EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

STATEMENT OF DOUGLAS H. GINSBURG
ADMINISTRATOR FOR INFORMATION AND REGULATORY AFFAIRS
OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE SECURITIES AND EXCHANGE COMMISSION
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Mr. Chairman and Members of the Commission:

I appreciate your invitation to appear before you today and discuss corporate takeover legislation. The Administration's Position on Corporate Takeovers, which was developed through months of deliberation among the departments and agencies and which has been approved by the President, is attached. We believe it is a thoughtful and prudent approach to the issues that have been raised in the debate over corporate takeovers. I hope you will agree.

I would like to focus today, however, as you requested, on those questions that are most relevant to the bill that the Commission proposed last year, which was subsequently amended in the Energy and Commerce Committee to such an extent that the Commission ultimately opposed it. The Commission's original proposal would have restricted several defensive tactics--including greenmail, golden parachutes, and stock issuances and repurchases--and also would have given the Commission the authority to "close the 13d window." Although we appreciate that the Commission's effort last year was to draft a tightly circumscribed bill that attempted to minimize Federal intrusion into both the capital markets and the traditional State province of corporate governance, we believe such limited efforts will inevitably fail, and then be extended. They should be avoided altogether, in our view, unless there is a serious market failure of national dimensions that requires Federal intervention.

We are highly sympathetic to the Commission's desire to avoid any significant erosion of public confidence in the securities markets--and we share that concern. Some of the tactics that have been employed in recent years may indeed have the potential to cast doubt on the integrity of the capital markets if they go unchecked and become widespread. We agree with the Commission that some of these tactics can be abusive of target shareholders.

Only a very small number of corporations have engaged in the most offensive of these tactics, however. Moreover, shareholders have learned that they can "immunize" themselves through charter amendments, and they are doing so with increasing frequency. Finally, the courts are beginning to show an increasing sensitivity to conflicts of interest in change of control

situations, although the evidence is far from conclusive that they will react appropriately in a consistent fashion. The level of activity in the courts at this time suggests that a high degree of caution should be exercised before considering Federal legislation. The fact-specific nature of these disputes strongly indicates a case-by-case approach to the issues, if at all possible, rather than a uniform legislative prohibition.

In Norlin Industries v. Rooney Pace _____ F.2d ___ (2d Cir. 1984) the Second Circuit Court held that a board that transferred shares to an ESOP that it also controlled violated the business judgement rule because the transaction was for the purpose of entrenching management. In Donovan v. Bierworth, 745 F.2d 1049 (2d Cir. Feb. 6, 1985) the Second Circuit found that pension fund trustees, who were also managers of the target company, violated their fiduciary duty to the fund when they used their position as trustees to oppose a hostile bid in a manner that did not maximize the fund's return.

In Smith v. Van Gorkom, No. 255 (Del.Sup.Ct., Jan. 29, 1985), the Delaware Supreme Court found a violation of the business judgment rule when, in the course of a leveraged buyout, the board did not adequately inform itself and did not pursue steps that could have resulted in the company's shareholders obtaining a higher price for their shares.

In Hechman v. Ahmanson, LACS No. 851 (Cal. App., 2nd Dist., May 8, 1985) a California Court of Appeals upheld the imposition of a constructive trust on the greenmail proceeds paid by Disney to Saul Steinberg's Reliance Group. The court ruled that plaintiffs could probably show that the greenmail payment constituted a breach of the business judgment rule by Disney's board. Under California law, because Steinberg participated in this probable breach and profited from it, he can be held liable along with the board. This suggests that California courts may adopt a "pox on both your houses" attitude to managements and stockholders who engage in improper targeted repurchases. If so, this can be an effective judicial remedy to the greenmail problem, far preferable to any legislation.

And, in a highly controversial decision rendered just last Friday, May 17, 1985, the Delaware Supreme Court ruled that Unocal could legally proceed with an exchange offer and not be obligated to repurchase Mesa's shares. Unocal Corporation v. Mesa Petroleum Co., No. 152, (Sup. Ct. Del., May 17,1985) (Transcript of Oral Rulings). Although it is far too soon to reach any conclusions about the ultimate impact of this decision--indeed, no written opinion has yet issued--the decision may create a potentially powerful defensive strategy for target management: targets can let a potential acquirer accumulate a substantial stock position and then cause him to suffer losses by diluting the value of his shares through a premium buyback that is open to all stockholders except the would-be acquirer.

Three recent cases have considered the legality of the "poison pill" defense. All three decisions have upheld the legality of poison pills, but the leading case is currently on appeal before the Delaware Supreme Court. The situation regarding poison pills should therefore be considered fluid, at least until Delaware's highest court speaks.

In the leading case, Moran v. Household International, No. 7730 (Del. Ch. Jan. 29, 1985), currently on appeal before the Delaware Supreme Court, the Chancery court upheld a "poison pill" warrant. The warrant springs from the target's stock and becomes convertible into stock of the acquiring corporation worth twice the face value of the poison-pill security.

