Mr. LeBaron ✓

MEMORANDUM

TO : Mr. Robert F. Greenhill (Morgan Stanley & Co.)

FROM : Alan R. Gruber

SUBJECT: COMMENTS ON APRIL 25TH DRAFT OF REPORT BY JOINT SUBCOMMITTEE ON REGULATION OF ACQUISITION OF CONTROL AND OPPOSITION TO ACQUISITION

DATE : April 28, 1983

My general reaction to the draft is that the authors should be commended for having proceeded so far so quickly. I do, however, feel that more discussion and work is needed and that, regrettably, the flavor of the draft report is such that it will be perceived as an endorsement of "business as usual" for the bankers and lawyers who are identified with the tender offer "industry".

I have a particularly great difficulty in the notion that our Joint Subcommittee should accept uncritically the conclusions of the Economics Subcommittee, especially Paragraph I-A-1. While tender offers clearly have positive economic consequences for target shareholders, it is not at all clear that the consequences are positive for bidder shareholders or for "all" shareholders. The report of the Economics Subcommittee (4/11/83) talks of bidder share appreciation of 4%. However, the Jensen & Ruback paper (MERC 83-08) on which the conclusions are based is not nearly so simple or clear. First, the studies summarized by Jensen & Ruback focus on near term (one month or less following offer announcement) impact; second, they are dated (only one of the six studies summarized goes through 1980, while the others are through 1978 at the latest); and third, studies summarizing bidder results one year later show indications of systematic reductions in bidder stock prices--which are called "unsettling because they are inconsistent with market efficiency". Jensen & Ruback further state that "explanation of these post-event negative abnormal returns is currently an unsettled issue".

I believe that the study of bidder stock performance, conducted by studies of general market residuals, is an example of answering the wrong question because it is answerable rather than recognizing that the right question may not be answerable. A key issue is just what is the relevant sample against which bidders should be compared. It clearly isn't the total universe of all companies; i.e., the companies which make tender offers are in a select group which have activist managements, resources (including the availability of credit), etc., and the unanswerable question is whether the shareholders of the bidders might have done as well or better if the tender offers had not been made.

The economic results of some of the recent larger (post-1980) tenders would surely have a negative impact on the Jensen & Ruback conclusions (which appear, incidentally, not to be weighted by size of tender). The Economics Subcommittee has found virtue in the fact that shortly after the duPont-Conoco transaction the loss to duPont shareholders was smaller than the gain to Conoco shareholders, reflecting "a real gain...to the economy as a whole". One might comment that the near term performance of duPont shares, close to the time of the transaction, reflected mystery about Seagram's intentions as well as the possible over-enthusiasm on the oil outlook. Viewing the transaction today, after a much longer time period than 20 days, the duPont shareholders have fared quite poorly on a relative basis compared with the shareholders of, say, Union Carbide or Dow, and their total capital loss is now comparable to the premium received earlier by Conoco shareholders. Similarly, the shareholders of Fluor have fared much less well than the shareholders of, say, Morrison-Knudsen, which didn't buy a St. Joe Minerals. Was the acquisition of Marathon by U. S. Steel really an example of "shifting resources to higher-valued uses on a large scale"?

Paragraph I-A-2 is, in its entirety, based on the premise that tender offers are necessarily good and should be encouraged. We should go no farther than to say that they may be good in given cases and are not necessarily bad. The statement in I-B-1 is as far as we should go and I-A-2 should be deleted.

The statement by the Economics Subcommittee in I-A-3 on shareholder interests makes them (and us) a perfect target for Robert Reich and the like. We should not forget that tenders have important economic consequences for employees, customers, communities, suppliers, etc. I-A-3 assumes no economic value in the maintenance of the corporate entity whose shares are sought. As a regulatory matter, perhaps it is true that the SEC should leave such concerns to the FTC, Antitrust Division, FCC, etc. However, to the extent Section I purports to address economic concerns perhaps it should at least acknowledge the case to be made for non-concentration, for management by persons experienced in a specialized field or industry, and for continuity of management. These may be matters outside the regulatory scope of the SEC but their omission from the "Economics" section reveals an unfortunate bias. We should also recognize that it isn't just regulation which has discouraged tender offers--it's the frequently poor economic results for the bidder (and its--shareholders)--whether the initial bidder or the "successful" white knight bidder in a given contest.

<u>I-B-2</u> - Shareholders have many reasonable expectations. There is no justification for suggesting that tender-offer-value realization is more important than others.

<u>II-A-5</u> - At a minimum, paragraph 5 should be revised to make it clear that if the bidder revises its "extended" offer upwards it has to pay the same amount for all shares tendered. The statement that the present procedure is very hard to justify may not hold water. In the case of a non-contested tender, extension of the proration date to the expiration date causes no one any harm. In the case of a contested tender offer, it may be hard to justify allowing the offeror to cut off some shareholders who tender shares and extend the offer as to other shareholders when there is another bidder in the field. Perhaps it should be made clear that an extension of the offer of this type can take place only when there is no competing bid.

