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Comment

REGULATION OF HOSTILE TENDER OFFERS: A DISSENTING VIEW AND RECOMMENDED REFORMS

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The Securities and Exchange Commission (SEC) Advisory Committee on Tender Offers was established on February 25, 1983.[1] Under its charter, the Advisory Committee was to "conduct an extensive examination of the tender offer process and other techniques for acquiring control of public issuers," and to recommend those "legislative and/or regulatory changes" in the existing securities regulation scheme that it might deem "necessary or appropriate."[2] The Advisory Committee's final report was presented to the Chairman of the SEC on July 8, 1983.[3]

The author of this Comment was a member of the Advisory Committee but did not agree with many of the views and recommendations presented in the Report. In order to express my disagreement I prepared a separate statement of my own views and proposals for reform;[4] that statement forms the basis of this Comment.

Many persons familiar with securities trading have long expressed concern about abuses in the tender offer process.[5] Public concern about

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1. SEC Exchange Act Release No. 19,528, 48 Fed. Reg. 9111 (1983).

2. CHARTER OF THE SECURITIES AND EXCHANGE COMMISSION ADVISORY COMMITTEE ON TENDER OFFERS, *reprinted in* ADVISORY COMMITTEE ON TENDER OFFERS, U.S. SEC, REPORT OF RECOMMENDATIONS 122 (separate statement of Arthur J. Goldberg), 137 app. 2, preamble (1983) [hereinafter cited as Goldberg statement].

3. ADVISORY COMMITTEE ON TENDER OFFERS, U.S. SEC, REPORT OF RECOMMENDATIONS (1983) [hereinafter cited as ADVISORY COMMITTEE REPORT].

4. Goldberg statement, *supra* note 2, at 122-33.

5. *See, e.g.*, Liman, *Has the Tender Movement Gone Too Far?*, 23 N.Y.L. SCH. L. REV. 687 (1978); Note, Corenco v. Schiavone: *The Cash Tender Offeror as Corporate Raider*, 26 ME. L.

those abuses was accentuated by Bendix Corporation's and Martin Marietta Corporation's acquisition of controlling shares in each other in a hostile takeover situation.[6] That episode was obviously a "distortion" which did public injury to our capital markets.[7]

But the problems concerning tender offers transcend that bizarre occurrence. In the words of the chairman and chief executive officer of a major company, "Maybe there's something wrong with our system when . . . companies line up large amounts of money in order to purchase stock, when it doesn't help build one new factory, buy one more piece of equipment, or provide even one more job."[8]

Some of the abuses which have occurred in recent tender offers are dramatically illustrated by the terms employed in the art or "game" of tender offers: golden parachutes, poison pills, lock-ups, two-tier systems, sales of crown jewels, Pac-Man defenses, scorched earth policies, and the like.[9] These terms seem more appropriate to video games than to the acquisition of capital assets of major companies. They are singularly inappropriate in characterizing substantial financial and economic matters involving shareholders and the public. The use of these terms is symptomatic of the fact that tender offers involve gamesmanship relating to control of management.

REV. 93, 103-04 (1974); Note, *Private Litigation Under the Williams Act: Standing To Sue, Elements of a Claim and Remedies*, 7 J. CORP. L. 545, 545-50 (1982); Wayne, *The Corporate Raiders*, N.Y. Times, July 18, 1982, § 6 (Magazine), at 18. For more recent commentary noting that some observers believe that tender offers divert resources from more economically productive uses, see Williams, *Frenzy and Style in the Merger Boom*, N.Y. Times, Jan. 15, 1984, § 3, at Fl. For a brief working definition of tender offers and an explanation of how they work, see Glenn, *Rethinking the Regulation of Open Market and Privately Negotiated Stock Transactions Under the Securities Exchange Act of 1934*, 8 J. CORP. L. 41, 42 (1982).

6. For background information on the Bendix-Martin Marietta drama, see Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 625-26 (D. Md. 1982); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 249-50 (1983). *See also* Masters, *Lawyers Debate Best and Worst of Bendix Takeover Maneuvers*, Legal Times of Wash., Oct. 11, 1982, at 1, col. 1; Salmans, *Tumultuous Takeover Saga Ends: Allied and Bendix Agree to Merge*, N.Y. Times, Sept. 25, 1982, § 1, at 1, col. 1.

