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March 13, 1987

TO : Senate Committee on Banking, Housing and Urban Affairs
Attention: Steve Harris

FROM : Kevin F. Winch
Specialist in Industry Economics
Economics Division

SUBJECT: Fees in Hostile Corporate Takeovers

In response to the letter dated February 12, 1987, from Senator William Proxmire to Mr. Joseph E. Ross, CRS Director, please note the attached CRS report, Hostile Corporate Takeovers: Investment Adviser Fees. Senator Proxmire's letter also asked for any available information on attorneys and public relations fees associated with hostile corporate takeovers. The CRS effort to identify such fees was unsuccessful.

In preparation of the attached report, assistance was sought from CRS professional staff in the American Law Division, the Congressional Reference Division, the Economics Division, and the Library Services Division. An economics bibliographer in the Library Services Division provided citations found in CRS's Scorpio database (CITN). In addition, to ensure comprehensive coverage 14 outside commercial databases were searched through the DIALOG information services database system using File 411 (dialindex). Relevant citations were found in the following data bases: ABI/Inform (File 15), PAIS International (File 49), Management Contents (File 75), and Harvard Business Review (File 122).

In addition to the CRS resources used in our effort to respond to your request, the following individuals and organizations outside of CRS discussed with us the problem of identifying fees paid in the course of hostile corporate takeovers.

Conference Board
Ms. Karen Pfeiffer
(212) 272-2618

Corporate Control Alert
Ms. Joanne Ganek, Esq.
(212) 973-2800

Ely and Associates
Mr. Bert Ely
(703) 836-4101

W. T. Grimm & Co.
Ms. Alex Ladias
(312) 346-5265

Investment Dealers' Digest Information Services
Mr. Tom Moore
(212) 513-0660

Investor Responsibility Research Center
Ms. Peg O'Hara
(202) 939-6500

Institutional Investor
Mr. Peter Steber
(212) 303-3300

M&A Database (Mergers & Acquisitions Magazine)
Ms. Lisa Santor
(215) 875-2631

Public Relations Society of America
Information Center
(212) 876-1750

Securities Data Company
V Ms. Dorothy Watkins/Mr. Bill French
(212) 668-0940

Securities Industry Association
Mr. George Monahan
(212) 608-1500

U.S. Federal Trade Commission
Mr. Jim Mullinix
(202) 326-2557

U.S. Securities and Exchange Commission
Mr. Ray Kramer
(202) 272-2618

If you have additional questions, please call on 287-7583.

Attachment

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CRS Report for Congress No. 87-217 E

HOSTILE CORPORATE TAKEOVERS: INVESTMENT ADVISER FEES

What do we know about fees paid for investment advice in hostile corporate takeover transactions? The record of successful hostile takeovers is presented as part of the current wave of corporate mergers, followed by examples of the fees for specific transactions in 1986, 1985, and 1984. Comments on general guidelines for fee schedules are also included.

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by
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HOSTILE CORPORATE TAKEOVERS: INVESTMENT ADVISER FEES

In exploring the dimensions of the current wave of corporate mergers, and the place within that movement of hostile corporate takeovers, the absence of straightforward and appropriate statistics designed to illuminate public policy issues is immediately apparent. When further investigating the nature of fees associated with hostile takeovers, the available data provide an even more obscure statistical environment.

The phenomenon of hostile corporate takeovers is fairly recent, dating only from 1974. In addition, successful hostile takeovers are uncommon, with the reported number of instances ranging from two in 1977 to a peak of seventeen in 1982. Both of these factors -- the short history and the low incidence -- limit the amount of information available for study. In the case of fees for investment advisers in hostile takeovers, information is available only for such transactions large enough to be monitored along with other major corporate financial deals in any one year. And even when such information is available, different sources report different fees for the same deals.

