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News Release

NEW REGULATORY ISSUES IN THE TAKEOVER ARENA

Remarks to

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I. INTRODUCTION

Good Afternoon.

I am sure you are all enjoying the Sixth Annual Northwest Securities Institute -- both for the wide array of timely securities issues examined and for the incidental tax benefits that I trust you will all appreciate -- no pun intended. As an economist, I feel very aware that I am speaking to a room filled with lawyers. I know that whatever I say will be analyzed with professional skepticism.

An attorney recently related a story, which I would like to share with you, about one of his colleagues. His friend is a very successful lawyer who had a running battle with his wife.

"You say you will, you say you will, but when the time comes you always find some excuse --" she said.

"Okay dear, I'll do it -- right now."

The legal wizard stalked up the steps and into his son's room.

"Junior," he said, "the time has come for us to have a man-to-man talk!"

"Sure, Dad. About what?"

"About -- the <u>alleged</u> facts of life."

This afternoon, I will speak to you about certain <u>alleged</u> new developments in the corporate takeover area as well as my views on some related issues that have emerged from the takeover environment; namely, rumors in the marketplace, news-pending trading halts, and the one share-one vote controversy.

I won't talk today about straight tender offer issues, which I'm sure you've heard before. Nor do I intend to rehash my ideas over whether tender offers are beneficial or harmful to the economy. I will, however, direct my remarks to some new tender-offer-related issues that are still unresolved by the Commission.

II. RECENT COMMISSION ACTION AFFECTING TAKEOVERS

Contrary to the image of the stereotypic government bureaucrat back east, the staff at the SEC and the Commission have been working long, hard hours to reach what we believe to be a proper regulatory response to corporate takeover activities.

What the Commission Did

This past January 9, the Commission met to articulate its position on a number of tender offer issues. Without examining the specific details of the Commission's recent actions concerning corporate takeovers, I would like to briefly identify what the Commission did and what the Commission did not do on January 9th.

I recognize that you have just come from a detailed SEC update which included a description of: (1) reducing the filing period under Section 13(d) to two calendar days; (2) the reproposal of the best price rule; (3) the Commission's decision to defer final action on the "all-holders" proposal until final action is considered on the best price rule; and (4) the adoption of timing amendments to place issuer and third party tender offers on the same time schedules. 1/

I think you've been through enough in one day having had to concentrate on the nuances of these convoluted timing amendments. Twice in one day is likely to bring us under the protection of the eighth amendment for cruel and unusual punishment.

Instead, I will concentrate on the forthcoming concept release that the Commission directed the staff to prepare for publication. As you may know, the concept release, which is expected to come before the Commission in the next few weeks, will focus on alternative approaches to certain takeover related activities. Specifically, the concept release will address the following topics: (1) whether certain acquisitions that are made after the commencement of a tender offer should similarly proceed by way of a tender offer; (2) the so-called "opt-out" provision as a means of providing greater flexibility in tender offer regulation; and (3) the appropriateness of legislation or regulation in response to "poison pill" defensive tactics. Taking them in order, the first proposal provides that once a conventional tender offer has commenced and until a specified time after termination of the offer, substantial acquisitions of a target company's stock (i.e., acquisition of ten percent or more) by any person (including the target company, the initial bidder or a third party) could be made only by way of a conventional tender offer subject to the Williams Act. The first -- often hostile -- bidder, in an effort to assume quick control, typically proceeds by way of a conventional tender offer. The approach of the concept proposal would prevent subsequent white knights or the target company itself from so-called "sweeping the street" without being subject to the same rules as the first bidder once the game is in play. This approach would also prevent the initial bidder from terminating its offer and immediately thereafter effecting large scale open market or privately negotiated purchases. Proponents of this proposal argue that by requiring all players

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1/ See Securities Exchange Act Release No. 22788, January 14, 1986.

to abide by the same set of rules, shareholders would be afforded an ample opportunity to evaluate and respond to all competing acquisition offers. I interject that this proposal is merely a suggested solution to certain tender offer activities. The Commission has yet to determine whether open market purchases and unconventional tender offers are problems that require a regulatory response. Consequently, we are also seeking comment on whether and in what ways such activities do actually present a problem.