7. According to the Senate Committee on Banking, Housing, and Urban Affairs, "Chairman Paul A. Volcker, of the Federal Reserve, has expressed concern 'about take-overs distorting banking judgments or the credit markets.' " Letter from Committee on Banking, Housing, and Urban Affairs, U.S. Senate, to John S.R. Shad, Chairman of the U.S. Securities and Exchange Commission (February 1, 1983), *reprinted in* ADVISORY COMMITTEE REPORT, *supra* note 3, at 158-60 [hereinafter cited as Senate Committee Letter]. *But see* ADVISORY COMMITTEE REPORT, *supra* note 3, at 13-14, 63 (tender transactions do not result in material distortion of credit markets).

8. Senate Committee letter, *supra* note 7.

9. A glossary of these and similar terms is provided as an appendix to this article. For a discussion of the tactics involved, see Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law Be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. L. 337, 339-43 (1983).

Mergers, unlike most tender offer situations result in outright acquisition of the assets and operating facilities of a business and most often are undertaken only with shareholder approval. Tender offers, on the other hand, frequently involve a contest for control of the management of a company in transactions not subject to vote by the shareholders of either the offeror or target company. Although a few tender offers may be designed to acquire an entire company, most are designed to effect a change in management control, and the offeror ordinarily pays a premium only for enough shares to accomplish the change.

Changes in management may or may not be in the interest of shareholders of the offeror or the target company. What seems to have been ignored in the Advisory Committee's Report[10] is whether such changes are in the public interest. Yet, the Advisory Committee's mandate derived in part from a letter sent to the Chairman of the SEC by the Senate Committee on Banking, Housing, and Urban Affairs, and that letter stated in pertinent part that "the public interest and the Congress would be best served by a broad study of the many issues surrounding tender offers and particularly hostile take-overs, and, therefore, we encourage the Commission panel to be comprehensive in both its approach and charter."[11]

The Advisory Committee Report made no significant reference to protection of the public interest, due to a misconception that, aside from possible antitrust violations, tender offers substantially affect only the interests of shareholders and not those of the public at large. Furthermore, although a limited determination as to the applicability of antitrust laws is made by the Antitrust Division of the Department of Justice and the Federal Trade Commission under the Hart-Scott-Rodino Act,[12] the resulting protection is inadequate because of the time limitation imposed by that legislation and the circumscribed nature of the inquiry.[13]

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10. *Supra* note 3.

11. Senate Committee letter, *supra* note 7. The Advisory Committee's mandate also is derived from its charter. *See* CHARTER OF THE SECURITY AND EXCHANGE COMMISSION ADVISORY COMMITTEE ON TENDER OFFERS, *reprinted in* ADVISORY COMMITTEE ON TENDER OFFERS, U.S. SEC, REPORT OF RECOMMENDATIONS 137-39.

12. Hart-Scott-Rodino Antitrust Improvements Act of 1976, Pub. L. No. 94-435, 90 Stat. 1383 (codified as amended in scattered sections of 15 U.S.C., 18 U.S.C. § 1505 & 28 U.S.C. § 1407(h) (1982)).

13. Under the Hart-Scott-Rodino Act, certain tender offerors and their targets must file with the FTC information about their operations and the proposed transaction, in order to permit review of the potential anti-competitive effect of a successful tender offer. 15 U.S.C. § 18a(a), (c)-(d) (1982). There is a waiting period of 15 calendar days after the initial filing by the offeror, during which the offeror may not purchase shares tendered. 15 U.S.C. § 18a(a), (b)(1) (1982); *See* 16 C.F.R. § 803.10 (1983). The FTC may request additional infor-

Protection of the public interest is not foreign to the federal securities laws. The Securities Exchange Act of 1934 declared that "transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest. . . ."[14] The stock market crash which contributed to the depression in the 1930s and led to the enactment of the federal securities laws is proof enough of the public interest involved in appropriate regulation of the securities markets and the economic necessity of proper regulation.

No evidence was presented to the Advisory Committee and no authoritative study seems to have been made as to whether, in the long run, tender offers have contributed to corporate viability or profitability or have benefitted shareholders of the offeror or target company or the public. Instead, attention has been focused on stock prices which are based primarily on market perceptions at the time of the tender offer. Moreover, the market is influenced by many factors, some of which relate to stock values and others to the general economy, inflation, interest rates and the like.

