



## Regulatory Intervention in the Market for Corporate Control

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### INTRODUCTION

The Securities and Exchange Commission acts as the government watchdog over the change-of-control process.<sup>1</sup> The Commission has the authority to intervene in hostile acquisition contests by bringing proceedings against offending participants.<sup>2</sup> More important, the Commis-

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<sup>1</sup> The "change-of-control process" refers to a change in control of the corporation resulting from an alteration of the corporation's ownership.

<sup>2</sup> For a sampling of enforcement actions, see *SEC v. Carter Hawley Hale Stores*, 760 F.2d 945 (9th Cir. 1985) (seeking to enjoin target company from repurchasing its stock in attempt to defeat hostile takeover); *SEC v. Zico Investment Holdings, Inc.*, 41 SEC Docket 262 (S.D.N.Y. 1988) (alleging defendant depressed market price of target's stock); *SEC v. Greater Columbia Bancshares*, 31 SEC Docket 69 (W.D. Wis.

sion has considerable authority to adopt rules that define the parameters within which participants must operate.<sup>3</sup> Rule changes may dramatically alter the dynamics of a hostile contest by affecting an acquisition's cost and the participants' range of offensive and defensive tactics. In some instances, rule changes may prove outcome-determinative.

Rulemaking endeavors by a government agency may seem dull affairs, at least to the uninitiated. Nevertheless, rulemaking in the takeover area deserves special attention for at least two reasons. First, on a practical level, any change in the existing regulatory framework often provides unintended tactical opportunities for those participants savvy and wily enough to exploit them. Rule changes can shift the balance in a takeover contest and create uncertainty. These collateral consequences often work to the detriment of shareholders, the very constituency the rule typically seeks to protect.

Second, the process illustrates broad deficiencies in how the Commission adopts rules. Administrative agencies should adopt rules on a fully informed basis. Aware of both the goal and ramifications of each particular alternative, agencies should select the most appropriate approach from an exhaustive list of possibilities. Rulemaking in the takeover area, however, has not followed this pattern. No central theme or goal guides the process. Instead, the Commission promulgates rules incrementally, motivated by a particular abuse, not some over-arching view of what regulation ought to accomplish.<sup>4</sup> This approach has gen-

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1984). The Commission has also intervened in numerous takeover cases as amicus. For a sampling of such cases, see Amicus Brief of the Securities & Exchange Commission, *Consolidated Gold Fields PLC v. Minorco*, 871 F.2d 252 (2d Cir. 1989); Amicus Brief of the Securities & Exchange Commission, *Newmont Mining Corp. v. Pickens*, 831 F.2d 1448 (9th Cir. 1987). Finally, and far more common, the Commission staff intervenes during the pendency of an acquisition attempt through informal communications and threats of enforcement action. See *Citicorp Unit Seeks Alliance With Rival That Would Allow Sweeter Cyclops Bid*, Wall St. J., Mar. 24, 1987, at 17, col. 1 (reporting on Commission's objection to change in bidder's terms and order to re-open bid).

<sup>3</sup> Section 23(a)(1) constitutes the Commission's general source of rulemaking authority under the Exchange Act. Securities Exchange Act of 1934, § 23(a)(1), 15 U.S.C. § 78w(a)(1) (1982 & Supp. V 1987) [hereafter Exchange Act]. Section 3(b) provides broad authority to define terms. Exchange Act, § 3(b), 15 U.S.C. § 78c(b)(1982). In addition, the Exchange Act contains other, broad grants of authority to adopt rules. See Exchange Act, § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1982 & Supp. V 1987); § 14(d)(1), 15 U.S.C. § 78n(d)(1) (1982); § 14(d)(4), 15 U.S.C. § 78n(d)(4) (1982); § 14(d)(5), 15 U.S.C. § 78n(d)(5) (1982); § 14(d)(8), 15 U.S.C. § 78n(d)(8) (1982); and § 14(e), 15 U.S.C. § 78n(e) (1982).

<sup>4</sup> The process may be described as "muddling through." See, e.g., Lindblom, *The Science of "Muddling Through"*, 19 PUB. ADMIN. REV. 79 (1959) (describing deci-

erated considerable instability and has lead to shortsighted decisionmaking.<sup>5</sup>

Thus, a process of action-reaction characterizes rulemaking in the takeover area.<sup>6</sup> With no central vision of an appropriate regulatory scheme, rule changes often emerge in an effort to ameliorate a specific abuse or to provide shareholders with some added benefit.<sup>7</sup> Yet these changes may disrupt the existing regulatory scheme. The "unexpected" consequences of regulatory intervention, in turn, often necessitate a Commission rulemaking response designed to eradicate a new abuse. Thus, one rule proposal begets another. The process becomes circular.

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sionmaking process of public administrators).

<sup>5</sup> For a general discussion of rulemaking in the absence of complete information, see Gifford, *Discretionary Decisionmaking in the Regulatory Agencies: A Conceptual Framework*, 57 S. CAL. L. REV. 101, 117-21 (1983).

<sup>6</sup> The interplay between Commission regulation and court decisions represents another aspect of the action-reaction phenomena. Judicial and Commission interpretations often diverge. In rare instances, the Commission expressly declines to follow particular decisions. See Brown, *Corporate Secrecy, The Federal Securities Laws, and the Disclosure of Ongoing Negotiations*, 36 CATH. U.L. REV. 93, 160 n.247 (1986). More often, the Commission attempts to use its regulatory authority to overturn unacceptable decisions. For example, rule 14d-10, 17 C.F.R. § 240.14d-10 (1988), arose directly from the desire to overturn *Unocal v. Pickens*, 608 F. Supp. 1081 (C.D. Cal. 1985). See Exchange Act Release No. 22198, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,797, at 87,560 n.5 (July 1, 1985); see also Exchange Act Release No. 26609, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,401 (Mar. 8, 1989) (reviewing rule 10b-4 in light of Second Circuit decision in *Merrill Lynch, Pierce, Fenner & Smith v. Bobker*, 808 F.2d 930 (2d Cir. 1986)). The Commission has not spared the Supreme Court from this phenomenon. The Commission adopted rule 14e-3, 17 C.F.R. § 240.14e-3 (1988), to alleviate concerns raised by the Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980). See Exchange Act Release No. 17120, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,646 (Sept. 4, 1980). Thus, much of the existing regulatory scheme reflects judicial sculpting. See generally Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672 (1987) (analyzing judicial interpretation of banking regulations).

Judicial intervention performs a theoretical function as well as a descriptive function. The regulatory scheme implemented by the Commission deviates considerably from the express terms of the Williams Act. See *infra* notes 44-45. Whether unable or unwilling, Congress has never intervened to alter Commission actions. See *infra* notes 83-84 and accompanying text. This leaves the courts as the source of authority to ensure that the Commission remains within the bounds of legislative mandate. See Farina, *Statutory Interpretation and the Balance of Power in the Administrative State*, 89 COLUM. L. REV. 452, 474-75 (1989). This role perhaps partially explains judicial willingness to upset regulatory norms.

<sup>7</sup> For a discussion of rule changes designed, at least in part, to protect shareholders, see *infra* notes 90-94 and accompanying text.

This article examines the consequences of regulatory intervention in the market for corporate control.<sup>8</sup> The Commission's 1986 decision to extend withdrawal rights to the length of the offering period serves as the example.<sup>9</sup> Although a seemingly innocuous change, this extension did not arise out of some thoughtful perspective on tender offer regulation. Rather, the Commission reacted to prior Commission rulemaking by adopting this extension.<sup>10</sup> Moreover, the extension had immediate and unintended tactical implications, such as the facilitation of market sweeps.<sup>11</sup> Market sweeps, in turn, prompted the Commission to propose a rule to prohibit this tactic.<sup>12</sup> After discussing the probable consequences of unlimited withdrawal rights,<sup>13</sup> this article concludes with a discussion of possible reforms designed to minimize the adverse consequences of regulatory intervention.<sup>14</sup>

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<sup>8</sup> Other articles have found fault in the Commission's rulemaking process. *See, e.g.,* Dent, *SEC Rule 14a-8: A Study in Regulatory Failure*, 30 N.Y.L. SCH. L. REV. 1 (1985).

<sup>9</sup> *See infra* Section II(C).

<sup>10</sup> Initially, the Commission extended the withdrawal period from 7 to 15 days. *See infra* notes 91-95 and accompanying text. This extension led to the use of multiple proration pools. *See infra* notes 107-14 and accompanying text. This tactic induced the Commission to extend proration rights to the length of the offering period. *See infra* notes 115-18 and accompanying text. Consequently, the extension of proration rights justified the extension of withdrawal rights to the offering period's length. *See infra* notes 125-49 and accompanying text.

<sup>11</sup> *See infra* notes 155-79 and accompanying text. For an example of the use of a market sweep in a hostile acquisition, *see infra* notes 180-85 and accompanying text.

<sup>12</sup> *See infra* notes 237-42 and accompanying text.

<sup>13</sup> *See infra* notes 243-44 and accompanying text.

<sup>14</sup> *See infra* notes 245-79 and accompanying text.

## I. OVERVIEW

A vigorous debate has raged in recent years over the merits<sup>15</sup> and demerits of hostile takeovers.<sup>16</sup> Much of the commentary relies on inno-

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<sup>15</sup> Proponents of hostile acquisitions began to articulate their views in the 1960s. Henry Manne provided an early, spirited defense of hostile acquisitions. See Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). Manne argued that hostile acquisitions disciplined inefficient management. *Id.* at 113. Manne's reasoning received some support from those witnesses at the Senate Hearings on the Williams Act who criticized the legislation for its obvious anti-takeover effects. See *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S.510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 3 (1967) [hereafter *Senate Hearings*]. But see 113 CONG. REC. 24664 (Aug. 30, 1967) (statement by Senator Williams) (noting that legislation might discourage some takeover attempts, but concluding that this was a "small price to pay" given the protections afforded shareholders in the legislation).

Manne's reasoning has had amazing resilience. Current proponents of hostile acquisitions continue to adhere to his rationale. See Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1169 (1981) (reasoning that bidding process polices and disciplines managers); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 843-44 (1981) (arguing that tender offer is centrally important to structure of corporation because it provides key displacement mechanism through which market for corporate control constrains management behavior).

<sup>16</sup> Hostile tender offers have generated substantial controversy. Early opposition flowed from the ethereal view that the offers represented a disdainful method of acquiring control of a company, used only by corporate raiders and other reprobates. See 111 CONG. REC. 28257-58 (Oct. 22, 1965). Most of the blue-chip companies and Wall Street firms refrained from participation in hostile acquisition attempts until mid-1970. See Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 258 (1983) (noting that after Morgan Stanley participated in hostile bid in 1974, "investment houses recognized that bankers can be useful merchants in both directions").

More recently, criticism has assumed a more specific form. Some critics object to the inevitable job losses following a combination. See Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 7 n.14, 48 n.131 (1986) (noting layoffs resulting from hostile acquisitions); Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 26 (1987). Even here, however, dispute exists. Some contend that any loss is a short-term aberration. See Grundfest, *Job Loss and Takeovers*, Address to the University of Toledo College of Law (Mar. 11, 1988) (arguing that takeover critics overstate job losses and downplay productivity gains resulting from restructurings).

Other criticisms of hostile acquisitions abound. Takeovers, particularly in the Reagan era, served as a device to eliminate competition. Additionally, acquisitions have caused companies to take on additional debt, which may cause a spate of bankruptcies in an economic downturn. Servicing the debt may likewise generate pressure on management to produce short-term profits. See *Will Mergers Help or Hurt in the Long*

vative, empirical data and economic analysis.<sup>17</sup> To a large extent, the debate has contributed enormously to an understanding of the change-in-control process.

For all of the benefits flowing from public exhumation of the issue, the debate has to some degree truncated the analysis used to assess tender offer regulation. The tendency has been to judge regulation on

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*Run?*, Wall St. J., May 2, 1988, at 1, col. 5 (reporting that need to service debt causes managers to pursue "short-term goals at the expense of long-term competitiveness"). Potential targets may suffer the same fate in an effort to maintain stock prices and to fend off potential acquirors.

Still others argue that the perceived benefits of hostile acquisitions do not exist, usually by assaulting the efficient market hypothesis. See Lowenstein, *supra*, at 306. Excessive acquisitions may also impair the market for managerial labor. See Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1234-38 (1984).

<sup>17</sup> For a considerable time, the often shrill debate on the merits and demerits of hostile acquisitions lacked a strong empirical foundation. Much of the early analysis merely described the phenomena. See Hayes & Taussig, *Tactics of Cash Takeover Bids*, HARV. BUS. REV., Mar.-Apr. 1967, at 135. By the late 1970s and early 1980s, academicians in business schools and economists began to produce empirical data and profoundly changed the debate's nature. Empiricists initially focused on quantification of regulation costs and on assessment of the impact of hostile acquisitions on share prices of both target and bidder. See, e.g., Bradley, *Interfirm Tender Offers and the Market for Corporate Control*, 53 J. BUS. 345, 360-65 (1980) (quantifying substantially reduced premium paid to target shareholders in two-tiered offers); Dodd & Ruback, *Tender Offers and Shareholder Returns*, 5 J. FIN. ECON. 351, 373 (1977) (quantifying average premium paid to target company shareholders); Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371, 387-403 (1980) (quantifying costs imposed on bidders by state and federal regulation of tender offers); Smiley, *Tender Offers, Transaction Costs and the Theory of the Firm*, 58 REV. ECON. & STATISTICS 22, 30 (1976) (quantifying transaction costs for tender offers at 13% of post-offer market price); see also Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 15-16, 22 (1983) (summarizing empirical data on hostile acquisitions).

The Commission attempted to use empirical data against First City Financial Corporation and Marc Belzberg. See *SEC v. First City Fin. Corp.*, 688 F. Supp. 705 (D.D.C. 1988). The Commission argued that First City failed to file a timely Schedule 13D disclosing stock ownership exceeding 5% of Ashland Oil Company. *Id.* at 708. The Commission argued that had First City timely disclosed its ownership, the market price of Ashland would have increased as investors speculated about a takeover effort by First City. *Id.* Studies of the impact of Schedule 13D filings by known corporate raiders on market price support the analysis. See Holderness & Sheehan, *Raiders or Saviors? The Evidence on Six Controversial Investors*, 14 J. FIN. ECON. 555, 577 (1985). By illegally delaying disclosure for two weeks, First City accumulated 890,000 shares at lower prices. *First City*, 688 F. Supp. at 726-27. The Commission argued that these "savings" resulted from illegal activity and ought to be disgorged. *Id.* at 727. The district court agreed and ordered First City to disgorge \$2.7 million. *Id.* at 728.

the basis of a single criterion: whether regulation facilitates or hinders the change-of-control process.<sup>18</sup> Those favoring hostile acquisitions tend to oppose imposing additional restraints on bidders, while supporting efforts to limit a target's ability to resist. Those with a less sanguine attitude toward tender offers generally take the opposite view.<sup>19</sup>

Using either view as a principal criterion for analyzing regulation presumes a resolution of the debate over the benefit or harm resulting from hostile acquisitions. The issue, however, defies resolution. The current state of uncertainty; therefore, provides an inappropriate basis for a regulatory agency to assess regulation,<sup>20</sup> at least absent specific congressional mandate.<sup>21</sup>

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<sup>18</sup> Proponents of hostile acquisition call for curtailment in the defensive repertoire of target management. See Easterbrook & Fischel, *supra* note 15, at 1194-1204 (arguing for rule of managerial passivity in face of hostile acquisition attempts); see also Gilson, *supra* note 15, at 865-75. Proponents, however, disagree on the precise role of management during hostile acquisition attempts. Opposing complete passivity, some argue that management ought to have the right to locate white knights, thereby creating an auction market. See Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982); Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982).

<sup>19</sup> Opponents of hostile acquisitions generally view the existing system as favoring the hostile bidder at the expense of a target's shareholders. Accordingly, some calls for increased regulation attempt to place more authority in the hands of shareholders. See, e.g., Lowenstein, *supra* note 16, at 317-18 (proposing legislation requiring hostile tender offer to remain open at least six months and shareholder approval of any structural changes proposed as defensive tactics). Still others view tender offers as harmful to society and propose regulatory reform to make tender offers more difficult. If the weight of proposed legislation provides any indication, sentiment exists within Congress to impose additional restraints on bidders. See, e.g., H.R. 5693, 98th Cong., 2d Sess. (1984).

<sup>20</sup> Clearly, the Commission must act in the best interest of shareholders. To the extent hostile acquisitions as a broad phenomenon prove beneficial, the Commission might justify a regulatory stance that facilitates hostile acquisitions even if, in specific instances, the transactions do not benefit shareholders.

<sup>21</sup> Congress seems as divided as anyone on the issue, making it unlikely that Congress will act in the near future. Although the most vocal members support additional regulation, they have never mustered sufficient support to pass legislation. See Tender Offer Disclosure and Fairness Act of 1987, S. REP. NO. 265, 100th Cong., 1st Sess. (1987); see also Equity in Foreign and Domestic Credit and Tender Offer Reform, H.R. REP. NO. 1028, 98th Cong., 2d Sess. (1984). For a study of takeover legislation, see Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion*, 57 U. CIN. L. REV. 457 (1988). Romano notes that the vast majority of bills favor anti-takeover measures. *Id.* at 470-75. Romano uses this data to conclude that Congress will enact legislation which restricts bidders. *Id.* at 458. The article suffers from a central flaw. The large number of bills represents a low cost method of signaling concern to constituencies and other interest groups. Very few of the endeavors, however, lead to

Irrespective of the debate's eventual outcome, tender offer regulation imposes costs on targets, bidders, and others involved in the acquisition process.<sup>22</sup> Focusing on these costs provides some basis for assessing regulation. Nevertheless, this article does not re-open the time consuming and sometimes strident challenge to the existing regulatory scheme.<sup>23</sup>

Sufficient consensus exists that benefits of the existing regulatory process, particularly expanded disclosure, are more than compensatory. This consensus makes repeal or radical revision of the existing regulatory scheme an exceedingly unlikely prospect. Consensus on the basic tenets, however, does not suggest agreement on every aspect of the regulatory system. Indeed, proposals for regulatory "reform" frequently occur. Rule proposals, some adopted, most not, litter the tender offer area. Even in an era characterized as antagonistic towards increased regulation, the Commission appointed during the Reagan Administration adopted some of the most far-reaching revisions of tender offer rules.<sup>24</sup>

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congressional action. Bills that actually emerge from committee more accurately indicate congressional intent. While having anti-takeover aspects, these bills have been more balanced. *See, e.g., S. REP. NO. 265, supra.*

<sup>22</sup> *See Jarrell & Bradley, supra* note 17. Defensive tactics presented the most obvious, but not the exclusive, impediment to bidders. The regulatory scheme established by the Williams Act, *see* 15 U.S.C. §§ 78n(d)-(f) & 78m(d)-(e) (1982), applies almost exclusively to bidders, increasing hostile acquisition costs. Witnesses at the Williams Act hearings and contemporaneous commentators did not fail to comment on the Act's negative effect on hostile acquisitions. *See supra* note 15; *see also* Brudney, *A Note on Chilling Tender Solicitations*, 21 RUTGERS L. REV. 609 (1967); Manne, *Cash Tender Offers for Shares — a Reply to Chairman Cohen*, 1967 DUKE L.J. 231. The regulatory scheme led these commentators to aim their analytical skills at state and federal regulation of tender offers. *See, e.g.,* Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978).

<sup>23</sup> Before joining the agency, one SEC Commissioner attacked the need for federal regulation in the tender offer area. *See Economic Report of the President: Transmitted to the Congress* 203 (Feb. 1985).

The [economic] losses caused by the Williams Act . . . represent wealth foregone as a result of beneficial transactions deterred by the Act. Therefore, unless society places greater value on the redistribution of gains to target stockholders than on aggregate wealth effects, the costs of the Williams Act, at the margin, currently appear to outweigh its benefits.

*Id.* at 204.

<sup>24</sup> The Commission extended prorationing to the length of the offering period in 1983. *See infra* notes 115-18 and accompanying text. It similarly extended withdrawal rights in 1986. *See infra* notes 125-49 and accompanying text. The same year, the Commission also approved rule 14d-10, requiring targets to allow all shareholders to participate in offers and to receive equal consideration. 17 C.F.R. § 240.14d-10 (1988);



These rule proposals and changes often engender considerable debate. Consistent with the Commission's mandate, the Commission often justifies these proposals as necessary to protect shareholders. Criticism generally focuses on the need for the rule and on the Commission's authority to make the change. Any debate over the impact of the rule change on the tender offer process gets lost in the shuffle.

Regulation provides some degree of certainty by establishing reasonably fixed parameters that limit the range of tactical and strategic decisionmaking. Each rule change disrupts the common set of ground rules accepted and understood by participants in takeover contests. With fixed parameters destabilized, the outcome of tactical decisions becomes less certain. Unable to carefully calibrate the effects of particular tactics, participants may underreact or overreact to changing fortunes in the takeover contest. Participants incur costs as they struggle to establish new parameters. Additionally, "reform" can tilt the regulatory balance in favor of targets or bidders, with the attendant harm to shareholders outweighing any benefits.

In subjecting cash tender offers and open market purchases to federal oversight with the adoption of the Williams Act,<sup>25</sup> Congress established a rudimentary framework. Congress delegated to the Securities and Exchange Commission the task of filling in the crevices and otherwise implementing congressional intent. The Commission has utilized broad rulemaking authority to adopt a complex set of rules that thoroughly regulate the change-of-control process.<sup>26</sup>

Reactive, rather than proactive, rulemaking characterizes Commission activity in this area. The existing set of rules did not arise out of a comprehensive vision of an appropriate regulatory scheme. Instead, rules or rule amendments often emerged in a hodgepodge fashion to remedy particular abuses.<sup>27</sup> Conceived with narrow purposes, the rules sometimes produce broader, unforeseen consequences. With the change-of-control process inherently dynamic and innovative, market participants have exploited both intended and unintended advantages resulting from rule changes. With the rules themselves providing a catalyst

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*see also infra* notes 125-34 and accompanying text. Finally, the Commission proposed, without yet adopting, a rule designed to prohibit street sweeps. *See infra* notes 237-42.

<sup>25</sup> The Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified at 15 U.S.C. § 78n(d)-(f) (1982) and as amended at 15 U.S.C. § 78m(d)-(e) (1982 & Supp. V 1987)) (adding sections 14(d)-(f) and 13(d)-(e) to Exchange Act).

<sup>26</sup> *See* rule 13d-1, 17 C.F.R. §240.13d-1 (1988); rule 14d-1, 17 C.F.R. § 240.14d-1 (1988); rule 14e-1, 17 C.F.R. § 240.14e-1 (1988).

<sup>27</sup> For a discussion of rules adopted to remedy specific abuses, *see infra* Section II(C).

for change, additional aberrations arose that, in turn, provoked further rulemaking.<sup>28</sup> The process inevitably becomes circular.

An example occurred in 1986 when the Commission amended rule 14d-7<sup>29</sup> to allow tendering shareholders to withdraw shares anytime during the offering period. The Commission also eliminated the automatic ten-day extension of withdrawal rights following a competing offer.<sup>30</sup> With withdrawal rights becoming co-extensive with the offering period, tendering shareholders could tender at the inception of an offer, reconsider the decision, and withdraw shares anytime prior to the offer's expiration.

The change seemed beneficial. Extended withdrawal rights provided shareholders with greater flexibility to react to fluid market conditions. Moreover, the change simplified the tender offer process by making uniform the offering, proration, and withdrawal rights periods. At worst, the change seemed innocuous. Shareholders simply obtained a few additional days to withdraw shares.

Subsequent developments, however, indicated that the rule change unleashed unexpected market forces and added substantial instability to the tender offer process.<sup>31</sup> No longer afraid of having shares trapped by the withdrawal period's expiration, sophisticated shareholders lost any disincentive to tender early in the offering period. Early tendering signaled the liquidity of the target's shares. With that information, tender offer participants could more easily assess the probable outcome of the acquisition contest and the probable success of particular tactics such as street sweeps.<sup>32</sup>

Unlimited withdrawal rights also added uncertainty to the takeover process. Regardless of the number of shares tendered, bidders could not know whether enough shares would remain until an offer's last few

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<sup>28</sup> The anti-sweep proposal contained in rule 14d-11 resulted from the extension of withdrawal rights in rule 14d-7. See *infra* Section III(D).

<sup>29</sup> 17 C.F.R. § 240.14d-7 (1988); see Exchange Act Release No. 23421, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (July 11, 1986) (adopting rule).

<sup>30</sup> Exchange Act Release No. 23421, *supra* note 29.

<sup>31</sup> For a discussion of these market forces and the resulting instability to the tender offer process, see *infra* Section III(E).

<sup>32</sup> For a discussion of market sweeps and the dual offer tactic, see *infra* Section III(A). In competitive bidding situations, the more favorable offer is not always easy to ascertain. Particularly in two-tier offers, uncertainties about the second step and the number of shares to be purchased in the first step make evaluation difficult. See *Hanson Trust PLC v. SCM Acquisition, Inc.*, 781 F.2d 264 (2d Cir. 1986). Tendering early allows shareholders that have determined the relative benefits of each offer to signal the preferred offer. The "losing" bidder may use this information to make its offer more favorable.

hours. The uncertainty complicated tactical decisionmaking over changes in an offer's terms or in an offering period's length. This uncertainty also complicated a bidder's efforts to acquire adequate financing before an offer's closing.<sup>33</sup>

The rule change also led to the development of tactics designed to circumvent the expanded withdrawal rights. Bidders could terminate a tender offer and engage in a street sweep or could complete the offer after the mandatory twenty-day offering period and immediately make a second offer at a higher price. These tactics often work to the disadvantage of shareholders. At the same time, by encouraging bidders to close offers without financing, the rule change added risk to the tendering process.

