SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
EXECUTIVE ASSISTANT
TO THE CHAIRMAN

July 11, 1984

Thomas J. Healey
Assistant Secretary for
Domestic Finance
Department of Treasury
15th & Pennsylvania Avenue, N.W.
Room 3321
Washington, D.C. 20220

Dear Tom:

In preparation for the meeting between the Secretary and the Chairman to discuss the Commission's legislative initiatives in the takeover area, this letter summarizes the points reviewed at our July 3 meeting. John, Dan and I also met with Chris DeMuth and Doug Ginsburg and their staff this week to discuss the legislation. I have taken the liberty of sending them a copy of this letter.

The proposed legislation is the result of the Commission's two year reconsideration of the federal securities regulation of tender offers. The Commission's reconsideration was undertaken in response to the dramatic increase in the size and number of tender offers since the adoption of the Williams Act in 1968. In light of these changes and since the Williams Act had not been reexamined since its adoption, the Commission deemed it appropriate to reexamine the takeover process and determine what regulation or deregulation of the process, if any, is necessary or appropriate.

Establishment of Advisory Committee on Tender Offers

To assist in this reexamination, the Commission, in February 1983 appointed a federal Advisory Committee comprised of 18 individuals, expert in the takeover area and the securities laws in general. The members represented a wide variety of disciplines, including investment and commercial banking, arbitrage, money management, accounting and management of companies that had participated in the takeover process either as targets or bidders. The mandate of the Committee was:

> To review techniques for the acquisition of control of public companies . . . and the laws applicable thereto in terms of the best interests of all shareholders (i.e. shareholders of all corporations, whether potential acquirors, target companies or bystanders) and to propose specific legislative and regulatory improvements for the benefit of all shareholders.

Committee Recommendations

The Committee presented its recommendations in July 1983. Principal among its 50 recommendations were findings that tender offers are a valid method of capital allocation, and that the purpose of the regulatory framework should be neither to promote nor deter takeovers. The Committee also affirmed the basic purposes of the Williams Act and its intended neutrality.

Overall, the recommendations of the Committee would redress an imbalance in the current regulatory framework, which, rather than maintaining the intended neutrality, works to the disadvantage of acquirors. To that end, the Advisory Committee recommended revising the Commission's regulations (i) to remove the regulatory disincentives for exchange offers, (ii) to adjust timing provisions and withdrawal rights for the benefit of first bidders, and (iii) to assure bidders the ability to obtain stockholder lists on a timely basis. The Committee further recommended that companies not be permitted to deter takeovers by adopting antitakeover provisions in their charters and by-laws, or by buying off prospective bidders with "greenmail". The Committee also proposed to limit the ability of target companies to issue stock or adopt golden parachutes <u>during</u> tender offers.

The Committee made three major recommendations that addressed the conduct of bidders. First, the Committee recommended a preacquisition filing of a Schedule 13D report. Pursuant to this recommendation an acquiror would have to file a Schedule 13D prior to acquiring more than 5% of an equity class. The result of this recommendation would be that no block in excess of 5% could be acquired without prior disclosure of the anticipated acquisition and the terms of the acquisition. Second, the Committee recommended that federal law require acquisitions resulting in ownership of more than 20% of the equity of an issuer to be by tender offer. This proposal would limit creeping tender offers. Third, it recommended that partial offers be subject to the regulatory disincentive of an additional two weeks minimum offering period.

Commission Recommendations

In considering the recommendations of the Advisory Committee, the Commission was guided by four basic premises: (i) that tender offers are a valid method of capital allocation and, therefore, regulation should be imposed only where necessary to protect shareholders and the integrity and efficiency of the national securities trading market; (ii) that tender offers are national securities transactions and, therefore, any regulation should be at the federal level; (iii) that target company shareholders should ultimately determine the success or failure of a tender offer bid; and (iv) that state corporate law should govern the actions of target company management except where such action frustrates the takeover process and the efficiency of the national trading market to the detriment of shareholders.

Thus, the Commission concurred in the Committee's recommendations to remove unnecessary regulatory disincentives to exchange offers, to provide bidders access to shareholder lists, and to amend withdrawal rights and other timing provisions to permit first bidders the timing advantages inherent in commencing an initial bid. These can be effected administratively by rule and the Commission has undertaken to do so. Proposals to provide simplified disclosure documents for certain exchange offers have already been published for comment. Additional rule proposals will be published later this year.