As a country, we justifiably take pride in the fact that shares in our publicly held companies are widely held and actively traded. As of the end of 1982, well over 32 million Americans held shares in these companies.[15] Many Americans hold shares in small numbers, holdings which nevertheless represent significant investments and, in aggregate, are substantial. Small shareholders, in the nature of things, do not have access to competent and readily available independent advice in evaluating tender offers. Institutional investors, unlike small shareholders, do resort to professional and expert advice.

The small shareholder, therefore, is at sea in a tender offer situation. Although some small shareholders may be able to follow market quotations, those quotations are difficult to interpret and do not furnish an adequate basis for evaluating a tender offer. A real and unanswered question is whether a typical non-institutional investor, in a target com-

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mation from either or both parties, and has discretion to extend the waiting period for not more than 10 days after receipt of all requested information and material. 15 U.S.C. § 18a(e) (1982); *See* 16 C.F.R. § 803.20 (1983). The FTC also, in its discretion, may terminate the waiting period prior to the running of 15 days. 15 U.S.C. § 18a(b)(2) (1982); *See* 16 C.F.R. § 803.11 (1983). *See generally* S. AXINN, B. FOGG & N. STOLL, ACQUISITIONS UNDER THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT 7 (1979) ("The Act is designed to make anticompetitive acquisitions more difficult to accomplish by giving the government the advantage of some advance opportunity to prepare for and expedite its antitrust attack.").

14. Securities Exchange Act, ch. 404, 48 Stat. 881, 881 (1934) (current version at 15 U.S.C. § 78b (1982)).

15. NEW YORK STOCK EXCHANGE FACT BOOK 49 (B. Wheeler ed. 1983) (in 1981 there were 32,260 individual owners of shares in public corporations, reflecting a 20% increase in the years 1975-1980 and an additional 6.8% increase between mid-1980 and mid-1981).

pany, is better off in the long run if he accepts a tender offer. The same question also applies to a small shareholder in the offering company. He likewise suffers a disability in evaluating whether his company, and consequently his shareholding, is better or worse off by the making of a tender. In both cases the market data are inadequate to answer this question.

SEC filings do not, under present regulations, enable small shareholders to determine whether a tender offer is good or bad from their perspective. Rather, SEC filings are disclosure statements in a form geared to professional investors.[16] They are as esoteric to a small shareholder as a Form 1040 is to an average taxpayer — in both cases, professional advice is virtually a necessity.

It is essential, in my view, that new procedures be created to ensure that all shareholders of offeror and target companies receive independent and expert advice regarding the fairness of every tender offer of sufficient size to warrant regulation. And such procedures also are essential if the public interest is to be safeguarded and confidence in our securities markets assured.

In light of these considerations and the Advisory Committee's broad mandate, I make the following recommendations:

1. Tender offers should be submitted to an independent person or institution, selected by the SEC, for evaluation as to (1) whether the offer is fair to the shareholders of both the offeror and target company, and (2) whether, in economic terms, the public interest is protected.[17] In Great Britain, the Panel on Take-Overs and Mergers requires an independent evaluation of a tender offer.[18] Testimony before the Advi-

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16. *See, e.g.*, SEC Schedule 14D-1, 17 C.F.R. § 240.14d-100 (1983) (requires that a tender offeror disclose, inter alia, the source of funds used, past transactions between the offeror and the target company, and any antitrust or other legal problems that might arise upon a successful tender offer).

17. An offeror or target company generally solicits professional advice in a tender situation, but such advice cannot be regarded as truly independent. This advice is basically designed to assist in the effectuation or resistance of a tender offer. Advisors of this character are scarcely independent or disinterested.

The proposed evaluation is for the purpose of informing shareholders and not for the purpose of preventing an unfair offer from proceeding to a shareholder vote. *See* recommendation number 2, *infra* p. 230; recommendation number 5 *infra* p. 232-33. The scheme proposed here thus is consistent with the purpose of the Williams Act as construed by Justice White in Edgar v. MITE Corp., 457 U.S. 624, 639-40 (1982) (dictum).

18. On British regulation of tender offers, see generally OFFICE OF FAIR TRADING, MERGERS: A GUIDE TO THE PROCEDURES UNDER THE FAIR TRADING ACT OF 1973 (1978) [hereinafter cited as MERGERS]; DeMott, *Current Issues in Tender Offer Regulation: Lessons From the British*, 58 N.Y.U. L. REV. 945 (1984). Briefly, the British system of tender offer regulation is based primarily upon the extralegal City Code on Take-overs and Mergers. The City Code consists of 14 general principles and 39 rules to give them effect. It is administered by the

sory Committee by representatives of the British Panel confirmed the value of an independent evaluation and also confirmed that such an evaluation does not impair the operations and effectiveness of the market place.