Finally, the lurching evolution of withdrawal rights illustrates that rulemaking endeavors often result from abusive practices caused by the adoption of prior rules. Extended withdrawal rights became necessary only after the Commission changed other rules, which unleashed new problems. This process has continued. The anomalies generated by unlimited withdrawal rights facilitated market sweeps. The popularity of sweeps caused the Commission to propose a rule designed to restrict this tactic.<sup>34</sup> Thus, one rule proposal generates another.

Chronicling the effects of unlimited withdrawal rights is more than a descriptive exercise. Many of the adverse effects were predictable and had been discussed extensively during the hearings on the Williams Act.<sup>35</sup> Yet, in extending withdrawal rights, the Commission apparently did not consider the broader ramifications. No analysis of the matter appeared in either the proposing or adopting releases.<sup>36</sup> The omission suggests a significant flaw in, and need for reform of, the rulemaking process.

## II. WITHDRAWAL RIGHTS

The existing regulatory scheme for tender offers revolves around a mandatory offering period. To permit informed decisionmaking, bidders must disclose considerable information about acquisitions in a

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<sup>33</sup> For a discussion of the increased difficulty in acquiring financing, see *infra* notes 275-79 and accompanying text.

<sup>34</sup> See Exchange Act Release No. 24976, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,160 (Oct. 1, 1987) (proposing rule 14d-11).

<sup>35</sup> See *infra* notes 51-63 and accompanying text.

<sup>36</sup> See Exchange Act Release No. 22791, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,955 (Jan. 14, 1986) (proposing release); Exchange Act Release No. 23421, *supra* note 29 (adopting release).

Schedule 14D-1.<sup>37</sup> To allow shareholders time to digest that information, the offer must remain open for at least twenty days,<sup>38</sup> with mandatory extensions required under certain circumstances.<sup>39</sup> More-

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<sup>37</sup> A person making a tender offer must file a statement containing the information required by Schedule 14D-1 as soon as practicable. 17 C.F.R. § 240.14d-3(a) (1988). Among other things, a Schedule 14D-1 must include the offeror's identity and background; prior dealings with the target company; the source of funds used to purchase the tendered securities; the purpose of the tender offer; the offeror's existing ownership of the target's securities; any contracts, arrangements, understandings, or relationships with respect to the target's securities; and certain financial and additional material information. *See* 17 C.F.R. § 240.14d-100 (1988).

<sup>38</sup> *See* rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1988). The offer must remain open until midnight of the last day. Accordingly, "bidders may not indicate that shares must be deposited prior to the close of business on the 20th business day." Exchange Act Release No. 16623, 3 Fed. Sec. L. Rep. (CCH) ¶ 24,284I, at 17,757 (Mar. 5, 1981). The Commission proposed a mandatory offering period to outlaw "Saturday night specials" and to provide shareholders with adequate time to consider an offer. *See* Exchange Act Release No. 15548, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,935, at 81,236 (Feb. 5, 1979) (proposing 30-day offering period); *see also* *Curtiss-Wright Corp. v. Kennecott Corp.*, 504 F. Supp. 1044, 1055 (S.D.N.Y. 1980) (stating minimum offering period provides adequate time for shareholders to consider offer and avoids pressure to tender to offer of short duration). In narrow circumstances, the Commission staff allows issuers to shorten the offering period to 10 calendar days. *See* Shearson Lehman Brothers, Inc., SEC No-Action Letter (Dec. 2, 1986) (involving tender offer for nonconvertible debt securities).

A private cause of action exists for violations of rule 14e-1. 17 C.F.R. § 240.14e-1 (1988). In contrast to rule 10b-5, 17 C.F.R. § 240.10b-5 (1988), a plaintiff need not establish scienter. *See* SEC v. Burns, 614 F. Supp. 1360 (S.D. Cal. 1985), *aff'd*, 816 F.2d 471 (9th Cir. 1987). Although a violation of § 14(e) requires proof of scienter, *see* *Connecticut Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 961 (2d Cir. 1987), rules adopted thereunder do not. *See* SEC v. Tome, 638 F. Supp. 596 (S.D.N.Y. 1986); *Caleb & Co. v. E.I. DuPont de Nemours & Co.*, 615 F. Supp. 96 (S.D.N.Y. 1985). Additionally, a plaintiff need not be a purchaser or seller, which provides nontendering shareholders with a cause of action. *See, e.g.,* *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 596 (5th Cir. 1974).

<sup>39</sup> *See* rule 14e-1(b), 17 C.F.R. § 240.14e-1(b) (1988) (requiring 10-day extension for increase or decrease in consideration or in number of shares sought). A bidder may accept up to an additional 2% of the target's outstanding shares without triggering the mandatory extension. *Id.* Originally, the rule only required extension of the offering period following an increase in price. *See* Exchange Act Release No. 16384, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,373 (Nov. 29, 1979); *see also* *Crouse-Hinds Co. v. Internorth, Inc.*, 518 F. Supp. 416, 452 (N.D.N.Y. 1981) (holding decrease in offering price does not require time extension).

A bidder must also extend an offer for other material changes in the offer. Rule 14d-4(c) requires prompt dissemination of material changes to shareholders. 17 C.F.R. § 240.14d-4c (1988). The Commission has required extensions in the offering period to give shareholders time to assimilate this information. Normally, a five-business-day extension will suffice, although the facts and circumstances may necessitate a longer pe-

over, the bidder cannot buy any tendered shares until the offering period expires.<sup>40</sup>

In addition to substantial disclosure and prohibitions on fraud, the regulatory scheme provides shareholders with a number of substantive

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riod. See Exchange Act Release No. 23421, *supra* note 29, at 88,196 n.70; Exchange Act Release No. 24296, 3 Fed. Sec. L. Rep. (CCH) ¶ 24,284J (Apr. 3, 1987).

The mandatory extension for material changes creates two, often difficult issues. First, a "material" change in an offer's terms is not always self-evident. The Commission has indicated that material changes include alterations in the terms of financing, see *CRTF Corp. v. Federated Dep't Stores*, 683 F. Supp. 422, 444 (S.D.N.Y. 1988), and include "a waiver by the offeror of the number of shares it has set as its fixed minimum." Exchange Act Release No. 24296, *supra*. Nonetheless, the Commission has conceded the uncertainty in this area. *Id.* at 17,760.

The other, at least conceptual issue posed by the mandatory extension concerns when, if ever, changes become so significant that they amount to a new offer. Rather than a 5-day or 10-day increase, a new offer would trigger the mandatory minimum offering period of 20 business days contained in rule 14e-1. The length of an extension may contribute to the outcome of a hostile acquisition because arbitrageurs and other short-term investors generally will favor the bid that expires first.

The notion that numerous changes can result in a new offer seems dubious. A new offer would cause logistical difficulties. A bidder would need to terminate the initial offer, return shares, announce another offer, and file with the Commission largely duplicative disclosure documents. More important, shareholders do not need the added time. Initially, shareholders may need a 20-business-day period. Shareholders not only must assess price, but also the changed dynamics caused by an initial bid or a competitive bid. Thereafter, shareholders know that an offer's terms may change. See *CRTF Corp.*, 683 F. Supp. at 428 (stating initial offer usually "regarded as a tentative opening ploy, subject to revision with respect to its terms and upward price adjustment"); see also *Newmont Mining Corp. v. Pickens*, 831 F.2d 1448, 1451 (9th Cir. 1987) (stating that Commission "has consistently permitted amendments to tender offers and has never regarded the original offer statement as final").

Subsequent changes involve less complex analysis, thereby requiring less time to assimilate. This is particularly true since the Commission largely eliminated proration and withdrawal periods as independent variables. In most cases, shareholders must assess the impact of changed terms on price and perhaps on the offer's continued viability. Market professionals often facilitate the analysis by quantifying the changes' effects. Given these factors, a full 20-business-day offering period appears unnecessary.

To date, courts generally refuse to characterize substantial changes as a new offer. See *CRTF Corp.*, 683 F. Supp. at 443 (holding increasing consideration and decreasing number of shares sought not a new offer); *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, 303 F. Supp. 1354, 1358 (S.D.N.Y. 1969) (holding increase in number of shares sought and change in source of financing not a new tender offer).

<sup>40</sup> Before the Commission extended withdrawal and proration rights to the length of the offering period, bidders sometimes bought the shares after expiration of the respective periods, even though the offer remained outstanding. With respect to open market or privately negotiated purchases, rule 10b-13 prohibits a bidder from acquiring shares during a tender offer's pendency. 17 C.F.R. § 240.10b-13 (1988).

protections. Shareholders must receive equal consideration and an equal right to participate in the offer.<sup>41</sup> In a partial offer, the bidder must purchase shares tendered during the offering period on a pro rata basis.<sup>42</sup> Shareholders may also withdraw tendered shares anytime prior to the offering period's expiration.<sup>43</sup>

The Commission utilizes the offering period to determine the extent of withdrawal and proration rights. The existing symmetry of withdrawal, proration, and offering periods did not, however, emerge from a single rulemaking endeavor or coherent plan, but instead evolved spasmodically. The Williams Act provided a seven-day withdrawal period, a ten-day proration period, and no minimum offering period.<sup>44</sup> With greater experience administering the Williams Act, the Commission concluded that these express periods were inadequate. In doing so, the agency entered a regulatory twilight zone.<sup>45</sup> Certainty ceased when

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<sup>41</sup> See Exchange Act § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1982). This provision requires a bidder to pay any increases in consideration to shareholders that tendered earlier. The Commission has leveraged this provision into a more general requirement that all shareholders have a right to participate in an offer and to receive equal consideration. See rule 14d-10, 17 C.F.R. § 240.14d-10 (1988).

<sup>42</sup> Exchange Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982) (requiring prorationing during first 10 days of offer and following any increase in consideration). The Commission subsequently increased the proration period to the length of the offering period. See rule 14(d)(8), 17 C.F.R. § 240.14d-8 (1988).

<sup>43</sup> See rule 14d-7(a), 17 C.F.R. § 240.14d-7(a) (1988).

<sup>44</sup> The Williams Act, Pub. L. No. 90-439, 82 Stat. 454, 456-57 (1968) (codified in relevant part at 15 U.S.C. § 78n(d) (1982)).

<sup>45</sup> Some uncertainty exists concerning the Commission's authority to implement a mandatory minimum offering period. Nothing in the Williams Act expressly calls for a minimum offering period. Moreover, a lack of awareness cannot explain the absence. Senator Williams noted the use of a minimum offering period in Canada. See *infra* note 54. Moreover, the NYSE had adopted a policy that urged exchange-traded companies to leave offers open at least 30 days. See Merjos, *Embracing Tenders*, BARRON'S, Mar. 6, 1961, at 5 (noting NYSE's preference for 30-day offering period); see also *Commonwealth Oil Ref. Co. v. Tesoro Petroleum Corp.*, 394 F. Supp. 267, 275 (S.D.N.Y. 1975) (citing NYSE's policy of providing minimum period for shareholders to consider offer). For a brief discussion of the NYSE rules regulating tender offers, see Sowards & Mofsky, *Corporate Take-Over Bids: Gap in Federal Securities Regulation*, 41 ST. JOHNS L. REV. 499, 503 (1967). Finally, commentators had documented the length of offers in the period predating the Williams Act. See Hayes & Taussig, *supra* note 17, at 141 (stating average offer lasted 17 days, with range of 4 to 82 days).

Presumably Congress could have imposed a minimum offering period. The absence in the legislative history of any express indication of the need for a minimum offering period, however, misses the mark. By providing for withdrawal and proration periods, the Williams Act effectively imposed minimum offering periods. Moreover, in partial bids, the offering period has little independent significance. The expiration of the pro-

the prescribed periods no longer applied. Determining the optimal periods for withdrawal and proration rights required a balancing of shareholder need against untoward interference in the change-of-control process. This determination amounted to educated guesswork and necessitated constant revision.

### A. Statutory Evolution

Congress adopted the Williams Act in an effort to close a "gap" in the federal securities laws.<sup>46</sup> Unlike other techniques for acquiring control of a publicly traded company, Congress left cash tender offers largely unregulated. Federal securities laws had long governed the proxy process.<sup>47</sup> Exchange offers, by virtue of the Securities Act's registration provisions, also fell within the ambit of the Commission's regulatory authority.<sup>48</sup>

Nothing in the securities laws, however, gave the Commission express regulatory authority over cash tender offers. The antifraud provi-

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ration period rather than the offering period represented the critical date for shareholders. By extending withdrawal and proration rights to 20 days and by requiring mandatory extensions in the event of a material change in the offer, the Commission could have established an identical regulatory scheme without ever mentioning a mandatory offering period.

Courts have sustained the minimum offering period's validity. See *Pryor v. United States Steel Corp.*, 794 F.2d 52 (2d Cir.), *cert. denied*, 479 U.S. 954 (1986); *L.P. Acquisition Co. v. Tyson*, 772 F.2d 201 (6th Cir. 1985); *Batus, Inc. v. McKay*, 684 F. Supp. 637 (D. Nev. 1988).

<sup>46</sup> See *Senate Hearings*, *supra* note 15, at 1 (statement of Senator Williams) (stating that legislation aimed at closing gap by providing shareholders with necessary disclosures); *id.* at 42 (statement by Senator Kuchel) (stating gap exists for "those who would misuse the public trust and hide under a blanket of secrecy [to] continue to carelessly speculate with the credit and fate of the nation").

<sup>47</sup> See Exchange Act § 14(a), 15 U.S.C. § 78n(a) (1982). Congress indicated that the Commission had broad authority to guarantee corporate suffrage. See S. REP. NO. 1455, 73d Cong., 2d Sess. 74 (June 6, 1933) (stating proxies often provide inadequate information depriving shareholders of information concerning corporation's financial condition and policy matters decided at shareholder meetings); H.R. REP. NO. 1381, 73d Cong., 2d Sess. 13-14 (Apr. 27, 1934). The Commission interprets the rulemaking authority under § 14(a) in an exceedingly broad fashion. As one Commissioner testified: "[T]he language of Section 14(a) is broad and quite clearly extends somewhat beyond disclosure, although how far is not at all clear." *The Role of the Shareholder in the Corporate World: Hearings Before the Subcomm. on Citizens and Shareholders Rights and Remedies of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 5 (June 27, 1977) (testimony of SEC Commissioner Loomis).

<sup>48</sup> See Exchange Act § 5, 15 U.S.C. § 77 (1982); see also rule 145, 17 C.F.R. § 230.145 (1988).

sions provided the only restraint on these transactions.<sup>49</sup> Given this regulatory void, cash tender offers proved more expedient and less expensive than other methods of acquiring control.<sup>50</sup> By mid-1960, cash tender offers had become the preferred method of making hostile acquisitions.

Congress responded in 1968 by adopting the Williams Act. Early drafts of the legislation<sup>51</sup> clearly favored target companies. The bill's sponsor expressly stated that the legislation intended to impede corporate raiders by making the acquisition process more difficult.<sup>52</sup> As proposed, bidders would have had to publicly announce a tender offer twenty days before commencement, with commencement accompanied by substantial disclosure.<sup>53</sup> Pre-announcement disclosure gave target companies time to devise defensive strategies.

The early proposal made no mention of withdrawal rights. Before Congress took any action, however, the Commission provided a critique of the legislation.<sup>54</sup> Highlighting the absence of substantive protections

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<sup>49</sup> In some circumstances, rule 10b-5 required disclosure. *See generally* Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317, 337-49 (1967) (discussing shareholder right to information from offeror); Comment, *The Regulation of Corporate Tender Offers Under Federal Securities Law: A New Challenge for Rule 10b-5*, 33 U. CHI. L. REV. 359 (1966) (exploring application of disclosure provisions to tender offers); *see also* Symington Wayne Corp. v. Dresser Indus., 383 F.2d 840 (2d Cir. 1967) (alleging nondisclosure by offeror). The rule, however, did not impose substantive restraints.

<sup>50</sup> *See* Hayes & Taussig, *supra* note 17, at 136 (noting that 79 tender offers occurred from 1956 through 1960 and 155 offers from 1964 through 1966); *see also* *Senate Hearings*, *supra* note 15, at 42 (testimony of Senator Kuchel, cosponsor of Williams Act) (stating that "cash tender offer has become an increasingly favored method of acquiring corporate control"). Unregulated, tender offers had the advantage of both secrecy and expediency. Notwithstanding these advantages, bidders in the pre-Williams Act period often launched unsuccessful bids. *See* Hayes & Taussig, *supra* note 17, at 137 (noting that of 83 contested cash offers between 1951 and 1966, about 65% proved unsuccessful). The availability of financing contributed to the "urge to merge," which contributed to the upswing in hostile acquisitions. *See Senate Hearings*, *supra* note 15, at 56.

<sup>51</sup> *See* S. 2731, 89th Cong., 1st Sess. (1965).

<sup>52</sup> In proposing the legislation, Senator Williams made unmistakably clear his intent to protect incumbent management from corporate raiders. According to Senator Williams, the bill was designed to prevent "industrial sabotage" by raiders that turn "proud old companies" into "corporate shells." 111 CONG. REC. 28257-58 (Oct. 22, 1965).

<sup>53</sup> *See* S. 2731, 89th Cong., 1st Sess. (1965).

<sup>54</sup> *See* 112 CONG. REC. 19003 (Aug. 11, 1966) (Commission memorandum commenting on S. 2731). To some degree, existing regulatory schemes in other countries framed both the Commission's comments *and* the resulting legislation. Senator Williams stated:



for shareholders, the Commission recommended that shareholders receive the right to withdraw tendered shares "within the first seven days from the tender offer and any time after sixty days from the date of the original offer."<sup>55</sup> Noting that "in some situations the sixty-day limitation might prove unnecessarily restrictive for bona fide offers," the Commission also requested rulemaking authority to alter the withdrawal period.<sup>56</sup>

Perhaps viewing the need as obvious, the Commission gave no reasons for the addition of withdrawal rights. Nor did the Commission explain the rationale for the seven-day and sixty-day periods.<sup>57</sup> A contemporaneous article written by then-Chairman Cohen indicated that withdrawal rights were intended to benefit incumbent management.<sup>58</sup>

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In Canada, the Ontario Securities Act was revised last year to regulate takeover bids in a manner similar to the method which I have proposed. Legislation has also been enacted in England, South Africa, Australia, and other nations. In this area investor protection in the United States lags behind that existing elsewhere.

See 113 CONG. REC. 855 (Jan. 18, 1967).

<sup>55</sup> As the Commission explained:

The purpose of the seven-day provision is to afford time for those opposed to the tender offer not only to dissuade security holders from depositing their stock but also to convince them to withdraw it if already deposited. The 60-day time limitation is provided in order that investors may not have their securities tied up indefinitely while the offeror makes up his mind whether or not to accept them or seeks to obtain additional tenders before acting.

113 CONG. REC. 855.

<sup>56</sup> *Id.*

<sup>57</sup> The Commission apparently borrowed the seven-day period from a similar regulatory scheme under contemplation in Canada. In March 1965, a committee in Ontario submitted a report on prospective securities legislation. See Province of Ontario, Report of the Attorney General's Committee on Securities Legislation (Mar. 1965). The report recommended a seven-day withdrawal period. *Id.* at 24 (stating shares tendered pursuant to a takeover bid "may not be taken up . . . until the expiration of seven days"). Senator Williams used the "taken up" language when describing the withdrawal rights provision in his legislation. See 113 CONG. REC. 856 (Jan. 18, 1967) (statement of Senator Williams) (stating "bill also regulates 'taking up' of shares pursuant to a tender offer").

<sup>58</sup> Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock*, 22 BUS. L. 149 (1966). Whether benefitting incumbent management provided the only rationale for withdrawal rights remains doubtful. At the time of the article's publication, Senator Williams' legislation sought to protect target companies from hostile acquisition attempts. See *supra* note 52. Cohen may have deliberately couched the proposal for withdrawal rights in language consistent with Senator Williams' goals. As the legislation moved inexorably closer to becoming law, the Commission promoted withdrawal rights as a means of protecting shareholders.

With a grace period to withdraw shares, a target's management gained time to react to a hostile offer and to present its side to shareholders. Assuming management made a persuasive case, shareholders could retrieve their shares. The analysis suggested that withdrawal rights represented a mild anti-takeover device.<sup>59</sup>

Revised legislation introduced by Senator Williams in 1967 implemented most of the Commission's suggestions, including the addition of withdrawal rights.<sup>60</sup> As recommended, the legislation provided withdrawal rights for the first seven days of an offer and after an offer had been open for more than sixty days.<sup>61</sup> The bill also acceded to the Commission the authority to alter those periods.<sup>62</sup> The section-by-section analysis noted that the withdrawal period "would both provide a short period within which persons who tendered their shares immediately after the offer is made could reconsider perhaps in the light of the countervailing arguments from the management, and would also prevent tendered securities from being tied up indefinitely. . . ."<sup>63</sup>

Seemingly victorious, the Commission began to rethink its position as hearings on the legislation approached. The basic premise that shareholders needed withdrawal rights remained unchanged. The limited periods, however, seemed unnecessarily restrictive. Therefore, the Commission recommended further amendments to permit shareholders to

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<sup>59</sup> The general counsel of the SEC also indicated that absent withdrawal rights, unsophisticated shareholders might tender immediately, only to learn of a higher competing offer. "The spectacle of unsophisticated investors tendering their shares at \$20 and the offeror taking them up and turning around and selling to a competing offer for \$25 is somehow somewhat unedifying." *Senate Hearings, supra* note 15, at 208 (remarks of Philip A. Loomis, Jr., General Counsel, SEC).

<sup>60</sup> Unanimity among regulators and most participants did not prevent Henry Manne from criticizing the Commission's call for withdrawal rights. Manne, *Cash Tender Offers For Shares — A Reply To Chairman Cohen*, 1967 DUKE L. J. 231, 251. His view on withdrawal rights received no support at the hearings. One witness, however, opposed the resumption of withdrawal rights after 60 days. *See Senate Hearings, supra* note 15, at 50 (testimony of Herbert F. Kahler).

<sup>61</sup> The Senate reasoned that a withdrawal period provides tendering shareholders with a brief period to reconsider and recognizes that a prudent investor will tender near the end of the pro rata period "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." *Senate Hearings, supra* note 15, at 208. The 60-day period is determined from the date of the "original tender offer." 15 U.S.C. § 78n(d)(5) (1982).

<sup>62</sup> The Commission obtained authority to extend the period "as necessary or appropriate in the public interest or for the protection of investors." *Senate Hearings, supra* note 15, at 12.

<sup>63</sup> *Id.* at 14.

withdraw shares *anytime* prior to acceptance.<sup>64</sup> As one Commission witness explained: "In a competitive bidding situation, the loser could purchase all tendered shares and tender the shares to the winner. In this way, the losing bidder rather than the tendering shareholder obtained the premium."<sup>65</sup>

In response to questions about the amendment, Commission witnesses acknowledged that unlimited withdrawal rights could add some uncertainty to the tender offer process.<sup>66</sup> Participants would not know the number of tendered shares until after the offer closed. Nevertheless, as a practical matter, offerors already could not obtain an accurate count until the last minute. Sophisticated investors typically withheld shares until shortly before an offer closed in the oft chance that a better offer would materialize. With large shareholders holding back, bidders remained unaware of the number tendered until the offer closed. Thus, according to Commission witnesses, unlimited withdrawal rights would not affect existing practices.<sup>67</sup>

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<sup>64</sup> The Commission proposed unlimited withdrawal rights in a memorandum submitted prior to the hearings. See Supplemental Memorandum of the Securities & Exchange Commission, *reprinted in Senate Hearings, supra* note 15, at 212. The Commission proposed the following language:

Securities deposited pursuant to a tender offer or request or invitation for tenders may be withdrawn by or on behalf of the depositor at any time until the expiration of seven days after the time definitive copies of the offer or request or invitation are first published or sent or given to security holders or at any time thereafter until taken up the offeror, subject to such terms and conditions as the Commission may prescribe by rules and regulations as necessary or appropriate in the public interest or for the protection of investors.

*Id.* at 38.

<sup>65</sup> *Senate Hearings, supra* note 15, at 36. The Commission explained the need for the change in a memorandum submitted to the Committee.

For this reason, we suggest that the specific provisions of the bill with respect to withdrawal of tenders or the requirement of pro rata acceptance be revised to provide for greater flexibility to deal with existing techniques which may tend to defeat the purposes of the bill and with others which may develop. It is wise not to underrate the ingenuity of those engaged in the complex game of promoting or opposing block acquisitions or the variety of ways in which professionals may seek to capitalize on these situations to the disadvantage of the unwary public.

*Id.*

<sup>66</sup> As soon as SEC Chairman Cohen mentioned the proposed change, counsel to the Committee, Stephen Paradise, asked about the possible instability that might flow from unlimited withdrawal rights. *Id.* at 23.

