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Take-Overs and Tenders: A Stock Exchange Viewpoint

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TAKE-OVERS AND TENDERS: A STOCK EXCHANGE VIEWPOINT

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This paper will discuss the policies of the New York Stock Exchange with respect to the securities of conglomerate corporations. Hopefully, my comments on some of the problems we have been grappling with in this complicated and often confusing area will clarify some of the Exchange's views.

As a point of departure, I will dispense with the word "conglomerate," which we never use at the Stock Exchange. Let me hasten to add that we have no quarrel with the conceptual definition of "conglomerate" adopted by the Financial Executives Institute. According to the Institute, a "conglomerate" is a company which is so managerially decentralized, so lacks operational integration, or has such diversified markets that it may experience rates of profitability, degrees of risk and opportunities for growth which vary considerably within the company — so that an investor requires information about these variations in order to make informed decisions.[1]

What we at the Exchange dislike about the term "conglomerate" is the way it has been used by others — often in a strongly pejorative sense — to suggest wider or narrower meanings. Consequently, we prefer to speak of multi-national companies, or multi-business companies, or companies with diversified operations — depending upon the specific circumstances. I think it makes better sense to use these more precise terms to describe a particular company and its activities.

A number of specialized and highly complex techniques have been developed and used by companies seeking to diversify their activities through the acquisition of other companies. There has been, for example, a tremendous increase in the number of tender offers to stockholders by companies seeking to gain control of others.[2]

EQUAL OPPORTUNITY FOR ALL STOCKHOLDERS

By and large, the Exchange's relations with listed companies engaging in these activities have centered on joint efforts to see that tender offers

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* President, New York Stock Exchange. This article is based upon the author's remarks before The National Conference of the American Society of Corporate Secretaries, San Francisco, California.

1 R. K. MAUTZ, FINANCIAL REPORTING BY DIVERSIFIED COMPANIES 7-8 (1968).

2 "[I]n 1966 there were over 100 such offers involving companies with securities listed on national securities exchanges as compared with eight in 1960." H.R. REP. No. 1711, 90th Cong., 2d Sess. 2 (1968). Since the passage of the Williams Amendments on July 29, 1968, the precise number of tender offers will be readily available because of the required SEC schedule filings which those amendments introduced. For example, the number of tender offers between the passage of the amendments and February 28, 1969 is reported to be 54. *See Hearings on Tax Reform Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess., pt. 7, at 2370 (1969).

are presented fairly and in accordance with good business practice. The vast majority of companies have indeed been extremely cooperative in this regard.

As a matter of policy, the Exchange does not comment on the merits of tender offers, or inject any subjective opinions into the often-vigorous corporate battles which sometimes result from them. Our policies in this area — which have developed over a period of some 15 years — are based upon certain principles which we regard as fundamental. Above all, we believe that all stockholders should have the opportunity to participate in a tender offer on equal terms. We believe that stockholders should be given sufficient time — preferably 30 days or more — to decide whether or not they wish to accept an offer.

Frequently, a company will limit the amount of a security covered by its tender offer. In such cases, we believe the offer should remain open for a period of at least 10 days to allow for the possibility that more shares may be offered than the company is prepared to accept. If that happens, the acceptance of shares should be prorated to prevent the exclusion of any stockholders signifying their desire to participate.

The so-called Williams Bill,[3] enacted in 1968, had the effect of buttressing the Exchange's policies which had previously lacked formal legal authority for enforcement. But that legislation by no means solved the problem of fair and equal opportunity[4] for all stockholders receiving tender offers. And, quite frankly, we sometimes find it necessary, in enforcing our policies, to insist that listed companies accept requirements more stringent than those set down by law.

An important case in point involves tender offers which are exempt from the provisions of the Williams Bill. The Bill covers only cash offers, exempting securities offers registered under the 1933 Securities Act.[5] We have been given to understand that, on a legal basis, an offer of securities need not be made on equal terms to all securities holders of a company which is the target of a takeover bid. Thus, the Exchange's policies are confronted with the legal possibility, in some instances, that institutions, for example, could be favored over the general public. And, indeed, some companies have wanted to offer institutions a cash premium over and above the amount of securities being offered. This is directly opposed to Stock Exchange policy, and we have insisted that any such premium must be offered to the non-institutional holder as well. In all our rulings on tender offers involving Exchange-listed companies, the guiding principle — to re-

[3] 82 Stat. 454 (1968), 15 U.S.C. § 78m(d),(e) (Supp. IV, 1969); 82 Stat. 456 (1968), 15 U.S.C. § 78n(d), (f) (Supp. IV, 1969).

