the company as a customer-borrower, and when the lending institution's position is buttressed substantially by holdings of the target's shares, there may be a conflict between its interest as a creditor and its fiduciary duty to act in the interests of beneficiaries for which the institution is holding shares. In the *Collins* case, the two banks which found themselves in this position stated that the decisions of the commercial department—to expand the repayment proviso in the credit agreement—and of the trust department—to resist the bidding company's exchange offer—were made independently of each other.

(7) *Litigation against bidder.*—As the case studies reveal, a frequently employed defensive tactic is the institution of a law suit against the bidder and its institutional and broker-dealer allies. The suit may charge violations of the federal securities laws, the antitrust laws or general corporate and fiduciary principles. While it would be inappropriate to infer that such litigation is necessarily without merit, it appears that one of the purposes in instituting suits is to prevent or at least deter transfer bids. Where the bids have succeeded in spite of such litigation, the lawsuits are usually voluntarily dismissed by the target company.

(8) *Negotiation for retention of power.*—Even when the transfer bid appears to be succeeding, the target's management may be able to negotiate with the bidding company for some retention of corporate power. Thus, for example, in the *Reliance Insurance* case study, the management of Reliance ultimately acceded to the transfer bid, but only after the acquiring company had agreed to give management employment contracts and a guarantee of non-interference in the target's ordinary business affairs for a period of five years. In the *Armour* case, the target's management was also able to retain power for some period of time by skillfully utilizing its continuing control over the corporate decision-making machinery to preclude the bidders

[126] A similar type of defensive tactic is an attempt by the target's management to block financing of a transfer bid by using its business relationships with commercial lenders to persuade them not to lend the bidder necessary funds (*see Armour* case study).

from ousting it summarily. The bargaining power of the target's management may be augmented by competing bidders whose existence creates an incentive to negotiate.

j. Post-transfer bid conduct

Even after the completion of a transfer bid, the denouement may be in doubt. Perhaps the most vivid illustration of this point is the *Armour* case, where two bidders completed their efforts by together controlling virtually all of the target's outstanding shares, but individually failing to control the company. While an uneasy coalition may exist in such circumstances for some period of time, one of the bidders will generally prevail.

This may be accomplished by the sale to the stronger bidder of the target's shares held by the more vulnerable bidder. As the *Armour* case showed, the fact that one bidder may have acquired the larger number of target shares will not necessarily assure its ultimate success (*see also United Fruit* case study).

Where the public transfer bid has failed to garner all of the target's outstanding shares—as will usually be the case—the acquiring company may conduct a renewed tender or exchange offer for the remaining shares. This may be followed by a merger of the two companies, permitting the acquiring company to make unrestricted use of the target's cash and other assets.

At this point, the acquiring company may undertake to retire or refinance some of the debt incurred in the course of the transfer bid: debt securities issued in an exchange offer, bank loans to finance purchases, and institutional purchases of the company's securities carrying the requirement that the bidding company repurchase such securities (*see, e.g., Great American* case study).

The case studies suggest that a transfer bid may leave the acquiring company's capitalization in a debilitated condition (*see Armour* case study); perhaps the greatest irony of such transfers is that the continued financial stability of the acquiring company may depend on its ability ultimately to draw on the target company's assets to ease the burden of the acquisition's cost.

Institutional activity during the post-transfer bid period may involve participation in the "when issued" trading market [127] in the bidder's securities. There is some evidence that institutions may help to stabilize the price of the securities during this period to facilitate consummation of the transfer (*see Great American* case study). Institutions may also begin to dispose of securities received in exchange for target shares tendered (*see Armour* case study), although the Study's trading data showed significant retention of securities received in exchange offers during the first year after the offer's expiration. Broker-dealers that assisted the acquiring company in the transfer bid may feel some obligation to find a market for these securities for allied institutions; they may, for example, block position these securities (*see, e.g., United Fruit* case study). If the institutions were unable to dispose of the acquiring company's securities, the profits they expected to realize from participation in the transaction might become illusory.

This period is also characterized by the fulfillment of earlier inducements made to assisting institutions: registration statements may be

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[127] "When issued" refers to securities as to which the registration statement has become effective, but which have not yet been issued because of various formalities and conditions precedent, such as tender of any minimum number of shares specified in the offer.

filed on their behalf to allow them to dispose of restricted securities they received in connection with the transfer effort; options to sell back securities may be exercised; the investment portfolio of the target company may be allocated among institutional allies for management by them.

6. Conclusion

The role of institutional investors in transfers of corporate control has been substantial and often critical. Whether the attempted transfer takes the form of concerted shareholder action from within the company or of an external bid for the target's shares, institutions with large holdings or the economic power to acquire such holdings can be and often are major forces in the facilitation of change in the structure of corporate power.