<sup>67</sup> The reasoning did not have the universal applicability as suggested by Commission witnesses. Assuming the absence of significant disincentives, large shareholders

Commission witnesses also argued that abbreviated withdrawal rights worked to the disadvantage of small, uninformed shareholders. Smaller shareholders might learn about a competing offer after the expiration of withdrawal rights. Sophisticated investors typically did not suffer the same fate. Better able to keep up with rapid developments, these investors usually delayed tendering until the last moment, which reduced the risk of trapped shares.<sup>68</sup>

In general, the need for withdrawal rights created little, if any, controversy. The proposal for unlimited withdrawal rights, however, represented one of the few contentious issues raised at the Williams Act hearings.<sup>69</sup> The proposal received vociferous opposition from a number of witnesses, particularly from self-regulatory organizations.<sup>70</sup> Witnesses from the New York Stock Exchange (NYSE) argued that insufficient abuse existed to justify unlimited withdrawal rights.<sup>71</sup> Moreover, the burden imposed on bidders outweighed any benefits. Bidders could not keep a meaningful tally of shares tendered.<sup>72</sup> Without that information, bidders would have a harder time determining the offer's success and the requisite changes, if any, needed to induce additional shareholders to tender.<sup>73</sup>

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might delay tendering until the last minute. An offer made on a first-come, first-serve basis, however, provided substantial disincentives to delayed tendering. A recalcitrant shareholder might lose the opportunity to participate in the offer.

<sup>68</sup> See *Senate Hearings*, *supra* note 15, at 24 (colloquy between SEC Chairman Cohen and Senator Bennett). Similarly, Commission witnesses feared that once the withdrawal period expired, bidders might continually extend the closing date. This tactic would delay payment and deprive shareholders of the use of their shares. *Id.* at 38-39. Even after adoption of the Williams Act, shareholders continued to avoid the risk of a shorter withdrawal period by tendering shares at the last moment. See *Macfadden Holdings, Inc. v. J.B. Acquisition Corp.*, 802 F.2d 62, 65 (2d Cir. 1986) (noting that bidder received 7 million out of approximately 11 million outstanding shares between 4 p.m. and 12 a.m. on offer's last day).

<sup>69</sup> Most witnesses agreed on the need for the legislation. Particular issues, however, engendered significant debate. Other than withdrawal rights, the most contentious issues included the prorationing period's length and the need to disclose the source of financing. See *Senate Hearings*, *supra* note 15, at 129-31.

<sup>70</sup> In addition to the NASD, see *id.* at 109, and the NYSE, see *id.* at 92-93, other commentators opposed unlimited withdrawal rights. See *id.* at 81 (statement of Philip West) (arguing that offeror will not know amount of shares acquired and may not be willing to take the financial risk); *id.* at 164 (statement by Francis R. Schank) (arguing that it is not "unreasonable to expect the depositor to leave the securities on deposit for a reasonable time when he has been offered a premium price for the securities").

<sup>71</sup> *Id.* at 91 (letter from G. Keith Funston of NYSE to Senator Williams).

<sup>72</sup> *Id.* at 92 (memorandum from Donald L. Calvin and Phillip L. West).

<sup>73</sup> *Id.* at 92-93.

Some witnesses also disagreed with the Commission's conclusion that unlimited withdrawal rights benefitted small shareholders.<sup>74</sup> They asserted that uncertainties caused by unlimited withdrawal rights would make partial offers more difficult.<sup>75</sup> Either the offer would fail, depriving shareholders of a premium for their shares, or the offer would require constant extensions, causing delays in payment.<sup>76</sup>

With equal vigor, Commission witnesses challenged these arguments and elucidated the underlying rationale for unlimited withdrawal rights.

Our recommendation was based on the simple fact, which the [NYSE] overlooks, that sophisticated investors do not tender their shares until near the end of the period for pro rata acceptance, because they have nothing to gain and incur substantial risks by tendering earlier, thus perhaps disabling themselves from taking advantage of a higher competing offer or a rise in the market. . . . Because of these circumstances, the offeror under present practice does not know how many shares will be tendered until shortly before the end of the pro rata period and the [NYSE's] objection that a withdrawal privilege will create that problem is not well founded; it will simply put the ordinary shareholder more on a par with the professional.<sup>77</sup>

Nevertheless, the Senate declined to include unlimited withdrawal rights in the legislation. Unbowed, the Commission attempted to insert the proposal in the House version of the Act.<sup>78</sup> The provision again drew formidable opposition from the self-regulatory organizations.<sup>79</sup> The House Committee ultimately deleted the provision.<sup>80</sup>

To some degree, the conflict between the Commission and the self-regulatory organizations arose over a conceptual difference about the purpose of withdrawal rights. To the exchanges and the National Association of Securities Dealers (NASD), mandatory withdrawal rights

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<sup>74</sup> *Id.* at 92.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at 93.

<sup>77</sup> *Id.* at 200. Commission representatives also argued that the Williams Act "may tend to induce earlier deposits in some situations because of the protections that this bill would provide." *Id.* at 23-24.

<sup>78</sup> *Disclosure of Corporate Equity Ownership: Hearings on H.R. 1711 Before the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 2d Sess. 18-19 (1968) [hereafter *House Hearings*].

<sup>79</sup> *Id.* at 4-5.

<sup>80</sup> *Id.* at 19. Chairman Cohen made the interesting argument that restricted withdrawal rights might aid those with knowledge of an impending offer. Such persons could make a tender offer, aware of an imminent higher offer. If seven days passed before the second offer, withdrawal rights would terminate. The initial bidder could buy the shares and tender them to the highest bidder, realizing an immediate profit.

simply provided a brief period for shareholders to learn about an offer. Instituted in a pre-electronic era, a withdrawal period effectively furnished time for the dissemination of information to shareholders outside major urban centers. The Commission embraced a broader view. Wholly unrelated to the dissemination of information, the Commission viewed withdrawal rights as a substantive protection designed to promote maximum investment flexibility and to protect small, less sophisticated shareholders. Withdrawal rights, therefore, had at its core the concept of equal treatment.

Congress largely left the dispute unresolved. The Act, as ultimately adopted, gave the Commission a partial victory. Although Congress refused to extend withdrawal rights throughout the offering period, Congress gave the Commission rulemaking authority to alter the withdrawal period.<sup>81</sup> Moreover, the legislative history indicated a relatively broad view of this authority.

The Securities and Exchange Commission would be authorized to vary the duration of either withdrawal period to provide for special situations. For example, the circulation of correcting material might in some instances be required and shareholders might need more than the initial seven-day period to assess the corrected information. In other instances, consummation of the tender offer might require the approval of a regulatory authority before the shares could be accepted, and such approval might not be obtainable within sixty days from the commencement of a tender offer.<sup>82</sup>

In short, the Commission lost the battle, but won the war. The rulemaking authority provided the regulatory basis for extending the withdrawal period. By 1986, the Commission had used the authority to extend withdrawal rights throughout the offering period, the very thing Congress had considered, but declined to adopt.

### *B. Administrative Evolution*

In the twenty-year period following adoption of the Williams Act, Congress largely left to the Commission the task of implementing the dual goals of disclosure and equal treatment. Recognizing the fluid and dynamic nature of the change-of-control process, the Williams Act provided the Commission with necessary authority to effectively administer the Act.<sup>83</sup> Other than relatively minor amendments in 1970,<sup>84</sup> Congress

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<sup>81</sup> Exchange Act § 14(d), 15 U.S.C. § 78n(d) (1982).

<sup>82</sup> S. REP. NO. 550, 90th Cong., 1st Sess. 10 (1967).

<sup>83</sup> The Commission, in part, obtained a free hand in implementing a regulatory system by default. Congressional sentiment to intervene surfaced often. Legislative proposals and hearings to alter the regulation of tender offers proliferated. Nevertheless, no

has never intervened to alter the regulatory scheme.

Left to its own devices, the Commission gradually constructed a comprehensive set of regulations for tender offers and open market purchases. The Commission implemented a series of "temporary" rules shortly after the Act's adoption.<sup>85</sup> These temporary rules imposed minimal disclosure requirements, but did not tamper with any of the Act's substantive provisions. Except for conforming changes designed to reflect the 1970 amendments to the Williams Act, the Commission left the "temporary" rules in place for almost ten years.<sup>86</sup>

The first hint of systemic reform, and the first indication that the Commission considered the seven-day withdrawal period inadequate, surfaced in 1974.<sup>87</sup> The Commission announced public hearings on a variety of tender offer topics and requested comments on whether to "adopt rules clarifying the applicability of the shareholders' withdrawal rights and pro rata rights."<sup>88</sup> Spurred by the hearings, the Commission decided to lengthen the withdrawal period.

Noting that "[e]xtensive testimony was received at the Tender Offer Hearing concerning . . . the effectiveness of the seven-day withdrawal right," the Commission proposed to extend the withdrawal period from seven to ten business days.<sup>89</sup> The Commission also recognized the need for additional withdrawal rights in certain circumstances. The proposed rule called for withdrawal rights for seven business days following the announcement of a competing tender offer. The proposing release did not clarify why the Commission opted for a three-day increase in the withdrawal period, although doing so would have made both the with-

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legislative consensus ever emerged.

<sup>84</sup> Act of Dec. 22, 1970, Pub. L. No. 91-567, 84 Stat. 1497 (codified at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(e) (1982)) (amending rules 13(d) and (e) and 14(d) and (e)).

<sup>85</sup> Exchange Act Release No. 8370, [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,581 (July 30, 1968); *see also* Exchange Act Release No. 8391, [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,593 (Aug. 30, 1968).

<sup>86</sup> *See* Exchange Act Release No. 9060, [1970-1971 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,946 (Jan. 18, 1971).

<sup>87</sup> Exchange Act Release No. 11088, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,004 (Nov. 5, 1974); *see also* Exchange Act Release No. 11003, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,956 (Sept. 9, 1974).

<sup>88</sup> Exchange Act Release No. 12676, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,659 (Aug. 2, 1976).

<sup>89</sup> *Id.* The Commission also proposed a 15-business-day offering period, a provision to permit bidders to extend the proration period beyond the 10 days provided in the Williams Act, and additional disclosure requirements. The Commission only adopted the disclosure requirements. *See* Exchange Act Release No. 13787, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,256 (July 21, 1977).

drawal and proration periods identical. Likewise, the proposing release contained no discussion of the Commission's authority to extend the period.

The rule proposal languished until 1979. In February, the Commission abandoned the earlier proposal and circulated for comment another set of comprehensive revisions to the tender offer rules.<sup>90</sup> The revisions included a withdrawal period of fifteen business days with an automatic ten-day extension following a competing offer.<sup>91</sup> The proposing release again contained little insight into the reasons for the increase. In adopting the fifteen-day withdrawal period later that year,<sup>92</sup> the Commission explained:

[The extension] affords securityholders a longer period to reconsider their decision to deposit their shares. It also gives bidders a reasonable time prior to the expiration of the offer to ascertain the number of shares deposited and to determine whether to accept such securities for payment or to change the terms of the offer, such as extending the expiration date.<sup>93</sup>

The final rule also included a mandatory extension of withdrawal rights in the event of a competing offer.<sup>94</sup>

For the first time since enactment of the Williams Act, the Commission extended withdrawal rights beyond the seven-day period provided by Congress. Addressing questions about the Commission's authority to extend the withdrawal period, the adopting release simply pointed to the express authority contained in section 14(d)(5).<sup>95</sup>

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<sup>90</sup> Exchange Act Release No. 15548, *supra* note 38.

<sup>91</sup> *Id.* at 81,208.

<sup>92</sup> Exchange Act Release No. 16384, *supra* note 39. The Commission extended withdrawal rights to 10 business days in issuer tender offers earlier the same year. Exchange Act Release No. 16112, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,182 (Aug. 16, 1979).

<sup>93</sup> Exchange Act Release No. 16384, *supra* note 39.

<sup>94</sup> *Id.* at 82,591. As originally proposed, the 10-day extension applied in the event of any competing offer. The rule, as ultimately adopted, eliminated the automatic extension for competing offers by a target company. As the Commission explained: "[A] subject company could obtain an advantage through the extension of the withdrawal period by making a tender offer for a de minimus amount of the securities being sought by the bidder." *Id.*

Even with issuer offers eliminated, the automatic extension had some potential for abuse. To delay expiration of an offer, management could induce a white knight to make a tender offer for a small percentage of shares, thereby triggering the mandatory extension in the withdrawal period. No evidence, however, indicates that this tactic occurred. *But see* T.B. PICKENS, JR., BOONE 176-78 (1987) (discussing efforts by Pickens to entice allies to make competing offer for small percentage of Mesa Petroleum to force Cities Service to extend Mesa offer 10 additional days).

<sup>95</sup> Exchange Act Release No. 16384, *supra* note 39. Nevertheless, perhaps doubting



*C. Action-Reaction: Withdrawal Rights Throughout the Offering Period*

Shareholders now had a longer period to withdraw shares. A number of factors, however, tended to pressure the Commission into again extending withdrawal rights, this time to the length of the offering period. First, the fifteen-day withdrawal period left shareholders unable to withdraw shares during the offer's last five business days. If market conditions changed or the bidder altered the offer's terms, shareholders might be unable to react by withdrawing shares. Second, administrative convenience seemed to dictate a withdrawal period coterminous with the proration and offering periods. Third, the bar exhibited support for a longer withdrawal period. A blue-chip panel studying tender offer reform recommended the change.<sup>96</sup> Finally, the automatic extension of withdrawal rights following a competing offer often produced confusion and opportunity for abuse.

Easily stated, these reasons obscured the true motivation for the extension of withdrawal rights throughout the offering period. The extension arose from interaction with, and changes in, the proration period. The Commission's 1979 decision to lengthen the withdrawal period from seven to fifteen days and to provide mandatory extensions in the event of a competing bid added instability to the takeover process. This instability led to the development of multiple proration pools, an abusive tactic designed to discourage shareholders from taking advantage of extended withdrawal rights. The Commission's decision to extend proration rights to eliminate multiple proration pools, in turn, provided the rationale for the increase of the withdrawal period to the length of the offering period.

1. Proration Rights

In adopting the Williams Act, Congress attempted to eliminate, or at least reduce, the "stampede" effect of first-come, first-serve tender offers.<sup>97</sup> These offers pressured shareholders to sell as quickly as possible

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the adequacy of rulemaking authority, the Commission submitted to Congress a proposed amendment designed to clarify the authority to change the withdrawal period. See SEC Report on Tender Offer Laws 92 (1980) (available upon request from SEC).

<sup>96</sup> See *infra* notes 119-22.

<sup>97</sup> In first-come, first-serve offers, a bidder seeks a designated number of shares and purchases them in the order tendered. *Senate Hearings*, *supra* note 15, at 17. Once shareholders tender enough shares, purchases cease. This process induced shareholders to tender immediately. Prior to the adoption of the Williams Act, bidders commonly made only partial offers. According to SEC General Counsel Loomis, only 20% of

or risk having no shares purchased. To address the problem, Congress required bidders to purchase shares on a pro rata basis. Although originally requiring prorationing for the length of the offer,<sup>98</sup> the final bill limited proration rights to all shares tendered during the first ten days of an offer,<sup>99</sup> with additional proration rights following any increase in consideration.<sup>100</sup>

The proration period meant that bidders must treat shareholders tendering during the first ten days equally.<sup>101</sup> Proration rights eliminated the pressure to tender immediately after an offer's announcement. Prorationing, however, did not completely obviate the pressure to tender. Bidders could still purchase shares tendered after ten days on a first-come, first-serve basis. Shareholders, therefore, had considerable incentive to tender during the first ten days. As a result, the ten-day proration period effectively amounted to a minimum offering period, at least for partial offers.<sup>102</sup>

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hostile offers made from 1965 through early 1967 were for all shares. *See Senate Hearings, supra* note 15, at 207. For an example of an extreme case of pressure to sell in a first-come, first-serve offer, see *600 California Corp. v. Harjean Co.*, 284 F. Supp. 843, 846 (N.D. Tex. 1968) (noting offer for 500,000 shares filled within a day).

<sup>98</sup> *See Senate Hearings, supra* note 15, at 12. The NYSE had only required prorationing for the first 10 days of an offer. Falling back on its wide "experience," the self-regulatory organization led the call for a similar period in the Williams Act. *Id.* at 90.

<sup>99</sup> Exchange Act § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1982).

<sup>100</sup> *Id.* Increases in the number of shares sought, however, did not trigger additional prorationing. *See, e.g., McDermott Inc. v. Wheelabrator-Frye, Inc.*, 649 F.2d 489, 492 (7th Cir. 1980); *Commonwealth Oil Ref. Co. v. Tesoro Petroleum Corp.*, 394 F. Supp. 267, 282-83 (S.D.N.Y. 1975) (requiring bidder to extend offer 10 days and withdrawal rights 7 days following disclosure of material facts omitted from Schedule 14D-1).

<sup>101</sup> The concept of equal treatment imbedded within proration rights has broad implications. At first blush, the provision simply mandates equal treatment of shareholders *tendering* within the first 10 days. In reality, the rights demonstrate congressional intent to have all shareholders, even those not tendering, treated equally. First, proration rights provide all shareholders with equal opportunity. By imposing a minimum offering period, the Williams Act "prevents insiders of the offeree corporation (and their friends) from being first in line with their shares." Fleischer & Mundheim, *supra* note 49, at 350. Second, the concept of prorationing means little if bidders could treat shareholders unequally in other respects. For example, excluding certain shareholders from an offer would circumvent the equal treatment requirement. This concept of equality is of considerable importance. The notion of equal treatment arguably represents sufficient congressional intent to justify the adoption of rule 14d-10. *See infra* note 131.

<sup>102</sup> *See Pryor v. United States Steel Corp.*, 794 F.2d 52, 56 (2d Cir. 1986) (holding that 10-day proration period creates mandatory minimum period); *Petersen v. Federated Dev. Co.*, 416 F. Supp. 466, 475 (S.D.N.Y. 1976) (holding that § 14(d)(6) creates minimum offering period for partial offers). Moreover, the 10-day period could be as

By mid-1970, the Commission became concerned that the ten-day proration period provided inadequate time for shareholders to decide whether to tender. The Commission responded with rule 14d-8.<sup>103</sup> This rule clarified that bidders could extend the proration period beyond ten days without violating the Williams Act.<sup>104</sup> The rule, however, did not mandate a longer period, perhaps out of concern over the Commission's rulemaking authority.

While the abbreviated proration period raised some concern, on the whole, the ten-day period appeared to function adequately. Ten business days, coupled with mandatory extensions, seemed to provide sufficient time to consider most offers. Moreover, any imperfections had to be balanced against doubts about the Commission's rulemaking authority. Litigants occasionally challenged the use of a ten-day offering period, but courts routinely upheld use of the period as consistent with the Williams Act.<sup>105</sup>

The Commission's 1979 decision to extend withdrawal rights from seven to fifteen days upset this tolerable state of affairs.<sup>106</sup> This change seemed innocuous enough. Shareholders simply received a slightly longer period to reconsider and to withdraw previously tendered shares. In the broader context of the tender offer process, however, the extension had significant and unexpected consequences.

The change in withdrawal rights provided the impetus for multiple proration pools.<sup>107</sup> Multiple proration pools arose out of opaque lan-

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short as six trading days. See Exchange Act Release No. 18761, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,222 (May 25, 1982). For an example of the 10-day prorationing period used as a minimum offering period, see *Commonwealth Oil Ref. Co.*, 394 F. Supp. at 271 (noting that tender offer documents filed with Commission at 5:30 p.m. on April 18; terms carried in New York Times on April 19; withdrawal rights expired on April 28; offer expired April 30).

<sup>103</sup> See Exchange Act Release No. 16384, *supra* note 39, at 82,592. The rule authorizing extended proration rights became necessary because of unclear language in § 14(d)(6). By calling for a 10-day proration period, the section arguably prohibited a longer period. See Griffin & Tucker, *The Williams Act, Public Law 90-439 — Growing Pains?: Some Interpretations with Respect to the Williams Act*, 16 How. L.J. 654, 710-11 (1971).

<sup>104</sup> Exchange Act Release No. 12676, *supra* note 88, at 86,700 (proposing release) (stating bidders may extend pro rata rights throughout offering period).

<sup>105</sup> See *Connecticut Nat'l Bank v. Fluor Corp.*, 808 F.2d 957, 961 (2d Cir. 1987) (holding that proration cut-off date of April 15 and offer expiration date of May 1 do not justify inference of illicit motive); *Commonwealth Oil Ref. Co.*, 394 F. Supp. at 275 n.1 (stating that offer's short time period may disadvantage Corco's management, but does not violate Williams Act).

<sup>106</sup> See *supra* notes 91-95 and accompanying text.

<sup>107</sup> In addition to problems with multiple proration pools, the increasing size and

guage in section 14(d)(6).<sup>108</sup> That section required prorationing not only during the first ten days of an offer, but also after *any increase* in the offering price. The section left unclear whether prorationing following an increase required a continuance of the initial proration period or a second, separate proration period. With two separate proration pools, the bidder could purchase all shares tendered in the first pool and, if needed, could purchase additional shares from the second pool on a pro rata basis. Thus, shares in the second pool received less favorable treatment.

Two separate pools were uncommon while the withdrawal period remained seven days and did not require an automatic extension following a competing offer. After expiration of the seven-day period, bidders could increase the offering price without fear of withdrawal of previously tendered shares. In providing additional proration rights following an increase in consideration, bidders typically extended the initial period an additional ten days. Thus, all shares tendered during the offering period ended up in the same proration pool.<sup>109</sup> Indeed, using a second, less favorable proration pool might have discouraged shareholders from tendering, which would work to the bidder's disadvantage.

The Commission's extension of withdrawal rights to fifteen business days changed the dynamics. Upon the initial proration period's expiration, shareholders still had five days, or ten in the event of a competing bid, to withdraw shares. Multiple prorationing pools became a device used to discourage the exercise of these additional withdrawal rights.<sup>110</sup>

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complexity of hostile offers made the 10-day proration period too short for informed decisionmaking. See Exchange Act Release No. 18761, *supra* note 102, at 85,141-42.

<sup>108</sup> 15 U.S.C. § 78n(d)(6) (1982). Prorationing generated certain abusive practices, particularly short-tendering. Short-tendering involved the tendering of more shares than were actually owned. See Exchange Act Release No. 26609, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,401 (Mar. 8, 1989). Commission witnesses noted the practice during the Williams Act hearings, see *Senate Hearings, supra* note 15, at 188. The Commission adopted a rule prohibiting short-tendering immediately after the legislation's passage. See Exchange Act Release No. 8321, [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,588 (May 28, 1968). Congress indicated that adequate rulemaking authority existed under § 10(b) to adopt the rule. See S. REP. NO. 550, 90th Cong., 1st Sess. 5 (1967). Given the rule's nondisclosure nature, Congress apparently believed the Commission had substantive rulemaking authority under the section.

<sup>109</sup> See Greene, *Recent Tender Offer Developments: On the Edge or Deep In?*, 45 OHIO ST. L.J. 721 (1984); Lederman & Ulanakis, *Pricing and Proration in Tender Offers*, 14 REV. SEC. REG. 813 (1981).

<sup>110</sup> Other devices induced the extension of withdrawal rights throughout the offering period. In 1979, the Commission established a minimum 20-day offering period. See Exchange Act Release No. 16384, *supra* note 39. The 20-day offering period had little practical relevancy in partial offers. To ensure participation in the proration pool,

In a typical tender offer for less than all shares, shareholders would tender shares in large numbers towards the end of the ten-day proration period. If, however, a second offer emerged, the rules required the initial bidder to extend the withdrawal period. Shareholders then had ten additional days to withdraw and to tender to competing bidders. To discourage withdrawals, the first bidder would often increase the offering price *and* create a second proration pool.

Thus, two separate proration pools emerged. Although shareholders in both pools received the same consideration, those that tendered into the first pool had a decided advantage. The bidder would purchase shares in the initial pool first. If the bidder needed additional shares, the shortfall would come out of the second pool. Depending on the number of shares in the initial pool, bidders might not acquire any shares in the second pool or might acquire the shares on a pro rata basis. The less favorable treatment accorded the second pool discouraged shareholders that had tendered in the first pool from withdrawing. If the shareholder subsequently retendered, the shares might end up in the second, inferior pool.<sup>111</sup> Multiple proration pools, therefore, provided shareholders with disincentives to withdraw previously tendered shares.

The use of proration pools came under intensive scrutiny by the Commission in the aftermath of the 1981 contest for control of Conoco Corporation.<sup>112</sup> Seagram, Mobil, and DuPont embarked on a mammoth, three-way battle to acquire Conoco Corporation. Each used multiple proration pools,<sup>113</sup> causing substantial confusion among sharehold-

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shareholders had to tender within 10 days. Thus, partial offers effectively had a shorter offering period. Following the extension of withdrawal rights from 7 to 15 days, the number of partial offers increased, in part because of the shorter offering period. Extending proration rights to the length of the offering period eliminated this discrepancy.

<sup>111</sup> See Comment, *Rulemaking Under Section 14(e) of the Exchange Act: The SEC Exceeds its Reach in Attempting to Pull the Plug on Multiple Proration Pools*, 36 VAND. L. REV. 1313 (1983).

<sup>112</sup> One proposing release cited the Conoco takeover as an example of harm resulting from the shorter prorationing period. See Exchange Act Release No. 18761, *supra* note 102, at 85,142 (noting that three-way bidding contest for control of Conoco resulted in nine proration dates and six proration pools).