[4] The Act states: "The provisions of this subsection shall not apply to any offer for, or request or invitation for tenders of, any security — (A) proposed to be made by means of a registration statement under the Securities Act of 1933; . . . ." § 14(d)(8)(A), 15 U.S.C. § 78n(d)(8)(A) (Supp. IV, 1969).

[5] Securities Act of 1933, 48 Stat. 74, *as amended*, 15 U.S.C. § 77a (1964).

iterate a point about which we feel most strongly — is that large and small stockholders should be offered equal terms for participation. Interestingly enough, we have been accused in some cases of somehow favoring one side or the other. And there have been situations in which each side has accused us of favoring the other. I suspect that this may really be one of the surest ways of knowing that impartiality has been achieved.

Timely Disclosure of Terms

Another matter of grave concern involves the preliminary planning of a tender offer. Great care should be taken to keep preliminary discussions confidential. But experience has shown that as soon as such information becomes known outside the top management echelon of the company or companies involved, there is inevitably the danger of a leak.

Incomplete or inaccurate information about a contemplated or pending offer can, of course, play havoc with investor confidence and, consequently, have an unsettling effect on the market. Thus, the Exchange insists that the participants recognize this and be prepared to disclose immediately, in such an event, pertinent information as permitted under the prior registration requirement.[6] In one recent situation in which a leak did occur, the Exchange, with the concurrence of the managements of the companies on both sides of the pending offer, suspended trading in the stocks of both companies for a day and a half. Both companies recognized that this was essential to protect the interests of their respective shareowners and of potential investors generally, and they worked without respite for some 36 hours to prepare an accurate public statement on the terms of the forthcoming offer.

Responsibilities of Target Companies

There is another important point which must be considered — the responsibilities of companies which are the targets of tender offers. We all realize, of course, that companies frequently oppose takeover bids. Nevertheless, we at the Exchange believe that when a company does become the target of a tender offer, management is obliged to notify its stockholders that the offer is being made. Management may certainly document its vigorous opposition to an offer — or, as may be the case, its enthusiastic support — and has no obligation to assist the offeror in any way. But management in all cases does have an obligation to acquaint all stockholders with the fact that an offer is being made.

It is sometimes very difficult to distinguish between a raid and a crusade, and it is certainly true that a takeover bid can, on occasion, be very beneficial to the stockholders of the target company. A great deal depends upon the viewpoint of the individual, which may, of course, be very different from the viewpoint of management. And the Exchange's role in all

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[6] *See* New York Stock Exchange Company Manual, § A2, at 18-21 (1968).

such situations hinges not on siding with one company or the other, but on trying to ensure that the stockholders have an adequate opportunity to make up their own minds about whether or not they wish to participate.

Only a few years ago, there was a rash of rather vehement proxy battles — some successful, others not so successful. And as times have changed, methods of doing things have also changed. Today, the takeover bid seems to have replaced the proxy fight as the principal instrument of corporate combat. And, not surprisingly, we have a whole new series of problems with which to contend.

Defensive Tactics

In its role as guardian of corporate democracy, the Exchange was disturbed to find a number of so-called "defensive tactics" developing in response to the growing number of takeover bids. Some of the techniques which began coming to our attention seemed clearly to violate the principles of corporate democracy which we believe are essential to building and maintaining a broad base of public ownership. And we have been particularly concerned about defensive procedures which — whatever their objectives — would discriminate among shareowners on the basis of the relative sizes of their investments.

The Board of Governors of the Exchange has not as yet adopted a formal policy in this area. However, in December 1968, the Exchange wrote to the presidents and secretaries of all listed companies, soliciting their views on some of these tactics. One of the proposed tactics which aroused our concern was the suggestion that an 80 percent favorable vote be required for a merger or similar transaction involving a tender offer by a corporation owning more than 10 percent of any class of the company's securities — as opposed to 66⅔ percent approval under any other circumstances. Another controversial tactic involved the proposal to create a small class of preferred stock, to be placed privately, which would have an 80 percent vote requirement for any merger. Such an arrangement would obviously permit a few holders friendly to management to negate any favorable action by the public holders of common stock. Nor are these two examples of so-called "defensive tactics" the only ones which have come to the attention of the Exchange.