The Commission, however, has significant concerns with the economic consequences of the Committee's recommendations relating to preacquisition filings of Schedule 13D, creeping tender offers, and partial offers. With respect to the Schedule 13D, the Commission proposed, consistent with the existing requirement of the Williams Act, to require a filing after crossing the threshold and before additional acquisitions are made. The Commission's proposal would avoid the early auction potential for block purchases with the consequent increase in the costs of such transactions inherent in the Committee's recommendation. With respect to partial and creeping tender offers, the Commission was not prepared to recommend any legislative or regulatory action. The Commission has indicated to Congress that problems cited by the Committee to justify its proposals need further study. The Commission has recently published a concept release soliciting public comment on the use of partial and two-tier offers and creeping tender offers and the effects of inhibiting their use.

Although it agreed with the Advisory Committee that shareholders would be better served if there were no charter or by-law provisions that discouraged takeovers, the Commission was unwilling to preempt state corporate law on such a fundamental issue. Therefore, the Commission did not endorse the Committee's recommendation of federal prohibition of such provisions.

The Commission, however, was prepared to recommend federal regulation of three specific target management tactics that can prevent or inhibit tender offers and thus deny shareholders the opportunity to accept or reject a bid. First, the Commission concluded, as did the Advisory Committee, that the issuance of shares and concomitant placement of votes in hands friendly to incumbent management should be proscribed when undertaken during a tender offer. The Commission proposed, therefore, that issuances in excess of 5% of a class of securities or voting power during a tender offer be prohibited unless approved by shareholders.

Second, the Commission concluded that defensive issuer reacquisitions by tender offer likewise blocked tender offers. The Commission has recommended that such defensive actions be prohibited unless approved by shareholders. Some have sought to justify issuer tender offers as providing a second step to shareholders where there is only a partial bid. In fact, however, these tender offers are generally subject to the condition that, if the initial bid is withdrawn, the issuer tender offer can likewise be terminated. The purpose of the issuer tender offer is two-fold. First, it is to attract shares into management's bid, and thus to prevent the first bidder from obtaining the minimum number of shares being sought. If the first bid does not get its minimum, it is usually terminated. Once the third party bid is eliminated, the issuer tender offer can be withdrawn and shareholders will receive nothing. Second, the target company bid is designed to make the issuer less attractive. Essentially, the target company management is threatening the bidder that if it proceeds with its bid, the bidder will end up with a company substantially less valuable because of a major equity redemption.

Third, the Commission endorsed the Committee's proposal to prohibit a management buyback of recently accumulated blocks of stock at a premium, unless approved by shareholders or accompanied by an equivalent offer to all shareholders. The Commission agrees with the Committee that such management activities erode confidence in the national securities markets and the takeover process and that such repurchases provide management the ability to block bids and inhibit potential takeovers by using corporate assets to buyout prospective bidders. Some have argued that the risks of failure for a first bidder are so substantial that the buyback possibility is necessary to encourage first bids. The Commission concluded that shareholders' interests are better served by reducing the risk to first bidders by eliminating management's ability to use the assets and authorized equity of a target company to frustrate a bid, while at the same time removing the disincentives to exchange offers, and eliminating the ability of competing offers to reopen withdrawal rights of other offers. The Commission's goal is to assure that the target company shareholders, not incumbent management, will determine the success or failure of a bid. The Commission's proposed legislation, coupled with its proposed rule revisions, is designed to implement this objective.

In response to a point raised by your staff on July 3, the Commission does not believe that less federal regulation will result in a less regulated tender offer process. To the extent that the federal government withdraws from the area, the states will step in. Since 1968, the states' anti-tender offer attitude has been clearly reflected in legislation struck down by the Supreme Court in Edgar v. Mite and in subsequent legislation drafted to try to avoid the constitutional problems discussed in Mite. To the extent that the states are primary regulators of tender offers, the regulatory process will not be neutral. Rather, it will favor target companies and deter tender offer activity.

Finally, you have raised the question of whether the SRO's might not be a preferable means for accomplishing these goals. This was one of the first alternatives we explored. As you know, there is currently wide variation in SRO policies governing antitakeover actions. The NASD, which does not limit antitakeover defenses by companies traded on NASDAQ, has found this to be a competitive advantage. On the other hand, the New York Stock Exchange, which does have such restrictions, has found companies willing to risk delisting in order to effect certain defenses. Given this variation, it is unlikely that the SRO's will voluntarily adopt uniform policies. Indeed, certain SRO's are in the process of reconsidering existing restrictions because of competitive pressures.

Sincerely,

Linda C. Quinn

cc: Mr. Christopher C. DeMuth
Mr. Douglas H. Ginsburg