There are no official merger statistics for the United States. No government agency regularly collects or reports these data. In place of official statistics, interested parties must rely on private data sources; one of the principal private sources, W. T. Grimm & Company, provided the trend data used in this report. The criteria for inclusion were established by Grimm, and are noted along with the data in this CRS report. Any criteria may distort the apparent trend. For example, Grimm reports all mergers where the purchase price is at least $500,000; but, without any adjustment for inflation, it is clear that in the 24 years for which data are available this threshold has declined in real terms, thus increasing the apparent trend.

At one time, the Federal Trade Commission published an annual report on corporate mergers and acquisitions; its 1981 report, presenting data for 1979, ended the FTC's long reporting history. The FTC data were incomplete; for example, the FTC covered only those industries under its regulatory jurisdiction, excluding financial services, transportation, and communication from its merger tracking system. As was appropriate for its purpose in collecting data, the FTC reports also used other limiting criteria. 1/

1/ For additional comments on FTC data, see Merger Tactics and Public Policy [by Carolyn Kay Brancato]. Prepared by the Economics Division, Congressional Research Service for the use of the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, U.S. House of Representatives. Committee Print 97-DD, 97th Congress, 2d session. Washington, U.S. Govt. Print. Off., 1982. p. 74; and, U.S. Library of Congress. Congressional Research Service. Mergers and Their Impact on Today's Economy: A Survey. Report No. 82-118 E, by Julius W. Allen. Washington, 1982. p. 64.

HOSTILE TAKEOVERS IN PERSPECTIVE

Descriptive statistics on hostile corporate takeovers are not common, in part because this practice is relatively recent, dating only from 1974, and in part because there are relatively few hostile corporate takeovers in any given year. Table 1, "Mergers and Hostile Tender Offers," provides a record of the relative importance of hostile tender offers compared to all merger and acquisition announcements.

Table 1. Mergers and Hostile Tender Offers

Year	Net Merger-Acquisition Announcements	Tender Offers for Publicly Traded Companies	Contested Tender Offers	Successful Contested Tender Offers
1963	1,361			
1964	1,950			
1965	2,125			
1966	2,377			
1967	2,975			
1968	4,462			
1969	6,107			
1970	5,152			
1971	4,608			
1972	4,801			
1973	4,040			
1974	2,861	76	12	8
1975	2,297	58	20	14
1976	2,276	70	18	4
1977	2,224	69	10	2
1978	2,106	90	18	13
1979	2,128	106	26	8
1980	1,889	53	12	3
1981	2,395	75	28	13
1982	2,346	68	29	17
1983	2,533	37	11	7
1984	2,543	79	18	10
1985	3,001	84	32	14
1986	3,336	150	40	15

Source: Compiled by CRS using data provided by W. T. Grimm & Co.

In Mergerstat Review 1985 W. T. Grimm & Company provided the following descriptive language for the data series included in Table 1.

> Net Merger-Acquisition Announcements W. T. Grimm & Co. began recording merger-acquisition announcements on January 1, 1963. The W. T. Grimm & Co. Research Department records publicly announced formal transfers of ownership of at least 10 percent of a company's assets or equity where the purchase price is at least $500,000, and where one of the parties is a U.S. company. These transactions are recorded as they are announced, not as they are completed. Cancelled transactions are deducted from total announcements in the period in which the cancellation occurred, resulting in net merger-acquisition announcements for that period. Unless otherwise noted, all merger-acquisition statistics reflect completed or pending transactions as of the end of the applicable period.
>
> Tender Offers for Publicly Traded Companies W. T. Grimm & Company utilizes the formal definition of tender offer which is an acquisition technique governed by the Securities & Exchange Commission as dictated by the "Williams Act." The acquirer/suitor files its offer with the SEC, which requires the offer to be open for a minimum of 20 days. The offer to purchase a specified number of shares outstanding of the target company is made directly to the shareholders who have a minimum of 20 days to tender their shares. W. T. Grimm & Company records tender offers seeking 10 percent or more of a target company's shares outstanding. Self tender offers are not monitored.
>
> Contested Tender Offers Hostile raids as an established acquisition strategy originated in 1974 when Morgan Stanley & Company represented International Nickel Company of Canada in its hostile and successful offer for ESB, Inc. The fact that Morgan Stanley, a reputable investment banking firm, was engaged in such an action rendered the hostile takeover an acceptable practice. The prevalence of takeover battles resulted in a specialized industry consisting of investment bankers, attorneys, proxy solicitors and public relations professionals, all of whom were offering expertise on offensive and defensive tactics.
>
> Successful Contested Tender Offers The contested, or hostile, tender offers which do not succeed are divided roughly equally between target companies which remain independent and target companies acquired by a white knight. W. T. Grimm notes that a so-called "white knight" is a corporate suitor that the target company feels is more compatible with its own business philosophy and corporate objectives, i.e., a friendly acquirer. Searching for white knights became a popular defense technique, especially since bids by white knights were at least 21 percent higher than those of hostile suitors from 1976 through 1981.