It may seem paradoxical that while institutions express reluctance to implicate themselves in corporate decision-making, many—particularly investment companies—have little hesitancy in participating in efforts designed to transfer control of portfolio companies. However, while such participation presents all of the potential conflicts and liabilities that might attach to institutional involvement in corporate decisions, institutional interest in transfer bids is attracted by the prospect of relatively clear and certain benefits. These benefits, which may inure to the advantage of institutional beneficiaries as well, appear to serve as justification for the risk of participation; involvement in other aspects of the decisional process ordinarily does not produce the kind of immediate and substantial benefits that are thought to justify such involvement.

G. SUMMARY AND CONCLUSIONS

1. Introduction

The relationships between institutions and portfolio companies involve some sensitive and significant questions. As pointed out in the introduction to this chapter, institutions, because of the size of their holdings, can have greater influence over portfolio companies than can the average individual investor. Questions may arise as to the impact of this influence on the management of portfolio companies, on their other shareholders and as to whether this influence would be used solely for the benefit of the institutional financial manager rather than for the benefit of investors or beneficiaries for which the institution is acting.

While a substantial number of questionnaires were utilized in connection with this chapter, the subject matter, involving as it does relationships among organizations and among people, does not (with some exceptions such as the section on concentration of stockholdings) lend itself to the same extent as prior chapters to conclusions based on intensive statistical analysis of masses of data, mostly expressed in quantitative terms.

2. The Legal Framework

A comprehensive analysis of the complex legal framework, state and federal, governing the operations of publicly owned corporations and the relationships of various persons and groups having an interest in them, is beyond the scope of the Study. For the purpose of this chapter, the primary concern in this area must be the legal relationships between shareholders of publicly owned corporations and their management. At the outset it may be noted that this legal framework does not, generally speaking, differentiate between the institutional shareholder and the individual shareholder although there may be significant practical and economic differences between them. State corporation law, still the basic source of law concerning the legal relationship between shareholders and management, has in general moved in the direction of recognizing the situation which has evolved since corporations became publicly owned: the power to direct corporate affairs is largely vested in management subject only to whatever controls are imposed by reason of the existence of fiduciary duties on the part of management to shareholders and the requirement that shareholders vote both in the election of directors and certain other major issues. With the diffusion of shareownership among tens of thousands of persons, most of whom are interested only as investors and not as owners, these requirements have not significantly diminished the powers of management.

Federal regulation, as applied to publicly owned corporations, has concerned itself primarily with providing adequate disclosure in order to permit informed investment and shareholder decisions including, more recently, decisions in connection with transfers of corporate control. It also seeks to avoid or mitigate certain conflicts of interest. Institutional investors in their role as stockholders may be subject to certain other restrictions imposed by legislative bodies or regulatory authorities but these, excepting to some extent the antitrust laws, are directed primarily to the investment policies of specific types of institutions rather than to their relationships to portfolio companies.

3. Concentration of Stockholdings

This section (unlike most of the others in this chapter) is based on an analysis of a substantial amount of statistical data. As might be expected in view of the growth of institutions and the emergence of very large institutions, the data show that the Study's sample of large institutions hold a substantial amount, approximately 30 percent, of the 800 widely held stocks included in another Study sample. These institutions, not surprisingly, do not divide their holdings more or less equally among all available stocks. On the contrary, a limited number of large institutions have very substantial holdings in a number of large publicly held companies.

The Study found that the institutions in the Study's sample held 727 of the 800 representative stocks. The sample stocks include New York Stock Exchange stocks constituting about 58 percent of the value of all such stocks, American Stock Exchange Stocks constituting about 23 percent of the value of all such stocks, and over-the-counter stocks estimated to constitute about 13 percent of the value of all such stocks. Excluding the 71 smallest companies, there were 348 companies in the sample in which ten or fewer institutions surveyed together held at least 10 percent of each such company's outstanding shares. (The data do not indicate that the same group of institutions held shares in every such company). There were 303 companies in which five or fewer institutions held 10 percent of each company's outstanding shares. Ten or fewer institutions held at least 15 percent of the outstanding shares of 247 companies, while five or fewer institutions held 15 percent of the outstanding shares of 182 companies. Ten or fewer institutions held at least 20 percent of the outstanding shares of 159 companies, while five or fewer institutions held 20 percent of the outstanding shares of 76 companies.

Comparable data for institutional holdings coupled with sole or partial voting authority show that of the 656 largest sample companies, ten or fewer institutions held at least 10 percent of 316 companies, 15 percent of 203 companies and 20 percent of 100 companies. Five or fewer institutions held at least 10 percent of 260 companies, 15 percent of 131 companies and 20 percent of 49 companies. In general, a larger proportion of concentrated institutional holdings were represented by investments in large companies.