<sup>113</sup> Legal challenges that a second, separate proration period following an increase in consideration contravenes § 14(d)(6) invariably failed. See, e.g., *Jacobs v. G. Heileman Brewing Co.*, 551 F. Supp. 639, 643-44 (D. Del. 1982). One court found that extending the proration period violated the section. See *Pryor v. United States Steel Corp.*, 794 F.2d 52, 56 (2d Cir. 1986) (holding that offerors may not extend proration period "where the effect is to diminish the number of shares purchased from those who tendered before the deadline").

ers, including sophisticated investors.<sup>114</sup> In an attempt to eradicate multiple proration pools, the Commission amended rule 14d-8<sup>115</sup> to extend proration rights to the length of the offering period.<sup>116</sup> As long as an offer remained open, the bidder had to acquire all shares on a pro rata basis. The Commission implemented the rule change notwithstanding substantial fissures over the issue<sup>117</sup> and questions about rulemaking authority.<sup>118</sup>

The extension of the proration period made a conforming change in the withdrawal period inevitable. With pro rata rights and the offering period coterminous, only the withdrawal period remained out of sync. Less sophisticated shareholders unaware of the discrepancy might find shares trapped once the shorter withdrawal period expired.

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<sup>114</sup> See Exchange Act Release No. 19336, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,306, at 85,651 (Dec. 15, 1982) (stating 10-day period caused confusion and misunderstanding).

<sup>115</sup> 17 C.F.R. § 240.14d-8 (1988). For a discussion of the development of rule 14(d)(8), see Prentice, *Front-End Loaded, Two-Tiered Tender Offers: An Examination of the Counterproductive Effects of a Mighty Offensive Weapon*, 39 CASE W. RES. L. REV. 389, 406-09 (1988-1989).

<sup>116</sup> See Exchange Act Release No. 19336, *supra* note 114. In addition to concerns over multiple proration pools, the Commission indicated problems with the proration period's brevity. The Commission noted that shareholders sometimes received tender materials near or after an offer's expiration. The Commission concluded that shareholders were often "foreclosed from participating in the offer and were likely to receive a lesser amount for their securities in a proposed second-step merger." *Id.* at 85,651. *But see* Dennis, Book Review, 37 HASTINGS L.J. 409, 421-22 (1985) (arguing that no empirical evidence exists that nonprofessional investors prevented from participating in proration pools).

<sup>117</sup> The Commission narrowly approved the change by a three-to-two vote. See Exchange Act Release No. 19336, *supra* note 114, at 85,652-54 (Chairman Shad and Commissioner Treadway, dissenting).

<sup>118</sup> As originally proposed, § 14(d)(6) provided for prorationing throughout the offering period. See *Senate Hearings*, *supra* note 15, at 12; *House Hearings*, *supra* note 80, at 4. Moreover, although requested by the Commission, the section omitted rulemaking authority to alter the proration period. *Senate Hearings*, *supra* note 15, at 38. As with the move to extend withdrawal rights, see *supra* note 71, self-regulatory organizations led the opposition to extended prorationing. See *Senate Hearings*, *supra* note 15, at 76-77 (statement of Donald L. Calvin, Vice President, NYSE); *id.* at 108 (statement of Robert W. Haack, President, NASD).

Given the dissent of two commissioners, some commentators argued that the Commission lacked authority to extend the period. See Note, *SEC Tender Offer Timing Rules: Upsetting a Congressionally Selected Balance*, 68 CORNELL L. REV. 914 (1983); Comment, *supra* note 111. Similarly, courts indicated concern over the rule's validity, but left the issue unresolved. See, e.g., *Pryor v. United States Steel Corp.*, 794 F.2d 52, 55 n.5 (2d Cir. 1986).

## 2. Tender Offer Advisory Committee

Beyond administrative convenience, support for extending withdrawal rights to the offering period's length came from a blue-chip panel assigned to recommend reforms in tender offer rules. Impanelled in the aftermath of the conflict over the Commission's extension of proration rights, the Tender Offer Advisory Committee received a mandate to re-examine the existing regulatory scheme.<sup>119</sup> Lacking broad vision, the Committee recommended fifty regulatory refinements, including an extension of withdrawal rights.<sup>120</sup> Not happy with all of the Committee's recommendations, the Commission nonetheless indicated support for the extension.<sup>121</sup> Testifying before Congress in 1984, then-Chairman Shad concurred in the recommendation.<sup>122</sup>

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<sup>119</sup> Established in February of 1983, the Advisory Committee had 16 members, representing most facets of the acquisition process. See Exchange Act Release No. 19528, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,319 (Feb. 24, 1983); see also Exchange Act Release No. 19635, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,331 (Mar. 29, 1983) (soliciting public comments on issues under consideration).

<sup>120</sup> See Report of Recommendations of Advisory Committee on Tender Offers at 28-29 (July 8, 1983) [hereafter Advisory Committee Report] (recommendation 17 suggested that proration and withdrawal rights periods should correspond with minimum offering period). For a list of members, see Matheson & Norberg, *Hostile Share Acquisitions and Corporate Governance: A Framework for Evaluating Anti-takeover Activities*, 47 U. PITT. L. REV. 407, 430 n.74 (1986).

<sup>121</sup> See *Hearings before the House Subcomm. on Telecommunications, Consumer Protection and Finance*, 98th Cong., 1st Sess. (1984) (statement of John R. Shad) (arguing that shareholders better protected by proration and withdrawal rights throughout 20-day minimum offering period). Others also called for extended withdrawal rights. As one commentator testified:

Extending withdrawal rights would protect those shareholders who, for any reason, tender early. Moreover, no withdrawal right presently exists if the consideration in an existing competing offer is increased. Similarly, no withdrawal rights are available if the target company makes an offer for its own shares while a tender offer is pending, even though these events may be as material to shareholders as new bids. The period to respond, for an existing bidder, is therefore limited to the existing withdrawal periods under all of the other bidders' pending bids. If the withdrawal period of a prior bid has expired, a shareholder who has tendered may be precluded from moving his shares into a preferable offer. Any alteration in these practices must be very carefully examined to ascertain if the objectives of change outweigh any possible adverse effects to the process.

*Corporate Takeovers: Oversight Hearing Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 97th Cong., 2d Sess. 133 (1982) (statement by Arthur Fleischer).

<sup>122</sup> Statement of John R. Shad, *supra* note 121.

### 3. All Holders/Best Price

A specific proposal to extend withdrawal rights throughout the offering period surfaced in early 1986. The proposal stemmed from Mesa Petroleum's much publicized effort to acquire control of Unocal Corporation. Flushed with profits from an unsuccessful takeover attempt of Phillips Petroleum, Mesa embarked on a quest for Unocal. After purchasing a significant amount of Unocal's shares, Mesa made an offer for a controlling interest. Confronted by a two-tiered tender offer, Unocal responded with an imaginative and desperate tactic. The company made a discriminatory tender offer for its own shares. The company opened its offer to all shareholders except Mesa and Mesa affiliates. Had the offer succeeded, Mesa would have acquired sole ownership of a debt-laden, largely insolvent company.

Mesa challenged the discriminatory offer by arguing that the offer violated the Williams Act's implicit requirement of equal treatment of all shareholders. Mesa lost.<sup>123</sup> Reverberating beyond a single, unsuccessful takeover attempt, the ruling challenged a fundamental tenet of the Williams Act, equal treatment of shareholders. The market responded to the ruling's implications. Sperry Corporation's threat to use the tactic to fend off an unwanted offer from Burroughs seemed to confirm widespread use of the tactic.<sup>124</sup>

The Commission responded by proposing a rule designed to prohibit discriminatory tender offers.<sup>125</sup> Commonly known as the "all-holders" and "best-price" rule, rule 14d-10<sup>126</sup> and amendments to rule 13e-4<sup>127</sup> required that offerors open tender offers to all shareholders of the class of securities subject to the offer and that offerors pay all shareholders

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<sup>123</sup> *Unocal Corp. v. Pickens*, 608 F. Supp. 1081, 1083 (C.D. Cal. 1985); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 957 (Del. 1985).

<sup>124</sup> See *Burroughs Bid Vetoed by Sperry*, N.Y. Times, May 15, 1986, at D1, col. 6.

<sup>125</sup> Exchange Act Release No. 22198, *supra* note 6 (third-party tender offers); Exchange Act Release No. 22199, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,798 (July 1, 1985) (issuer tender offers). With respect to third party offers, the Commission staff had taken the position that bidders must open offers to all shareholders. See *United Cable Television Corp.*, SEC No-Action Letter (Apr. 8, 1975) (stating that "a tender offer subject to Section 14(d) must be made in a nondiscriminatory fashion to all shareholders of the class"). With respect to issuer tender offers, the staff's position was more unsettled. The Commission had proposed a rule prohibiting discriminatory tender offers by issuers, but declined to adopt it. See Exchange Act Release No. 16112, *supra* note 92, at 82,208.

<sup>126</sup> 17 C.F.R. § 240.14d-10 (1988).

<sup>127</sup> 17 C.F.R. § 240.13e-4 (1988).



the highest price *offered*.<sup>128</sup> The “highest price offered” provision allowed bidders to increase, but not decrease, the offering price. Because an increase in consideration might cause a shareholder to reconsider the decision to tender, the Commission also proposed a mandatory ten-day extension of the withdrawal period following an increase in the offering price or in the number of shares sought.

The all-holders rule met with a fusillade of criticism. Issuers inevitably opposed any restrictions on defensive tactics, particularly one proven so effective.<sup>129</sup> With equal predictability, those representing bidders or raiders tended to bestow accolades on the proposed rule.<sup>130</sup> Aside from comments on the proposal’s wisdom, critics raised legitimate questions about the Commission’s authority to outlaw discriminatory offers. Nothing in the legislative history specifically required equal treatment of nontendering shareholders.<sup>131</sup> Moreover, Supreme Court

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<sup>128</sup> Requiring the highest price *offered* effectively prohibited any decrease in the bid price. To lower the price, a bidder had to make a new offer. *See* Exchange Act Release No. 22198, *supra* note 6, at 87,563.

<sup>129</sup> Thirty-two commentators focused specifically on the all-holders requirement in rule 14d-10. Seventeen opposed the requirement. Those registering opposition included Amsted Industries, Apache Corp., Boise Cascade, Ohio Manufacturers’ Association, Proctor & Gamble, the Business Roundtable, Santa Fe Southern Pacific Corporation, and Unocal Corporation. *See* Exchange Act Release No. 22200, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,799 (July 1, 1985) (withdrawing rule).

<sup>130</sup> Fourteen of the thirty-two comments on the all-holders rule favored the change. *Id.*

<sup>131</sup> Plainly, the Williams Act requires equal treatment of *tendering* shareholders. *See Senate Hearings, supra* note 15, at 21 (statement of SEC Chairman Cohen) (stating bill seeks “to assure fair treatment of all shareholders who decide to accept a tender offer”); *see also id.* at 50 (statement of Herbert F. Kahler, General Counsel, International Silver Co.). Rule 14d-10, however, required equal treatment for both tendering *and* nontendering shareholders. The legislative history does not explicitly indicate that bidders have to open tender offers to all shareholders. *But see* S. REP. NO. 265, *supra* note 21, at 1-2 (stating Williams Act requires “equal treatment of all investors in connection with tender offers”); Note, *SEC Takeover Regulation Under the Williams Act*, 62 N.Y.U.L. REV. 580, 590 (1987) (arguing that Williams Act intended to ensure equal treatment of all, not just tendering, shareholders).

The absence of an explicit prohibition on discriminatory tender offers has a number of possible explanations. Congress may not have intended to prohibit the practice. That seems unlikely. The legislative history indicates a desire for equal treatment of shareholders. Congress adopted prorationing, a concept borrowed from the NYSE, to permit all shareholders a grace period to learn about and to participate in an offer. *See Merjos, supra* note 45, at 5. Moreover, apparently no practice of discriminatory third party tender offers had occurred. “When Big Board companies are involved, the Stock Exchange prefers that all shareholders be given an opportunity to take advantage of the offer.” *Id.*; *see also* [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,554, at

rulings suggested a relatively narrow interpretation of the Commission's rulemaking authority.<sup>132</sup>

Given the resulting maelstrom, the rule languished for six months. In January 1986, the Commission modified the original proposal.<sup>133</sup> Rather than require bidders to pay all shareholders the highest price *offered*, the Commission would simply require the payment of equal consideration. The change would enable bidders to lower the price without commencing a new offer.<sup>134</sup>

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83,173 (Mar. 25, 1968) (speech by Robert Haack, NYSE President) (reciting NYSE's policy of allowing all stockholders of company "an opportunity to participate on equal terms in any offer"). With most bidders seeking to acquire shares, excluding shareholders, even unfriendly ones, seemed self-contradictory. Without ongoing abuse, Congress had no need to prohibit discriminatory offers.

Issuer tender offers, however, did concern Congress. The hearings and the Williams Act itself reflect uncertainty towards open market purchases by issuers. During the hearings, the Senate inserted in the record a copy of a proposed Commission rule designed to ban discriminatory tender offers by issuers. See *Senate Hearings*, *supra* note 15, at 214-16. Congress, however, did not adopt a specific regulatory scheme. Instead, the legislation acceded to the Commission rulemaking authority to regulate these purchases. Exchange Act § 13(e)(2), 15 U.S.C. § 78m(e)(2) (1982). The Commission has imposed essentially identical regimes for third party and issuer tender offers. See *infra* note 170.

<sup>132</sup> See *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 11 n.11 (1985); *Santa Fe Indus. v. Green*, 430 U.S. 462, 473 n.12 (1977). Although not the most convincing analysis, the Third Circuit has sustained the Commission's authority to adopt the rule. See *Polaroid Corp. v. Disney*, 862 F.2d 987, 994-95 (3d Cir. 1988).

<sup>133</sup> Exchange Act Release No. 22791, *supra* note 36.

<sup>134</sup> The best-price provision may ultimately prove a supple source of litigation. In *Priddy v. Edelman*, 679 F. Supp. 1425 (E.D. Mich. 1988), shareholders of Fruehauf Corp. argued that Merrill Lynch violated the rule by acquiring shares in Fruehauf from Asher Edelman at a "premium." *Id.* at 1429. Edelman received \$49 in cash and \$21 million in expenses. *Id.* at 1428. In a subsequent tender offer, Merrill offered \$49.50 for 71% of Fruehauf's stock and indicated a willingness to pay an identical amount in cash or securities in a second-step merger. *Id.* at 1429. The court rejected the argument, in part on the basis that Edelman had not received a premium for the shares. *Id.* at 1431. Concluding that \$49.50 was more than \$49, the court reasoned that the "premium" argument relied on the payment of \$21 million in expenses. *Id.* Since the evidence indicated that Edelman had incurred expenses in excess of that amount, the court summarily dismissed the argument. *Id.*

Several problems exist with the court's reasoning. First, Edelman received cash for the shares. Other shareholders confronted the possibility of receiving securities for any shares remaining at the time of the second step. No matter what the face amount, securities in a second-step often trade at a steep discount. Moreover, the securities often lack liquidity. Thus, the superiority of the Merrill Lynch offer was by no means certain.

Second, the court did not consider the time value of money. Edelman apparently received his consideration immediately. Tendering shareholders waited a week for the

The revised formulation necessitated additional changes in the withdrawal period. Without changes, a bidder could lower an offering price after the withdrawal period's expiration and trap tendered shares. The Commission proposed two alternatives to address the problem.<sup>135</sup> First, the Commission could extend withdrawal rights for ten business days following any decrease in consideration or in number of shares sought.<sup>136</sup> By allowing shareholders a grace period to react to changed terms, the proposal modestly refined the existing scheme. Alternatively, the Commission proposed to extend withdrawal rights throughout the offering period and to eliminate the automatic ten-day extension in the event of a competing offer.<sup>137</sup>

The Commission adopted the all-holders rule in the summer of 1986. At the same time, the Commission extended withdrawal rights to the length of the offering period and eliminated the automatic ten-day ex-

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offer to commence, at least 20 business days for the offer to close, and some period of time for payment. Moreover, payment for the remaining shares had to await a second-step merger that could take months. Discounted for the delay and the back-end consideration, shareholders arguably received less consideration than Edelman.

Finally, by excluding expenses from the concept of premium, the court's reasoning would permit similar payments during an offer's pendency. Expenses could become a vehicle for circumventing the best-price requirement. At least one court includes expenses in determining the best-price paid. *See Field v. Trump*, 850 F.2d 938 (2d Cir. 1988). The court stated:

Whether the "fees and expenses" for which the Trumps paid \$900,000 to the Stroums were actually incurred is irrelevant under the "best-price rule." Some or all of those sums were expended in order to obtain a premium for the Stroums, and it would thwart the purposes of Section 14(d)(7) to allow reimbursement. Moreover, we believe the "best-price rule" would be unworkable if offerors were permitted to discriminate among shareholders according to expenses that were not uniformly incurred, such as broker's or attorney's fees.

*Id.* at 944 n.1.

<sup>135</sup> *See* Exchange Act Release No. 22791, *supra* note 36.

<sup>136</sup> *See id.* at 87,981.

<sup>137</sup> *Id.* at 87,983. Ironically, opponents of the extension could have cited the Commission's past position. A 1976 proposal to increase the withdrawal period indicated that:

[A] depositor should not be permitted to withdraw any or all securities deposited during the entire period that the offer is open. At some point prior to expiration of its offer, the bidder should have the opportunity to ascertain the number of securities deposited in order to determine whether or not to accept securities for purchase or to extend or change other terms of a tender offer.

Exchange Act Release No. 12676, *supra* note 88, at 86,698.

tension.<sup>138</sup> Only five commentators expressed views on the withdrawal rights issue. Commentators agreed that the adoption of the all-holders rule necessitated conforming changes in the withdrawal period, but lacked unanimity on the solution. At least one commentator noted that the Commission should delay resolution of the issue to provide additional opportunity for consideration.<sup>139</sup>

Commentators, however, did consistently oppose elimination of the automatic ten-day extension.<sup>140</sup> Unimpressed, the Commission, in a somewhat imperious manner, decided to abandon the ten-day extension.<sup>141</sup> As the release concluded, "given the significant extension of withdrawal rights there is no need to continue to require the additional withdrawal rights upon commencement of a competing bid."<sup>142</sup> A few commentators raised questions about the Commission's authority to lengthen the withdrawal period, but to no avail. The Commission simply shrugged off the criticism.<sup>143</sup> Noting express rulemaking authority to extend the period, the Commission concluded that additional withdrawal rights furthered the public interest and protected investors.<sup>144</sup>

To some degree, the dearth of comments represented a breakdown in the mandatory notice and comment process of the Administrative Pro-

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<sup>138</sup> Exchange Act Release No. 23421, *supra* note 29, at 88,197.

<sup>139</sup> The commentator stated: "We suggest that separate consideration and further explication of the bases and purposes of Proposal II [to extend withdrawal rights throughout the offering period] and the impact of its adoption on the mechanics of tender offers would be appropriate." Letter from Richard M. Phillips and Robert Todd Lang, American Bar Association, Feb. 24, 1986 [hereafter Phillips Letter].

<sup>140</sup> Exchange Act Release No. 23421, *supra* note 29, at 88,197. One commentator noted the possibility that bidders may terminate tender offers to prevent withdrawals. See Phillips Letter, *supra* note 139.

<sup>141</sup> Exchange Act Release No. 23421, *supra* note 29, at 88,197.

<sup>142</sup> *Id.* The Commission reasoned that by eliminating automatic extensions, a "bidder will be the master of its own bid; timing will not be altered by actions of a competing bidder. This should reduce the potential for gamesmanship in commencing competing bids." *Id.* Superficially appealing, the reasoning is suspect. No evidence exists that participants employed any prevalent practice which abused the automatic extension. Moreover, the rule change lessens the time that competing offerors have to make a bid. Until the change, a putative bidder could delay a bid until the last day of the offering period. With the automatic extension, shareholders had time to withdraw and to tender into this second offer. Elimination of the automatic extension meant that the putative bidder must make the second offer early enough to give tendered shareholders sufficient opportunity to withdraw. In at least some instances, this shortened period will prevent an auction market from developing.

<sup>143</sup> *Id.* at 88,188-91.

<sup>144</sup> *Id.* at 88,188.

cedures Act.<sup>145</sup> This process normally provides a mechanism for limiting a rule proposal's unexpected consequences. Interested parties have an opportunity to criticize a proposed rule and to enlighten the relevant regulatory authorities about the rule's impact. Particularly in the tender offer area, rulemaking endeavors receive substantial publicity and engender lively debate.<sup>146</sup> Moreover, hostile commentators often have their intended effect. Abandoned rule proposals litter the Federal Register.<sup>147</sup> In the conflagration over the all-holders rule, however, the proposed changes in the withdrawal period largely escaped notice. Of the five commentators that even bothered to express views, none did so in any significant detail.<sup>148</sup>

In quickly proposing and approving the extension of withdrawal rights in the midst of controversy over the "all-holders" rule, the Commission minimized the opportunity for public debate. Consequently, the Commission failed to seriously consider the possibility that unlimited withdrawal rights might disrupt the tender offer process. Notwithstanding the absence of comments, possible adverse consequences from the change should not have escaped notice. The Williams Act hearings dwelled at length on the damaging impact of unrestricted withdrawal rights.<sup>149</sup> Additionally, the Commission failed to consider how the change in withdrawal rights would interact with other tender offer rules.

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<sup>145</sup> 5 U.S.C. § 553(b) (1982) (requiring federal agencies to publish notice of proposed rule in Federal Register); *see also id.* at § 553(d) (requiring publication of adopted rule at least 30 days before effective date).

<sup>146</sup> For example, the all-holders rule attracted the attention of the press. *See, e.g., Exclusionary Tender Offers Banned*, N.Y. Times, July 9, 1986, at D1, col. 3; Hershey, Jr., "All-Holders" Rule Studied, N.Y. Times, Nov. 4, 1985, at D2, col. 3.

<sup>147</sup> Prior to the 1986 adoption of the all-holders rule, the Commission twice proposed and abandoned rules that would have required the opening of offers to all shareholders. *See* Exchange Act Release No. 16384, *supra* note 39; Exchange Act Release No. 16112, *supra* note 92. The Commission also abandoned proposed definitions of the term "tender offer," *see* Exchange Act Release No. 16385, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82, 374 (Nov. 29, 1979); and mandatory cooling-off periods for bidders following an offer's termination, *see* Exchange Act Release No. 16384, *supra* note 39. The Commission ultimately adopted requirements for going private transactions, after completely rewriting the requirements due to the comment process. *See* Exchange Act Release No. 11231, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,104 (Feb. 6, 1975).

<sup>148</sup> Exchange Act Release No. 23421, *supra* note 29, at 88,196. By contrast, the July 1985 release proposing the all-holders rule generated 76 comment letters. *Id.* at 88,187.

<sup>149</sup> *See supra* notes 61-80 and accompanying text.

### III. MARKET EFFECTS: THE CONSEQUENCES OF REGULATORY INTERVENTION

The extension of the withdrawal period was reactive in the sense that the desire to conform withdrawal rights to the other tender offer time periods motivated the extension. Moreover, as with the original extension of the withdrawal period from seven to fifteen days,<sup>150</sup> the change seemed beneficial. Shareholders received extra flexibility to reconsider a decision to tender. The Commission, however, did not consider possible repercussions on the regulatory scheme as a whole. Had the Commission engaged in such an analysis, the potential damage and instability of unlimited withdrawal rights would have quickly become apparent.

Unlimited withdrawal rights had one immediate effect. They removed any inhibitions to tendering shares during the early stages of a tender offer. As the legislative history to the Williams Act indicated, sophisticated investors typically waited until the last moment to tender. Delayed tendering avoided the risk that the initial bidder could purchase shares even though a higher offer emerged or market conditions changed.<sup>151</sup> With unlimited withdrawal rights, however, sophisticated investors could tender immediately, yet withdraw shares minutes before the offering period expired.

The ability to tender early produced a number of consequences. By tendering, investors informed the market of the shares' liquidity and of the minimum sale price.<sup>152</sup> Without further inquiry, bidders and targets knew that these shareholders would sell to the highest bidder. The percentage of shares tendered could also indicate the contest's outcome. A large number, particularly in a partial offer, indicates a predisposition of shareholders to sell, suggesting a desire for a change-of-control.

These signals facilitated market sweeps. Aware of the herd-like mentality of arbitragers, a bidder could terminate the offer and

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<sup>150</sup> See *supra* notes 91-95 and accompanying text.

<sup>151</sup> See *supra* note 61; see also *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 792 (2d Cir. 1969) (noting that 85% of shares tendered on last day of offer); *Griffin & Tucker*, *supra* note 103, at 709 (noting that shareholders consistently tender on tender period's last day).

<sup>152</sup> Although ultimately unsuccessful because of legal constraints, Minorco's bid for Consolidated Gold Fields attracted over half the outstanding shares. The high percentage arguably influenced Hanson Trust's decision to make an offer for the company at a lower price. See *Hanson Seeks Consolidated Gold Fields*, Wall St. J., June 23, 1989, at A-3, A-11, col. 1 (reporting "most Consolidated Gold shareholders clearly want to dump current management").

purchase shares from these sophisticated investors at a price approximating or even slightly under the highest offering price.<sup>153</sup> Moreover, early tendering identified shareholders willing to sell, making a sweep even easier. The extended withdrawal rights also made market sweeps more attractive. As with multiple proration pools, sweeps represented a means of curtailing the exercise of extended withdrawal rights.<sup>154</sup> In the event of a higher competing offer, a seemingly victorious bidder confronted the risk of massive withdrawals during an offer's final moments. A sweep ended the uncertainty. The bidder could acquire the shares outright. Thus, sweeps circumvented the requirement of unlimited withdrawal rights.

