United States Senate
WASHINGTON, DC 20510

June 11, 1987

Dean David S. Ruder
School of Law
Northwestern University
357 East Chicago Avenue
Chicago, Illinois 60611

Dear Dave:

I thought you would be interested in a copy of the "Tender Offer Disclosure and Fairness Act" recently introduced by Senators Proxmire and Riegle. Also enclosed is a summary of the bill's provisions.

Along with several other members of the Senate Banking Committee, I have decided to co-sponsor this legislation. This bill includes many of the recommendations that were included in the corporate takeover report that I issued last December while chairing the House Subcommittee on Finance.

Among these recommendations are: closing the "13(d) window"; curbing greenmail, poison pills, and golden parachute provisions; extending the tender offer period; and increasing the penalties for insider trading.

The current plan is for the Banking Committee to begin hearings on this bill sometime within the next two weeks. I would welcome your thoughts on this legislative proposal and any additional suggestions you may have.

With best wishes,

Sincerely yours,

Timothy E. Wirth

TEW/bh
Enclosures

June 2, 1987

Summary of Tender Offer Reform Legislation

Section 1, Short Title.

Section 1 of the bill states that the bill may be cited as the "Tender Offer Disclosure and Fairness Act of 1987."

Section 2. Findings and Purpose.

Section 2 of the bill discusses the abuses which have, in recent years, become a substantial part of the corporate acquisition process, especially in connection with tender offers. The purpose of the bill is "to foreclose the opportunities for abuse under the present provisions of law and to expand the protective mechanisms of the Federal securities laws."

Section 3. 10-day Window; Contents of Report.

Closing the "10 Day Window"

Currently any person who acquires more than 5 percent of a class of registered equity securities must publicly disclose, among other things, the amount and percentage of securities beneficially owned, the identity of the beneficial owner, the source and amount of funds, the purpose of the transaction, and any contracts or arrangements with respect to the subject securities, within 10 business days. During the 10 day window period, however, such person may acquire additional securities without public disclosure.

In 1983, the SEC Advisory Committee on Tender Offers (the "Advisory Committee") found that the 10 day window presented "a substantial opportunity for abuse," and recommended that the 10 day window be closed to "provide adequate notice of the shareholder's investment and intentions regarding the issuer and [to give] time for the market to assimilate such information."

The proposed amendment would reduce the acquisition threshold to 3 percent and require disclosure by the close of business on the next trading day. The purpose of the proposed legislation is to more timely alert the marketplace to every large rapid accumulation of target company shares and to provide every shareholder an equal opportunity to share in any possible control premium, as well as to alert the target company's board of directors, and its shareholders to such accumulation.

Other Disclosure

The proposed legislative language is intended in part to address the recent phenomenon of modern pools -- operations in which investment bankers, institutions, arbitrageurs, and others join with stock accumulators in takeover activities -- which increase the possibilities for market manipulation. These entities, representing potent allies to an acquiror in its potential acquisition of control, are proper subjects of disclosure.

Accordingly, the proposed legislative language would require that persons subject to Section 13(d)'s reporting requirements disclose: (1) any communications in the 90 days prior to the filing with a third party regarding such third party's intention to purchase the securities which are the subject of the filing person's statement if such third party (i) previously has filed a statement under either Section 13(d) or 13(g) or (ii) to the knowledge of the filing person, subsequently acquired, or agreed to acquire, such securities, (2) information relating to such person's financing of the purchases, including the identity of the lenders and a summary of the financing agreements, and (3) the amount of any fees paid or to be paid in connection with such purchases, including the identity of any person to whom such fees have been or will be paid. Such information would assist shareholders and the marketplace in determining the future course of conduct of the acquiror, its resources, and possible affiliates.

The legislative proposal also contemplates that, in Section 13(d)(1)(C), the Commission would be required to provide a means by which persons would be required to choose between a control intention and an investment intention in stating the purpose for which they have acquired the securities. Currently, many people are able to avoid any meaningful disclosure of their purposes by narrative descriptions which are designed more to conceal than to illuminate the reasons for their acquisition of the securities.

The proposed legislation would also bar further purchases by a person first crossing the 3 percent threshold until the initial statement is filed and the purchaser publicly disseminates an announcement containing such information as the Commission may prescribe. This requirement will give the shareholders and the marketplace time to learn of those disclosures.