In addition, the Commission has asked the staff to once again try its hand at a definition of the term "tender offer." Some think that bringing more change of control activities within the definition of a tender offer is appropriate because it will eliminate certain open market purchases and unconventional tender offers. Although I remain skeptical that a definition can be drafted that will not later come back to haunt us as being either too broad or too narrow to anticipate future varieties of open market and large block purchases, I will keep an objective mind when and if a consensus is reached on a suitable definition.

The Commission is exploring and will seek comment on the pros and cons of an "opt-out" provision to the proposed all-holders rule. Such a provision would permit an exclusion for corporations whose shareholders have voted to so amend their corporate charters and would allow a target company to commence an exclusionary issuer tender offer if such amendment is made in accordance with state corporate law. The opt-out procedure is also being examined with respect to other provisions of takeover regulation in accordance with shareholder approved resolutions. Judging from the press reaction to this provision, we expect to receive the benefit of extensive comments on this issue.

While this provision has been characterized as an attack from within on the Commission's authority to regulate, any opt-out provision would be limited to situations that involve a change of control. Contrary to what some would imagine, it is not as though we are asking company's to have their shareholder's vote on something as sacred as whether or not the company should make periodic disclosures.

Also, the Commission will seek comment on the wisdom of pursuing legislation or regulation in response to recent developments involving the defensive poison pill tactic. The Commission is seeking comment on the need for shareholder approval for the adoption of poison pill plans. I am particularly concerned that poison pill plans may deter hostile takeovers that otherwise benefit the shareholders without those shareholders having the opportunity to consider the offer.

In this regard, there is evidence that poison pills deter tender offers and thereby have an immediate negative effect on share prices. Specifically, the Commission's Office of the Chief Economist has concluded, in its most recent study on shark repellents and stock prices, that, in general, share prices decline about 3.5 percent net of market when poison pills are adopted. 2/

When shareholders decide to vote in favor of a poison pill, they should be permitted to exercise their votes and adopt the amendment even if it decreases share value. On the other hand, where the board adopts a poison pill without shareholder approval, I am concerned that the amendment and resulting decrease in share value may not be what the shareholders want. Investor protection may require that shareholders vote on poison pills. In any case, the Federal government treds a delicate line if it attempts to intrude on state corporate law by regulating what shareholders can or cannot vote on, and, as we have seen with respect to other defensive tactics, any regulatory action on poison pills may be premature.

What the Commission Did Not Do

While the issue of the poison pill is still of concern to the Commission, it has concluded that certain other defensive as well as offensive takeover tactics, no longer warrant regulatory or legislative intervention. I will not take the time to discuss the dozen or so defensive tactics and other issues where the Commission has determined not to take or recommend action, however, the unanimous judgment of the Commission was not to impose prohibitions or restraints on such activities as the granting of golden parachutes, greenmail transactions, two-tier and partial tender offers or lock-ups by target companies. In every instance, it was the Commission's judgment, that the marketplace and/or state and federal courts have adequately responded to these particular tactics and strategies. Clearly, it is better for the Commission to retreat than to press forward on the wrong path.

III. OTHER RECENT DEVELOPMENTS IN THE TAKEOVER AREA

On February 19, the Commission invited representatives from the NYSE, AMEX, NASD, along with Arbitrageur Ivan F. Boesky, Merrill Lynch CEO William Schreyer, and distinguished representatives of the legal, financial and academic fields to discuss a variety of issues that have arisen out of the recent proliferation of corporate takeovers. The specific areas addressed at the Roundtable were market rumors, rumor related disclosure obligations of public companies, and rumor related trading halts.

2/ Shark Repellents and Stock Prices: The Effects of Antitakeover Amendments Since 1980, A Study by the Office of the Chief Economist, SEC, July 24, 1985.

A. Rumors and Market Manipulation

In the current atmosphere where the market is particularly sensitive to any news involving a potential takeover because the stock price gains are so great, it is widely believed that false rumors are being planted in the market as a manipulative tool. Some rumors are based on educated guesses. Some rumors are a form of insider trading where nonpublic information about takeover developments has been leaked. In other instances, however, the rumors have no foundation in fact and have been circulated by persons seeking to profit from the misinformation.

The difficulty lies in attempting to sift out false rumors that have been intentionally planted in the market to manipulate the stock price from other causes of market volatility. At the same time, there is a danger that the large scale trading volatility, when it is traced to information leaks and rumors, will jeopardize public trust in the integrity of the securities markets.

