ADDRESS

by

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Many years ago Theodore Roosevelt warned of the danger that governmental supervision would become governmental interference "if the business leaders of the business community confine themselves to thwart the effort at regulation instead of guiding it right." In the case of securities regulation, the warning has been heeded. An enlightened business community has, for the most part, given us cooperation and advice, to the end that our supervisory duties can be discharged responsibly, with due regard for the interest of investors and the protection of the public interest.

The American Society of Corporate Secretaries has, over the years, been an important source of the cooperation and advice to which I refer. Perhaps more than any other group, you are in a position to help us avoid mistakes, and to warn us when action is needed. You have provided an effective liaison mechanism between government and management, for the benefit of both. I want to thank you not only for what you have done in the past, but also for the assistance I know you will give us in the future.

Sometimes, I must admit, you raise some difficult regulatory problems -- and I mean that not as a complaint, but as a compliment. Your proposal to amend our Rule 14a-8 is a recent example. In that Rule we deal with the difficult problem of maintaining corporate democracy without imposing unnecessary burdens on companies. The Rule is based on the premise that a shareholder has a right to have a matter which is proper for shareholder action considered and voted on by his fellow shareholders -- whether or not management, or we, agree with its merits. The staff has been carefully considering the various changes in the Rule which you believe necessary to prevent abuse and unwarranted costs, and they have been trying to obtain the facts necessary for the Commission to decide the questions you raised. I understand that they may be asking you for some of this information. I am hopeful that the Commission will act on your suggestions, one way or the other, before the next proxy season.

I want to speak to you today not about the proxy rules, but about a new and developing concern in securities regulation: The protection of public investors in connection with the acquisition of control by cash tender offers -- so-called takeover bids -- and the acquisition by a company of its own stock.

<u>Takeover Bids</u>

As I am sure you know, the acquisition of control by cash tender offers has become much more common in the past few years than ever before. This is probably due in part to the greater availability of cash for this purpose, and the relative ease this method offers for acquiring other companies. It is certainly simpler, and perhaps less costly, than a proxy fight for control. To illustrate the increased use of the device, during the last year there have been 29 cash takeover bids involving companies listed on the New York Stock Exchange and 15 involving companies listed on the American Stock Exchange. This compares with only 8 cash takeover bids in 1960 involving stocks listed on both exchanges.

It is interesting to contrast the regulatory requirements applicable to cash tender offers with those which apply when an offer is made by one company to exchange its shares for shares of another. The exchange offer, as you know, requires registration under the Securities Act of 1933. The law recognizes that the shareholder whose stock is sought by means of the exchange offer is in the position both of a seller and a buyer: that is, he is selling the security he presently owns, and buying the security offered to him. The shareholder therefore gets a prospectus, explaining all material facts about the offer. He knows who the purchaser is, what plans have been made for the company, and is in a position to make an informed decision either to hold his original security or exchange it for the other. The disclosures, as in the case of a proxy contest, are filed with the Commission and are subject to statutory requirements and sanctions, which operate for the protection of the opposing parties as well as the shareholder.

Now look at the situation when the tender offer is solely for cash. The investment decision is similar -- the choice whether to retain the original security or sell it is, in substance, little different from the decision made on an original purchase of a security, or on an offer to exchange one security for another. In many cases of cash tender offers, however, the public investor does not even know the identity of the purchaser, much less what the purchaser plans to do with the company if the takeover bid is successful.

Two substantially identical bills now pending before the Congress would correct this failure to require adequate disclosures. The bills, S. 2731 introduced by Senator Harrison Williams of New Jersey, Chairman of the Subcommittee on Securities of the Banking and Currency Committee, and H.R. 14417, introduced by Harley O. Staggers, Chairman of the House Interstate and Foreign Commerce Committee, would amend the Securities Exchange Act of 1934. They are designed primarily to require disclosure of material information <u>before</u> a person acquires control whether by a cash tender offer or by open market purchases. The bills would require this disclosure by any person holding, or intending to acquire, beneficial ownership of more than 5% of a class of equity security registered under Section 12 of the Exchange Act. It would apply with respect to listed companies and those larger over-the-counter companies registered as a result of the Securities Acts Amendments of 1964.

