TAKE-OVER BIDS

Remarks of

Philip A. Loomis, Jr., General Counsel

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Philip A. Loomis, Jr. *

The Chairman has referred not only to the growing importance of tender offers and take-over bids but also to some of the principal questions of public policy and investor protection which this development presents. He has also outlined the principal provisions of S. 510, a bill to close some of the gaps in available investor protections in this field. My part of the program is concerned more with the procedures and mechanics of tender offers and the questions of policy and investor protection which they present.

It might be assumed at first blush that the procedures and mechanics of tender offers are quite simple. The offeror bids for a specified number of shares at a specified price, and he either gets them or he doesn't. In practice it does not usually work out quite that way. The Chairman has pointed out some of the complications which are introduced either by competing tender offers or by the defensive maneuvers of the management. A recent writer has described the tender offer as "the business equivalent of what in the waning seconds of a professional football game has come to be called the long bomb." 1/ Pursuing this analogy, both the offensive and

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* General Counsel, Securities and Exchange Commission.
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1/ Cheney, The Tender Offer and Corporate Public Relations, Public Relations Journal, February 1967.

the defensive pass patterns can become quite complicated.

Many of the procedural problems arise from the fact that an offeror seldom simply offers to buy all the shares tendered. He usually puts both a minimum and a maximum limitation on his offer in order to avoid either getting a few shares, which will simply make him a minority stockholder, or at the opposite extreme being obligated to buy more shares than he is in a position to pay for. According to a tabulation of 58 tender offers made by one company for the stock of another during the period from 1965 to the early part of 1967, which appeared in the April issue of Forbes Magazine and is described as a representative list from over 130 cash tender offers in the 1965-1967 period, only 11, or slightly less than 20%, were for all shares.

In the usual case where an offeror seeks less than all of the outstanding shares there is always the substantial possibility that more shares will be tendered than he is prepared to take. Where this occurs some procedure for selection is necessary. Offerors often prefer to specify that they will take up shares on a first-come first-served basis. This increases the likelihood of success by putting pressure on shareholders to deposit promptly. On the other hand, it presents problems for shareholders. In the first place, this pressure on shareholders to deposit in haste seems inconsistent with the principle that investors should not only have information but they should be allowed to make an informed and unhurried investment decision. In the second place, if the tender offer is an attractive one, the first-come first-served procedure makes it possible for insiders who are likely to know more and to know it sooner, to jump in and pretty well preempt the offer to the exclusion of ordinary investors. In recognition of this problem, the New York Stock Exchange has worked out a procedure, which it endeavors to enforce as to companies subject to its jurisdiction under which there must be a minimum period of 10 days during which shares are taken up on a pro rata basis, and only after that period is the offeror allowed to use a first-come first-served basis as to any additional shares which may come in after the 10-day period. The Exchange's initiative in providing investor protection in this area is certainly a commendable one.

The Canadians have gone somewhat further and require in the new Ontario legislation that if less than all the shares are bid for then the offeror must take them up pro rata for the entire period of the offer, and the Williams bill as introduced contained a similar provision.

I am inclined to think that the Exchange's approach is basically sound although the 10-day period may be somewhat short and I believe any regulation in this area should be sufficiently flexible to make provision for such matters as an increase in the tender price or perhaps a competing offer.

A related problem is whether tendering shareholders should be given the privilege of withdrawing their shares either for a limited period or until the offeror makes up his mind whether or not to accept tendered shares. The Ontario legislation contains a detailed time schedule in this respect. It provides that the offer must be open for at least 20 days and that shares which are tendered cannot be taken up until the expiration of 7 days from the date of the offer and may be withdrawn at any time during that period. It also requires that unless all the shares are bid for, no shares can be taken up during the first 20 days, and the total period of the offer cannot exceed 35 days. This may be somewhat too rigid for American conditions. The Williams bill provides a 7-day withdrawal period and also limits the duration of the offer to 60 days, except as the Commission may otherwise prescribe by regulation. The Commission might find it necessary to extend this period if, for example, more than a majority had been tendered but the offeror was seeking 80% for tax reasons.

There are two reasons for a withdrawal period. First, it allows investors who have tendered in haste a brief period to reconsider in the light, perhaps, of management's reaction or a competing offer. In the second place, it recognizes the fact that where shares are to be taken up pro rata the prudent investor will wait until near the end of the pro rata period before tendering since he has nothing to lose and may have a good deal to gain if a better offer comes along or if the market rises. The spectacle of unsophisticated investors tendering their shares at $20 and the offeror taking them up and turning around and selling them to a competing offeror for $25 is somehow somewhat unedifying.

These and some other problems spring from a rather basic characteristic of the average tender offer. The shareholders are asked, in effect, to give the offeror an option to buy. They may be bound when he is not. To some degree this is a necessary feature of tender offers, but it seems to me that it can be carried too far. There is a tendency for offerors to reserve the maximum freedom of action. I suspect that this may be traceable not so much to the fact that the offeror doesn't know what he wants to do but rather that his counsel drafts the papers so as to provide for all possible contingencies. Thus in a case of a company with say one million shares outstanding, the offer may provide that the offeror is not bound to take any shares unless at least 100,000 are tendered but may take a lesser number, and that if more than 100,000 are tendered he will take at least that number, but shall not be obligated to take more than say 400,000 but can take all tendered shares if he wants to. Although all this latitude is attractive from the offeror's viewpoint, it creates considerable uncertainty for stockholders and investors generally and may introduce an elaborate guessing game as to what the offeror's real intentions are. A reasonable maximum period and a reasonable withdrawal period seem justified in order to reduce this inequality and to avoid a situation where tendering shareholders are left for an extended period in a state of uncertainty as to whether and how many of their shares are going to be taken up.