2. The independent evaluation should be performed expeditiously and made available to the shareholders of both the offeror and the target companies as well as to the public at large.[19]

3. "Golden parachutes"[20] should be prohibited. They have be-

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Panel on Take-overs and Mergers, a private body established by the British financial industry in 1968 in order to forestall threatened governmental regulatory activity. The Panel has no legal authority, but relies upon measures such as adverse publicity and peer pressure to enforce its Code.

As noted in the text, the City Code provides that once a tender offer has been made the target company's board must "obtain competent independent advice about the offer and disclose the substance of that advice to shareholders." *Id.* at 965. The Panel itself does not pass upon the merits or disadvantages of offers. *Id.* at 960. It must consent to any partial offers, but for offers for less than 30% of the target's outstanding stock the Panel's review is limited. *Id.* at 962, 985.

In contrast to the Panel, the Monopolies and Mergers Commission reviews tender offers only if a preliminary investigation has satisfied the Secretary of State for Trade and Industry that the transaction appears to be one covered by the Fair Trading Act of 1973. The Act, which is primarily concerned with the anticompetitive effects of business combinations, permits the Secretary of State (Minister) to refer for review what it terms "merger situations qualifying for investigation." Fair Trading Act, ch. 41, § 64(1), (8) (1973). Qualifying situations must involve, inter alia, either (1) establishment of "common ownership or common control" of the parties, or (2) elimination of the activities, or parts of the activities, of either corporate party. *Id.* §§ 63(2), 64(1), (8), 65(1).

> Because all mergers do not necessarily take the form of share acquisitions in companies, the [Act] is not concerned with the form of the transaction but with its substance[,] and is therefore drawn widely enough to include within its scope certain types of situation[s] not normally thought of as being mergers. In practice, however, most of the cases dealt with under the [Act] are those which also fall within the scope of the City Code . . . .

MERGERS, *supra*, at 2.

Once a transaction has been referred to the Commission, the Commission must report on "whether the creation of [a qualifying] situation operates, or may be expected to operate, against the public interest." Fair Trading Act § 69(1), (4). Section 84 of the Act sets forth a number of broad considerations to be taken into account by the Commission in determining whether a transaction might operate against the public interest, including "the desirability of maintaining and promoting the balanced distribution of industry and employment in the United Kingdom." *Id.* § 84(d).

For a discussion of what factors may influence a recommendation by the Director General of Fair Trading that a case be referred to the Commission for review, see MERGERS, *supra*, at 13-18. For reference to some of the procedural provisions of the Act pertaining to review by the Commission, see *infra* note 29.

19. *Cf.* DeMott, *supra* note 18, at 965 (rule 4 of the City Code requires that the substance of the independent advice obtained by the target company be disclosed to target shareholders).

20. *See* appendix, *infra*, p. 237, for a definition of this term. *See also* Prentice, *supra* note 9, at 341.

come a scandal and a discredit to sound fiscal corporate governance.[21] By and large, corporate executives of listed companies are well paid and receive substantial fringe benefits. I have no quarrel with this, when deserved. A laborer, whether white or blue collar, is worthy of his hire. Golden parachutes, however, typically provide for several years' compensation to be paid to managers of a target company in anticipation of a tender offer, and are designed either to frustrate such an offer or to "feather the nest" of corporate executives.[22] Further, golden parachutes are creating great cynicism among shareholders and the public about the integrity of our corporate system.[23]

Assertions that golden parachutes are justified by the business judgment rule are without foundation because they are based upon a misconception of the rule. The business judgment rule was designed to safeguard not the personal interests of managers but rather the good faith judgment of managers as to what is in the best interests of the corporation. Managerial judgment must and should not be affected or tainted by a conflict of interest. Simply put, the business judgment rule is fashioned to permit latitude to managers of corporations in the ordinary good faith conduct of business affairs in the interest of the corporation, where there is no self-dealing or other conflict of interest involved.[24]