The decision in Moran also served as the basis for a parallel holding by the same Chancellor in Edelman v. Phillips Petroleum Co., No. 7899. (Del. Ch. Feb. 12, 1985). There the court denied a motion for a preliminary injunction seeking to prevent submission of Phillips' second recapitalization plan to stockholders. The court ruled that the plan, even though it included a "poison pill" in the form of a debt instrument that would spring in the event Pickens obtained a sufficiently large position, did not violate the business judgment rule.

A Household International type poison pill was also upheld under the business judgment rule in Nevada. Horowitz v. Southwest Forest Industries, Inc. No. 84-467 (D.Nev. March 20, 1985).

In Enterra v. SGS Associates, 600 Fed. Supp. 678 (E.D. Pa. 1985), a 15 percent stockholder entered into a standstill agreement with management. The target's share price then dropped and the stockholder presented the board with an all cash tender offer for all outstanding shares at a substantial premium. The board rejected the offer as inadequate. The stockholder, who could not make the offer directly because that would violate the standstill, then sought a preliminary injunction that would require the board to present the offer to stockholders. The court denied that injunction, and held that it was properly within the scope of the director's authority, given the standstill, to prevent stockholders from entertaining the offer. This decision is in line with "poison-pill" cases that support a board's authority to act as "traffic cop" for tender offers.

More importantly, perhaps, it appears that Sir James Goldsmith has recently caused the triggering of a poison pill in the Crown Zellerbach takeover contest. This would be the first practical experience with consequences of the poison pill as an antitakeover device. It is also significant that stockholder opposition to poison-pills appears to be growing, and that stockholders of the Rorer Group recently adopted a proposal requesting that Rorer's board rescind or redeem recently issued poison-pill securities.

We applaud the SEC's recent decision to file an amicus curiae

brief in the Household case. There is a clear national interest to be served by working through the State courts as a means of trying to influence the course of public policy in the corporate governance area as it affects securities issues. To date, the country's reliance on State law to govern internal corporate matters has served us well. Unless the States and courts prove incapable or unwilling to act responsibly, we should continue to rely on them.

With respect to the specific provisions in last year's bill, we appreciate the tightrope the Commission was trying to walk in attempting to minimize its intrusion into corporate governance. We fear, however, that the steps taken down that path would be impossible to retrace and would soon turn from a tiptoe to a full sprint.

The defensive tactics that were restricted by the Commission's bill were only a few of many--but it would be impossible to resist adding to the list in ever-increasing detail as the well-paid creative minds of Wall Street develop new tactics. The inevitable end result would be a Federal business judgment rule, which is exactly the result I think the Commission was trying to avoid.

In conclusion, I would urge the Commission not to resubmit last year's bill but rather to monitor closely the ways in which corporations, shareholders, and the courts are responding to these issues, and give them time to succeed or fail in dealing with them. There is no basis for a uniform federal solution if the diverse state corporation laws are adequate to the task.

March 1, 1985

ADMINISTRATION POSITION
CORPORATE TAKEOVERS

I. Corporate takeovers perform several beneficial functions and are generally good for the economy.

II. The Williams Act represents a compromise between the desire to afford target shareholders and managements adequate disclosure and a reasonable period of time in which to evaluate offers, and the needs of the competitive markets in securities and in corporate control to operate with a minimum of government regulatory interference. We have not seen sufficient evidence that the existing provisions of the Williams Act are inadequate to achieve their purpose.

III. Various limitations on bidder activities have been proposed, but a need for additional restrictions on bidders has not been demonstrated.

IV. Target company shareholders need and have protection from abuses by target managements in conjunction with contests for corporate control.

V. State law, enforceable in the courts, governs the permissible terms of corporate charters, management contracts, and managers' and directors' fiduciary obligations, each of which may serve to check management abuses. From existing state statutes and decisions of state and Federal courts, however, it is unclear whether state law is adequate to protect target company shareholders from abuses by target management. As new defensive tactics evolve, moreover, existing protections may prove inadequate.

VI. The balance between management's need to act expeditiously in the interest of the corporation and the shareholder's right to call that action into account should be resolved at the level closest to the problem and the relevant facts--by the corporation, its owners, and managers in the first instance; by state law, if necessary; and, by Federal law only as a last resort. If there is a serious market failure of national dimensions, then the Federal Government should consider taking appropriate steps to curb the potential for abuse. Otherwise, the Federal Government should take no step towards the establishment of Federal corporation law to govern relationships between shareholders and managers.

VII. While matters of corporation law have traditionally been the subject of state rather than Federal jurisdiction, the Federal Government should play an informational role by making public the best information about critical issues that shareholders are likely to face in many corporate change of control contests.

VIII. The Federal Government should also carefully consider the unintended effects that other Federal policy decisions may have on merger and acquisition activity. To the extent that these Federal decisions encourage more or less merger and acquisition activity than otherwise would have taken place in a free market, resources may be misallocated.