Section 4. Time for Filing Amendments.

The proposed legislative language would also require public disclosure of any material change in facts relating to a filing by the close of business on the next trading day following such change. Currently, SEC rules require the disclosure of such changes including additional acquisitions of at least 1 percent, but merely provide that such disclosure should be made "promptly."

Section 5. Enforcement Measures.

Group Activity

The concept of a "group" required to report their aggregate holdings would be expanded to encompass persons acting in a parallel manner with knowledge of one another's transactions. Under the legislative proposal, it would no longer be necessary to detect or prove the existence of an agreement between persons in order to require that they report their combined holdings and purposes.

Remedial Provisions

Additional enforcement mechanisms are needed to ensure compliance with the disclosure requirements of Section 13(d).

New paragraph 13(d)(4) would prohibit for six months any further acquisitions by means of a tender offer where the purchaser fails to alert the marketplace and holders of the security in question of an intended change in corporate control.

This new paragraph reads in pertinent part:

> "It shall be unlawful for any person who has disclosed in any statement required to be filed under this subsection or any amendment thereto that the acquisition of securities is for investment purposes, by making a designation of purpose pursuant to paragraph (1)(C)(ii) of this subsection, to acquire by tender offer or request or invitation for tenders, directly or indirectly, beneficial ownership of any additional shares of the class of equity security that is the subject of the statement required by this subsection until 6 months after the date an amendment is filed under paragraph (2) of this subsection disclosing that the purpose of the purchases or prospective purchases is to obtain or influence the control of the issuer of such securities unless such person can demonstrate to the Commission that there has been a material change of circumstances which resulted in a change in the purpose for which such securities are held or were acquired. The Commission shall have the power, by order, upon application, and after notice and opportunity to participate are given to interested persons, to grant exemptions from the prohibition of this paragraph upon the applicant's making such a demonstration."

The most basic necessity of the disclosure statements is that the information they contain must be accurate and complete. Accordingly, the proposed language at the end of Section 5 makes illegal any untrue statement of material fact or any omission of material facts needed to make the other statements not misleading. It is also made illegal to engage in any fraudulent, deceptive or manipulative acts or practices in connection with any such disclosure.

Section 6. Civil Liability.

New Section 13(i) provides for a private right of action not now uniformly recognized by the courts for any intentional disclosure violations of Section 13(d), 13(g) or 13(f) or for any violation of the margin requirements under Section 7 in connection with tender offer financing. The proposed language bars liability where the violation resulted from a bona fide error.

Section 7. Tender Offers.

Extension of the Minimum Offering Period

The proposed legislative language would require a tender offer to remain open for a minimum of 35 business days. Currently, a bidder may limit the offering period to only 20 business days.

Essential to providing an equal opportunity to all target company shareholders to participate in the offer is a minimum offering period that is sufficient to permit a reasonably diligent shareholder (individual or institution) to evaluate the merits of often complex transactions (particularly in the case of a front end loaded offer) and to make an informed decision.

Extension of the tender offer period would also allow for more of an auction market, allowing shareholders as well as management to consider another bid or other ways of maximizing

shareholder wealth. It would also provide all parties additional time to make fundamental decisions regarding the future of the company.

As with any bright line rule, the choice of 35 business days is to an extent arbitrary. Various alternative measures have been proposed both before and after the adoption by the Commission of Rule 14e-1, requiring that a tender offer be held open for 20 business days.

In 1983,the SEC Advisory Committee on Tender Offers recommended that the minimum offering period be changed to 30 calendar days.

A proposed bill be Senator D'Amato would extend the minimum offering period to 30 calendar days, while legislation introduced by Senator Simon would extend the minimum offering period to 45 business days and legislation introduced by Senator Metzenbaum would extend it to 60 calendar days. A bill introduced by Congressmen Dingell and Markey would also extend the period to 60 calendar days.

The investment banking community generally favors a minimum offering period of 30 calendar days although Felix G. Rohatyn, senior partner, Lazard Freres and Company, testified before the Senate Banking Committee on January 28, 1987, in favor of lengthening the tender offer period to 60 days.