I recently examined the price and volume histories of a number of public companies that have been subject to reported rumors of imminent takeover or merger developments. The companies, which included: RCA, Sperry Corporation, CBS, Nabisco, Pennzoil, and Merrill Lynch, each either responded to an inquiry as to whether there was any truth to the rumor or made a statement about the rumor on its own. The price and volume figures suggest that even where the issuer denies a rumor the market will draw its own conclusions and does a fairly good job of anticipating merger developments.

Opinions vary as to what kind of response is appropriate when there is a substantial rumor trading; either a no comment, a denial of the rumor or a confirmation that negotiations are, in fact, ongoing.

B. Issuers Duty to Disclose

In July of last year, the Commission made clear, in its investigative report on Carnation Company that issuers cannot make public statements which are false or materially misleading when queried about takeover or merger developments. The report further specifies that when an issuer makes a substantive statement about acquisition discussions, that it has a duty to correct that information. Finally, it notes that where a corporation does not have an affirmative disclosure obligation, that it may issue a "no comment" response to inquiries from the press regarding market activity. 3/

3/ In the Matter of Carnation Company, Securities Exchange Act Release No. 22214, July 8, 1985.

The Carnation problem, as you may recall, involved false and misleading statements by a Carnation spokesman that he knew of "no corporate reason for the recent surge in its stock price." While the statement was made, senior officers of Carnation were negotiating with Nestle management in Switzerland for Nestle to acquire Carnation.

The Commission has been severely criticized over the Carnation report. I strongly disagree with those who say that we've gone too far. What the Commission did was to say that you don't have to speak during a merger or takeover negotiation if speaking would kill the deal. Rather, you can simply say "no comment." If you do speak, however, you must be willing to speak the truth.

Some critics argue that there are times when it is appropriate for a company to issue misleading statements rather than a "no comment" response simply because the market may interpret "no comment" to mean that there is truth to the rumor. The market may or may not read many different things into "no comment" responses, but the alternative that companies may lie, if the lie serves good corporate purposes, is not acceptable.

This is not to say that there is no problem with the present state of disclosure in the face of takeover rumors. William Schreyer, of Merrill Lynch, described at the Roundtable how Merrill Lynch recently found itself in a Catch 22 situation with respect to its duty to disclose. While Mr. Schreyer wanted to issue a truthful statement that there were no corporate developments that could account for the substantial rise in Merrill stock during a siege of takeover rumors a few weeks ago, he was advised by counsel not to do so. Under current law, an issuer that denies a false rumor may later have to correct or update its statement if the facts change and the statement remains "alive" in the marketplace. This is to say, if some acquiring company subsequently did approach Merrill, it would have to disclose this in a timely manner even if disclosure were premature from Merrill's view and could possibly damage the deal.

In an effort to resolve this problem, the Commission is exploring the possibility of adopting a rule that would provide a safe harbor for a company that finds itself in such a Catch 22 situation with respect to a rumor that was generated outside of the company. The company would be permitted to make a statement denying a false rumor, without having to concern itself with future Commission updates, if the denial statement is true, accurate and made in good faith at the time it is issued.

C. Trading Halts

Another issue that arises out of rumors regarding corporate takeovers is that of trading halts. If a company confirms, denies or gives a "no comment" response to inquiries from the press or an exchange on which the company is listed, the exchange, in its discretion, could halt trading in its stock. The policy on trading halts presents some very difficult questions both for the Commission and for the primary exchanges to resolve. When the New York Stock Exchange or the American Stock Exchange learns that a material news announcement is about to be released by one of its listed companies, the traditional policy has been for the respective exchange to respond by instituting a "regulatory halt" on trading of that stock. If an exchange finds a substantial increase in the price and trading activity in the securities of a particular issuer, it is likely to contact the issuer to determine if there is any corporate development that would account for the market interest in the stock. The exchange may determine, after speaking with the issuer, that a trading halt is required. The trading halt is intended to provide investors and the market with an adequate opportunity to learn of and evaluate the news before formulating investment decisions.