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21. *See generally* Riger, *On Golden Parachutes — Ripcords or Ripoffs? Some Comments on Special Termination Agreements*, 3 PACE L. REV. 15, 25-33 (1982) (golden parachutes are gifts to executives at a corporation's expense and amount to a waste of the corporation's resources); Lewin, *Business and the Law Using "Golden Parachutes,"* N.Y. Times, Nov. 30, 1982, at D2, col. 1. *But cf.* ADVISORY COMMITTEE REPORT, *supra* note 3, at 39-41. In recognition of the fact that golden parachute arrangements may create a public perception of self-dealing or other breach of fiduciary duties by management, the Advisory Committee took the position that directors should be barred from entering into such an arrangement while a tender offer is in effect. When golden parachutes are adopted prior to a tender offer, however, the Advisory Committee merely would require that the agreement be subject to (1) disclosure (of terms and parties) in annual proxy statements, and (2) an advisory (non-binding) shareholder vote at each annual meeting. ADVISORY COMMITTEE REPORT, *supra* note 3, at 39-41.

22. Some commentators have questioned whether golden parachutes in fact deter tender offers. *See, e.g.*, Prentice, *supra* note 9, at 341 n.35. The Advisory Committee took the position that they do not, because "they are a small fraction of an acquisition price." ADVISORY COMMITTEE REPORT, *supra* note 3, at 39-40.

23. The Advisory Committee essentially conceded this point. ADVISORY COMMITTEE REPORT, *supra* note 3, at 40.

24. *See generally* Steinberg, *Some Thoughts on Regulation of Tender Offers*, 43 MD. L. REV. 240 (1984) [hereinafter cited as Steinberg, *Thoughts*]; Steinberg, *Application of the Business Judgment Rule and Related Judicial Principles — Reflections From a Corporate Accountability Perspective*, 56 NOTRE DAME LAW. 903, 904-07 (1981). *But see* Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 633-34 (D. Md. 1982); DeMott, *Pac-Man Tender Offers*, 1983 DUKE L.J. 116, 128-29; *cf.* Note, *Tender Offer Defensive Tactics and The Business Judgement Rule*, 58 N.Y.U. L. REV. 621, 649-58 (1983) [hereinafter cited as Note, *Tender Tactics*] (the business judgment rule should be applied to target management responses to hostile tender offers, but there should be

4. The sale of crown jewels[25] during a tender offer should be prohibited. Such sales are designed to frustrate a tender offer by making the target company less desirable because of the sale of some of its best assets. This is not to say that a corporation should be prevented from conducting its ordinary business during a tender offer, but rather that it should be prevented from disposing of significant assets as a defensive tactic to resist a tender offer. The same prohibition should be applied to the scorched earth tactic, the poison pill device, and the sheer absurdity of the Pac-Man defense,[26] best illustrated by the Bendix-Martin Marietta fiasco.[27]

5. There should be a freeze period during a tender situation, with respect to both offensive and defensive maneuvers. Adequate time should be allowed so that competing offers can be made. The time period selected should be sufficient to permit competing tender offers and to allow a more adequate determination of possible anti-trust implications to be made by the Department of Justice and the Federal Trade Commission than now is possible under the limited waiting period prescribed by the Hart-Scott-Rodino Act.[28] British law permits a freeze for up to nine months.[29] A reasonable mandatory freeze period, it seems to

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no presumption of good faith if it is shown that the directors are likely to be replaced after a successful tender offer). The Advisory Committee took the position that "the business judgment rule should be the principal governor of decisions made by corporate management, including decisions that may alter the likelihood of a takeover." ADVISORY COMMITTEE REPORT, *supra* note 3, at 34.

25. *See* appendix, *infra*, p. 237 for a definition of this term.

26. *See* appendix, *infra*, p. 237 for a definition of this term; *see also* Prentice, *supra* note 9, at 342-43. For some of the problems associated with the Pac-Man defense, see Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44, 64-66 (1983). *See generally* DeMott, *supra* note 24 (legal problems arising from use of the defense may not be amenable to solution under traditional legal principles). *But see* ADVISORY COMMITTEE REPORT, *supra* note 3, at 42-45 (Pac-Man defense should not be restricted except where a bidder has made a cash tender offer for 100% of the target; sales of corporate assets to third parties should be permitted subject only to the business judgment rule).

27. *See supra* note 6 and accompanying text; *cf.* DeMott, *supra* note 18, at 965. DeMott notes that once a tender offer has been made or appears imminent, the British City Code

> prohibits the target board from taking specified actions without shareholder approval. The prohibited actions include issuing authorized but previously unissued shares; granting options on unissued shares; issuing convertible securities; agreeing to sell or acquire assets in any material amount; or entering into contracts outside the ordinary course of business, unless any of these transactions are conducted pursuant to a previously incurred contractual obligation, itself a circumstance subject to Panel review.