The concentration analysis thus establishes that large institutions, particularly banks, have the potential economic power to exert significant influence over many companies whose securities comprise their portfolios, particularly large companies. Ordinarily, however, no individual institution would be in a position to exert this type of influence and it is necessary to aggregate the holdings of several institutions before these constitute a substantial percentage of a particular company's outstanding shares. While this statistical aggregation may disclose potential economic power in the hands of a group of institutions, it does not follow that institutions will necessarily act together or that the influence of any one institution will be augmented through concerted activities.

4. Personnel and Business Relationships

Relationships between institutions and portfolio companies are not necessarily limited to the relationship of the institution as a shareholder. Particularly in the case of banks, other types of relationships frequently exist. On the basis of available data, the Study has limited its inquiry to personnel relationships (primarily common directorship), creditor relationships, bank depository relationships, and relationships as a manager of portfolio company employee benefit plans. It should be recognized that the number of factors that may account for the coexistence of various relationships is virtually limitless and the Study made no attempt to analyze all such factors. An effort has, however, been made to determine whether or not the presence of one or more of the specified relationships is correlated with the presence or magnitude of other specified relationships. Restricted to those factors for which data are available, the Study was able to test whether there is any systematic pattern of intercorrelation among shareholding, personnel and business ties.

Regression analysis shows that in the case of banks each of the types of relationships analyzed was more likely to occur or to occur in greater magnitude whenever another type of relationship was present. This is so even after the effects of regional proximity and institution size are controlled. The same pattern of correlation was not observed for other institutional types.

It is not, however, possible to attribute any causal relationship to the results of the regression analysis. The inability to do so in part results from the conclusion that numerous factors not susceptible to factual measurement may enter into the creation of any or all of such relationships. The data collected by the Study does show, however, that the likelihood that these functional interrelationships between banks and portfolio companies occur entirely by chance is extremely remote. As is not surprising, relationships that may exist between banks and portfolio companies are much greater than in the case of other institutions which do not offer to a company the variety of financial services which are available to a company from banks.

5. Institutional Involvement in Corporate Decision-Making

The existence of potential power on the part of institutions to influence corporate decisions by reason of their substantial shareholdings does not demonstrate that such influence is in fact exercised. Information upon which to base a judgment as to whether or not the potential power of institutions to influence corporate decision-making is or is not exercised is hard to come by. The response to the Study's questionnaire shows some reluctance on the part of institutions and corporations to discuss this matter.

Such data as is available tends to show that institutions tend to vote with management on questions put to a shareholder vote and that if they lose confidence in management they tend to sell their holdings in a company rather than to attempt to control or influence management decisions. This conclusion appears attributable to two factors. First, institutions are inclined to believe that their responsibility is to make investment decisions rather than to attempt to influence management decisions. Second, while there are no statutory restrictions upon the right of institutions to attempt to influence management decisions, institutions tend to believe that an effort to do so would be inappropriate and would subject them to criticism. Over half of all institutional respondents to the Study's questionnaire did not respond to specific policy questions asking them to submit their own views about the appropriate role of institutions as shareholders.

With respect to voting, the practices of institutions vary. Thus, institutions, particularly banks, which act as trustees, believe that they are under a fiduciary duty to cast an informed vote and, consequently, formal procedures, more or less elaborate, are followed in analyzing proxy statements and arriving at a decision as to which way they will vote. In the case of other institutions, these decisions tend to be made on a more informal basis. Banks also tend to abstain from voting or vote negatively more frequently than do other institutions. Abstention from voting would ordinarily indicate lack of agreement with the particular proposal presented without demonstrating a lack of confidence in management which a negative vote might indicate.

Institutions are more likely to take a definite position on those questions which have a clear impact on their economic position and rights as shareholders. These include proposals to abolish preemptive rights, authorization of mergers, and authorization of corporate acquisitions, particularly where such acquisition involves issuance of additional securities. In general, it can be concluded that even where institutions have the potential power to influence management decisions they tend to be reluctant to exercise this power, particularly in an open and public way. While there are, no doubt, instances where institutions influence corporate decisions informally through personal consultations with management, reliable statistical evidence of the extent to which this occurs is not available.

6. Institutional Involvement in Transfers of Corporate Control

During the late 1960's there was a remarkable upsurge in efforts to transfer corporate control. In some instances this involved an effort on the part of shareholders to displace corporate management, but more frequently it involved efforts on the part of one company to acquire another. In the latter case, where incumbent management had agreed to the proposed acquisition of their company, the issues presented to shareholders, institutional or otherwise, were essentially a question of how they should vote, and were generally similar to the matters discussed in the prior section of this chapter. Quite frequently, however, the company seeking to make the acquisition was attempting to do so over the opposition of incumbent management.