1986 HOSTILE TAKEOVER FEES

According to preliminary estimates by W. T. Grimm & Company, there were a total of 150 tender offers in 1986; of these, 40 were contested, that is, the tender offer was hostile. There were 15 successful contested tender offers, resulting in a 38 percent success rate for hostile corporate tender offers for 1986. W. T. Grimm staff were able to tentatively identify 13 of the 15 successful hostile tender offers in 1986; of that group of 13, the largest was the acquisition of Sperry Corporation by Burroughs Corporation to form a new entity, Unisys. 2/

The Grimm information does not include fees of any kind associated with takeovers, while reports in Fortune, Institutional Investor, and Corporate Control Alert include such information, but do not separately identify hostile takeovers. Of the 13 deals identified by Grimm, only the Burroughs/Sperry merger appears on Fortune's "Deals of the Year" list of the fifty largest deals completed in 1986. 3/ The Burroughs/Sperry deal also appears on a list of 13 merger deals selected" as the most noteworthy of the year" by Institutional Investor magazine, 4/ and in a survey of the 15 largest deals conducted by Corporate Control Alert. 5/ As noted below, the three sources of information available report different amounts for this transaction. Institutional Investor notes that the takeover of Allied Stores by Campeau Corporation, a Canadian company, was unfriendly, and this transaction is also included below. Thus investment banking fees for 1986 hostile takeovers are available at this time only for two transactions.

At this time, it is not possible to identify the reason behind the differences in the reported figures; especially noteworthy is the difference in identifying advisers. According to Fortune, Burroughs purchased 51 percent of Sperry common stock through a cash tender offer, followed by the purchase of the remaining shares for cash and preferred stock on September 16, 1986, and Campeau acquired Allied for cash on December 31.

The reports included the following estimates of fees and related information. All dollar estimates are in millions; the fee as a percent of the deal is noted in parentheses following the dollar estimate of the fee.

2/ Telephone discussion, March 6, 1987.

3/ Wiener, Daniel P. Deals of the Year. Fortune, February 2, 1987. p. 68-72, 74. Fortune calculates the fee as a percent of deal in its reports, and those figures are used by CRS; for other sources, the fee as a percent of deal is calculated by CRS.

4/ Mergers and Acquisitions: In Under the Wire. Institutional Investor, v. 21, Jan. 1987. p. 109-112, 117, 120, 125, 127, 129, 131, 133.

5/ The Price of Advice. Corporate Control Alert, v. 4, Feb. 1987. p. 2.