Specifically, the bills would require official disclosure concerning:

(1) the name, background, and security holdings in the issuer, of the person making the takeover bid and of his associates;

(2) the source of funds to be used in the acquisition; and if borrowed, the name of the lender;

(3) any special arrangements that might exist with respect to the securities, such as option contracts, guarantees against loss, or the giving or withholding of proxies, and the name of the other party to the arrangement;

(4) the person's market activity in the company's securities; and

(5) any additional matters which the Commission finds are necessary for the protection of investors.

If the purchases are to be made to acquire control, or representation on the issuer's board of directors, the purchaser would also be required to disclose his plans for the future conduct and continuation of the issuer. Any material changes in the information filed would be required to be reported.

The basic principle of investor protection underlying the two bills is simple: Investors should be informed of the identity, background, future plans and other material information about anyone seeking to acquire control of their company before they sell securities to that person. This is necessary if public investors are to stand on an equal footing with the acquiring person in assessing the future of the company and the value of its shares. Further, the bills recognize that the need of investors for full and complete information in arriving at a decision to <u>sell</u> securities is just as great as when they are arriving at a decision to <u>buy</u> securities -- a concept which is inherent in the Exchange Act.

The proposed legislation would, of course, subject a new class of persons to the reporting requirements of the Exchange Act; that is, persons not yet in control.

But it would not represent a change in the fundamental policy underlying the federal securities laws that investors should be fully informed of all material facts before reaching an investment decision. I believe you will agree that information about control, or a potential change in control, which is so clearly essential to an informed decision to buy securities, is equally important in reaching an informed decision to sell securities -- whether for cash, or in exchange for other securities.

Information about a potential change in control can be particularly essential to an informed decision. A change in control brings with it the possibility of different operating results and different investment results, or perhaps the possibility of realizing on a company's liquidation value. This may be either good, or bad, depending on the facts and circumstances involved. But no investor can reach a conclusion on the possible effects of a change in control until the facts are available to him.

It is argued by some that the basic factor which influences shareholders to accept a tender offer is the adequacy of the price. But, I might ask, how can an investor evaluate the adequacy of the price if he cannot assess the possible impact of a change in control? Certainly without such information he cannot judge its adequacy by the current market price. That price presumably reflects the assumption that the company's present business, control and management will continue. If that assumption is changed, is it not likely that the market price might change? An example will show why. Assume that a company's stock sells for $5 per share -- its going concern value as assessed by investors. Its earnings are poor; its prospects dim; its management uninspired. Is a cash tender offer of $6 per share adequate? Or do we need more information? Suppose a person believes that with control he can liquidate the company and realize $15 per share, or maybe more. Certainly the company's shareholders would want to know about liquidation plans. Indeed, it is the plan to liquidate which makes the bidder willing to pay more than $5 per share. Whether or not the company's liquidation value is generally known is not important, for without someone to carry out the liquidation, this value is unobtainable. If the company's shareholders, at the time of the tender offer, know of the plan to liquidate, would they consider $6 per share adequate? I think a reasonable question arises.

I do not need to make the example so dramatic. Assume simply that the offeror has a proven record of accomplishment in the company's field, as opposed to a present management which has not done well. This factor alone would undoubtedly affect investors' assessments of the future worth of the company's securities. While the disclosure required by the bills might discourage some tender offers, it is perhaps a small price to pay for an informed choice by shareholders.

The importance of a potential change of control illustrates why the shareholder to whom even a cash tender offer is made is, in a sense, a purchaser as well as a seller of a security. A change in control can result in what amounts to a new, or at least vastly changed, company. A decision not to accept the offer amounts to a decision to buy into that new company. It is anomalous, therefore, to treat the cash tender offer differently from the exchange offer, and require -- as we do now -- full disclosure for one, but not the other. Another relevant factor which should be considered is that when management is opposed to the takeover bid, in fairness to the shareholders it should have a real opportunity to make its case, either in opposition to the proposed change in control or with respect to any aspect of the bid, whether it is the price or any other pertinent consideration.