Business executives testified on March 4, 1987, in favor of 90 days.

Labor favors a minimum offering period of at least 90 days.

The North American Securities Administrators Association, Inc., advocates 60 days. And, a minimum offering period of 6 months has been proposed. Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 Colum. L. Rev. 249, 317 (1983).

Regardless of the measure chosen, the purpose of these proposed measures uniformly has been to permit target company shareholders and directors the time necessary to make an informed decision.

Prohibition of "Creeping Tender Offers" and "Sweeping the Street" Transactions

Section 7 of the bill would add a new Section 14(d)(4) to the Securities Exchange Act in order to deal with several abuses.

Creeping Tender Offers. On January 28, 1987, Nicholas F. Brady, Chairman of Dillon, Read and former Republican Senator from New Jersey, testified before the Senate Banking Committee that "we should outlaw the creeping tender."

According to Brady, "There is something unfair when a bidder acquires economic control in the open market without paying a control premium and without offering all holders the ability to sell at the same price." According to Brady, "I believe that 'control' is, in effect, an asset of the corporation that should be transferred only in the light of day, with all holders -- particularly the unsophisticated ones -- having the opportunity to share in the proceeds. This rule should also apply to issuers tendering for their own stock."

In July 1986, the Commission proposed for comment the concept that during a tender offer "any person seeking to acquire a substantial amount of target company securities (e. g., 10 percent) would be required to effect that acquisition through a conventional tender offer." The Commission was concerned with the consequences of regulating conventional tender offers "while permitting other large acquisitions [i.e., open market purchases] to compete with such offers, unfettered by such restrictions."

The proposed legislative language would prohibit the acquisition of more than 15 percent of a corporation through open market purchases or private transactions.

Large, open market purchases, even when resulting in a change of control, generally do not constitute tender offers. Control is primarily a corporate asset. Requiring acquisitions of control to utilize the tender offer process and its protective mechanisms (i.e., adequate disclosure and equal treatment of shareholders) assures that target company shareholders will have an equal opportunity to share in any premium paid for such asset.

Most interested persons support establishing a threshold above which all purchases of a company's securities must be by tender offer. There is disagreement over what this threshold should be, however. The securities industries generally favors a 20% threshold. The business community generally favors a 10% threshold.

The proposed amendment would also maximize shareholder wealth by ensuring that bidders do not use techniques to reduce the takeover premium -- such as open market or privately negotiated purchases in lieu of a tender offer.

The current disparate treatment between open market or negotiated purchases and tender offers places the tender offer bidder at a competitive disadvantage in a control contest. A bidder may only buy in a tender offer, and the tendering shareholder may be subject to proration under the tender offer bid, Section 14(d)(6) of the Exchange Act. The proposed language would equalize the competitive position of the tender offeror and open market purchasers.

Finally, given the current absence of a definition of the term "tender offer," the proposed amendment, by requiring any transaction resulting in the acquisition of a defined magnitude to be pursued by means of a tender offer, adds certainty to the planning of transactions and diminishes the needless possibilities of litigation.

"Sweeping the Street". By requiring that acquisitions of more than 15 percent of a corporation be made by tender offer, the proposed language would also address the practice known as "sweeping the street". Under that practice, a bidder withdraws a tender offer and acquires control from a few arbitrageurs who hold large blocks, depriving other shareholders of the benefit of the tender offer. Nicholas F. Brady also recommended that this practice be eliminated. Written Statement of Nicholas F. Brady before the Senate Banking, Housing, and Urban Affairs Committee (January 28, 1987).

The purpose of the proposed legislative language is to ensure that individual investors are afforded the protection of the tender offer process. As noted by the SEC, "After the announcement of a tender offer, shares of the target company often become concentrated in the hands of a smaller number of investors. This concentration represents an allocation of the risk

created by uncertainty over the outcome of the takeover process. Shareholders who wish to receive some portion of the tender offer premium but who are unwilling to assume the risk that the tender offer will not be consumated frequently sell into the market. These shares are often purchased by professionals, who assume the risk and provide liquidity to the market."

Concentration of a large block of stock in relatively few hands permits the acquisition of control through open market purchases and privately negotiated transactions without the substantive protections afforded by the tender offer process including adequate disclosure, equal treatment of shareholders and sufficient time to make an informed investment decision.