Id.; *cf.* Lowenstein, *supra* note 6, at 255, 317-18, 328-34 (recommending a similar referendum requirement for U.S. corporations, with specific comparison to the City Code).

28. For a discussion of the Hart-Scott-Rodino Act, see *supra* notes 12-13.

29. Under British law, a tender offer which meets certain criteria may be referred to the Monopolies and Mergers Commission for review of possible anticompetitive effects. Fair Trading Act, ch. 41, §§ 64-68 (1973), *amended by* Merger References (Increase in Value of

me, would be 120 days. Competing tender offers should be permitted during the first thirty days. After all competing tender offers are made, the Department of Justice and the Federal Trade Commission should be afforded a sixty-day period to discharge adequately their responsibilities under the Hart-Scott-Rodino Act.[30] Significantly, this sixty-day period also would give the independent person or institution an adequate opportunity to evaluate the various tender offers in terms of fairness to shareholders and the public. Following the expiration of this sixty-day period, a thirty-day period should be provided to submit the various tender offers, the views of the Justice Department and the Federal Trade Commission, and the independent evaluation to the shareholders on both sides for their approval or rejection of a tender offer.[31]

6. Partial[32] and two-tier[33] tender offers generally should be prohibited.[34] Under our system of corporate governance, changes in con-

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Assets) Order 1980, Stat. Inst. 1980 No. 373. Review normally must be completed within a specified period not longer than six months, but may be extended once by up to an additional three months if the Secretary of State (Minister) for Trade and Industry is satisfied that there are "special reasons" to do so. *Id.* § 70. The Minister may order that the tender offer not be consummated, that other activities be carried on or not carried on, or that assets be safeguarded while a transaction is under review by the Commission; in general, the Minister may make orders with respect to "any action[s] which might prejudice the reference or impede the taking of any [remedial] action . . . which may be warranted by the Commissioner's report" when it is received. *Id.* § 74(1), (2). Usually, however, the parties involved are asked to give voluntary assurances that they will refrain from taking prejudicial actions during the period of review. *See* MERGERS, *supra* note 18, at 5, 12.

For critical comments on the review of takeover bids by the Monopolies and Mergers Commission, and an example of a recent hostile bid the review of which took eight months, see Ingrassia, *Hostile Takeovers Are All the Rage in U.K. as Civility Declines*, Wall St. J., Mar. 16, 1984, at 1, col. 1. For information about the statutory review framework within which the Commission reviews bids, see *supra* note 18.

30. *See supra* notes 12, 13.

31. *Cf.* Lowenstein, *supra* note 6, at 255-56, 317-18, 322-34 (recommending that hostile tender offers be required to be kept open for six months and that shareholders be required to vote on certain defensive actions taken in response to hostile tender offers, and discussing the effects of such requirements on the tender offer process).

32. Partial offers are tender offers for some percentage that is less than 100% of the target company's shares.

33. *See* appendix, *infra* p. 238, for a definition of this term; *see also* Comment, *The Front-End Loaded, Two-Tiered Tender Offer*, 78 NW. U.L. REV. 811, 812 (1983).

34. *Cf.* DeMott, *supra* note 18, at 960-62 (under the British City Code, partial offers are discouraged by (1) providing that any party who accumulates 30% or more of a company's voting shares must make a cash offer for all remaining shares at the highest price paid by that party for those shares within the preceding year, and (2) requiring the Panel's consent for any partial bid). *But cf.* Radol v. Thomas, 534 F. Supp. 1302, 1312 (S.D. Ohio 1982) (any tender offer is coercive to some degree yet Congress has chosen not to outlaw tender offers but rather to regulate them); ADVISORY COMMITTEE REPORT, *supra* note 3, at 24-26. While the Report noted that there are "coercive elements" in partial and two-tier tender offers, and that such offers hold "potential . . . for abusive tactics and practices," *id.* at 25, disagreement between Advisory Committee members who strongly favored permitting such offers and those

trol by and large should be accomplished through proxy solicitations and pursuant to the democratic vote of shareholders of the offeror and target companies. Tender offers should not be a contest between competing persons or groups to acquire control of management. A partial tender offer leaves shareholders who, for one reason or another, do not tender to the mercy of the market which often declines after the partial offer is consummated.