While it is not now empowered to halt trading in the over-the-counter market, the NASD has made it a practice of suspending quotations on NASDAQ for securities upon which a trading halt has been called. (The NASD, however, is currently considering a rule change that would allow it to halt trading in the OTC market.) It is important to note that trading halts by regional exchanges, and the NASD's decision to stop the flow of quotations on NASDAQ, are made despite the fact that neither the regional exchange nor the over-the-counter market is otherwise prohibited from trading a security that is subject to a primary market trading halt.

Recently, over-the-counter market makers and a certain regional exchange, the Boston Stock Exchange, have continued to trade during primary market trading halts. While it is still true that most regional exchanges will stop trading during a news-pending halt, the Boston Stock Exchange has developed a practice of continuing to accept orders from broker-dealers who are otherwise subject to off-board trading restrictions, which precludes them from trading as principal in the third market.

As we saw with Carter Hawley Hale, Gulf Oil, Walt Disney Productions, and more recently, RCA, Jefferies and Co., a prominent third market player, successfully provides a trading forum while the primary market is waiting to resume trading. In what is becoming a common occurrence, Jefferies benefits from substantial trading volume by offering a substitute marketplace, primarily for institutional investors.

Let's take a closer look at the extent of this third market activity. On June 11, 1984, the New York Stock Exchange halted trading in Disney shares, at the company's request, pending an announcement from Disney's Board of Directors. While the Board considered the hostile takeover threat of investor Saul Steinberg, Jefferies managed to trade a volume of nearly 400,000 shares of Disney stock before the New York Stock Exchange reopened its trading.

Jefferies has recorded similarly impressive trading volumes during other New York Stock Exchange trading halts including: Electronic Data Systems, 632,400 shares traded; Petrolane, 745,200 shares traded; Carter Hawley Hale, 1,177,200 shares traded; and Gulf Oil, where a total of 1,675,000 shares were traded.

It is no surprise that the New York Stock Exchange feels and has responded to the competitive pressure from the third market, or that it has fashioned its policies on trading halts in an attempt to relieve some of that pressure. The New York Stock Exchange instituted an informal three hour policy allowing the Exchange to continue trading three hours after instituting a regulatory halt, if the company has not released any information within that time. It is interesting to note that the New York Stock Exchange implemented its three hour policy during the trading halt for Disney; the Big Board clearly felt the volume loss. On December 10, 1985, the Commission approved a New York Stock Exchange rule change which would allow the Exchange to resume trading within thirty minutes after a halt has been instituted, if the pending news has not been forthcoming within that half-hour span.

At the Roundtable, the leaders of the three major markets made it perfectly clear that they wanted everyone -- exchange and OTC -- to stop trading a stock when a trading halt is called. While each exchange executive was able to say loudly that the SEC should impose across the board halts on all the markets, no one explained, to my satisfaction, why it is in the interest of investor protection to prohibit willing buyers and sellers from transacting when they both want to do so. Consider the reasoning offered: First, it takes time for investors to digest the information. True, but the speed of information digestive systems varies. Surely some investors have polished off information dinner and are ready for a late night snack before others are done with information breakfast. And some investors may even want to trade on an empty stomach. Second, if institutions trade in the third market while trading on the exchange is halted, some investors may think large institutions manipulated the price up or down. Perhaps, but some people may think that witches move the prices; neither fallacy justifies complete trading halts. Certainly, I have no objection to the New York Stock Exchange or the American Stock Exchange calling a trading halt, if they determine that it is in the best interest of the exchange's customers to do so. I do find fault, however, with the primary exchanges request that the Commission prohibit the third market from trading if it so chooses. Moreover, I am sure that the exchanges are well aware that institutions will trade in Tokyo, or London or wherever a market is made if all U. S. trading is halted. Therefore, the exchanges are, in effect, advocating that small investors be denied the opportunity to trade.

Pursuant to Section 12(k) of the Exchange Act, the Commission has the authority to summarily suspend trading in a security "if it determines that the public interest or the protection of investors so require[s]." Nevertheless, the Commission generally has not chosen to insist on a suspension of all trading during a primary market imposed trading halt and, in so doing, has not prevented Jefferies or the Boston Stock Exchange from taking advantage of a big board trading halt. The Commission, despite its authority to suspend trading in all markets, has not exerted regulatory pressure in this area.

It is my view, that if an exchange elects to halt trading for a reasonably short period of time, it is not appropriate for the Commission to insist on a trading halt for all markets. I would consider an across the board trading halt to be an anticompetitive burden that does not benefit investors.