### A. Market Sweeps

The announcement of a tender offer dramatically affects a target company's stock. Bidders typically offer a premium of 30% to 40% over the prevailing market price as an inducement for shareholders to tender.<sup>155</sup> Thus, share prices significantly increase in the post-an-

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<sup>153</sup> A number of factors militate in favor of rapid turnover by arbitrageurs. Opportunity costs represent a concern. Arbitrageurs tie up capital which becomes unavailable for use in other deals. Holding shares may also entail transaction costs that ultimately reduce returns. For example, borrowed funds provide an important source of capital for arbitrageurs. See *Boesky Builds \$1 Billion War Chest*, N.Y. Times, Mar. 13, 1986, at D1, col. 4. Assuming some type of revolving line of credit, interest charges increase the longer a particular deal ties up funds. See Johnson, *Disclosure in Tender Offer Transactions: The Dice Are Still Loaded*, 42 U. PITT. L. REV. 1, 10 (1980).

In addition, raising investment capital from investors, rather than through borrowing, generates costs. Raising such funds may necessitate paying fees to brokers or investment bankers. See *Top Arbitrageurs Are Increasing Capital, Raising Some Concern As Well As Money*, Wall St. J., Apr. 3, 1986, at 10, col. 1 (reporting Merrill Lynch's annual fee of 5% of assets). Capital raised through the sale of high-yield "junk bonds" may also generate considerable costs. See *Boesky Builds \$1 Billion War Chest*, *supra*. Finally, arbitrageurs need to maximize short-term returns to attract sufficient investment capital.

<sup>154</sup> See *supra* notes 107-10 and accompanying text.

<sup>155</sup> The Office of the Chief Economist at the Commission studied 148 successful tender offers occurring from 1981 through 1983. The study revealed that target shareholders received an average premium of 63.4% above the pre-takeover market price in offers for all shares, 55.1% in two-tiered offers, and 31.3% in partial tender offers. See Exchange Act Release No. 21079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637, at 86,916 (June 21, 1984). Others have placed the premium between 49% and 73%. See Bradley, *supra* note 17, at 345-46; Jarrell & Bradley, *supra* note 17, at 373.

While target shareholders profit from the acquisition, the advantages to the bidder's shareholders are less apparent. One study determined that the bidder's share prices increase an average of only three to four percent following the announcement of a

nouncement period. In addition, a substantial change occurs in the target's shareholder profile.<sup>156</sup> Rather than wait for the offer to terminate, risk-averse shareholders sell into the market.<sup>157</sup> With the market price buoyed by the offer, shareholders obtain much of the premium promised by the bidder. At the same time, these shareholders avoid the risk of an offer failing and the risk of prorationing.<sup>158</sup>

As risk-averse shareholders sell, arbitrageurs and other sophisticated investors buy. In return for assuming the risk of premature termination

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tender offer. See Advisory Committee Report, *supra* note 120, at 7 n.6. Other researchers exhibit even less ebullience, concluding that "returns to successful bidding firms in mergers are zero." Jensen & Ruback, *supra* note 17, at 22.

<sup>156</sup> The profile change often begins before an offer's announcement. A number of studies indicate that takeover announcements often follow dramatic changes in share price. See Laderman, *The Epidemic of Insider Trading*, Bus. Wk., Apr. 29, 1985, at 78. Laderman discusses a study which examined 229 takeovers, mergers, or leveraged buyouts of exchange traded companies. The study determined that the target's share price increased before the official announcement of the transaction in 72% of the cases. *Id.* at 79. The study suggests that such information leaks into the market prior to announcement. Indeed, in adopting the Williams Act, Congress considered testimony suggesting that even diligent companies cannot prevent selective leaks of information about impending tender offers. See *Senate Hearings*, *supra* note 15, at 72 (testimony of Donald J. Calvin).

A series of cases brought by the Commission dramatizes the fact that select individuals may trade on information concerning an impending acquisition. See, e.g., SEC v. Drexel Burnham Lambert, Inc., 41 SEC Docket 1047 (S.D.N.Y. 1988) (injunctive action against investment banking firm alleging improper use of inside information); SEC v. Boesky, 37 SEC Docket 66 (S.D.N.Y. 1986) (injunctive action against arbitrager for trading in securities while possessing material nonpublic information about impending mergers and tender offers, requiring arbitrager to disgorge \$50 million and to pay penalty of equal amount under the Insider Trading Sanctions Act); SEC v. Reich, 36 SEC Docket 949 (S.D.N.Y. 1986) (injunctive proceeding against attorney for tipping material nonpublic information "relating to actual or contemplated tender offers, mergers, leveraged buyouts or other business combinations or extraordinary corporate transactions"); SEC v. Levine, 31 SEC Docket 898 (S.D.N.Y. 1986) (injunctive proceeding against managing director of Drexel Burnham Lambert for trading while possessing material nonpublic information); see also SEC v. Levine, 35 SEC Docket 1085 (S.D.N.Y. 1986) (settlement of injunctive proceeding requiring disgorgement of approximately \$11.6 million).

<sup>157</sup> See Hamilton, *Some Reflections on Cash Tender Offer Legislation*, 15 N.Y.L.F. 269, 294 (1969) (arguing that arbitrage activity causes "market price of the target corporation's security to rise quickly to approximate the tender price"). Hamilton estimated that arbitrageurs generally tendered between 60% and 90% of shares received by a bidder. *Id.* at 294 n.101.

<sup>158</sup> See Samuelson & Rosenthal, *Price Movements as Indicators of Tender Offer Success*, 41 J. FIN. 481, 481 (1986) (stating price movements in target's shares following tender offer's announcement "represent the collective opinion of the market participants as to the success or failure of the offer").



and prorationing, arbitrageurs obtain the spread between the market price and the offering price.<sup>159</sup> Both the risk assumed and the benefits obtained can be extraordinary.<sup>160</sup> Despite bad press, legitimate arbitrage activity benefits the market by providing needed liquidity in a target's stock.

The frenzied, post-announcement buying activity often causes a dramatic shift in a target company's ownership. Shares become concentrated in the hands of a small number of short-term investors seeking to maximize returns. This configuration can facilitate the acquisition of control. With ownership no longer dispersed, a bidder can obtain control by purchasing from a handful of shareholders who have strong incentives to sell. Colloquially known as "street sweeps,"<sup>161</sup> such rapid

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<sup>159</sup> For example, following a management buyout offer for \$68 per share, Macy's stock traded at \$66- $\frac{5}{8}$ , a spread of 2.4%. Arbitrageurs buying shares at that price and tendering them two weeks later when the offer closed earned an annualized return of about 27%. See *Wall Street's Arbs on the Hot Seat*, U.S. NEWS & WORLD REP., June 2, 1986, at 41.

<sup>160</sup> In some instances, arbitrageurs have lost substantial amounts of money. See *Wall Street's Risk Takers Roll the Dice Again*, U.S. NEWS & WORLD REP., Feb. 18, 1985, at 60 (reporting loss by one arbitrageur of \$80 million on single transaction); Dennis, *supra* note 116, at 410 n.4 (speculating that Boesky lost \$53.7 million in two transactions); *Drawn-Out Battle For Farmers Group Has Arbitrageurs Gnashing Their Teeth*, Wall St. J., July 21, 1988, at 10, col. 1 (reporting estimates of losses at \$200 million). The practice of arbitrage in the change-of-control context, however, has proven famously profitable. See *Stock Trader Who Shoots for the Moon*, U.S. NEWS & WORLD REP., Apr. 15, 1985, at 11 (reporting on Boesky's profits); *Top Arbitrageurs Are Increasing Capital, Raising Some Concern as Well as Money*, Wall St. J., Apr. 3, 1986, at 10, col. 1 (reporting that in 1985, arbitrage firms paid outside investors return of 30%).

<sup>161</sup> Market sweeps resemble two-tier tender offers, although even more coercive. A two-tier offer involves a partial offer, at an attractive price, for enough shares to acquire control. A second-step merger at an inferior price follows to eliminate remaining shareholders. Notes and stock, rather than cash, often serve as consideration in the second step. While shareholders may know of the offer's inadequate price, rational behavior dictates that they tender anyway. If the offer succeeds, those that did not tender will receive the inferior consideration paid in the second step. See *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69, 83 (1987). Although inherently coercive, use of two-tier offers does not violate the Williams Act. See *Radol v. Thomas*, 772 F.2d 244, 255 (6th Cir. 1985). Some commentators, however, have suggested abolishing two-tier offers. See Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 330-40 (1974); Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1361-62 (1978).

Sweeps resemble the first step in a two-tier offer. A bidder typically enters the market and buys enough shares to acquire control at an attractive cash price. See Exchange Act Release No. 21079, *supra* note 155, at 86,915 n.1; Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1708-

and large scale purchases by tender offer participants may ultimately determine the outcome of a contest for control.<sup>162</sup>

The inevitable concentration of ownership following an offer's announcement is not a new phenomenon. The use of sweeps, however, has only recently become common. A lack of appreciation for the tactic did not cause the failure to use sweeps. Instead, the obvious advantages notwithstanding, a number of legal impediments, or at least legal uncertainties, prevented protagonists from engaging in sweeps.<sup>163</sup>

In some circumstances, rules restricted the use of sweeps. Adopted in October 1969, rule 10b-13<sup>164</sup> prohibited bidders from making open market purchases of a target's shares from announcement until comple-

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10 (1985). As with two-tier bids, a rational shareholder will sell if the sweep will result in the transfer of control, notwithstanding the inadequate purchase price. The suddenness of sweeps, however, deprives some shareholders of the opportunity to engage in this rational behavior. Additionally, if the offer is truly unfavorable, management must get that message to shareholders, locate possible white knights, and devise appropriate defenses. A sweep, however, may deprive management of any opportunity to engage in tactics which increase the consideration paid to shareholders.

<sup>162</sup> At least one commentator has likened sweeps to creeping tender offers. See Lipton, *supra* note 16, at 17. A creeping tender offer involves the gradual acquisition of control through open market and privately negotiated purchases. The use of the adjective "creeping" suggests that the purchases occur over a long period of time and do not involve a single, large scale purchase that might be characterized as a tender offer. As a result, the acquiror obtains control without providing shareholders with the substantive and disclosure protections contained in § 14(d). 15 U.S.C. § 78n(d) (1982). Because an acquiror making a creeping tender offer must disclose its purpose and any additional purchases in a Schedule 13D, the market at least has notice of the acquisition program. Shareholders and management can plan accordingly. Sweeps, on the other hand, usually occur quickly and without notice. Management and shareholders typically have no time to react. As such, sweeps more closely resemble the first step in a two-tier offer.

<sup>163</sup> While scanty, some evidence suggests that sweeps existed in the pre-Williams Act era. See *American Tobacco Bids for Control of Gallaher Ltd.*, Wall St. J., July 17, 1968, at 32, col. 1 (reporting that in response to tender offer by R. J. Reynolds for Gallaher Ltd., American Tobacco bought 15% of Gallaher's common stock in one day, increasing ownership to 28%). Sweeps were also uncommon during the first 16 years after the Act's adoption. See E. ARANOW, H. EINHORN & G. BERLSTEIN, *DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL* 22 (1977) (noting that sweeps were used twice prior to 1977).

<sup>164</sup> See rule 10b-13, 17 C.F.R. § 240.10b-13 (1988); see also Exchange Act Release No. 8712, [1969-1970 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,745 (Oct. 18, 1969) (adopting release). As originally proposed, rule 10b-13 permitted purchases during an offer, but required bidders to pay all tendering shareholders at least the amount paid for shares acquired in the market. See Exchange Act Release No. 8391, *supra* note 85.

tion of the tender offer.<sup>165</sup> In explaining the rule's purpose, the Commission indicated that:

The rule accomplishes the objective of safeguarding the interests of the persons who have tendered their securities in response to a cash tender offer or exchange offer; moreover, once the offer has been made, the rule removes any incentive on the part of holders of substantial blocks of securities to demand from the person making a tender offer or exchange offer a consideration greater than or different from that currently offered to public investors.<sup>166</sup>

Thus, although an offer might result in concentrated ownership, bid-

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<sup>165</sup> Exchange Act Release No. 8712, *supra* note 164. The Commission further explained:

Where securities are purchased for a consideration greater than that of the tender offer price, this operates to the disadvantage of the security holders who have already deposited their securities *and who are unable to withdraw them* in order to obtain the advantage of possible resulting higher market prices.

*Id.* at 83,708 (emphasis added); *see also* Exchange Act Release No. 9395, [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,417, at 80,918 (Nov. 24, 1971) (stating rule designed "to protect the public investors who, if the tender offer were prorated, might lose the opportunity to tender all their shares whereas those whose shares were purchased outside the tender offer would not be prorated"). For an early discussion of the rule, see Lowenfels, *Rule 10b-13, Rule 10b-6 and Purchases of Target Company Securities During an Exchange Offer*, 69 COLUM. L. REV. 1392 (1969).

The continued need for rule 10b-13 is unclear, at least when applied only to bidders. First, the extension of withdrawal rights to the offering period's length removes one of the principal justifications for rule 10b-13. Bidders engaging in an open market purchase program can no longer trap shares. A shareholder could withdraw tendered shares immediately and sell into the market. Second, the rule disproportionately impacts bidders. As long as a tender offer exists, the bidder remains the only market participant that cannot buy. The target and any third party can enter the market and buy shares in an effort to defeat the offer. Third, bidders can easily circumvent the rule.

A bidder may accomplish the same goal by terminating an offer and immediately buying shares in the market. Campeau's acquisition of 48% of Allied Stores within minutes of the offer's termination represents the most stunning example. *See infra* notes 207-25 and accompanying text. To avoid this, the Commission might extend rule 10b-13 to other participants. Alternatively, a bidder might receive the right to buy shares in the market if the bidder acquires all tendered shares before terminating an offer.

<sup>166</sup> Exchange Act Release No. 8712, *supra* note 164. A private right of action exists for violations of rule 10b-13. *See, e.g.,* Warren v. Bokum Resources Corp., 433 F. Supp. 1360, 1366 (D.N.M. 1977). The rule may apply not only to actual purchases, but to agreements to purchase. *See* City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 717 (4th Cir. 1986) (holding stock purchase agreement executed before tender offer does not immunize bidder if consideration for stock paid after offer occurred).

ders could not take advantage of the situation, at least while the offer remained in effect.<sup>167</sup>

The rule did not present the only impediment to market sweeps. Issuers not only operated under the constraints of rule 10b-13, but also had to comply with rule 13e-4's mandatory cooling-off period.<sup>168</sup> Rule 13e-4 regulates self-tender offers. This rule prohibits an issuer from making any purchases "[u]ntil the expiration of at least ten business days of the date of termination of the issuer tender offer."<sup>169</sup> Assuming an issuer terminates an offer, arbitrageurs will not wait two weeks to sell to the issuer. By the time the cooling-off period lapses and the issuer returns to the market, dispersed ownership renders a sweep impossible.

Neither rule 10b-13 nor rule 13e-4's cooling-off period presented the most important impediment to market sweeps. For example, the rules did not restrict purchases by putative bidders or issuers that had not yet made a tender offer.<sup>170</sup> Nor did the rules restrict purchases by bidders

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<sup>167</sup> Generous Commission relief has ameliorated rule 10b-13's arguably onerous effects. In general, the Commission staff provides relief from the rule if bidders provide tendering shareholders with identical or equally advantageous terms.

<sup>168</sup> See rule 13e-4, 17 C.F.R. § 240.13e-4 (1988). The Commission also proposed a 10-day cooling off period for third party offers in 1979, but never adopted the requirement. See Exchange Act Release No. 16385, *supra* note 147 (proposing rule 14e-5).

<sup>169</sup> See rule 13e-4(f)(4), 17 C.F.R. § 240.13e-4f-4 (1988); see also Exchange Act Release No. 16112, *supra* note 92.

<sup>170</sup> An interesting anomaly, proration and withdrawal rights do not apply to private companies, while the offering period does apply. Section 14(d) only applies to tender offers for companies with securities traded on an exchange or registered under § 12(g) of the Exchange Act. Section 14(e), however applies to *any* tender offer. See *L.P. Acquisition Co. v. Tyson*, 772 F.2d 201, 209 (6th Cir. 1985); *Henry Heide, Inc.*, SEC No-Action Letter (May 1, 1972). Similarly, while § 14(d) exempts issuers, see 15 U.S.C. § 78n(d), section 14(e) subjects issuers to antifraud proscriptions. See Exchange Act Release No. 26609, *supra* note 108, at 80,012 n.11.

The separate regulatory evolution of rules applicable to third party and issuer tender offers is another anomaly in this area. Because rule 13e-4 evolved somewhat differently from the rules governing third party tender offers, the requirements for each have varied. Indeed, only in 1986 did the Commission impose essentially identical time limits for third party and issuer tender offers. See Exchange Act Release No. 22788, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,954 (Jan. 14, 1986).

Moreover, differences persist. For example, rule 13e-4 imposes a 10-day cooling off period *once* an issuer completes or terminates an offer. No similar requirement applies to third party offers. A bureaucratic reason probably explains the difference. Differences in the two regulatory schemes, in part, arose from separate divisions within the Commission overseeing third party and issuer tender offers. Issuer tender offers fall under the regulatory auspices of the Division of Market Regulation, see Exchange Act Release No. 16647, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,476 (Mar. 13, 1980). The Division of Corporation Finance oversees third party offers, see

following a tender offer's termination. The fear that the Commission or courts would characterize the massive purchases as a tender offer most effectively restrained sweeps.<sup>171</sup>

The Williams Act did not define the term "tender offer," conceivably an intentional omission.<sup>172</sup> Nor do legislative history or Commission rules shed much light on its meaning. Reminiscent of the phrase "insider trading," Congress left the definition to judicial development.<sup>173</sup> To provide courts with guidance, the Commission developed an eight-factor test.<sup>174</sup> The test includes factors such as the existence of a pre-

Exchange Act Release No. 16623, *supra* note 38.

<sup>171</sup> See Black & Sparks, *Triggering the Williams Act*, 8 REV. SEC. REC. 967, 971 (1975) (calling for Commission to treat large scale, open market purchases as tender offer); see also Lipton, *Book Review*, 72 MICH. L. REV. 358, 365 (1973).

<sup>172</sup> Why Congress did not define the term remains a matter of some dispute. The Commission takes the position that Congress intentionally omitted a definition to provide flexibility as market conditions change. Some courts accept this rationale. See *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1206 (2d Cir. 1978); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 598 (5th Cir. 1974), *cert. denied*, 419 U.S. 873 (1974) (noting that Congress and the Commission intentionally refrained from defining "tender offer" so that courts could develop term on case-by-case basis).

Alternatively, Congress may have intended to limit § 14(d) to conventional offers. With the elements of a conventional offer widely recognized, Congress may not have felt the need for a specific definition. See *Senate Hearings, supra* note 15, at 17. But see Andre, *Unconventional Offers Under the Williams Act*, 12 J. CORP. L. 499, 503-04 (1986).

<sup>173</sup> The absence of a definition of insider trading has caused considerable controversy. In 1984, Congress adopted the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (codified as amended at 15 U.S.C. §§ 78c, 78o, 78t, 78u & 78ff (1984)). The Act increased sanctions to treble damages and criminal prosecution, which spurred efforts for Congress to define insider trading. See Goelzer & Berueffy, *Insider Trading: The Search for a Definition*, 39 ALA. L. REV. 491, 494 (1988). Given the lack of unanimity on the issue, however, no definition appears likely to emerge in the near future. See Phillips & Lavoie, *The SEC's Proposed Insider Trading Legislation: Insider Trading Controls, Corporate Secrecy, and Full Disclosure*, 39 ALA. L. REV. 439, 442-43 (1988) (discussing Senator D'Amato's proposed definition, Commission's opposition, and Commission's alternative definition).

<sup>174</sup> For cases utilizing this test, see *Wellman v. Dickinson*, 475 F. Supp. 783, 823-25 (S.D.N.Y. 1979); *Hoover Co. v. Fuqua Indus.*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,107, at 96,150 (N.D. Ohio 1979); *S-G Securities v. Fuqua Inv. Co.*, 466 F. Supp. 1114, 1126-27 (D. Mass. 1978). Even before articulating the eight-factor test, the Commission indicated that the term "tender offer" applied to large scale purchases that placed pressure on shareholders to sell. See Exchange Act Release No. 12676, *supra* note 88, at 86,696 (noting term "to be interpreted flexibly" and applies to "any transaction where the conduct of the person seeking control causes pressures to be put on shareholders similar to those attendant to a conventional tender offer"); see also Amicus Brief of the Securities & Exchange Commission, *Cattlemen's Inv. Co. v.*

mium, widespread solicitation, and the acquisition of large percentages of shares at fixed terms.<sup>175</sup> The test's amorphous nature has generated substantial uncertainty.<sup>176</sup>

Under the test, the Commission often argued that large scale, open market or privately negotiated purchases constituted an "unconventional" tender offer. To the Commission, these purchases created the same type of abuse that the Williams Act attempted to eliminate.<sup>177</sup> Similar to first-come, first-serve offers, these purchases placed inordi-

Fears, 343 F. Supp. 1248 (W.D. Okla. 1972).

On at least three occasions, the Commission expressly declined to define the term "tender offer." Exchange Act Release No. 12676, *supra* note 88, at 86,695-96; Exchange Act Release No. 15548, *supra* note 38, at 81,206; Exchange Act Release No. 16385, *supra* note 147, at 82,600, 82,602-06.

<sup>175</sup> The eight factors are:

- (1) an active and widespread solicitation of the target's shareholders;
- (2) a solicitation for a substantial percentage of the issuer's stock;
- (3) the offer to purchase is at a premium over the existing market price;
- (4) the terms of offer are firm rather than negotiable;
- (5) the offer is contingent on the tender of a fixed minimum number of shares;
- (6) the offer is open for only a limited period of time;
- (7) the offerees are subjected to pressure to sell their stock;
- (8) public announcements of a purchasing program precede or accompany a rapid accumulation of large amounts of the target company's stock.

The Commission articulated the eight-factor test in three amicus briefs filed in 1979. See Amicus Brief of the Securities & Exchange Commission, *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773, 791 n.13 (S.D.N.Y. 1979); Amicus Brief of the Securities & Exchange Commission, *Wellman v. Dickenson*, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979); Amicus Brief of the Securities & Exchange Commission, *Hoover Co. v. Fuqua Indus.*, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,107, at 96,148 (N.D. Ohio 1979).

<sup>176</sup> See *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 57 (2d Cir. 1985) (warning that "elevation of [test] to a mandatory 'litmus test' appears to be both unwise and unnecessary"); *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773, 791 (S.D.N.Y. 1979) (labeling eight-factor test vague and unpredictable). The problem of "unconventional" tender offers arose almost contemporaneously with the adoption of the Williams Act. See *Griffin & Tucker*, *supra* note 103, at 700-01 (attempting to define tender offer); Exchange Act Release No. 8392, [1969-1970 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,715, at 83,638 (Aug. 30, 1968) (indicating "special bids" fell within the meaning of tender offer).

<sup>177</sup> According to one district court:

This purchase was designed in intent, purpose and effect to effectuate a transfer of at least a 20% controlling interest in BD to Sun in a swift, masked maneuver. It would surely undermine the remedial purposes of the Act to hold that this secret operation, which in all germane respects meets the accepted definition of a tender offer, is not covered by Section 14(d)'s pre-acquisition filing requirements because Sun's coup was not

nate pressure on shareholders to sell. Moreover, if the purchases occurred in a short period of time, smaller, less sophisticated shareholders had no opportunity to participate. Deprived of an opportunity to sell into the market, remaining shareholders confronted the risk of a coercive, freezeout merger at an inferior price.

Uncertainty bred conservative behavior. If the Commission and courts characterized sweeps and other large scale purchases as tender offers, the full panoply of regulatory requirements contained in the Williams Act applied. If a sweep violated the Williams Act, a court could enjoin the sweep. Additionally, relying on equitable authority, courts could void purchases or sterilize shares.<sup>178</sup> Moreover, the Commission maintained a high profile by litigating the issue directly and by participating in private actions through amicus briefs.<sup>179</sup> Third parties also raised the issue with frequency and vigor in injunctive proceedings. The threat of successful litigation encouraged participants to avoid sweeps and to rely on other tactics.

The system began to unravel in 1984. Confronted by a hostile offer from The Limited, Carter Hawley announced an ambitious acquisition program and promptly began buying its shares on the open market.<sup>180</sup> The legal uncertainties of large, open market purchases meant little to a company fighting for survival. In eight trading days, Carter Hawley bought almost half of its outstanding shares.<sup>181</sup> The purchases decreased the number of shares and, concomitantly, increased the percentage held by insiders. Upon completion of the acquisition program, The Limited's offer collapsed.<sup>182</sup>

Predictably, the Commission challenged the purchases by arguing that the purchases constituted an unconventional tender offer.<sup>183</sup> After losing at the district court, the Commission brought the issue to the Ninth Circuit. The Ninth Circuit gave the Commission a partial vic-

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heralded by widespread publicity and because no shares were placed in a depository.