II-A-6 - I would eliminate use of business days only when the number of days involved is 10 or more. For instance, the 3-day proposal on shareholder lists could cause a real hardship if the demand is made on a Friday. If it is made on a holiday weekend, it could well be impossible to comply with the demand.

II-C-1(a) - See the comment for II-A-6.

II-C-2 - With the whole shelf registration process still in a trial phase, it seems to me that we would go a step too far by suggesting that shelf registered securities could be earmarked "for acquisitions". We would already have accomplished the objective of putting securities on the same footing as cash if the earlier recommendation re streamlined registration for S-3 companies is accepted. While S-3 companies are given instant relief, it seems to come as an afterthought (II-C-2(d)) that future consideration should be given to smaller issuers; this is one of several areas in which the proposal may be seen as suggesting a regulatory system which would favor larger issuers over smaller issuers. One possible approach might be to provide a confidential review procedure for S-1 and S-2 issuers so that they would at least have the ability to process their registration on a non-public basis until they could be reasonably sure of coming to market in the time frame which would be competitive with S-3 issuers and cash offerors.

II-C-5 - Thirty days would seem to be a more fair period.

II-C-6 - I would opt unenthusiastically for choice (aa), if the second offer seeks at least as many shares as did the first offer. Choice (a) seems to suggest that only targets engage in gamesmanship. Choice (aa) is not entirely satisfactory in limiting the total available evaluation period to 40 days. As a practical matter, this means that unless the target company has a contingency plan with a particular white-knight, the counter offer may in almost every case have to be a cash offer in order to make it easily able to be evaluated and in order to avoid even a short 5-day delay in registration.

II-C-7 - There seems to be an implication in the first line of this comment that there will be circumstances in which the bidder will have purchased shares during the tender offer. If the proposal is that proration and withdrawal dates are to be coextensive with the expiration date, then this paragraph may be unnecessary except to the extent that it suggests that price increases other than within the last five calendar days will not cause extensions of existing deadlines.

II-C-9 - I would opt for (aa), feeling that a tender offer is a tender offer is a tender offer. Choice (a) has a real potential for unfairness and for stimulation of litigation.

II-C-10 - Calendar-day measurement should apply only to periods over some number of days (probably 10).

III - I would delete items III-A-2 and III-B-2. The bidder chooses to play a game on the basis of a blind bid. If the company's response is that the bid is not realistic and the company is worth more, it should be allowed to go out and do whatever it can do without any reference to what the bidder knows or doesn't know. This whole approach proceeds on the assumption that once a company is "put in play", it should sit back and leave the auction process to parties who have no interest other than winning the company at the least expense to them. The target company has an interest in maximizing the sale price if it is to be sold and should be allowed to pursue that interest.

IV-A-1 and IV-B-1 - I would prefer to see the 13D filing requirement arise only after a level has been passed even if there must be some intermediate level (such as 7½%) which cannot be crossed until the filing is made. If the requirement is to make a filing before passing a certain level, I can foresee lots of litigation as to whether the filing should be made once someone has evolved an "intent" to pass that level.

IV-A-4 - Given the amount of time effort and litigation which has gone into the present inability to have evolved the definition of "tender offer", I think it is entirely unrealistic to try to deal with the creeping tender problem by trying now to define the even more subtle concept of a "buying program."

IV-B-2 - I would opt for 2(b), with a 20% threshold and with further open-market purchases which do not exceed the rate of 1% per month. The block purchase loophole should be omitted.

V-A-2 - I remain unhappy about the recommendation on two-tier pricing. While the lesser-valued portion of the offer must meet fairness standards (leading often to litigation and to settlement on a compromise improved offer), I hate to see our Committee lose an opportunity to put an end to an abuse. Part of the broader fairness question is whether it is appropriate to allow the two-tier sort of pressure to be used.

V-B - I believe that it it perfectly reasonable for target shareholders to expect to know what the buyer has in mind for the second step of a two-step-acquisition. Here is another opportunity for elimination of abuse. A possible modification would be to prohibit making the second-tier offer for one year unless disclosure of its terms has been made at the time the first-tier offer is made.

VI-C-1 - I would opt for paragraph 1; periodic renewal by shareholders is an unnecessary burden.

VI-C-4 - I would strongly prefer the 4(a) version.

VIII-B - I would opt for recommendation 3(a) re Pac-Man Defenses, although I'm unhappy with the way some Boards have gone in their application of the business judgment rule.

VIII-E - I see no problem in leaving block repurchases at a premium to the business judgment rule, if a block has an average age of at least one year.