Table 2. Burroughs/Sperry
(dollar amounts are in millions)

	Fortune	Institutional Investor	Corporate Control Alert
Value of Transaction	$4,753.7	$4,850	$4,800
Adviser fees			
Burroughs Corp. advisers			
Lazard Freres	$7.5 (0.16%)	6.75 (0.14%)	$7.5 (0.16%)
James D. Wolfensohn	5.0 (0.11%)	4.25 (0.09%)	4.25 (0.09%)
Sperry Corp. advisers			
First Boston	8.75 (0.18%)	9.25 (0.19%)	9.2 (0.19%)
Salomon Brothers			8.0 (0.17%)
Paine Webber			8.0 (0.17%)

Table 3. Campeau/Allied
(dollar amounts are in millions)

	Fortune	Institutional Investor	Corporate Control Alert
Value of Transaction	$3,505.7	$3,500	$3,600
Adviser fees			
Campeau Corp. advisers			
First Boston	$7.0 (0.20%)	$7.01 (0.20%)	$7.0 (0.20%)
Paine Webber		5.75 (0.17%)	5.75 (0.16%)
Allied Stores adviser			
Goldman Sachs	12.0 (0.34%)	not available	13 (0.36%)

1985 HOSTILE TAKEOVER FEES

According to W. T. Grimm & Company, of the 84 tender offers for publicly traded target companies in 1985, 32 were contested, that is, they were hostile tender offers. Fourteen of these hostile offers were successful. An additional 18 contested offers were reported unsuccessful, 9 under the heading "White Knights to the Rescue," while 9 other offers were counted unsuccessful because the target company remained independent. Grimm & Company reports that, altogether, there were 336 acquisitions of publicly traded companies in 1985. 6/

Only three of the 14 hostile takeovers identified by Grimm were large enough to be included on Fortune magazine's list of the 50 biggest corporate combinations and securities offerings, a source of fees for advisers in these transactions. 7/ The three deals noted in the Fortune report were the Coastal Corp. acquisition of American Natural Resources Co. on May 15 (Coastal previously owned 4.2 percent), the acquisition by Pantry Pride, Inc. of Revlon, Inc. on December 26, and the Cooper Industries, Inc. acquisition of McGraw-Edison Company on May 31. The Coastal/American Natural Resources deal was the only one of the 14 hostile takeovers reported by Grimm to appear on Institutional Investor's list of the fifteen largest mergers announced during the year. 8/

The reported estimates of fees and related information are presented below, following the pattern for 1986. All dollar estimates are in millions; the fee as a percent of the deal is noted in parentheses following the dollar estimate of the fee.

Table 4. Coastal/American Natural Resources
(dollar amounts are in millions)

	Fortune	Institutional Investor
Value of Transaction	$2,462.0	$2,460
Adviser fees		
Coastal Corp. adviser		
Drexel Burnham Lambert	$0.5 (0.02%)	$1.0 (0.04%)
American Natural Resources advisers		
Goldman Sachs	8.0 (0.32%)	8.0 (0.33%)
First Boston	3.0 (0.12%)	3.0 (0.12%)

6/ Simic, Tomislava, ed. Mergerstat Review 1985. Chicago, W. T. Grimm & Co., 1986. p. 108-116. Grimm includes as an unsuccessful contested offer the bid by Sir James Goldsmith for Crown Zellerbach Corp., even though the Grimm report points out that "Crown adopted a poison pill defense strategy which was overcome by Goldsmith's accumulating Crown shares on the open market." Note also that the acquisition by Royal Dutch/Shell of Shell Oil was completed in 1985, but reported by Grimm in 1984; information on this transaction appears below with the 1984 entries.

7/ Kirkpatrick, David. Deals of the Year. Fortune, January 20, 1986. p. 26-30.

8/ M&A Deals of the Year. Institutional Investor, January 1986. p. 263-266, 268, 270, 274, 277, 280, 282.