*Wellman*, 475 F. Supp. at 822; see also *SEC v. Fuqua Indus.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,954, at 96,009 (D.D.C. 1979) (holding offer to over 100 members of Hoover family for 41% of stock constituted unconventional tender offer).

<sup>178</sup> See *Bayly Corp. v. Marantette*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,834 (D.D.C. 1982) (exemplifying sterilization of shares in proxy contest); *Hastings-Murtagh v. Texas Air Corp.*, 649 F. Supp. 479, 486 (S.D. Fla. 1986) (noting court's authority to order merger unwound).

<sup>179</sup> See *supra* note 175.

<sup>180</sup> *SEC v. Carter Hawley Hale Stores*, 760 F.2d 945, 947 (9th Cir. 1985).

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

tory at best. Although adopting the Commission's eight-factor test, the court found that Carter Hawley's purchases did not constitute a tender offer.<sup>184</sup>

The soundness of the reasoning aside, the court jarred open a gaping hole in the regulation of hostile tender offers. The court's opinion sanctioned the purchases during the midst of a fierce battle for control. More important, by approving the defensive tactic, the court provided a significant advantage to target companies. The holding damaged the prevailing notion that targets and bidders operated on a level playing field. The holding also seemed to harm small shareholders unable to participate in the purchase program. The offer's defeat caused a precipitous decline in Carter Hawley's stock price and generated losses for shareholders that did not participate in the acquisition program.<sup>185</sup>

The significance of *Carter Hawley Hale* remained unclear. Other courts could have limited the decision to its somewhat unusual facts. Additionally, in more than one instance, the Ninth Circuit has employed "unique" reasoning in a securities case.<sup>186</sup> Thus, no guarantee existed that other circuits would abide by the Ninth Circuit's reasoning. The degree to which courts would undermine the unconventional tender offer doctrine remained in doubt until the Second Circuit's decision in *Hanson Trust PLC v. SCM Corporation*.<sup>187</sup>

*Hanson Trust* involved the battle over SCM Corporation. After a drawn out struggle, Hanson Trust ultimately defeated a competing, white knight offer from Merrill Lynch Capital Corporation and acquired control of SCM. Hanson's success resulted from an innovative strategy. In response to SCM defensive tactics, Hanson terminated its tender offer and within hours purchased 24% of SCM's outstanding shares from seven large shareholders. With these purchases, Hanson doomed Merrill's hope of acquiring control and effectively ended the contest.<sup>188</sup>

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<sup>184</sup> *Id.* at 950-52.

<sup>185</sup> *Id.* at 947.

<sup>186</sup> The Ninth Circuit has often adopted novel interpretations of the federal securities laws. For example, the court has used a risk capital analysis in defining the term "security" rather than the more conventional *Howey* test. See *Simon Oil Co. v. Norman*, 789 F.2d 780, 781-82 (9th Cir. 1986). The Supreme Court has also reversed the Ninth Circuit in a number of recent securities cases. See *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985); *SEC v. O'Brien, Inc.*, 467 U.S. 735 (1984); *Transamerica Mortgage Advisors v. Lewis*, 444 U.S. 11 (1979).

<sup>187</sup> *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985).

<sup>188</sup> *Id.* at 51-53. Hanson still had to overcome a variety of anti-takeover tactics implemented by SCM, including a lockup option for the company's crown jewels. *Id.* at 51-52.



To some degree, Hanson's massive acquisitions resembled the purchases upheld by the Ninth Circuit in *Carter Hawley Hale*.<sup>189</sup> Hanson purchased a large number of shares in a short period of time and acted out of desperation. Nevertheless, the purchases differed in a number of significant respects. Foremost, Hanson was not a target, but a bidder. Rather than using the purchases to fend off a hostile offer, Hanson used the purchases affirmatively to gain an insurmountable advantage in a control contest. Perhaps more important, Hanson took advantage of an ownership configuration that it had created. The Hanson tender offer caused the shares to become concentrated in the hands of seven large investors.

SCM challenged the purchases. On appeal, the Second Circuit requested the Commission's views. In an amicus brief, the Commission weakly argued that the Hanson purchases constituted an unconventional tender offer.<sup>190</sup> The Second Circuit not only rejected the Commission's reasoning, but disparaged the whole concept of an eight-factor test.<sup>191</sup> Instead, borrowing from section 4(2) of the Securities Act of 1933,<sup>192</sup> the Second Circuit looked to the purchasers' sophistication and their need for protection of the Williams Act.<sup>193</sup> Concluding that sophisticated arbitrageurs had no such need, the court refused to characterize the purchases as a tender offer subject to section 14(d).<sup>194</sup>

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<sup>189</sup> See *supra* notes 180-86 and accompanying text.

<sup>190</sup> Amicus Brief of the Securities & Exchange Commission, *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985).

<sup>191</sup> *Hanson*, 774 F.2d at 57.

<sup>192</sup> 15 U.S.C. § 77(d) (1982).

<sup>193</sup> *Hanson*, 774 F.2d at 57. The court borrowed this standard from the Supreme Court's definition of a private placement. See *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124-25 (1953). In some respects, *Hanson* and *Carter Hawley* were consistent with prior decisions. In general, the earlier cases routinely declined to characterize large scale purchases *after* an announced takeover attempt as an unconventional tender offer. Courts treated only large scale acquisitions in a market not first conditioned by a tender offer as tender offers. See *Ludlow Corp. v. Tyco Laboratories*, 529 F. Supp. 62, 67-68 (D. Mass. 1981); *LTV Corp. v. Grumman Corp.*, 526 F. Supp. 106, 109-10 (E.D.N.Y. 1981); *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773, 789-90 (S.D.N.Y. 1979); *Calumet Indus. v. MacClure*, 464 F. Supp. 19, 29 (N.D. Ill. 1978); *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 449 F. Supp. 951, 961 (S.D.N.Y. 1978); *Macke Co. v. Allegheny Beverage Corp.*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,612, at 98,290 (D.D.C. 1980); *Water & Wall Assoc. v. American Consumer Indus.*, [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,943, at 93,759 (D.N.J. 1973).

<sup>194</sup> The court's relatively harsh criticism of the eight-factor test seems disingenuous given the opinion's remaining analysis. In determining when shareholders require the

Read together, *Hanson* and *Carter Hawley Hale* removed the restraints on rapid, large scale, open market purchases following a tender offer.<sup>195</sup> Market sweeps then became an additional tactic in the repertoire of bidders, issuers, and third parties. Predictably, market sweeps began to occur with frequency.<sup>196</sup>

### B. The Tendering Process

At about the same time the legal restraints on sweeps unraveled, the process of tendering and withdrawing shares entered the electronic age. The prospect of sweeps meant that investors might have to sell shares at a moment's notice. Unlimited withdrawal rights theoretically enabled investors to regain their shares and to participate in a sweep at any time. Yet, if the mechanical process of withdrawing resulted in untoward delay, the propitious moment might pass.

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protections of the Williams Act, the Second Circuit applied many of the elements propounded by the Commission. *Hanson*, 774 F.2d at 57-58. Thus, although somewhat repackaged, the *Hanson* test seems to alter the analysis minimally.

In the aftermath of *Hanson*, the Williams Act clearly does not prevent bidders from taking advantage of a market configuration that they created. An offer commenced solely to centralize stock ownership and to permit a sweep represents a significant exception. Under such circumstances, the tender offer documents would be fraudulent for failing to disclose that the bidder never intended to complete the offer. *See Stern v. Leucadia Nat'l Corp.*, 844 F.2d 997 (2d Cir. 1988), *cert. denied*, 109 S. Ct. 137 (1988).

<sup>195</sup> The unconventional tender offer doctrine arguably continues to retain some vitality, but only in particular circumstances. Attempts to acquire large or controlling blocks of shares *before* an offer occurs may involve a sufficiently widespread solicitation. *See Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983) (purchasing 34% of target shares from 30-40 investors). *Carter Hawley* and *Hanson* stand for the proposition that large scale purchases from a small number of shareholders does not constitute a tender offer. But for the volatile environment of a hostile acquisition attempt, little room exists to dispute the dispositions of these cases. Although, the Second Circuit's reasoning is clearly suspect. Purchasing control of a family controlled business by acquiring the holdings of a small number of family members would not constitute a tender offer, even absent the judicial wisdom of *Carter Hawley* and *Hanson*.

<sup>196</sup> *See Crown Zellerbach Corp. v. Goldsmith*, 609 F. Supp. 187, 188 (S.D.N.Y. 1985) (terminating offer on April 26 and acquiring 10.6% of Crown Zellerbach on May 7 and 8). The use of street sweeps may become widespread. *See Datapoint Corp. Chairman Buys 30% of Its Stock*, Wall. St. J., Sept. 13, 1989, at A4, col. 4 (following proxy contest's disclosure, company's chairman purchased 30% of company's shares in open market over two-day period); *Black & Decker Rejects Limits on Tender Offer*, Wall St. J., Mar. 14, 1988, at 6, col. 1 (reporting Black & Decker's refusal to forego possible market sweep as condition to receiving nonpublic information from target of hostile takeover).

Until recently, tendering often entailed physical delivery of a certificate to the bidder's agent.<sup>197</sup> The agent remained available to receive shares throughout the offering period.<sup>198</sup> Ordinarily, a tendering shareholder delivered a letter of transmittal and an endorsed stock certificate to the agent.<sup>199</sup> If the tendering shareholder could not obtain the certificate, the shareholder could tender through a "guarantee of delivery," if authorized by the offer's terms. This guarantee obligated the shareholder to provide the certificate within a specified time.<sup>200</sup> To withdraw shares, shareholders sent the agent appropriate instructions and retrieved the certificate.

The need to deliver certificates often engendered delays, particularly for less sophisticated shareholders.<sup>201</sup> Shareholders with street name accounts did not have certificates. Certificates might be lost, misplaced, or located in inconvenient locations. As the Commission explained, "a security holder who decides at the last minute to tender — or even a security holder who decides to tender by guarantee of subsequent delivery — may be unable to accomplish timely delivery of physical certificates to the bidder."<sup>202</sup>

Delivery and retrieval of the certificate made rapid action more difficult. To participate in a sweep, tendering shareholders had to learn of the purchase program, make the decision to sell the shares, and with-

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<sup>197</sup> The agent also accepts payment for shares from the bidder and distributes the funds to tendering shareholders. *See* Exchange Act Release No. 19678, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,340, at 85,876 n.13 (Apr. 15, 1983). Absent indemnification or other protection, the offeror's agent may incur liability for incorrectly prorating shares. *See* First Jersey Nat'l Bank v. Dome Petroleum Ltd., 723 F.2d 335 (3d Cir. 1983).

<sup>198</sup> During the offer, bidders must be prepared at all times to accept shares. *See* Exchange Act Release No. 16623, *supra* note 38.

<sup>199</sup> The transmittal letter accepts the offer and designates the bidder's agent to hold the shares. Exchange Act Release No. 19678, *supra* note 197, at 85,877 n.19.

<sup>200</sup> The shareholder must usually deliver the certificate within eight business days. *Id.* at 85,878 n.21. Bidders often limited the use of guarantees to large institutional investors. Individual shareholders still had to present certificates.

The ability to submit guarantees of delivery instead of actual certificates resulted in short-tendering, a practice ultimately prohibited. *See* Exchange Act Release No. 8321, [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,558 (May 28, 1968); *see also* Exchange Act Release No. 8224, [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,515 (Jan. 3, 1968) (declaring short-tendering a "manipulative or deceptive device" in violation of Exchange Act).

<sup>201</sup> *See* Bebhuk, *supra* note 161, at 1734 (noting ability of market professionals to deliver share certificates within hours, whereas unsophisticated investors need substantial time).

<sup>202</sup> Exchange Act Release No. 19678, *supra* note 197, at 85,878.

draw the certificate from the bidder for delivery to the purchaser. With sweeps lasting days, hours, or even minutes, the delay engendered by the certificate's retrieval could make participation impossible.

By the 1970s, a more rapid means of tendering and retrieving shares emerged. In the aftermath of the paperwork crisis of the late 1960s, Congress and the Commission embarked on a concerted effort to facilitate the stock transfer process through the creation of a national system of clearance. This system employs central depositories to hold shares for brokers, banks, and other participants.<sup>203</sup> With certificates immobilized in depositories, shareholders could transfer the shares by book entry.

Depositories developed "voluntary offering programs" to permit electronic tendering and withdrawing of shares. Shareholders with street name or nominee accounts instructed depositories to tender. Participants submitted the instructions to the bidder's agent. Participants could submit instructions until shortly before the offer closed. The registered depository then transferred the requisite number of shares to the account of the bidder's agent. Agents must have an account with any depository using a voluntary offering program.<sup>204</sup>

Thus, shareholders could withdraw shares at any time during the offering period by submitting appropriate instructions to a participant prior to the offering period's expiration.<sup>205</sup> For shares tendered electronically, the bidder's agent need only instruct the appropriate depository to recredit the withdrawn shares to the shareholder's account.<sup>206</sup>

Electronic transfer removed the last disincentive to early tendering. While unlimited withdrawal rights removed the legal impediments to tendering at an offer's inception, shareholders might still delay until the last minute if shareholders could not withdraw shares in a timely fashion. The growth of voluntary offering programs eliminated this concern.

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<sup>203</sup> See Brown, *The Shareholder Communication Rules and the Securities & Exchange Commission: An Exercise in Regulatory Utility or Futility?*, 13 J. CORP. L. 683 (1988).

<sup>204</sup> To encourage use of registered depositories, agents designated by the bidder must set up specific accounts with registered securities depositories within two business days of the offer's commencement. See rule 17Ad-14(a), 17 C.F.R. § 240.17Ad-14(a) (1988).

<sup>205</sup> See Exchange Act Release No. 20581, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,480, at 86,548 n.24 (Jan. 19, 1984).

<sup>206</sup> A participant must submit instructions to withdraw directly to the agent, not to the depository that tendered the shares.

### C. Case Study: Allied/Campeau

Campeau Corporation's efforts to acquire Allied Stores illustrate the instability and increased fluidity caused by unlimited withdrawal rights. Campeau Corporation, a large real estate development company headquartered in Canada, sought to expand into the United States. Campeau focused on Allied Stores, a retailer that owned such august lines as Brooks Brothers and Ann Taylor. After unsuccessful attempts to negotiate a friendly acquisition, Campeau launched a hostile offer for 30 million shares, or about 55% of the outstanding shares, at a cash price of \$58.<sup>207</sup> The offer indicated that Campeau would exchange the remaining shares for cash and securities worth an identical amount. Announced on September 12, 1986, Campeau provided for an expiration date of October 9.<sup>208</sup>

Twelve days later, the battle lines formed. Allied filed a Schedule 14D-9 recommending that shareholders reject the Campeau offer. Allied also disclosed its intention to explore alternatives to the offer, including possible business combinations with other companies. On September 25, Allied's management met with officials of the Edward J. DeBartolo Corporation to discuss the sale of six shopping centers.<sup>209</sup>

Shortly thereafter, Campeau amended its offer, increasing the price to \$66 and the number of shares to 80%.<sup>210</sup> In response, Allied and DeBartolo broadened the negotiations from the sale of shopping centers to a possible white knight offer for the entire company.<sup>211</sup> DeBartolo ultimately agreed to make an offer of \$67 for all Allied shares in return for a "break-up" fee of \$100 million, plus expenses, if the offer failed. On October 7, ASC Acquisition Corporation, a company owned 90% by DeBartolo and 10% by Paul Blizerian, announced the offer and set the expiration date for November 7.<sup>212</sup>

Confronted with the more lucrative competing offer, Campeau responded with a promise to pay a \$2-to-\$3 dividend on any unpurchased

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<sup>207</sup> *In re Allied Stores Corp.*, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,142, at 88,764 (June 29, 1987).

<sup>208</sup> *Id.*

<sup>209</sup> *Id.* The Wall Street Journal described DeBartolo as "the nation's largest shopping mall developer." *Allied Stores Corp. to be Acquired by DeBartolo for \$3.25 Billion*, Wall St. J., Oct. 8, 1986, at 5, col. 1.

<sup>210</sup> See *Allied Stores Studies Offer*, N.Y. Times, Oct. 6, 1986, at D10, col. 6.

<sup>211</sup> Allied never amended its Schedule 14D-9 to disclose the commencement of negotiations. The Commission sanctioned Allied for this failure. See *In re Allied Stores*, *supra* note 207, at 86,764-65. The Commission also attempted to sanction the attorney responsible for the failure. *Id.*

<sup>212</sup> See *New Offer Accepted by Allied*, N.Y. Times, Oct. 8, 1986, at D1, col. 6.

shares. The dividend would allow Campeau to use Allied's treasury to pay more for the remaining shares.<sup>213</sup> The strategy backfired. In subsequent litigation, the district court agreed that the dividend amounted to an increase in consideration and required Campeau to extend the offering period ten additional days, which extended withdrawal rights ten more days.<sup>214</sup>

Besides the extension and the white knight bid by DeBartolo, Campeau confronted another hurdle. Allied had adopted a shareholders rights plan, more colloquially known as a poison pill. The plan gave shareholders the right to exchange common stock for one year notes with a face value of \$67 and a 12% interest rate. A type of fair price provision, this plan effectively required bidders to pay Allied shareholders at least \$67 for each share.<sup>215</sup>

Campeau challenged the plan by asserting that it constituted an illegal tender offer.<sup>216</sup> On October 23, the district court declined to enjoin the plan. Confronted with a white knight and a poison pill, Campeau appeared to have lost the struggle.<sup>217</sup> The defeat meant that investors would likely withdraw shares from the Campeau offer.<sup>218</sup>

The next day, at 8:50 a.m., Campeau terminated its tender offer and, within thirty minutes, purchased 25.8 million shares from Jefferies & Company at a cash price of \$67. The purchases gave Campeau over

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<sup>213</sup> See *Campeau's Allied Bid Delayed by Court After It Offers a Dividend "Inducement,"* Wall St. J., Oct. 13, 1986, at 2, col. 2.

<sup>214</sup> Campeau announced the dividend on Friday morning. The court ordered a 10-day extension of the offering period that same day. *Id.* During the day, shareholders tendered 34.5 million shares, representing 73% of the outstanding shares. In explaining the large number of tendered shares, one investment banker stated that "withdrawal rights are such that shareholders can take back shares any time in the next ten days." *Id.* By October 15, shareholders tendered 38.2 million or 81% of the outstanding shares. *Campeau Warns Allied of Auction to Further Its Bid*, Wall. St. J., Oct. 16, 1986, at 45, col. 1.

<sup>215</sup> See *Campeau's Allied Bid Delayed by Court After It Offers a Dividend "Inducement,"* *supra* note 213.

<sup>216</sup> See *Campeau Sweetens Bid for Allied Stores, Files Suit to Block Target's "Poison Pill,"* Wall St. J., Oct. 21, 1986, at 10, col. 1.

<sup>217</sup> See *Allied Stores Corp. to be Acquired by DeBartolo for \$3.25 Billion*, *supra* note 209 (reporting analysts' conclusion that Campeau's offer "doomed from the start").

<sup>218</sup> Dixons Group faced a similar situation in its battle to acquire Cyclops Corporation. In the wake of a higher, competing offer, over half of the tendered shares withdrew in a single day. See *Dixons Group Bid for Cyclops May Founder*, N.Y. Times, Mar. 26, 1987, at D19, col. 4. Aware of a lost contest, Dixons Group resorted to a sweep. See *Dixons Offer Wins Cyclops*, N.Y. Times, Mar. 28, 1987, at 45, col. 2.

50% of Allied's outstanding shares.<sup>219</sup> With a single purchase, Campeau vanquished all opposition and acquired control. A week later, Allied's management, bowing to the inevitable, entered into a merger agreement with Campeau.<sup>220</sup> The acquisition of 25 million shares proved outcome-determinative.<sup>221</sup>

This contest illustrates the impact of unlimited withdrawal rights. First, no longer concerned that the withdrawal period might expire and trap tendered shares, Allied shareholders tendered early. Published reports indicated that Allied shareholders tendered a substantial percentage of shares to Campeau prior to the offer's closing.<sup>222</sup>

By tendering early, shareholders indicated that a majority of shares were liquid. Tendering early also indicated to Allied that Campeau would win the contest absent a defensive strategy predicated on increased share prices.<sup>223</sup> That information influenced Allied's defensive strategies. Allied realized, from the number of shares tendered, that its

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<sup>219</sup> See *Judge to Rule on Acquisition of Allied Stake*, Wall St. J., Oct. 27, 1986, at 3, col. 1. Campeau had threatened to use a sweep a week earlier. See *Campeau Warns Allied of Action to Further Its Bid*, *supra* note 214.

<sup>220</sup> See *Allied Stores to be Bought by Campeau*, Wall St. J., Nov. 3, 1986, at 3, col. 1.

<sup>221</sup> The sweep of Allied shares illustrates the potential harm to less sophisticated shareholders. At least in *Carter Hawley*, the purchases occurred over eight trading days, allowing smaller shareholders some opportunity to participate. See *supra* notes 180-86. *Hanson* involved purchases over a period of hours. See *supra* notes 187-94. However, Jefferies assembled the block in advance. Only shareholders learning of the block's formation could participate.

<sup>222</sup> See *supra* note 214.

<sup>223</sup> Jefferies' activities warrant examination. According to Allied, Jefferies acted as Campeau's agent. If true, Campeau violated rule 10b-13, and Jefferies likely aided and abetted the violation. Nonetheless, some facts suggest that Jefferies played a more independent role. First, a broker had also offered the shares to Acquisition Corp. Second, Jefferies did not need to obtain an agreement in violation of the securities laws. With no funds actually committed to the purchase of shares, Jefferies had little at risk if it did not sell the block. Moreover, once assembled, shopping the shares by contacting participants accomplished most of what would have resulted from direct negotiations.

Section 13(d) represented the only possible violation. A Schedule 13D must be filed upon the acquisition of more than 5% of a publicly traded company's equity securities. In computing the threshold, shares beneficially owned are included. Shares are beneficially owned if the holder has *either* the power to vote or to invest the shares. See rule 13(d)(3), 17 C.F.R. § 240.13d-3 (1988). Jefferies did not own the shares. Nevertheless, Jefferies may have had authority to commit shares above a certain price level. Moreover, Jefferies apparently had sufficient investment control to negotiate terms of the sale. For example, Jefferies agreed, on behalf of shareholders, to pro rate the shares sold to Campeau.

shareholders intended to take advantage of Campeau's hefty premium offer. Given the obvious predisposition of shareholders to sell, Allied realized that continued independence no longer presented a viable option. Only a competing offer at a high price offered much chance of success. As a result, Allied shifted the negotiations with DeBartolo from a sale of some assets to a sale of the entire company.

Tendering early also provided Campeau with the identity of shareholders willing to sell. Because of rule 10b-13, Campeau could not directly negotiate with shareholders during the offer's pendency.<sup>224</sup> Jefferies, however, did not operate under similar constraints. Over a seven-week period, Jefferies approached a number of shareholders about the possible sale of Allied stock.<sup>225</sup> The large number of tendered shares indicated the viability of assembling a block. Moreover, by tendering early, investors gave Jefferies early notice of the share's liquidity, which provided additional time to assemble the block.

Published reports do not clarify how Jefferies learned the identity of the shareholders that Jefferies contacted. Jefferies may have known some through filings with the Commission. Others may have contacted Jefferies after learning about brokers' efforts to assemble a block. Although no reports indicate that Campeau provided a list of tendering shareholders, without a doubt, such a list would have facilitated Jefferies' task. Moreover, as long as Jefferies did not act as an agent for Campeau, simply providing a list would not appear to violate the securities laws.<sup>226</sup>

In addition to facilitating the sweep, unlimited withdrawal rights encouraged Campeau to consider the sweep as a means of winning the contest.<sup>227</sup> By withdrawing late in the offering period, shareholders sent

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<sup>224</sup> See *supra* notes 164-67 and accompanying text.

<sup>225</sup> Activities such as Jefferies' enhance the ability of tender offer participants to engage in market sweeps. Jefferies identifies sellers, assembles the block, and determines the sale price. Furthermore, third parties can assemble blocks with relative ease. Assuming the proposed sale price is at or above the highest offering price, arbitrageurs and other sophisticated investors have incentive to join. Moreover, even if not contacted directly, shareholders, now aware of the likelihood of a block's assembly, may contact Jefferies. Campeau's purchases did not represent the first block accumulated by Jefferies. Jefferies had sold a block of 14 million shares of NL Industries to Harold Simmons following Simmons' termination of a tender offer. This acquisition enabled Simmons to acquire control of NL Industries. Jefferies also put together the block of shares purchased by Dixons Group in acquiring control of Cyclops Corp. See Ryngeart, Netter, & Malmquist, *Shareholder Welfare and Substantial Share Acquisitions Outside of the Williams Act*, 1988 COLUM. BUS. L. REV. 505, 525.

<sup>226</sup> See *supra* note 223.