Institutions with large holdings or the economic power to acquire such holdings could be and often were major forces in the determination of the outcome of such efforts. While, as noted in prior sections of this chapter, institutions are disposed to be somewhat passive in ordinary management decisions, their participation in contested takeovers was often active and crucial. This appears to result from the fact that unlike ordinary questions of corporate policy, participation in corporate takeovers afforded to the institutions involved opportunities for immediate profit from the effects upon the market of such efforts.

Again, the extent, nature and impact of institutional participation in corporate takeovers is not a matter which to any significant extent is susceptible of statistical analysis. The Study, therefore, endeavored to explore this question by case studies of particular contested takeovers. Nine such case studies were made, in each of which there was an examination of institutional participation. Summaries of these case studies are included in section F of this chapter. These summaries necessarily do not include all the details contained in the basic case studies. The summaries, together with such other statistical data as was obtainable, demonstrate, however, the significant role of institutions in determining the outcome of contested takeovers. In such situations, opportunities for obtaining substantial benefits are obtainable by institutions, including but not limited to benefits for their beneficiaries. There is also the possibility that by such participation institutions may obtain advantages not available to the individual investor. Such participation involves the possibility of conflicts of interest and of the use of information not generally available to investors which are obtainable by institutions because of the recognition by all parties to such takeovers of the economic power of institutions to influence the outcome of the contest.

Participating institutions have been involved in transfer efforts in several ways:

(1) Institutions purchase the bidding company's shares in anticipation of a transfer bid for the target company, thereby helping to maintain or increase the price of the bidder's securities. This may be particularly important if an exchange offer is to be made.

(2) Institutions purchase the target company's shares in anticipation of a transfer bid, with the expectation of selling or tendering those shares at a higher price after the public tender or exchange offer has been announced.

(3) Institutions provide financial assistance to the bidding company, either directly by loans, or indirectly by private purchases of the bidding company's securities (supplying the cash necessary for initial purchases of the target's shares) or by purchases of the target company's securities under an arrangement contemplating subsequent resale to the bidding company.

Among the special inducements or benefits that institutions have received are:

(1) Advance information that a takeover effort will be made (permitting the institution to make purchases of the bidding company or target company securities before the market impact of a publicly announced tender offer has affected the price of the securities involved).

(2) Most-favored shareholder provisions, under which institutions selling an initial block of the target's shares to the bidding company have the right to receive any higher price subsequently offered to all shareholders of the target company through a public tender or exchange offer.

(3) Assurances of contingent benefits (sometimes available only if the transfer bid succeeds), such as management of the target company's investment portfolio or commercial banking arrangements with the bidding or target company.

7. Conclusions

(1) The prevailing legal framework does not distinguish materially between institutions and other holders of corporate shares in terms of shareholder prerogatives within the structure of corporate power, although there are significant practical and economic differences between them.

(2) Institutions have the potential economic power to influence many companies, particularly large companies, because of their stock holdings. Part Two of the Study demonstrates that investment assets are concentrated in relatively few institutions. These institutions in turn tend to concentrate their portfolios in relatively few stocks. Hence, it follows that institutional holdings may constitute a large percentage of the outstanding shares of certain companies. Since institutions tend to invest primarily in the securities of larger companies, concentration is most pronounced in the shares of such companies.

(3) Some institutions, particularly banks, have personnel and business relationships with portfolio companies. These relationships may tend to reinforce any power conferred as a result of stock holdings. They also create potential conflicts of interest and the possibility of misuse of inside information. Although the Study can draw no general conclusions as to whether these adverse consequences actually occur or to what extent they may occur, it appears that there is a strong statistical correlation between bank stock holdings and personnel and business relationships.

(4) Institutions do not generally involve themselves directly in corporate decision-making, but instead have a policy of liquidating their holdings where corporate policies and proposals appear inappropriate. They generally vote in favor of management proposals and only rarely report informal participation or consultation. A number of institutions have a policy of always voting with management or of refraining from participation, particularly where general corporate matters (as opposed to acquisitions) are involved. Participation is more likely to occur when the institution cannot readily liquidate its holdings in the company's shares and when the benefits of such participation are clear.

(5) Some institutions have been actively and significantly involved in facilitating contested transfers of corporate control. In such cases, unlike ordinary corporate decision-making, the benefits to participating institutions may be more certain: in addition to trading and tendering profits, institutions may receive special inducements and benefits not made available to other shareholders of target companies.