Section 8. Actions by Issuers.

Anti-Greenmail Provision

Under current law, the ability of a target company to repurchase shares from dissident shareholders at a premium has created an incentive for an investor to accumulate blocks with the intention of reselling them to the purchaser. This practice has become known as "greenmail."

The proposed legislative language would prohibit an issuer from buying back its securities at a price above the market value from any person holding more than 3 percent of those securities if that person held the stock less than six months, unless the stock is purchased by a tender offer open to all shareholders or the repurchase is approved by a majority of the issuer's shareholders. Market value for this purpose is defined as the average market price either during the 30 trading days preceding the purchase of the securities, or, in the case of a tender offer or other announced intention to seek control, the 30 trading days preceding the commencement of the tender offer or the making of such announcement.

From January 1979 to March 1984, approximately $5,500,000,000 has been paid by issuers to repurchase blocks of common stock from individual shareholders at an aggregate premium of over $1,000,000,000. Office of the Chief Economist, Securities and Exchange Commission, The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices (Sept. 11, 1984) ("SEC Impact of Greenmail"). This practice is objectionable on the grounds that is derails the auction process, and thwarts equal shareholder participation in the control premium.

Empirical evidence suggests that nonparticipating shareholders suffer substantial and statistically significant share price declines upon the payment of greenmail.

The purpose of the proposed legislative language is to limit the practice except as specifically permitted by the issuer's shareholders or unless made pursuant to an offer open to all shareholders.

Restrictions on Adoption of Golden Parachutes and Poison Pills During Tender Offers.

In recent years, targets of takeover bids have, during the pendency of such bids, resorted to certain defensive measures that critics have suggested can be detrimental to shareholders. One such defensive measure is the adoption of "golden parachute" agreements that generally give its officers the right to substantial severance payments, without further action by the target, in the event of their termination following a change in control of the target.

Another measure which has been the subject of controversy in recent years involves the adoption of so-called "share purchase rights plans," or "poison pills." Such plans typically provide for the issuance of stock purchase rights to shareholders that automatically, without any further action by the target, permit such shareholders to purchase securities of an acquiring company or the issuer in takeover situations not approved by the issuer's board of directors. These rights generally provide for a purchase of those securities at a substantial discount and on terms designed to make the issuer a less attractive takeover candidate. Such plans have generally been adopted without shareholder approval.

The legislative language would prohibit the adoption of golden parachute agreements or poison pills during the pendency of a tender offer unless the Commission provides an exemption by rule, regulation or order. The effectiveness of any golden parachutes or poison pills adopted prior to commencement of the tender offer, however, would not be affected, even if the tender offer has the effect of triggering such pre-existing rights.

Section 9. Registration and Regulation of Arbitrageurs.

The purpose of the proposed amendment is to provide a scheme for the registration and regulation of "tender offer arbitrageurs."

Because of the secretiveness of arbitrageurs, most accounts of their activities are based on estimates and speculations. It is clear, however, that arbitrageurs are a force in the market. It has been stated that "arbitrageurs may be responsible for up to 90 percent of the trading activity in the two securities involved in an uncontested exchange offer and that over 50 percent of all tenders comes through arbitrageurs."

The common wisdom holds that tender offer arbitrageurs provide an alternative to target company shareholders who are unwilling to assume the risk that the tender offer will be unsuccessful, stabilize the price of the securities involved, and provide liquidity to the market. It has also been contended that tender offer arbitrageurs overprice target company shares, tipping the balance in favor of the bidder. Thus, many tender offers succeed for reasons only "tangentially related" to the merits of the offer itself.

Subsection (a) of the proposed amendment would make it unlawful for any person to be a "tender offer arbitrageur" unless registered as such with the Commission.

The definition of tender offer arbitrageur (new subsection (3)(a)(47) of the Exchange Act) makes use of the definitions of broker and dealer presently found in Section 3 of the Exchange Act. Thus, any person, who for his own account through a broker or otherwise, or for the account of others, regularly engages in tender offer arbitrage as part of a business, must register with the Commission.