Table 5. Pantry Pride/Revlon
(dollar amounts are in millions)

	Fortune
Value of Transaction	$1,768.2
Adviser fees	
Pantry Price advisers	
Drexel Burnham Lambert	$5.5 (0.31%)
Morgan Stanley	6.0 (0.34%)
Revlon adviser	
Lazard Freres	12.75 (0.72%)

Table 6. Cooper/McGraw Edison
(dollar amounts are in millions)

	Fortune
Value of Transaction	$1,053.6
Adviser fees	
Cooper adviser	
Morgan Stanley	$4.25 (0.40%)
McGraw Edison adviser	
Goldman Sachs	3.2 (0.30%)

1984 HOSTILE TAKEOVER FEES

W. T. Grimm reports that there were 79 tender offers for publicly traded target companies in 1984. Eighteen (23%) of these offers were contested, i.e, hostile, and ten of these contested offers were successful. All types of acquisitions of publicly traded companies totaled 211 in 1984. 9/

The largest offer reported by Grimm, the takeover of Shell Oil Co. by Royal Dutch/Shell Group of the Netherlands, was completed in 1985, and is included in Fortune's "Deals of the Year" listing for 1985; Royal Dutch/Shell acquired the 30.5 percent of Shell Oil (95 million shares) it did not

9/ Simic, Tomislava, ed. Mergerstat Review 1984. Chicago, W. T. Grimm & Co., 1985. p. 90-96.

already own in a cash deal completed on June 7, 1985. 10/ The Shell takeover was reported in Institutional Investor magazine's record of the ten largest mergers and acquisitions announced or completed in 1984, but the magazine did not include investment adviser fees in that year's list. 11/ The Fortune "Deals of the Year" list for 1984 included the acquisition by Gulf + Western Industries Inc. of Prentice-Hall Inc. for cash on December 21, 1984; this is the only other hostile takeover reported by Grimm for which adviser fee information was found. 12/

Table 7. Royal Dutch, Shell/Shell Oil
(dollar amounts are in millions)

	Fortune
Value of Transaction	$5,700.1
Adviser fees	
Royal Dutch/Shell Group adviser	
Morgan Stanley	$5.0 (0.09%)
Shell Oil adviser	
Goldman Sachs	3.7 (0.06%)

Table 8. Gulf + Western/Prentice-Hall

	Fortune
Value of Transaction	$ 705.3
Adviser fees	
Gulf + Western adviser	
Kidder Peabody	$3.5 (0.50%)
Prentice-Hall adviser	
Dillon Reed	0.875 (0.12%)

10/ Kirkpatrick, Deals of the Year.

11/ M&A Deals of the Year. Institutional Investor, January 1985. p. 211-214, 218, 221, 222, 224, 226, 228.

12/ Steinbreder, H. John. Deals of the Year. Fortune, Jan. 21, 1985. p. 126-130.

GENERAL GUIDELINES

The practice of hostile corporate takeovers is relatively new, and the successes are relatively few. Thus, in trying to identify general guidelines to establishing fee schedules for hostile corporate takeovers, evidence was sought in the more general category of all mergers and acquisitions.

It is possible that, in the absence of complete or even representative statistical evidence, there would be a rule of thumb guideline in general use by the community of experts who offer advice in merger and acquisitions situations. There is some evidence that such a broad guideline does exist; however, it apparently does not apply to hostile takeovers. It seems to have been used primarily for relatively small merger transactions. As a general rule, hostile takeover fees appear to be negotiated for each deal; the presence of guidelines is noted but they are generally not identified, and may be specific to a particular adviser at a particular time.

There is no requirement that any merger adviser, in either a hostile or a friendly deal, must report fees for advice. Thus, fee schedules are not generally a matter of public knowledge. In the absence of reliable concrete information, a model for establishing fee schedules, the Lehman formula, is briefly summarized and compared to the information on investment adviser fees in hostile takeovers noted earlier in this report. Excerpts from three articles in business publications are included as an indication of the anecdotal information on fees in merger and acquisition deals which appears from time to time in the business press.