D. Rewards to Informants

The SEC is concerned about claims that insider trading is rife prior to the announcement of a takeover. In addition, I have already discussed the Commission's concern that the market is subject to manipulation through false or misleading takeover rumors. While the staff of the Enforcement Division is actively investigating both types of violations, it must rely on circumstantial evidence to prove its case. The Commission's Chairman, John Shad, has suggested that cash rewards for reliable informants could be a useful tool for the Enforcement Division. While the idea has many as yet unexplored wrinkles, I do see some benefits to such a program. Where the staff might otherwise expend countless hours sifting through telephone records or subpoenaing unreliable witnesses, an informant could provide a more efficient means of identifying an inside trader or tracing a manipulative rumor to its source. Although some participants at the Roundtable found the concept of money payments for evidence to be objectionable -- repugnant and heinous were the words -- I suggest that if we are serious about deterring insider trading, the idea warrants serious consideration. Alternatively, if the public decides insider trading is to be a sport where the Enforcement Division must do its hunting with a restricted range of weapons (telephone, bank, and trading records) that can only produce a circumstantial case, along with hopes that a scorned lover will come forward to offer testimony, then the notion of paying informants should be cast aside as repugnant and unsportsmanlike.

The SEC would not be the first Federal agency to adopt an informant reward program; the FBI, the Department of Justice and the IRS all have such programs. An analogous program established by the IRS has been very effective and has resulted in the collection of taxes on unreported income that may otherwise have gone undetected. With annual rewards to informants of approximately $450,000 over the past ten years, the IRS collected a total of $172.5 million in unpaid taxes. 4/

4/ GAO Report to the Commissioner of Internal Revenue, GGD-85-11, April 19, 1985.

E. One Share-One Vote

Another problem that has emerged because of takeover developments is the one share-one vote controversy, a topic that was discussed at an earlier Commission Roundtable in September of last year. The one share-one vote issue is, in large part, a response to the fact that numerous corporations have, as a takeover defense, recapitalized their companies and are issuing dual classes of common stock with disparate voting rights.

Much has been said about the one share-one vote notion and how permitting management to issue dual classes of common stock with unequal voting rights is inconsistent with corporate democracy. Proponents of one share-one vote include such influential people as: Senator Al D'Amato of New York; Congressman John Dingell of Michigan; Harrison J. Goldin, Comptroller of the City of New York and Co-Chairman of the Council of Institutional Investors; John Whitehead, Assistant Secretary of State and former Chairman of Goldman Sachs & Co.; and T. Boone Pickens, Chairman of Mesa Petroleum and takeover specialist.

Such proponents of one share-one vote frame their arguments in terms of corporate democracy and contend that "[w]ith one vote, shareholders disenfranchise themselves and their successors for all time," 5/ when they adopt dual class stock and that the existing movement toward disparate voting rights is simply not in the best interest of the shareholder. Mr. Pickens argues that the adoption of dual class capitalization carries with it an inherent danger of creating an economy replete with "entrenched corporate bureaucracies [that are] forever insulated from competition for control, since voting strength is concentrated in friendly hands." 6/

The New York Stock Exchange has long refused to list issuers with more than one class of common stock or non-voting common stock. If it were to abandon its current standard, and adopt the recommendations proposed by a New York Stock Exchange subcommittee, 7/ a company with securities listed on the New York Stock Exchange would no longer jeopardize its listing status if it were to adopt charter provisions to create two classes of common stock having disproportionate voting rights provided it

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5/ Herzel and Katz, "Investors Can Weigh Voting Rights," The Wall Street Journal, February 13, 1986.

6/ Pickens, "Second-Class Stock Impairs Market," The Wall Street Journal, February 13, 1986.

7/ New York Stock Exchange, Initial Report of the Subcommittee on Shareholder Participation and Qualitative Listing Standards, "Dual Class Capitalization," January 3, 1985.

complied with certain requirements. As proposed, the requirements provide: (1) that there be approval by two-thirds of all shares entitled to vote on the proposal and by the company's outside directors; (2) that the ratio of voting differential per share between the high vote and low vote stock be no more than ten to one; and (3) that the characteristics of the two stock classes, with the exception of the voting power per share, be substantially equivalent. Since July 1984, the New York Stock Exchange has had an informal moratorium on delisting companies that violate its shareholder participation requirements pending a final determination by the Exchange or the consideration of the dual class recommendations. Without the imposition of a moratorium, the New York Stock Exchange would have been hard pressed not to delist three of its companies, namely, Hershey Corp., Coastal Corp. and General Motors; each of which has created more than one class of common stock with different voting rights.