That takeover bids should be regulated and shareholders provided with basic information has been recognized for many years in a number of foreign countries. To name some, Australia, Canada, France, Germany, Italy, the Netherlands and England have all adopted rules regulating takeover bids in one way or another. While we looked at all these laws before making our comments on the proposed bills, we looked particularly at the proposed legislation for regulating takeover bids which is now pending before the legislature in Ontario, Canada. Theirs was the most recent consideration of this problem. The guiding principle of the drafters of this legislation was set out in the Report of the Attorney General's Committee on Securities Legislation in Ontario, known (after its Chairman) as the Kimber Report. It states: "Shareholders should have made available to them, as a matter of law, sufficient up-to-date relevant information to permit them to come to a reasoned decision as to the desirability of accepting a bid for their shares." This, however, must be balanced against the need to insure that new regulations do "not unduly impede potential bidders or put them in a commercially disadvantageous position vis-a-vis an entrenched and possibly hostile board of directors of an offeree company."

In considering the provisions of the pending bills to regulate tender offers, we agreed with the Kimber Report that this balancing of interests is appropriate. While we favored the legislation in general, we thought that certain changes might improve its overall operation.

We suggested to the Senate and House Committees considering the bills that a person should not be required to disclose open market purchases until five days after they were made. We did not think a person could effectively come close to acquiring control in the market within that short period.

As introduced, the bill required that a tender offer be made known to the offeree company 20 days prior to making the offer to shareholders. We suggested instead that the offering material be filed with the Commission on a confidential basis five days in advance, and additional offering material at least two days before its use. This would allow us an opportunity to examine material to assure compliance with the law, but would not give an opposed management a period in which to mobilize its resources and take action against the offer, at a time when the offeror could not solicit tenders or otherwise make his case.

We also suggested that any recommendation to shareholders to accept or reject the tender offer, whether by management or others, be subject to regulation. In this way the opponents in an opposed takeover bid would be placed on an equal footing. Each would be subject to equivalent disclosure and anti-fraud regulations. In a general sense, our approach would apply the same principles and examination procedures to opposed takeover bids that we have developed in proxy contests. In these contests each side has an opportunity fairly to present his story in accordance with the same disclosure requirements and standards.

Indeed, in developing our approach to these bills we relied heavily on our experience with the proxy rules, and particularly proxy contests. The disclosures would be similar to many we now require, and the technique of pre-filing on a confidential basis has worked extremely well. We believe that we can keep up with the hectic pace of contested takeover bids just as we have been able to keep up with proxy battles.

I might note that the rules of the Board of Trade in England regulating takeover bids require the offer to be filed with the offeree company three days before it is made to shareholders. Although this requirement was not criticized in the Jenkins Report which reconsidered England's securities regulation in 1962, we differed with this approach. Legally, the offer is being made to shareholders, not to the company. In some instances the interest of all persons would probably be best served by an initial approach to the offeree company's board of directors. There are cases, however, where the offeror may justifiably believe that this approach would hinder the success of the bid. In some it might even insure its failure.

The Commission recommended several other changes in the bills as introduced in Congress. It was originally proposed that a statement describing the offer be filed with the Commission and mailed to the offeree company at least 20 days before the solicitation commenced. This would have given shareholders 20 days to evaluate a tender offer. As indicated above, we believed this might give management an unwarranted advantage when the offer is opposed. However, since time for careful consideration of the offer by shareholders is desirable and management should have a reasonable opportunity to present its case, we suggested that shareholders be allowed seven days after the offer is made to withdraw any shares they may have tendered.

For similar and additional reasons we also wanted to avoid having shareholders rush to accept an offer. To accomplish this, we suggested that where the person making the offer takes less than all the shares tendered, he should be required to take them on a pro rata basis. Further, we recommended that where a tender offer price is increased, that all persons having tendered shares, whether or not already taken up, be given the increased offering price. In this way we intended to remove a purely fortuitous factor from the calculation of the amount shareholders should receive for their shares, and to avoid the discriminatory effect of paying some holders more than others.