The Exchange has pointed out, with regard to listed companies, that an arrangement which could be applied uniformly to all transactions of similar nature and without regard to the parties involved normally would not be regarded as objectionable. On the other hand, any proposal which results either in discrimination against an existing substantial stockholder or in discouragement of anyone seeking to make a substantial investment would appear to raise serious problems. Such a proposal could possibly conflict with the Exchange's philosophy of corporate democracy and stockholders' voting rights.[7] Over the years, the Exchange has insisted that all holders

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[7] *Id.* at 280-82.

of common stock must have the right to vote in proportion to their ownership or equity in a corporation, on an equal basis with all other stockholders. Certain states, on the other hand, have attempted to legislate so as to give the board of directors — rather than the stockholders — the controlling voice in questions of corporate combination.[8] Indeed, when we solicited listed companies for suggestions concerning corporate defenses against unwelcome takeover bids, a few companies answered, in effect, that the Exchange should mind its own business, leaving the resolution of matters to state or federal legislators. But the Exchange believes these matters are very much its business. The Exchange has a firm commitment to the interests of corporate democracy, and to maintaining quality markets for corporate securities. And we have no intention of abandoning that commitment. As I pointed out earlier, a great many of the Exchange's requirements and agreements — both with member brokerage firms and listed corporations — embody terms which are considerably more stringent than those prescribed by law. And it is unrealistic to expect that the same would not hold true when we confront the controversial and perplexing problems posed by some of the elaborate anti-takeover defense mechanisms.

"Funny Money" Securities

One key to the Exchange's philosophy may be found in its uncompromising attitude toward the issuance of non-voting common stock by listed corporations.[9] Although very few laws exist which prohibit such issues, the Exchange, in the interests of corporate democracy, has refused to list non-voting common stock for more than 40 years. All common stocks listed on the Exchange today, without exception, carry the right to vote. Moreover, we will delist the voting common stock of any listed company which creates a class of non-voting common stock or fails to solicit proxies for meetings of its stockholders.

In this connection, there is another matter of serious concern to the Exchange, again in the area of tender and exchange offers, which is worthy of discussion. We have become increasingly concerned about the various types of securities being issued in connection with certain tender and exchange offers — referred to by some Wall Street lexicographers as "funny money."

In this regard, I should point out that the Exchange is not at all averse to the use of new financing techniques. However, I cannot emphasize strongly enough that these techniques will not be permitted to be used at the expense of present stockholders. For example, last February we approved the listing of long term stock warrants but only after long and careful review of our policy and after establishing criteria for such listings that were designed to assure the Exchange's standards of equitability and fair treatment of all stockholders.

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[8] *See, e.g.*, OHIO REV. CODE ANN. §§ 1701.79(A)(2); 1701.84(A) (Page 1965). *See generally* Folk, *Corporation Statutes: 1956-1966*, 1966 DUKE L.J. 875, 943-46.

[9] *See* New York Stock Exchange Company Manual, *supra* note 6.

Under the new guidelines each warrant issued will represent the right to buy at least one share of common stock and cannot carry any privileges granted to common stockholders, such as dividends, pre-emptive rights or voting rights. The company must have at least one million warrants outstanding and a minimum of 1,800 holders of 100 warrants or more. The aggregate number of shares purchasable upon exercise of warrants being considered for listing shall not be more than 20 percent of the total common stock outstanding without the consent of stockholders. In no case would companies be able to list warrants representing more than 50 percent of the outstanding shares. Warrants will be required to have a life span of between 3 and 10 years and an exercise price not greater than approximately 25 percent above the value of the common stock at the time they are issued. At the same time the Board said it would consider the listing of long term warrants if the number of warrants fell below 100,000 or if the number of warrant holders declined to less than 500.

We are also formulating standards for the listing of bonds which will preclude companies from precipitating situations as dramatic as two recent cases in which we refused to accept the bonds of two listed companies after finding, from the company's own prospectuses, that, on a pro forma basis, earnings before taxes would not have been sufficient to cover the interest on the bonds which were being used for the purpose of acquisitions.

Under certain circumstances I should point out, failure to obtain authority for listing new securities could result in the Exchange consideration of delisting of a company's stock.

I think the Exchange has made it abundantly clear that it is determined that securities issued for the purpose of acquiring or absorbing other companies must be soundly based. It is not necessary to say that some of the problems in these areas are so fundamental that great care must be exercised in finding the most satisfactory answers. The Exchange is working toward some of these answers and will remain vigilant to assure that Exchange policy will continue to reflect the basic rights of shareholders as well as the needs and requirements of corporations and the market.