The New York Stock Exchange's initiatives in this area have arisen in large part because it finds itself in a difficult competitive posture with the NASD. The NASD has no stock voting rights restrictions and is able to attract issuers with dual class capitalization. The New York Stock Exchange hopes to gain leverage in an area that it perceives as a competitive disadvantage. In this regard, the New York Stock Exchange has indicated that while competitive pressures may force it to go to a dual class standard, it would hope that the Commission would put its imprimatur on one share-one vote for all markets. As the issue currently stands, there are three conceivable alternatives: (1) a one share-one vote standard could be imposed on all exchanges; (2) a lesser dual class capitalization standard could be uniformly applied; or (3) the markets could be left to choose their own preferred standard of regulation in this area.

The Commission has listened to all sides of the argument, and to date, it has not expressed a position as to the appropriateness of allowing separate classes of common stock with disparate voting rights to list on an exchange. This is mainly a consequence of the fact that the Commission has not received a proposed rule change, from any of the self-regulatory organizations, affecting shareholder voting rights.

Speaking for myself, I find the arguments equating corporate democracy with one share-one vote to be patently unpersuasive. First, although the questions of evaluating listing standards for exchanges and the appropriate capitalization for a corporation are related, I think they are most usefully analyzed as two distinct issues. With regard to listing standards for exchanges, I believe that those standards should be treated as a business decision of the exchange. The decision involves an analysis of the best way to attract companies to list on the exchange and to attract investors to trade. Some issuers, for example, might find it attractive to be listed on an exchange that represented itself as the tiffany of exchanges where, among other stringent listing requirements, only companies with one share-one vote could list. Still other issuers may require a different focus. A similar kind of reasoning applies to investors. It is up to the exchange to strike the right balance.

As far as corporate capitalization, it seems to me that the shareholders are in the best position to determine how any particular corporation should be capitalized. Similarly, the market is well equipped to evaluate shares with limited voting rights. I agree with the words of Messrs. Herzel and Katz when they said in a recent Wall Street Journal article, that:

> Voting rights are part of the bargain struck between management and shareholders. There's no need for all those bargains to look alike. Democracy is just one way of doing business. To impose democracy by fiat is to interfere unnecessarily with the freedom of contract that is the basis for efficient capital markets. 8/

If the shareholder elects to give up his voting rights, he should be able to do so. It is especially important to realize that in these situations voting rights are not taken away from shareholders, rather shareholders are compensated for relinquishing those rights. It is also important to realize that we are not dealing with an inalienable political right to vote. Rather, we are examining voting rights that were purchased by shareholders as part of the "package" when they purchased the company's stock. Should they not be allowed to "sell" part of that package?

IV. CONCLUSION

In closing, I would like to communicate the Commission's struggle to exercise its regulatory clout in a responsible and realistic manner given the dynamics of the tender offer process. The SEC has observed the many changes in the marketplace, sometimes, with approval and other times, with great frustration. Sometimes a problem has come and gone before any regulatory response was attained.

I have long maintained that attacking specific takeover tactics, both defensive and offensive, in such a dynamic and creative environment would simply not solve the problem. Frankly, I am happy to observe, once again, that the free market philosophy works. Certainly with respect to several of these tactics, the market has shown its capacity to take care of itself, and in those areas the Commission has chosen not to act. It was not an easy decision, yet the Commission unanimously agreed when it considered a host of offensive and defensive takeover tactics and other issues, that any regulatory or legislative action would be both ineffective and unnecessary and that federal intervention is not always the wisest course.

8/ See supra note 5.

There is a story making the rounds in Washington about an earnest first-term congressman who sent out a long questionnaire to his constituents asking for their opinions on the economy, military spending, school prayer, etc. The final question was: "In light of all the complex problems that face our nation, what do you suggest Congress do?"

Several answers read: "Adjourn."

I think I will do just that, but before I do, I would be happy to answer any questions.

Thank you.