<sup>227</sup> Ironically, sweeps added new vitality to some defensive tactics used by target



Campeau a message that it was losing the struggle. On the last day of the offering period, reports indicated that shares flowed out of the Campeau offer.<sup>228</sup> An increase in consideration might have stemmed the outflow, but also would have resulted in an additional ten-day withdrawal period. The prospect of an improved offer from DeBartolo and increased withdrawals influenced Campeau to drop the tender offer in favor of a sweep.

#### D. Commission Reaction: Rule 14d-11

The decisions in *Hanson*<sup>229</sup> and *Carter Hawley*<sup>230</sup> left the Commission in a quandary. While the Commission did not foreclose litigating the issue,<sup>231</sup> the defeats before the Second and Ninth Circuits suggested decreasing odds of success.<sup>232</sup> Still concerned, but lacking the means to stop sweeps, the Commission issued a "concept" release requesting comments on a possible ban of sweeps.<sup>233</sup> The issuance of a concept

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companies. In responding to hostile offers, management may only adopt defensive tactics "reasonable in relation to the threat posed." *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985). Targets may justify poison pills when designed to stop coercive, two-tier offers. *See A. Copeland Enters. v. Guste*, 706 F. Supp. 1283 (W.D. Tex. 1989). Courts could characterize poison pills as a reasonable response to possible street sweeps. *See CRTF Corp. v. Federated Dep't Stores*, 683 F. Supp. 422, 440 (S.D.N.Y. 1988) (upholding poison pill as means of preventing sweep). Irving Trust apparently justified the adoption of a poison pill as a means of preventing a street sweep by Bank of New York. *See Arky, Defensive Moves*, CRAIN'S N.Y. BUS., Apr. 4, 1988, at 21. Accordingly, a target may adopt a pill when confronted with a noncoercive, all cash offer because some risk of termination followed by a sweep always exists. Courts should also treat other defensive tactics triggered by large scale acquisitions as valid methods of preventing sweeps.

<sup>228</sup> The depository bank and, presumably, the bidder know the number of shares tendered. Market participants also learn this not otherwise public information. *See Tenders for Grand Met's Pillsbury Bid on "Upswing" in Hours Before Deadline*, Wall St. J., Nov. 9, 1988, at A3, col. 2.

<sup>229</sup> *See supra* notes 187-94 and accompanying text.

<sup>230</sup> *See supra* notes 180-86 and accompanying text.

<sup>231</sup> The Commission authorized the filing of a brief in the Allied case. *See Memorandum to Goelzer, Gonson, Stillman and Fienberg*, from Jonathan G. Katz, Secretary, Securities & Exchange Commission (Oct. 28, 1986) (obtained under FOIA and on file at U.C. Davis Law Review). The Commission would argue that Campeau's massive purchases of Allied stock violated the Williams Act. *See Campeau Can Buy Allied Shares*, N.Y. Times, Oct. 31, 1986, at D5, col. 6. Apparently, attempting to avoid the discredited eight-factor test, the Commission intended to argue that the purchases constituted a de facto continuation of the initial offer. *Id.*

<sup>232</sup> In the three-year period since *Hanson*, the Commission has never resorted to the eight-factor test to challenge sweeps.

<sup>233</sup> *See Exchange Act Release No. 23486*, [1986-1987 Transfer Binder] Fed. Sec. L.

release in no way presaged additional Commission action. Concept releases often generate no subsequent action and simply wither on the vine.

Nevertheless, concept releases serve a function. They place the market on notice of Commission concern over particular activity. Absent voluntary corrective action, a concept release carries the implicit threat that the Commission may resort to more coercive measures, such as rulemaking proceedings. The concept release on market sweeps, however, did not have a sedating influence on target and bidder practices. In particular, the acquisition by Campeau demonstrated that voluntary restraint would not work in the case of sweeps. Campeau's purchases provided the additional incentive for a rule proposal to regulate sweeps.

Campeau's purchases raised particularly troubling concerns. To some degree, the purchases continued a trend started by *Hanson* and *Carter Hawley*. Yet, more accurately characterized, Campeau's acquisition represented something qualitatively different and far more ominous. Both Hanson and Carter Hawley acquired a large block of stock, which made competing offers more difficult. In neither case, however, did the companies completely foreclose additional bidding. While debates can rage over appropriate parameters, stock purchases during a hostile offer do not differ from other tactics if the purchases merely impede, rather than foreclose, future bidding.<sup>234</sup>

Campeau, however, stopped the bidding. No matter what happened subsequently, the auction for Allied ceased. Moreover, Campeau engaged in a tactic that, if implemented by a target, might have violated the board's fiduciary duty to shareholders.<sup>235</sup> Nor did Campeau's late 1986 acquisitions prove an isolated example. In early 1987, the Dixon

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Rep. (CCH) ¶ 84,018 (July 11, 1986). Twenty-three commentators addressed sweeps. Thirteen favored regulation, while five registered opposition. Summary of Comments Relating to Takeovers and Contests for Corporate Control, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,112 (Mar. 1987). The concept release also sought comments on a self-governance exception to the all-holders rule and on possible federal regulation of poison pills. The Commission took no action on either of the latter two proposals.

<sup>234</sup> See generally Bradley & Rosenzweig, *Defensive Stock Repurchases*, 99 HARV. L. REV. 1378 (1986) (proposing retention of target authority to self-tender when other tactics fail to prevent outside bidders from tendering to target).

<sup>235</sup> Once an auction market begins, management has a fiduciary obligation to obtain the best possible price for shareholders. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). A target company cannot adopt defensive tactics that arbitrarily stop bidding or favor a particular side in the contest. See *Hanson Trust PLC v. SCM Acquisition*, 781 F.2d 264 (2d Cir. 1986); *CRTF Corp. v. Federated Dep't Stores*, 683 F. Supp. 422 (S.D.N.Y. 1988).

Group purchased 60% of Cyclops Corporation stock in a single acquisition. Paul Blizerian attempted to purchase 41% of Pay-N-Pack Stores in the summer of 1987. Finally, Consolidated Gold Mines acquired about 25% of Newmont Mines shares in late 1987.<sup>236</sup>

The Commission responded to the increasing use of market sweeps by proposing rule 14d-11.<sup>237</sup> The rule sought to regulate large scale purchases in a market sensitized by an existing tender offer.<sup>238</sup> Following an offer's commencement, no one could directly or indirectly acquire more than 10% of a target's shares except by means of a tender offer. With respect to initial bidders, the 10% restriction continued for thirty business days after the offer's termination. By requiring the use of tender offers and prohibiting sweeps, all bidders would operate under the same set of rules. Shareholders would have a grace period to consider each offer.<sup>239</sup>

The proposed rule placed bidders at a decided disadvantage. Once an offer triggered the rule, a putative bidder could purchase 10% in the market and make an offer for the remainder. If the putative bidder already owned a large number of shares, the 10% increase might prove outcome-determinative. The initial bidder, however, could not engage in similar purchases as long as rule 10b-13<sup>240</sup> remained in effect. Per-

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<sup>236</sup> See *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1337 (Del. 1987).

<sup>237</sup> Exchange Act Release No. 24976, *supra* note 34. Although not expressly designed to tackle market sweeps, prior Commission rulemaking initiatives, if adopted, would have effectively outlawed sweeps. See Exchange Act Release No. 16385, *supra* note 147 (defining tender offer to include purchases of 5% of class of securities within 45-day period).

<sup>238</sup> In fairness, Commission rulemaking endeavors often occur after considerable soulsearching and opportunity for state courts to ameliorate the abuse. See *supra* note 147. While sweeps might not contravene the federal securities laws, state fiduciary law principles provided an independent avenue to limit the practice. In *Ivanhoe Partners*, 535 A.2d 1334, however, the Delaware courts sustained the use of sweeps. *Ivanhoe*, a partnership controlled by Mesa Petroleum and Boone Pickens, made a tender offer for Newmont Mining Corp. To defeat the offer, Consolidated Gold Fields acquired 26% of Newmont's outstanding shares. This acquisition increased its interest to 40% and effectively defeated a hostile tender offer. *Ivanhoe* argued that the sweep breached the fiduciary duty owed by Newmont and Consolidated to the remaining shareholders. *Id.* at 1343. The court rejected the argument, noting that the sweep represented a reasonable response to the threat posed. *Id.* at 1344. With respect to Consolidated, the court rejected the argument that a fiduciary relationship existed. *Id.*

<sup>239</sup> For a more detailed summary of the proposed rule's mechanics, see Comment, *Proposed SEC Regulation of Market Sweeps: Should Market Sweeps be Governed by the Williams Act?*, 56 *FORD. L. REV.* 797 (1987).

<sup>240</sup> See *supra* notes 164-67 and accompanying text.

haps recognizing this issue, the proposed rule requested comments on the "advisability of integrating" rule 10b-13 and proposed rule 14d-11.<sup>241</sup>

Thus, the extension of withdrawal rights facilitated sweeps. The increased use of sweeps triggered a Commission rule proposal to restrict sweeps. Whether the Commission will adopt the rule remains unclear. Nevertheless, the market forces unleashed by unlimited withdrawal rights continue unchecked.<sup>242</sup>

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<sup>241</sup> Exchange Act Release No. 24976, *supra* note 34.

<sup>242</sup> The proposed rule caused dissension among the Commission staff. *See* Exchange Act Release No. 24976, *supra* note 34. Although widely supported by the staff, the Office of Economic Analysis (OCE) strongly opposed the proposal. OCE put forth two primary arguments. First, OCE questioned whether sweeps harmed nonparticipating shareholders. Second, OCE argued that companies could prevent or minimize sweeps and the alleged harm resulting from sweeps by adopting appropriate defensive tactics or charter amendments.

Contrary to OCE's conclusion, sweeps do harm nontendering shareholders. In a number of cases, these shareholders either saw share values drop dramatically in a sweep's aftermath or had the shares purchased in a second-step acquisition at a lower price. Moreover, while the number of sweeps may provide insufficient data for reliable, empirically based conclusions, once a sweep succeeds, nonparticipating shareholders run the risk of an inferior, second-step acquisition.

The suggestion that defensive tactics can prevent sweeps embodies much irony. OCE has previously opposed the use of defensive tactics and has attempted to document their adverse impact on shareholders. OCE now employs reasoning that promotes the use of such defensive tactics.

More to the point, the analysis is faulty. Unquestionably, some defensive tactics can impede sweeps. Courts have sustained various tactics as necessary to prevent sweeps. *See* CRTF Corp. v. Federated Dep't Stores, 683 F. Supp. 422 (S.D.N.Y. 1988). Yet, unless OCE believes that publicly traded companies adopt defensive tactics long before a hostile offer, inadequate time often exists to implement appropriate tactics. A sweep may occur before a board has time to devise appropriate tactics. In the face of a clearly inadequate bid, a board may not implement draconian defenses, but may still confront a sweep from a putative bidder. Moreover, given the need to act quickly, a board confronting a hostile offer will almost certainly employ tactics that do not require shareholder approval or action. Issuers often use poison pills to prevent coercive, two-tier offers. *See, e.g.,* Desert Partners, L.P. v. USG Corp., 686 F. Supp. 1289 (N.D. Ill. 1988) (allowing use of poison pill in defense of coercive, two-tier tender offer). A profusion of poison pills may result. Indeed, prudence would seem to dictate that all companies adopt poison pills. Even in the face of an adequate cash offer for all shares, a target may justify a pill as necessary to prevent sweeps by the initial bidder and by any putative bidder. OCE never considered whether the cure of encouraging poison pills would outweigh any harm from an antisweep rule.

### E. Tactical Implications

Unlimited withdrawal rights raise a host of tactical concerns. Extended withdrawal rights render an offer's success more uncertain.<sup>243</sup> Participants will not know the number of shares that can be acquired until the offer terminates. Any extension of the offering period adds uncertainty to the acquisition process by providing shareholders with additional opportunity to withdraw. This uncertainty induces bidders to devise tactics which minimize withdrawal rights.

The possibility of additional withdrawal rights occurs anytime a bidder contemplates a material change in the offer. Material changes trigger mandatory extensions in the offering period which, concomitantly, trigger additional withdrawal rights. Bidders changing the number of shares sought, the consideration for tendered shares, or the financing terms, confront the risk of mandatory five- or ten-day extensions of the offering period and the threat that shareholders will withdraw tendered shares.<sup>244</sup>

Bidders can obviate this uncertainty and minimize withdrawal rights in at least one of two ways. A bidder with an insufficient number of shares on the last day of an offering period might terminate the offer and engage in a sweep. Sweeps avoid all of the Williams Act's substan-

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<sup>243</sup> See *infra* notes 244-49 & 275-78 and accompanying text.

<sup>244</sup> The Commission requires a mandatory extension of the offering period anytime a material change in the offer's terms occurs. "Rule 14d-4(c) requires that a tender offeror generally provide a minimum of five business days, and under certain circumstances ten days or more, in which shareholders can consider new material information." Letter from Daniel L. Goelzer, General Counsel, Securities & Exchange Commission, to the Honorable Leonard B. Sand, United States District Court, Southern District of New York (Mar. 28, 1988), *reprinted in* [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,224, at 89,024 [hereafter Goelzer Letter]. When a bidder makes substantial changes, some have unsuccessfully argued that a new offer occurred, which requires a 20-day offering period. See *supra* note 39; see also Exchange Act Release No. 22791, *supra* note 36. The Commission maintains that 10 days provide sufficient time for investors to evaluate a decrease in securities sought and rejects the argument that this change constitutes a new tender offer. *Id.* at 87,982. The Commission originally asserted that a decrease in the number of shares sought constituted a new offer. See Exchange Act Release No. 22198, *supra* note 6, at 87,563 n.16.

Difficulty in obtaining financing may also cause an extension in the offering period, thereby providing additional opportunity to withdraw. For example, on October 9, 1987, Asher Edelman made a tender offer for Telex Corp. The offer was to expire on November 4: Although no competing offer for Telex appeared, and incumbent management remained neutral, Edelman extended the offer when financing proved difficult to obtain. As a result, management had time to develop a competing recapitalization plan and to find a white knight. See *Solash v. Telex Corp.*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608 (Del. 1988).

tive protections, including the rights to withdraw and to equal consideration.<sup>245</sup> Additionally, sweeps provide certainty. A bidder need not wait until an offer's waning minutes to determine the number of shares acquired.

Sweeps, however, have drawbacks. Costs become significant. A bidder must have sufficient cash available to purchase a sizeable block of the target's stock.<sup>246</sup> Essentially, sweeps remain a viable tactic only for those bidders sufficiently flush to have firm financing in place.

Avoiding material changes in an existing offer affords an alternate, cheaper method of minimizing withdrawal rights. Bidders could simply complete an existing offer, purchase all tendered shares, and immediately make a second offer at a higher price.<sup>247</sup> This strategy would eliminate the risk of withdrawal and would avoid the requirement that tendering shareholders receive any subsequent increase in consideration.<sup>248</sup> By not paying the increase to those tendering in the first offer, the bidder could pay an even higher premium in the second offer. This premium would entice more shareholders to sell, thereby foreclosing other bidders.<sup>249</sup>

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<sup>245</sup> Under rule 14d-10, bidders must pay all tendering shareholders substantially identical consideration. *See* rule 14d-10, 17 C.F.R. § 240.14d-10 (1988); *see also* rule 13e-4, 17 C.F.R. § 240-13e-4 (1988). The requirement applies to shares purchased in a tender offer, but does not apply to open market purchases. Therefore, bidders engaging in sweeps need not pay identical consideration. Indeed, bidders have incentive to avoid paying identical consideration. To the extent the eight-factor test remains viable, fixed terms satisfy one factor indicating a tender offer. *See supra* note 175. Moreover, the ability to vary the price may prove advantageous. Once it appears that a sweep will result in a change-of-control, the pressure to sell increases. Shareholders know that the failure to participate in the sweep may result in significantly less advantageous terms in a second-step merger. This pressure allows bidders to purchase shares of late sellers at lower prices than that paid to those selling at the sweep's commencement.

<sup>246</sup> *See, e.g., Judge Bars Campeau's Allied Step*, N.Y. Times, Oct. 25, 1986, at 33, col. 6 (noting that Campeau's sweep of Allied shares cost \$1.73 billion).

<sup>247</sup> An offer that exceeds the market price will likely attract some shares, even if not enough to acquire control. Moreover, once some shareholders tender, some shares invariably remain tendered on the closing date irrespective of market conditions. *See, e.g., Salant Acquisition Corp. v. Manhattan Indus.*, 682 F. Supp. 199, 201 (S.D.N.Y. 1988).

<sup>248</sup> The Commission has indicated some concern with this practice. *See*, Griffin & Tucker, *supra* note 103, at 704 (arguing shareholders tendering in first offer entitled to increased price in second offer). The Commission's position, however, applied to back-to-back offers. When a bidder spaced tender offers over a month, the staff did not integrate the offers and did not require the payment of any increase in consideration. *Id.* at 713. To date, no court has required payment of any increase in subsequent offers to shareholders in an initial offer.

<sup>249</sup> This practice has already begun to emerge with increased frequency. *See* Field v.

Termination of an offer followed by another offer in rapid succession presents some risks. The second offer would need to remain open at least twenty business days, while simply amending an existing offer requires only a ten-day extension. The longer time period provides target management with additional time to devise defensive tactics and provides putative bidders with additional time to make a competing offer.<sup>250</sup> Nonetheless, if a bidder acquires sufficient shares in the initial offer, the bidder will have obtained a blocking position, making the contest unattractive for others to enter.<sup>251</sup> Similarly, a blocking position may cause target's management to surrender and to agree to a merger.

Additional time does not represent the only risk. Shareholders tendering in the first offer might challenge the second offer as a continuation of the initial offer. If characterized as a continuation, shareholders that tendered in the original offer would acquire additional withdrawal rights and any increase in consideration paid to those tendering in the second offer.

The small number of cases that have addressed the "continuation" argument have produced mixed results.<sup>252</sup> According to the Second Circuit in *Field v. Trump*:<sup>253</sup>

[A]n announcement of a withdrawal is effective when the offeror genuinely intends to abandon the goal of the original offer. . . . [W]here the goal has not been abandoned, a purported withdrawal followed by a

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*Trump*, 850 F.2d 938, 942 (2d Cir. 1988); *Feder v. Macfadden Holdings, Inc.*, 698 F. Supp. 47 (S.D.N.Y. 1988).

<sup>250</sup> The acquisition of Fruehauf Corp. exemplifies this tactic. See *Priddy v. Edelman*, 679 F. Supp. 1425 (E.D. Mich. 1988). After purchasing Edelman's shares for cash, Merrill announced a new offer for 71% of Fruehauf's stock at a cash price of \$49.50, with all remaining shares to be purchased for an identical amount in cash or securities in a second-step merger. In rejecting the argument that Merrill's purchases violated rule 14d-10's equal price provision, the court noted that Merrill did not purchase the Edelman shares pursuant to a tender offer. Therefore, rule 14d-10 did not apply. The court refused to integrate the Edelman purchases into the subsequent offer. The court concluded that, "An offeror is free to terminate an offer and then purchase shares upon whatever other terms may be negotiated, free of the constraints of the [Williams Act]." *Id.* at 1432.

<sup>251</sup> For example, Hanson used a sweep to acquire 25% of SCM, see *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985). The purchases fell short of the amount needed to trigger exercise of lockup options, while at the same time dooming the white knight offer from Merrill Lynch.

<sup>252</sup> See, e.g., *Field v. Trump*, 850 F.2d 938 (2d Cir. 1988). The best-price provision in § 14(d)(7) and rule 14d-10 have provided the impetus for actions. Shareholders that tender in the first, inferior offer allege that courts should integrate the two offers and should award them the increase in consideration.

<sup>253</sup> 850 F.2d 938 (2d Cir. 1988).

"new" offer must be treated as a single continuing offer for purposes of the "best-price rule."<sup>254</sup>

The court indicated a number of factors to consider in resolving the issue. These factors include whether the successive offers (1) represent a single plan of acquisition, (2) involve the same security, and (3) are made at about the same time.<sup>255</sup>

If followed by other courts, the test suggests that courts will often integrate back-to-back offers. Invariably, the offers will fulfill the first two prongs. Thus, the cases will generally focus on the timing of the offers. Courts have integrated offers spaced apart by one day<sup>256</sup> and by one week.<sup>257</sup>

Nevertheless, formative and confused characterizes case law in this area. For one thing, courts completely sidestep the entire regulatory construct, something normally given considerable deference.<sup>258</sup> The tender offer rules require equal treatment of shareholders during a tender offer. Yet, nothing in the rules prohibits or discourages successive offers so long as once made, all shareholders receive equal treatment.<sup>259</sup> Indeed, the two instances in which the Commission asserted the continuation theory involved not back-to-back offers, but sweeps.<sup>260</sup> In those circumstances, shareholders received none of the Williams Act's substantive protections. In the case of successive offers, all of the protections apply.

Perhaps more important, these two instances predate the extension of withdrawal rights throughout the offering period. The extension funda-

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<sup>254</sup> *Id.* at 945.

<sup>255</sup> *Id.*; see also Moylan, *Exploring the Tender Offer Provisions of the Federal Securities Laws*, 43 GEO. WASH. L. REV. 551, 566 (1975) (arguing that integration depends on "the lapse of time between the offers, the success of the first tender offer, and the intention of the tender offeror").

<sup>256</sup> *Field*, 850 F.2d 938.

<sup>257</sup> *Feder v. Macfadden Holdings, Inc.*, 698 F. Supp. 47 (S.D.N.Y. 1988). Although the test depends on the particular facts and circumstances, a 10-business-day waiting period between offers seems sufficient. See 17 C.F.R. § 240.13e-4(f)(6) (1988).

<sup>258</sup> See *City Capital Assocs. v. Interco, Inc.*, 860 F.2d 60 (3d Cir. 1988) (giving great deference to regulatory scheme in defining "bidder").

<sup>259</sup> Rule 10b-13 illustrates the Commission's views. This rule prohibits a bidder from purchasing shares during the pendency of the offer. See rule 10b-13, 17 C.F.R. § 240.10b-13 (1988). Nevertheless, bidders may purchase shares immediately before and after the offer. The Commission seems to believe that equal treatment requires bidders to treat shareholders equally during an offer. The Commission has never looked beyond an offer's narrow confines to ensure a broader notion of equal treatment.

<sup>260</sup> See *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985); see also *supra* note 231 (describing amicus brief never filed in *Allied*).



mentally shifted the equities. Until this extension, bidders could trap shares on the fifteenth day of an offer, close an offer, make the purchases, and, in response to new developments, announce a second offer. Shareholders that tendered could not react to the changed circumstances by withdrawing shares during the offer's last five days. Thus, unfairness tainted the entire process. This type of unfairness prompted Congress to adopt section 14(d)(7).

These inequities, however, are no longer present. Shareholders may withdraw shares until the last moment. Bidders can no longer trap tendered shares during the offering period. Assuming shareholders know that a second offer may occur,<sup>261</sup> no sound reason prevents a bidder from purchasing shares in an offer and then making a second offer at a higher price to induce remaining shareholders to sell.<sup>262</sup>

Additionally, the Second Circuit's decision in *Field v. Trump* lacks consistency.<sup>263</sup> To the extent the court finds reason to integrate successive offers, the rationale would seem even more compelling to integrate pre- and post-acquisitions in the open market with a tender offer. Yet, the Second Circuit has generally refused to do so.<sup>264</sup> Finally, the court's analysis failed to address the negative implication flowing from the Commission's unsuccessful attempts to address the problem. At one time, the Commission proposed a rule designed to integrate post-acquisition purchases with an earlier tender offer.<sup>265</sup> The Commission never adopted the rule. A court could conclude that the failure to adopt the

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<sup>261</sup> This disclosure should appear in tender offer materials either to fulfill the requirements of Schedule 14D-1 or the antifraud provisions.

<sup>262</sup> This tactic resembles a Dutch auction. See *Murray v. Hospital Corp.*, 873 F.2d 972 (6th Cir. 1989).

<sup>263</sup> 850 F.2d 938 (2d Cir. 1988). The Second Circuit rejected the continuation argument in *Hanson*. See *Hanson*, 774 F.2d at 47.

<sup>264</sup> In this context, the Second Circuit generally rejects an integration argument. See *Hanson*, 774 F.2d at 60 (holding bidder may terminate tender offer and then purchase target's shares in privately negotiated transactions without violating securities laws); see also *Brill v. Burlington N., Inc.*, 590 F. Supp. 893, 898 (D. Del. 1984) (holding early termination of offer followed by new offer for fewer shares at lower price the next day not continuation of first offer). The court further held that, "The offeror, as the master of his offer, has wide latitude over the terms of the offer." *Id.*

<sup>265</sup> See Exchange Act Release No. 12676, *supra* note 88, at 86,699 (noting that purchases within 40 business days of termination by bidder or affiliate "would be integrated with and deemed a part of the tender offer"). The proposed rule prevented "the bidder from taking advantage, either directly or indirectly, of any unsettling market conditions after the termination of its tender offer." *Id.* The integration concept arose after courts refused to combine pre-tender offer acquisitions with a subsequent tender offer. See *Gulf & W. Indus. v. Great Atl. & Pac. Tea Co.*, 356 F. Supp. 1066 (S.D.N.Y. 1973), *aff'd*, 476 F.2d 687 (2d Cir. 1973); see also *Sunshine Mining Co. v.*

proposal tacitly approved the practice.<sup>266</sup>

Perhaps the most important impediment to successive offers is not

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Great W. United Corp., [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,049 (D. Idaho 1977).