The complications do not end even at this point. Further difficulties are introduced by the practice, which frankly I had never heard of until quite recently, of tendering short. This, I think, may well be a perversion of a feature of tender offers originally introduced for the protection of certain stockholders. A person tendering shares is normally required to deposit his stock certificates at a bank selected by the offeror where they are held pending a determination as to whether or not they will be purchased. Tender offers commonly provide, however, that the shares need not be deposited if a bank or a member firm of a stock exchange guarantees that the certificates will be delivered on demand or at a specified time in case they are accepted. This was originally introduced to provide for the shareholder who desired to accept but whose certificates were temporarily unavailable and to permit acceptances on behalf of shareholders who were out of town or otherwise not in a position to deposit their certificates. This reasonable and equitable arrangement has, however, been used to permit so-called short tendering, but to restrict this privilege, in effect, to members of the stock exchanges. A member firm will simply tender shares which neither it nor its customers owns. It need not even borrow certificates but will simply sign the guaranty. This offers a particular advantage where shares are to be taken up on a pro rata basis. If the firm estimates for example that twice as many shares will be tendered as will be accepted, it will simply tender twice as many shares as it owns, with the result that it will get all of the shares it actually owns accepted and the number which ordinary investors will be able to sell will be correspondingly reduced. The discrimination inherent in this practice is intensified if the tendering firm is able in some way to keep abreast of the progress of the tender offer and form a pretty good idea as to the percentage of acceptance which is likely to occur. I have heard of instances where some of these estimates have been remarkably accurate, and some unkind persons have suggested that this may be attributable to the fact that the tendering firm is friendly with the dealer-manager. On the other hand if the short tenderor guesses wrong a problem in the securities markets can be created. The New York Times for October 18, 1966 described such a situation in connection with the Columbia Pictures tender offer. There the offer provided that the offeror, a French bank, would purchase up to 350,000 shares if 200,000 or more were tendered, but that if more than 350,000 shares were tendered, it was not obligated to take them all. According to the Times it was assumed that the bank would stop at 350,000 and some people tendered short accordingly. When the bank decided to take 675,000, the Times reports that quite a scramble developed. The stock was unable to open at all on Monday, October 18, and on Tuesday it opened at 38-1/2, up 6-1/8 from Friday's close.

Since offerors cannot be expected to deal with short tendering, which probably increases their likelihood of success, I think, and we have suggested to the Senate committee, that consideration should be given to providing either by legislation or through Commission rules that it shall be unlawful for a member firm to sign such a guaranty unless to its knowledge the person on whose behalf the tender is being made owned the securities involved at the date of the guaranty. This would restore the guaranty provision to its original purpose.

Last Monday's Wall Street Journal referred to another aspect of tender offers which involves not merely the existing shareholders, offerors and management, but rather the market generally. This is the practice of arbitrage against a tender offer. Apparently whenever a tender offer is made at a price appreciably above the market, there are some investors who will prefer to immediately sell their shares for a price slightly below the tender price, on the theory that a bird in the hand is worth two in the bush. They would rather have their money now than take a chance either that the tender will not go through or that only part of their shares will be taken up. There are other people who provide such sellers with an outlet by buying shares in the open market and tendering them. So far, so good. This type of arbitrage would appear to serve a useful purpose in narrowing the spread between the market price and the tender price and enabling those so disposed to sell immediately at a good price rather than taking a chance. But into this arbitrage activity there is interjected another unanticipated use of a reasonable feature of tender offers. Offerors commonly agree to pay securities dealers a commission for soliciting tenders. Indeed, until recently rules of the New York Stock Exchange required members to charge a commission when they tendered shares on behalf of customers and offerors ordinarily agreed to absorb this commission in order to increase the attractiveness of the offer. It appears, however, that offerors go further and pay the commission to dealers on all shares tendered where the tendering papers have the firm's name on it, thus including not only shares of customers solicited by the firm but also shares tendered for the firm's own account. The result of this is that securities dealers, in effect, are paid a higher price for shares they tender for their own account than is received by other shareholders, a situation which seems a little discriminatory. Furthermore, it has been represented to us that in combination, the ability to tender short and the ability to collect a slightly higher price has, in effect, given member firms acting for their own account almost a complete monopoly of the business of arbitraging against tender offers. I am not suggesting that this is necessarily wrong, only that it may be, since professionals in the securities markets necessarily enjoy some advantages over the general public and it may be a proper regulatory purpose to reduce these disparities where there is no economic necessity for them.

In closing I would like to reiterate what the Chairman has said, that the Commission does not seek authority to pass on the merits of tender offers, to determine whether or not they should be made, or to fix the price or otherwise interfere with the right of the offeror to attach any reasonable conditions. On the other hand, we are inclined to feel not only that investors are entitled to disclosure but that they are entitled to a reasonable opportunity to make informed investment decisions. Further, where complexities, not to say gimmicks, in the burgeoning field of tender offers create unnecessary problems or disadvantages for investors or introduce possible distortions into the marketplace, then any regulatory scheme must take these matters into account. It is for this reason and because I suspect that we are near the beginning rather than near the end of the evolution of tender offer procedures, that the Commission has suggested to the Senate committee that any legislation in this area should include a certain reasonable amount of rule-making power for the Commission in order that it may, to some extent at least, referee the use of the corporate "long bomb" in the interest of ordinary investors.

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