It is generally thought that most tender offer arbitrageurs are registered brokers or dealers. Recent news reports, however, indicate that controlling shareholders of small, publicly held companies are issuing stock the proceeds of which are used to engage in arbitrage, Forbes, Feb. 23, 1987, at 35, and that insurance companies and pension funds have become neophyte investors in arbitrage pools, Bus. Week, Dec. 8, 1986, at 36.

Section 10. ERISA Amendments.

Fiduciary Duties and Tender Offers

The proposed legislative language would permit employee benefit plan trustees in discharge of their fiduciary duty to consider the long-term benefits of continued stock ownership in the event of a tender offer.

The Employee Retirement Income Security Act ("ERISA") is silent with respect to the fiduciary duty of plan trustees in the face of a tender offer. It currently requires that plan fiduciaries discharge their duty with the care of a "prudent man" and "solely in the interest" of the plan's participants and beneficiaries. Thus, in the face of a premium, plan trustees may find themselves with no recourse but to tender the shares of the target company.

This required response is arguably a source of institutional investors' "short-time horizons" and, because of their recognized dominance of the market (accounting in 1985 for approximately 45 percent of public stock ownership), contributes to corporate managements' preoccupation with short-term earnings at the expense of capital investment, research and development, and other long-term goals.

Excess Pension Plan Assets

The proposed legislation would prevent a company from transferring excess pension plan assets from a plan to the company's general coffers if any part of such assets are used to finance, directly or indirectly, any acquisition of the employer's securities, whether by a bidder who has obtained control by tender offer or by an issuer self-tender.

In recent years, there have been a number of instances in which an acquiring company has utilized funds of a target company's pension plans to partially finance the acquisition. This occurs when, following an acquisition, the acquiror terminates one or more of the target's pension plans and transfers the excess plan assets into the target's general operating funds, which moneys the acquiror then uses to pay down acquisition-related debt.

Although current law requires acquirors to leave sufficient assets in terminated plans to fund, on an actuarially determined basis, already earned benefits, it does not mandate that the excess assets be left in place to provide benefits to be earned in the future or to provide a cushion in case the actuarial assumptions and calculations prove to be too optimistic or there is a later shrinkage in the value of the plans' assets. Thus, not only are employees of a target subject to termination or forced resignation following an acquisition, but also the assets of the pension plans which would provide them their earned benefits in such event are being stripped after such acquisitions, leaving them with only the minimum mandated amount of assets to protect those benefits. As a consequence, they have no cushion to protect them if the plans' investments falter or the entity which results from the merger is forced into bankruptcy during an economic downturn.

The proposed amendment would prohibit any earned assets from being transferred to finance an acquisition of securities and the full amount of excess assets in pension plans at the time of an acquisition would remain in such plans to provide a cushion in case the acquisition proves to have been ill-considered or ill-timed, or in case the value of the plan's assets decline during such

period. It would thus help ensure that they do not suffer a loss of already earned retirement benefits solely because a raider wanted to acquire their former employer.

Section 11. Increased Penalties for Insider Trading, Perjury and Obstruction of Justice.

In light of the recent insider trading scandals and the minimal deterrence which the civil and criminal sanctions provided for in the Insider Trading Sanctions Act of 1984 apparently have engendered, the need for increased deterrence has become apparent. The bill would amend Section 32 of the Exchange Act to provide for criminal fines of up to $1,000,000 and imprisonment for up to 10 years for any willful insider trading. The bill would also provide for an additional one year sentence, to be served concurrently, for intentional obstructions of justice and perjury in connection with any investigation of any alleged insider trading.

On April 22, 1987, Rudolph W. Giuliani, United States Attorney for the Southern District of New York, testified before the Senate Banking Committee on the subject of improper activities in the securities industry. Mr. Giuliani recommended a "mandatory minimum additional penalty of a year or two years for those who are proven beyond a reasonable doubt to have been engaged in perjury or obstructing [an SEC] investigation."

On May 13, 1987, Securities and Exchange Commission Chairman John Shad testified before the Securities Subcommittee during oversight hearings on the SEC authorization stating "I think the greatest inhibitor of insider trading is imprisonment."

The proposed provision would follow the recommendations of Mr. Giuliani and Chairman Shad.

Section 12. Role of State Law.

The continued role of states in the internal affairs and governance of corporations is affirmed by this section of the bill.