<sup>266</sup> In *Unocal*, the court held that the Williams Act did not require bidders to open offers to all shareholders. In disparaging the notion of an implicit requirement of equal treatment, the court noted that the Commission had twice proposed rules prohibiting discriminatory tender offers, but had declined to do so. *See Unocal Corp. v. Pickens*, 608 F. Supp. 1081, 1082 (C.D. Cal. 1985). The unadopted rules seemed to tilt the balance in *Unocal*'s favor.

Litigants and the Commission have not yet fully developed the continuation argument. In an extreme case, the Second Circuit refused to give effect to the termination of a tender offer followed in quick succession by privately negotiated purchases and by a second offer. *Field v. Trump*, 850 F.2d 938 (2d Cir. 1988). Defendants made a tender offer for Pay 'n Save Corporation at \$22.50 per share. *Id.* at 940. Four business days after announcement, defendants terminated the offer and acquired 18.4% of the shares from dissident directors for \$25 per share. *Id.* at 941-42. The next day, defendants announced a second offer for \$23.50. *Id.* at 942. Predictably upset, shareholders filed suit alleging that the payment to dissident directors violated the best-price provision in § 14(d)(7). *Id.* at 940.

The court held that periodic withdrawals allowing purchases with a discriminatory premium and followed by new offers would subvert the best-price rule. *Id.* at 944. Therefore, the court held that the second offer constituted a continuation of the first. *Id.*

The result seems correct. Although, the holding seems narrow and the facts unusual. Note what the court did not do. First, the court did not repudiate *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985), or suggest that the continuation doctrine applied to an offer's termination followed by a sweep. Nor did the court suggest that integration applied to a terminated tender offer followed by a second offer. The court simply held that momentarily terminating a tender offer to purchase open market shares clearly trampled upon the plain intent of the Williams Act. *Field*, 850 F.2d at 943-44.

Although the court reached a seemingly fair result, the reasoning seems unpersuasive. The case does little more than utter a majestic "you cannot do that" with little support. *Trump* conformed to all of the procedural requirements, particularly rule 14d-2(b)(1), which specifically authorizes withdrawal of an offer within five business days of announcement. 17 C.F.R. § 240.14d-2(b)(1) (1988). The court seemed most concerned with the use of back-to-back offers to circumvent the requirements of § 14(d)(7). *Field*, 850 F.2d at 944.

The court's fear seems unjustified. The change-of-control process already contained sufficient impediments to make widespread use of the practice unlikely. First, a second offer would trigger a new, 20-business-day offering period. *See* rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1988). Added time works to the disadvantage of bidders by providing putative bidders with further opportunity to enter the fray and by providing management more time to implement defensive tactics. A bidder also will incur additional expenses and will confront difficulties in maintaining financing. A second offer would require additional schedules for the Commission, disclosure to shareholders, and filing fees. Attorneys, investment bankers, and other professionals would obtain added

legal, but practical. A bidder acquiring shares tendered in the first offer may end up in the uncomfortable position of minority shareholder in a company with hostile management. The second offer could prove unsuccessful, with control never obtained. The bidder would have made a substantial expenditure for a permanent minority status.

Minority status, however, does not inevitably follow from pursuing a second offer. If a competing bidder enters the fray and emerges victorious, the initial bidder can resell shares on the market at a premium.<sup>267</sup> Greenmail represents another possibility. A bidder could resell the shares to the target at a premium over the purchase price. The best, although most legally uncertain, method of minimizing the likelihood of permanent minority status would be to make payment for shares tendered in the initial offer contingent upon the second offer's success.

Closing an offer, yet delaying payment until the second offer's completion, arguably would run afoul of rule 14e-1(c).<sup>268</sup> This rule requires "prompt payment" for shares following an offer's termination. Neither the rule nor the adopting and proposing releases provide much insight into the definition of "prompt."<sup>269</sup> Moreover, in other areas, the

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fees. Third, by discouraging second offers, the court encourages sweeps as an alternative.

Trump used back-to-back offers only because he terminated the first offer within five business days of announcement. Apparently, Trump had not made any filings because the minimum offering period had not commenced. *See* rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1988) (offering period commences on date tender offer materials deemed published or sent). Had his second offer been more advanced in time, the costs and risks associated with back-to-back offers would have increased substantially.

<sup>267</sup> In competitive bidding situations, the initial bidder often loses. With similar frequency, a losing bidder that acquired significant target shares often walks away from the contest with a substantial profit. *See* Comment, *supra* note 18, at 1034-38; Gilson, *supra* note 15, at 871.

<sup>268</sup> 17 C.F.R. § 240.14e-1(c) (1988).

<sup>269</sup> In adopting rule 14e-1, the accompanying release provided only minimal guidance as to the meaning of "prompt":

The Commission recognizes that the operation of this standard will be affected by the practices of the financial community and the following factors: current settlement, handling and delivery procedures relating to tenders made by guaranteed deliveries by appropriate institutions; procedures to cure technical defects in tenders; and the application of the Hart-Scott-Rodino Antitrust Improvement Act of 1976 and the rules promulgated thereunder.

Exchange Act Release No. 16384, *supra* note 39; *see also* Zemans v. Karris, 1989 LEXIS 1492 (N.D. Ill. Feb. 15, 1989).

Few cases have addressed the meaning of "prompt." What little authority exists suggests that the definition depends on the facts of each case. *See* Macfadden Holdings, Inc. v. JB Acquisition Corp., 802 F.2d 62 (2d Cir. 1986) (delaying payment until FCC

term generates substantial uncertainty.<sup>270</sup>

The Commission has indicated that payment within five business days will satisfy the prompt requirement.<sup>271</sup> Nevertheless, the Commission has vacillated,<sup>272</sup> and courts have approved longer delays.<sup>273</sup> More-

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approval of acquisition considered prompt); *see also* Exchange Act Release No. 16623, *supra* note 38, at 17,757 (stating that “[n]othing in the rules prohibits offers under the terms of which the acceptance for payment is conditioned upon fulfillment of a condition requiring regulatory approval”).

<sup>270</sup> *See In re Cooper Laboratories*, Exchange Act Release No. 22171, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,788 (June 26, 1985) (discussing “prompt” in connection with rule 13d-2); Exchange Act Release No. 23320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006 (June 16, 1986) (discussing “prompt” in connection with rule 14d-9(b)); *see also* Brown, *supra* note 6, at 113. In some instances, the Commission has conceded the term’s uncertainty and has ultimately abandoned the amorphous requirement in favor of a specific time period. *See* Exchange Act No. 20021, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,406, at 86,130 (July 28, 1983) (noting that proposal to abandon “promptly” in favor of specified time period received support from “overwhelming majority of commentators”).

<sup>271</sup> *See IU Int’l Corp. v. NX Acquisition Corp.*, 840 F.2d 220, 223 (4th Cir. 1988) (en banc); *see also* Goelzer Letter, *supra* note 244, at 89,024 (stating Commission’s view that material change will occur upon CRTF’s acquiring commitments for substantially all of remaining financing, which will require minimum of five business days for shareholders to consider change). While no court has expressly upheld the staff’s position, one court did agree to a five-business-day extension out of expediency. *See* CRTF Corp. v. Federated Dep’t Stores, 683 F. Supp. 422, 444 (S.D.N.Y. 1988) (ordering five-business-day extension of offering period following disclosure of definitive details concerning financing).

<sup>272</sup> In 1987, King World Productions made a self-tender offer for up to 4.1 million shares. The company gave shareholders the option of receiving payment in the summer of 1987 or in January of 1988. The five-month delay conflicts with the concept of prompt payment. Nevertheless, the Commission staff approved the delay. *See* Letter from W. Clayton Johnson to Nancy J. Burke, Branch Chief, Trading Practices, Securities & Exchange Commission (June 19, 1987) (obtained under FOIA & on file at U.C. Davis Law Review); *see also* Chrysler Corp., SEC No-Action Letter (Mar. 25, 1983) (exchanging common stock for warrants and delaying payment until common stock registered and sold to public pursuant to effective registration statement).

The Commission originally proposed that offerors make payment within 10 business days of termination. Exchange Act Release No. 12676, *supra* note 88 (proposing rule 14e-2(c)). A delay in payment can result in considerable risk to tendering shareholders. For example, on October 9, 1987, TLX Acquisition made an offer of \$65 per share for Telex Corp. The price of Telex stock increased to \$70 in anticipation of a higher bid or competing offer. On Black Monday, Telex shares lost 50% of their value, falling to \$34.25. *See* Telex Corp. v. Edelman, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,526 (N.D. Okla. 1987). Had the fall in price occurred after the completion of the offer, but before payment, Telex might not have acquired financing.

<sup>273</sup> *See Macfadden Holdings, Inc.*, 802 F.2d 62 (upholding delay of up to 60 days); *IU Int’l Corp.*, 840 F.2d at 225 n.1 (Winter, C.J., dissenting) (noting uncertainty as to

over, assuming complete and accurate disclosure, the Commission's ability to prescribe a substantive time requirement for payment is not free from doubt.<sup>274</sup>

The lack of consistency and uncertainty about rulemaking authority may induce bidders to delay payment for an extended period, such as the twenty business days necessary for a second offer. Clearly, a bidder should disclose and highlight the possibility of extended delay. Once a bidder fulfills disclosure requirements, a bidder should have immunized itself from challenge.

Aside from these strategic implications, extended withdrawal rights will have other practical implications on the change-of-control process. The extended rights arguably make financing more difficult to obtain. Perhaps inconvenient to the bidder, the absence of firm financing before closing poses considerable risk to shareholders.

With increasing frequency, bidders make tender offers without first obtaining the necessary financing.<sup>275</sup> Bidders must often scramble fran-

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when bidder must make payment). Moreover, in adopting the Williams Act, Congress implicitly indicated that payment could be delayed more than 60 days in certain circumstances. In providing rulemaking authority to alter the withdrawal period, Congress indicated that the Commission could toll withdrawal rights when bidders could not obtain regulatory approvals within 60 days. H.R. REP. NO. 1711, 90th Cong., 2d Sess. 10 (1968). Thus, Congress contemplated that a bidder could await regulatory approvals before closing the offer and paying for shares.

<sup>274</sup> See *Schreiber v. Burlington N., Inc.*, 472 U.S. 1 (1985) (holding cancellation of tender offer 21 days after its deadline does not violate § 14(e) unless accompanied by nondisclosure). One case predating the adoption of rule 14e-1(c) declined to find improper a 14-day delay in payment. The court rejected the argument that the disclosure document, assuring prompt payment, violated § 10(b). *Salinger v. Ling-Temco-Vought, Inc.*, 324 F. Supp. 1006, 1008 (W.D. Pa. 1971).

<sup>275</sup> See *Nomad Acquisition Corp. v. Damon Corp.*, 701 F. Supp. 10, 12 (D. Mass. 1988) (noting that Schedule 14D-1 filing failed to include material terms regarding potential financing arrangements); *Salant Acquisition Corp. v. Manhattan Indus.*, 682 F. Supp. 199, 200 (S.D.N.Y. 1988) (reciting financial advisors' confidence of arranging financing); *Burlington Indus. v. Edelman*, 666 F. Supp. 799, 810 (N.D.N.C. 1987) (stating banks provided letters indicating need to further analyze transaction before committing financing, when Schedule 14D-1 disclosed that bidder "expects" a "confident" letter); *Telex Corp. v. Edelman*, *supra* note 272, at 97,328 (alleging that Schedule 14D-1 inadequately disclosed source of funds for offer).

Two appellate courts have held that a bidder need not acquire firm financing at an offer's inception. See *IU Int'l Corp.*, 840 F.2d 220; *Newmont Mining Corp. v. Pickens*, 831 F.2d 1448 (9th Cir. 1987). With respect to an offer's completion, the Commission staff takes a contrary position. The Commission's view apparently relies on the requirement in Item 4 of Schedule 14D-1 and rule 14d-3 that the bidder disclose all loan agreements. See *CRTF Corp.*, 683 F. Supp. at 444. The requirement, however, applies only to loan agreements executed prior to or during an offer's pendency. Nothing in the

tically during an offer's pendency to put together an adequate financing package. Bidders generally obtain financing before the offer closes.<sup>276</sup> Nevertheless, that may change. Lenders may want some indication of success before committing funds. With unlimited withdrawal rights, neither bidders nor lenders will know the number of shares acquired until the last moment. As a result of this uncertainty, a bidder may close an offer without first obtaining financing.<sup>277</sup>

Closing an offer without financing may have little practical consequence. Once the offer closes and financial institutions or investment bankers see that the bidder has acquired control, a bidder may easily obtain financing.<sup>278</sup> The lack of firm financing, however, may harm shareholders. Shareholders must decide whether to tender without knowing if the bidder has obtained sufficient funds. Competitive bidding exacerbates this difficulty.

Indeed, the present tender offer rules encourage bidders to close of-

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provision's administrative background indicates that the provision applies to postclosing disclosure.

Disclosing firm financing when none exists may violate the antifraud provisions. *See Raybestos-Manhattan, Inc. v. Hi-Shear Indus.*, 503 F. Supp. 1122, 1129 (E.D.N.Y. 1980). Attacks on financing have always represented a popular anti-takeover tactic. *See Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, 303 F. Supp. 1344 (S.D.N.Y. 1969) (alleging that funding for takeover attempt came from competitor and violated antitrust laws).

<sup>276</sup> *See* Goelzer Letter, *supra* note 244, at 89,025 (noting that, "As a practical matter, a tender offeror will obtain financing commitments before it concludes its offer"); *see also Campeau Extends Federated Offer; 98% is Tendered*, Wall St. J., May 3, 1988, at 10, col. 1 (noting that, although 98% of shares tendered, Campeau twice extended offer because financial arrangements incomplete). Moreover, even if an investment banker provides a "highly confident" letter, financing is not assured. If trouble raising the funds develops, investment bankers sometimes withdraw the letters. *See "Highly Confident" Morgan Stanley Backs Out*, Wall St. J., Sept. 12, 1989, at C1, col. 3.

<sup>277</sup> As Judge Winter noted in dissent, by concluding that a bidder need not acquire financing at an offer's inception, courts should not require the acquisition of financing at an offer's expiration. *IU Int'l Corp.*, 840 F.2d at 228 n.6. The majority concurred in that view. *Id.* at 224 n.1.

<sup>278</sup> *See Schy v. FDIC*, 465 F. Supp. 766, 768 (E.D.N.Y. 1977) (noting banks approved financing only after tender offer's successful completion). Even after acquisition of control, acquirors may not find financing. Acquirors often must agree to sell assets as a condition of financing. A number of states have adopted a type of takeover statute designed to prevent bidders from obtaining a target company's assets for at least several years. *See, e.g., DEL. CODE ANN. tit. 8, § 203* (1988). To date, the statute has survived constitutional challenge. *See RP Acquisition Corp. v. Staley Continental, Inc.*, 686 F. Supp. 476 (D. Del. 1988); *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458 (D. Del. 1988).

fers without first obtaining financing. According to the Commission, obtaining commitments to finance the purchases constitutes a material change in the offer, necessitating a five-day extension in the offering period.<sup>279</sup> This offering period extension triggers additional withdrawal rights, again providing other bidders with time to make a competing offer and allowing shareholders more time to retrieve tendered shares. To avoid the increase in the offering period, a bidder should close the offer, purchase the shares, and then finalize the financing.

Unlimited withdrawal rights also provide other opportunities for abuse. Shareholders could use the newfound flexibility to provide disinformation to bidders and other participants. Bidders often condition offers on the tendering of a minimum number of shares. As a tactical matter, shareholders may tender to lull a bidder into believing that the offer will succeed. These shareholders could then withdraw at the last moment. This tactic may cause the offer to fall short of the mandatory minimum, resulting in an offer's defeat. Again, this tactic will harm shareholders that tendered to the unsuccessful offer.

#### IV. SOLUTION?

Unlimited withdrawal rights may adversely impact the change-of-control process. Yet this article did not intend to propound the merits of a particular rule change.<sup>280</sup> Instead, extending withdrawal rights represents only a symptom of a larger, endemic problem, which transcends a single rulemaking endeavor.

Rulemaking presumes an end result. Rules embody the most appropriate method of achieving that result. With a specified goal and adequate information, administrative agencies can select the best alternative from an exhaustive list. Even with a definable goal, administrative agencies may rationally opt for a more incremental and less comprehensive change rather than a single, global solution. Incremental change seems most appropriate in circumstances involving inadequate information. The agency sees a need to alter existing practices, but has inadequate information to assess fully the implications.

Incremental rulemaking characterizes Commission activity in the takeover area. Although the absence of adequate information presents a problem, a more serious concern exists. A dearth of information does

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<sup>279</sup> See Goelzer Letter, *supra* note 244, at 89,024. "The conversion of the offer from a partly financed to a fully financed offer is a material change wholly apart from the anticipated terms of the financing." *Id.*

<sup>280</sup> An assault on unlimited withdrawal rights would require a more vigorous effort to establish the absence of rulemaking authority to implement the change.

not explain the incremental evolution of the rules. Rather, the Commission lacks an overriding theme to guide the rulemaking process. Without a definable goal, a propensity to view changes in isolation plagues the process. A narrow perspective permits continued regulatory intervention in the market for corporate control, while enabling the Commission to avoid more difficult issues about the broader purpose of rulemaking. In failing to consider broader implications, rules often unintentionally affect the change-of-control process and ultimately prove harmful.

Withdrawal rights illustrate this process. The extension of withdrawal rights throughout the offering period resulted not from a visionary approach to regulation, but from changes in the proration period. Changes in the proration period resulted from abusive practices that arose after the Commission lengthened withdrawal rights from seven to fifteen days. Moreover, each change rippled through the interlocking matrix of regulatory requirements governing the change-of-control process. Consequently, participants received an opportunity to use the new requirement to tilt the balance in a contest for control.

No solution would eliminate the possibility of unintended consequences. Nor does this article suggest that rulemaking provides an inappropriate mechanism for eradicating harmful practices such as market sweeps. Instead, the Commission must employ a broader perspective when intervening in the change-of-control process through rulemaking endeavors. At a minimum, the Commission should not limit a rule's consequences to benefits and harms immediately flowing from the change. The Commission should seek to assess the broader impact on the entire change-of-control process.

The Commission might employ proactive rulemaking. Rather than amending in an ad hoc fashion to eliminate harmful practices as they arise, rulemaking could proceed from an overriding vision of an appropriate regulatory scheme. Proactive rulemaking, however, presupposes an end result; a view of what regulation ought to accomplish. In the tender offer area, an appropriate end result does not appear intuitively obvious. Those favoring an unrestricted market for corporate control offer a solution. Regulatory "reform" ought to eliminate the shackles that curtail bidder activity. This view, however, remains a fringe position with no prospect of success.<sup>281</sup>

Shareholder protection presents a more agreeable goal, but one more illusory than real. From what do shareholders need protection? Corpo-

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<sup>281</sup> See *supra* note 18.



rate raiders and two-tier offers? Defensive tactics that impede hostile acquisition attempts? Any effort to protect shareholders will likely affect bidders or targets and either discourage or facilitate hostile acquisitions. A proactive regulatory scheme premised on shareholder protection requires resolution of the debate over the merits of hostile acquisitions.

Hemmed in by legislative command,<sup>282</sup> buffeted by changing political winds,<sup>283</sup> and lacking any consensus from market participants,<sup>284</sup> the Commission should not resolve the debate.<sup>285</sup> Thus, calls for a proactive

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<sup>282</sup> In adopting the Williams Act, Congress indicated that regulation must not benefit either target or bidder and that participants ought to play on a level field. An impossible command, the Commission nevertheless attempts to implement that policy.

<sup>283</sup> The Reagan Administration generally favored a free market approach to regulation, abhorring any additional restraints on bidders. At the same time, the Democrat-controlled Congress tended to favor such restraints. *See, e.g.*, Tender Offer Reform Act of 1987, H.R. 2172, 100th Cong., 1st Sess. (1987); Tender Offer Disclosure and Fairness Act, S. 1323, 100th Cong., 1st Sess. (1987). Yet even within these divisions, significant subdivisions exist. In restricting an effective anti-takeover device, supervoting stock, the Commission drew scorn from Senator Proxmire, Chairman of the Senate Banking Committee, and support from Congressman Dingell, Chairman of the House Committee on Telecommunications. Both are Democrats, and both chair committees that oversee Commission activities and legislation within their respective chambers.

Not outdone, the Reagan Administration divided. The concept of an unrestrained market for corporate control had strong support until it ran into conflict with the concept of states rights. States have long attempted to play a role in the acquisition process through takeover statutes. The Commission generally opposed the intrusion, a view not shared by some in the Justice Department. Then-Attorney General Ed Meese promoted states rights. The Commission's amicus brief filed in *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987), revealed the conflict's result. Filed by the Solicitor General of the Department of Justice, the brief weakly argued that an Indiana takeover statute violated the Constitution. Beyond ignoring some obvious arguments, the Solicitor General confessed error on a line of reasoning effectively employed in other cases to strike state takeover statutes. *See* Amicus Brief for the Securities & Exchange Commission and the United States, *CTS Corp. v. Dynamics Corp.*, 481 U.S. 69 (1987). The Commission studiously avoided any expression of support for the position. *Id.* at 8.

<sup>284</sup> For a discussion of the debate among market participants, see *supra* notes 16 & 18.

<sup>285</sup> Professor Coffee suggested that the Commission intervene in the market for corporate control by requiring the self-regulatory organizations to adopt rules prohibiting various harmful practices. *See* Coffee, *supra* note 16, at 1254-55. An important avenue, his position again presupposes some type of coherent and overriding policy. Widespread use of the authority to implement any such policy seems perilously close to, if not outside, the furthest border of permissible administrative activity.

Perhaps the principle weakness in Coffee's article, as with other commentators, is the narrowness of the analysis. The article tends to view tender offers as self-contained transactions. After resolving the transaction's benefit or harm, calls for changes in the

rulemaking process, while perhaps conceptually a preferred approach, provide an unrealistic and insipid solution.

Consigned by realities to a reactive rulemaking process, ending the analysis becomes tempting. Doing so, however, would require acceptance of inevitable and unintended problems caused by regulatory intervention. Again, this article takes the position that the adoption of unlimited withdrawal rights caused or will cause a number of adverse consequences that arguably outweigh any incremental benefits.

The rulemaking process ought to treat the effects of change on the acquisition process with far more circumspection. Already, rule proposals contain a mandatory cost-benefit analysis. Why not include a mandatory "acquisition effects" analysis? Essentially, this analysis would require an attempt to view any rule change in a broader context,

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regulatory process to promote the end result follow. Professor Coffee spends much time determining the best vehicle for regulatory reform.

Changes in takeover regulation, particularly those designed to remove restraints on bidders, overlook other, equally important avenues. If tender offers most effectively discipline inefficient management, a disputed proposition, that does not necessarily lead to the conclusion that tender offers are inherently good. Given restraints on other methods of disciplining management, tender offers may only represent the least worst method of doing so.

The removal of restraints on the use of the proxy mechanism might discipline management. Insurgents could receive access to shareholder lists, particularly beneficial owners. Shareholders owning certain percentages of shares could gain the right to insert into management's proxy statement a competing set of candidates for directors.

No one pretends that reform of the proxy system presents an easy or an effective solution. Proxy solicitations have never functioned properly. Nonetheless, that does not mean that, given appropriate levels of reform, the proxy process might operate as a preferred method of disciplining target management. If more efficient management is the goal, proxy contests would allow a broader spectrum of potential managers to seek control rather than the more limited group of candidates that have the financial ability to purchase control.

Irrespective of overall benefits, bidders launch hostile tender offers presumably after deciding that an acquisition most efficiently uses capital. In making this determination, the costs of both successful and unsuccessful attempts influence the decision. Thus, some proponents of hostile acquisitions would remove "costs" by ridding the acquisition process of regulatory restraints and target company discretion. But regulatory costs are only a single factor in a bidder's analysis. Capital obviously offers a myriad of possible uses, including dividends, capital construction, and research and development. A bidder's choice does not depend solely on a tender offer's costs, but also on the relative costs and advantages of other capital uses. Theoretically, a takeover market free of all impediments to hostile acquisitions might involve minimal activity if more advantageous avenues for capital existed.

Thus, the investment tax credit may limit tender offer activity more than the regulatory costs imposed by the Williams Act. The double tax on dividends may render the costs of regulation insignificant.

free of the particular abuse that instigated the process.

Shifting the view of a rule proposal from the narrow to the broad also seems consistent with the edicts of the securities laws. Commission authority contains the reasonable requirement that rules further the public interest. Assessing the public interest would seem to require analysis of a rule's overall impact on the change-of-control process.

As a practical matter, rule proposals ought to request comments on the issue. At the same time, the Commission staff ought to undertake an independent analysis. The adopting release should include analysis and any conclusions.

Perhaps in the end, the prescription suggested in this article seems obvious, even pedantic. Yet, review of administrative history leading to unlimited withdrawal rights suggests a complete absence of analysis about a proposed rule's broader consequences. The omission becomes more striking because Congress recorded concerns in the legislative history of the enabling act.

With appropriate analysis, the Commission still could have concluded that the benefits of unlimited withdrawal rights outweighed any harm. This certainly does not present an untenable result. Nevertheless, this did not occur. As a result, the true balance of benefit and harm only becomes clear after adoption, when ramifications begin to surface.