In some unusual circumstances economic and corporate conditions may justify a partial tender offer. In such situations, the offeror seeking to make a partial tender offer should bear the burden of satisfying the SEC, under appropriate and specific regulations, that a partial tender offer is justified.

7. An acquisition of shares in a company resulting in ownership of fifteen percent or more of its outstanding securities should be required to make a tender offer for all shares.[35] SEC regulations should define the circumstances for granting appropriate "grandfather" exemptions and also should give consideration to the owner of a private company who is left with more than fifteen percent of the shares after the company goes public.

8. As I have noted, before a tender offer is made it should be approved by shareholders of the offeror.[36] Before it is accepted or rejected, it should be approved by a vote of shareholders of the target company. This requirement is simply an application of corporate democracy. After all, shareholders own corporations; management does not. Shareholders risk their capital and consequently are entitled to make the ultimate decision on matters directly affecting the future of the offeror and target companies.

Those who would advocate an advisory vote of shareholders in this context are mistaken. Advisory votes would be inadequate to protect vital shareholders' interests precisely because they would not bind management. Rather, there should be definitive and binding votes of the shareholders of both the offeror and target companies.[37]

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who would have prohibited them resulted in Recommendation 16, which merely urged the establishment of a longer minimum offering period as a "regulatory disincentive" to making such offers.

35. *Cf.* Lowenstein, *supra* note 6, at 317 (20% beneficial ownership should trigger requirement of a tender offer for hostile acquisitions of more than 5% of shares); ADVISORY COMMITTEE REPORT, *supra* note 3, at 22-23 (recommending that no person be allowed to acquire a resulting ownership of more than 20% of a company's voting shares unless such purchases are made either directly from the issuing company or pursuant to a tender offer).

36. *See supra* text accompanying note 31.

37. *See* Nordhous, *The Vanity of the Takeover Game*, N.Y. Times, Oct. 3, 1982, § 3 (Business), at 3, col. 1 (approval of bidder's shareholders should be required). *Cf.* Lowenstein, *supra* note

9. Supermajority provisions in charters and by-laws of corporations should be prohibited.[38] These provisions require votes by substantially more than simple majorities of shareholders to approve or defeat takeovers. Their use is a recent development in defensive strategy which is contrary to corporate democracy. Like our political institutions, corporate democracy is based on the principle that in a democracy the majority prevails. While I do not favor a federal corporations act, prohibition of these provisions is consistent with federal regulations designed to correct abuses in corporate governance and securities regulation.

The reforms I suggest might well be accomplished by revision or imaginative application of section 14(e) of the Securities Exchange Act of 1934,[39] or by adoption and enforcement by the stock exchange of effective self-regulatory rules.[40] If after a detailed legal analysis it ap-

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6, at 255, 317–18, 328–34 (would require approval by shareholders for certain defensive actions that would result in "structural changes" to the target corporation, defined as "actions likely to affect significantly the target's business, assets, financial condition or capital structure, or the voting rights of its shareholders" even if a tender offer were to be defeated). The British City Code requires approval by the target's shareholders for certain defensive maneuvers that might frustrate a pending or imminent offer. DeMott, *supra* note 18, at 965. *But see* ADVISORY COMMITTEE REPORT, *supra* note 3, at 33 (there should be no federal regulation regarding approval of a tender offer by shareholders of a bidder company); *cf. id.* at 37–39 (certain specified defensive policies, provisions, and agreements should be subject to (nonbinding) advisory shareholder vote).

38. *Cf.* ADVISORY COMMITTEE REPORT, *supra* note 3, at 34–38 (federal legislation and/or regulations should be adopted to prohibit use of charter and by-law provisions that erect high barriers to change of corporate control; to the extent that supermajority provisions are permitted they ought to be disclosed to shareholders and subject to (nonbinding) advisory shareholder vote); Friedenberg, *Jaws III: The Impropriety of Shark-Repellent Amendments As A Takeover Defense*, 7 DEL. J. CORP. L. 32, 42-44, 67-92 (1982) (supermajority provisions, like other shark-repellent amendments, should be banned unless there is some compelling reason for them; although supermajority provisions may protect minority shareholders from socially undesirable freezouts, they may prevent desirable ones and permit "tyranny of the minority"). Gilson, *The Case Against Shark Repellent Amendments: Structural Limitations On the Enabling Concept*, 34 STAN. L. REV. 775 (1982) (the possibility of successful tender offers without the consent of management is a necessary control on the performance of management; supermajority provisions should have to be adopted by the same supermajority that they require).