In a 1982 article, Bert Ely presented a brief introduction to the "venerable Lehman, or 5-4-3-2-1, formula for paying investment bankers and other intermediaries" for merger and acquisition work. This is a sliding scale formula; the commission earned by the adviser is 5 percent of the first $1 million of transaction value, 4 percent of the second $1 million, 3 percent of the third $1 million, 2 percent of the fourth $1 million, and 1 percent of all the transaction value over $4 million. 13/

Because of the large size of hostile takeovers, it is clear that if such a formula as the 5-4-3-2-1 one were applied to hostile takeovers, it would mean an effective rate for an adviser's fee of approximately 1 percent. In the examples provided in this report, the total fees for a hostile takeover exceed one percent only in the Pantry Pride/Revlon transaction, and in no case does the fee for any one adviser approach one percent. It appears that the traditional Lehman formula does not apply to hostile corporate takeovers; many commentators indicate that applying such a formula would result in fees which were unjustifiably high. It may be that a variation with different brackets or rates may apply, but, if so, the appropriate formula is not apparent from empirical evidence or in the scant literature available publicly.

13/ Ely, Bert. Alternatives to the Lehman Formula for Broker Fees. Mergers & Acquisitions, Summer 1982. p. 45-46; also see Broker Views on the Lehman Formula. Mergers & Acquisitions, Fall 1982. p. 52-53.

Articles in Forbes, Fortune, and Business Week offer descriptions of the current status of fee determination.

> Precedent plays a large part in the way such fees are set, but there is plenty of room for negotiation in an arena where there sometimes seems to be comparatively little external logic. . . . Fees for the top ten mergers announced (but not final) this year [1985] seem modest, averaging less than one-fifth of 1% of the selling price. But for a billion-dollar deal, that's at least $1.8 million for each side. 14/

> Egos and precedent play big roles in how fees are set. Dealmakers often negotiate with a customer by pulling from a briefcase a printout showing what bankers have received for comparable deals. "I give the comparison sheet to the chief financial officer, the financial policeman who wants to chisel anything he can," confides a veteran dealmaker. "Then I negotiate the fee with the chief executive, whose company is on the line or who is about to make the biggest purchase of his career. The sheet keeps the chief financial officer from objecting too much."
>
> The prevalent practice among dealmakers is to peg fees to the total amount of the deal, using a sliding scale of percentages that drops as the deals grow larger. For some dealmakers, the touchstone is Morgan Stanley's fee scale, which occasionally turns up in proxy material. In an early 1984 version, Morgan charged 1% for a $100-million transaction and 0.5 percent for a $500-million deal. A $1-billion megadeal will cost you 0.4 percent, or $4 million; a $4-billion deal 0.23 percent, or $9.2 million. Later in 1984, Morgan Stanley hiked its prices for deals between $100 million and $900 million by about 15 percent, citing heavy demand. 15/

> Nothing has fattened investment banks' bottom lines more than the takeover game. An investment banking team can bring in $10 million or $15 million at a pop for a couple of weeks spent advising on a major deal. Despite a steady undercurrent of grumbling from CEOs, the M&A advisory business has been spared the price-cutting generally rampant on the Street in recent years. 16/

14/ Phalon, Richard. Fuel For the Flames? Forbes, Nov. 18, 1985. p. 126.

15/ Petre, Peter. Merger Fees That Bend the Mind. Fortune, January 20, 1986. p. 23.

16/ Bianco, Anthony. American Business Has A New Kingpin: The Investment Banker. Business Week, Nov. 24, 1986. p. 80. The sentiment expressed is not uncommon; for example, see also: Stewart, James B., and Daniel Hertzberg. The Deal Makers; Investment Bankers Feed a Merger Boom And Pick Up Fat Fees. Wall Street Journal, April 2, 1986. p. 1, 16.

The information available on guidelines is not specific to hostile corporate takeovers, but refers to corporate mergers and acquisitions in general. Even so, evidence of any systematic pricing policy such as a formula runs the gamut from scarce to vanishing. Fee schedules vary from one transaction to another. This variation may be due in part to differences in effort required for different transactions, but also seems highly dependent on the negotiating skills of the advisers and principals.