We also wanted to improve the way in which shareholders could learn the facts about a takeover bid. The bills would require a person making a takeover bid to file a statement with the Commission and the company, but nothing in the bill required delivery of information to shareholders. Information filed with the Commission is, of course, available to the public. But we wanted to assure that the information reaches shareholders and their advisers promptly and in full. We recommended, therefore, that all written tender offers and advertisements concerning them contain such information as the Commission may determine is necessary for the protection of investors. This would assure that shareholders would have at their fingertips all the information necessary to evaluate the offer.

We made numerous other suggestions concerning the bills, but they were largely technical and I will not go into them now. However, before I leave the subject of takeover bids, I would like to point out that we did differ substantially from the drafters of the Ontario proposed legislation on one matter: Whether a cash takeover bid could be made by an undisclosed principal. The Ontario legislation would allow it. The bills before Congress would not. And we think properly so. From the Kimber Report we learned that the drafters of the proposed Ontario legislation thought that to require this disclosure would be to discourage some takeover bids. We believe, however, that this possibility was simply a price which had to be paid so that investors could make an informed investment decision. As I explained before, the managerial ability of the person making a takeover bid, as reflected by his past performance, may be overwhelmingly different from that of present management. The materiality to shareholders of the identity of the potential control person, we believe, is simply too great not to require that it be disclosed.

Company Purchases of Its Own Securities

The two bills also contain provisions relating to cash purchases by a company of its own registered equity securities. They would specifically authorize the Commission to adopt rules requiring a company which purchases its own shares, to disclose:

(1) the reason for the purchase of its stock;
(2) the source of funds;
(3) the number of shares to be purchased;
(4) the price to be paid, and
(5) the method of purchase.

The bills would also authorize the Commission to require the issuer to file additional financial or other information necessary for the protection of shareholders.

The practice of companies acquiring their own securities, like takeover bids, has been a growing phenomenon, particularly as companies have generated cash balances greater than needed to finance their projected growth. In an article published in the April 1965 issue of the Harvard Business Review, it was noted that the total number of shares reacquired by companies has been rising steadily over the past years. The author found that between 1954 and 1963 the average percentage increase year to year was close to 20% for companies listed on the New York Stock Exchange.

The purchase by a company of its own securities can be the subject of a number of abuses and special circumstances requiring disclosure to the seller, whether the purchases are by a tender offer or made in the open market. Some of these potential abuses were the subjects of recent actions by the Commission, and I am sure you are familiar with them. We have several rules which already apply in this area, and I believe that we have additional rule-making power, which has not yet been exercised, under the existing statutes. We welcome, however, the specific statutory authority which the pending bills would give us.

Conclusion

In conclusion, I would like to point out that the bills now pending before Congress would fill a hiatus which presently exists in the protection offered under the federal securities laws to investors selling their securities for cash. The Securities Act of 1933 was designed to protect investors against fraud and to give them adequate information when they purchase securities. The Securities Exchange Act was designed to protect investors through a combination of disclosure, anti-fraud, anti-manipulative and regulatory requirements in both the purchase and sale of securities. But I think it is safe to say that our primary emphasis and thought over the years has been on protecting investors in the purchase of securities. This, of course, has been the area of greatest abuse in the past. And certainly the loss which an investor suffers when a stock he purchases declines in price seems at first blush more tangible than the loss an investor suffers when he sells securities that later rise in price. But is it any less a loss to that seller who would not have sold had he been in possession of all the facts? I think not.

We have taken action before to protect investors in the sale of their securities. We have adopted rules to protect investors when they sell their securities and we have supported them in private law suits. Nevertheless, the development of the law has left a gap in securities regulation protecting investors selling their securities pursuant to a cash takeover bid. While it is probable that we can adopt rules regulating takeover bids without legislation, it may be desirable to make this power entirely clear. Certainly the bills now pending before Congress, with the changes we have recommended, would provide more complete protection to shareholders than we can provide without their passage.

If we are to retain and build investors' confidence in the integrity of our securities markets, so vital to the free flow and development of capital in our country, we must place all participants in the securities markets in a position to compete on an equal footing with respect to the availability of significant facts about a company, its management and its securities. This is the premise on which our securities markets are supposed to work, and all Americans, whether shareholders or not, have a vital stake in making sure that it is a correct one.