39. *See, e.g.*, Mobil Corp. v. Marathon Oil Co., 669 F.2d 336, 376–77 (6th Cir. 1981). *But see, e.g.*, Data Probe Acquisition Corp. v. Datatab, Inc., 722 F.2d 1, 5 (2d Cir. 1983); Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757, 759-60 (2d Cir. 1983); Martin Marietta Corp. v. Bendix Corp., 549 F. Supp. 623, 628–30 (D. Md. 1982) (dictum); Prentice, *supra* note 9, at 351–58; Note, *Tender Tactics, supra* note 24, at 629–39. *See generally* Note, *Lock-Up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068 (1983) (Mobil Corp. v. Marathon Oil Co. was wrongly decided, and state law should be the source of protection for target shareholders).

40. *Cf.* 15 U.S.C. § 78f(b)(5) (1982) (In order to be registered by the SEC as a national securities exchange, the self-regulatory rules of the exchange must be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, . . . and, in general, to protect investors and the public interest . . . ."); Silver v. New

pears that further legislation is necessary, however, the Senate Committee on Banking, Housing, and Urban Affairs has indicated that it is willing to consider appropriate legislation.[41]

Abuses in the tender situation are substantial, serious, and continuing. They cannot be treated with bandaids, nor can they be swept under the rug. The abuses cast a shadow on our system of corporate accountability and governance. All of us who believe in the free market should be conscious of a simple fact: As long as the market is responsive to both shareholders and the public it will, by and large, be free; if the market is not responsive, it will be subject to legislative restraints far greater than the reforms I propose.

York Stock Exchange, 373 U.S. 341, 360-61 (1963) (only those exchange self-regulations that fall within the scope of, and further the purposes of, the Securities Exchange Act of 1934 will be excused when challenged as unreasonable restraints of trade under the antitrust laws).

41. The Senate Committee Letter, *supra* note 7, gives ample evidence of such willingness.

APPENDIX

GLOSSARY OF TERMS

Crown Jewel:	The most prized asset of a corporation, i.e. that which makes it an attractive takeover target. One defensive tactic against a hostile tender offer is to sell this asset to another party, thereby removing the asset that the unfriendly bidder was hoping to acquire. This may cause withdrawal of the offer without the purchase of any target shares.
Golden Parachute:	A generous severance package that protects certain key executives if control of their company changes.
Lock-up:	An arrangement, made in connection with the proposed acquisition of a publicly held business, that gives the proposed acquiror an advantage in acquiring the subject company over other potential acquirors. Lock-ups may take the form of stock purchase agreements for treasury or unissued shares, options to purchase treasury or unissued shares, options to buy certain assets (see "Crown Jewel"), merger agreements, agreements providing liquidated damages for failure to consummate an acquisition, options and stock purchase agreements between a "white knight" and principal shareholders, and similar arrangements.
Pac-Man Defense:	A tender offer by the subject company for the securities of the original bidder.

Scorched Earth Defense:	Efforts by the directors of the subject company to sell off the company's assets, or failing this, to destroy the character of the company. Sale of a crown jewel may be part of a scorched earth defense. The aim, of course, is to cause the offeror to lose interest in the target or to deprive the offeror of the fruits of a successful tender offer.
Two-tier Offer:	A two-step acquisition technique in which the first step (front end) is a cash tender offer and the second step (back end) frequently is a merger in which remaining shareholders of the subject company may receive securities of the bidder valued below the consideration offered in the first step. Despite the reduced consideration offered, the merger is certain to be approved because the bidder will vote its controlling shares in favor of the merger.
Poison Pill:	Any provision in an agreement or charter which will mature upon a change of control to cause immediate problems for the acquirer, such as issuance of a class of securities of the target company convertible upon a change in control into the common stock of the acquiring entity.
Greenmail:	The purchase of a substantial block of the subject company's securities by an unfriendly suitor, with the primary purpose of coercing the subject company into repurchasing the stock at a premium over the amount paid by the suitor.
Shark Repellent:	Any amendment to a potential subject company's charter or by-laws that has been devised to discourage unsolicited approaches from bidders, such as requirement of "supermajority" shareholder approval of mergers.

White Knight: A party sought out by the subject company to make a competing offer—either a tender offer or an offer of merger—or to purchase and hold shares in the subject company as a party friendly to that company's management.