CORPORATE TAKEOVERS AND FREEZEOUTS TENDER OFFERS

BY LOUIS BARASH *

Tender offers do not generally imply valuation issues, but it is a bridge topic between what was discussed this morning and what will be discussed later.

In a tender offer, a corporation is often faced with an immediate decision as to its total future. There are serious questions, as in the *Tanzer* [1] case, about what a board of directors must do. The key issue is often the valuation of the company.

I want to touch on several issues concerning tender offers—first of all, the Delaware corporation takeover statute.

As the outline which has been handed out states, the Delaware statute [2] appears for all intents and purposes dead, and right now that is a pretty fair statement. The Delaware statute was probably intended to help management take its time in considering tender offers. Even though Delaware's is probably the mildest statute in terms of helping management in considering a tender offer, the SEC's consistent position is still that these statutes are unconstitutional. The SEC passed a rule which became effective in January of 1980 [3] with the intent of blocking statutes like Delaware's. They have done so.

The effect now is that in an "any and all" cash tender offer, when somebody makes an offer for a company, the target management has twenty-six days in which to consider what they want to do and to take any action to try and oppose the tender offer.[4] There is a recent Seventh Circuit decision [5] which is now on *certiorari* to the Supreme Court. Unless there is action by the Supreme Court to reverse that decision, it seems clear that the Delaware statute and almost all other statutes, despite some recent state court decisions, are

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1. Tanzer v. IGI, 379 A.2d 1121 (Del. 1977).

2. DEL. CODE ANN. tit. 8, § 203 (Supp. 1980).

3. 17 C.F.R. § 240.14d-2 (1979).

4. 17 C.F.R. § 240.14e-1(a) (1979). Rule 14e-1(a) requires that a tender offer remain open for at least 20 business days, which normally amounts to 26 calendar days.

5. Mite Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980).

going to be effectively ended. The only protection companies will have for a tender offer will be federal protection.

The other issue of somewhat more interest intellectually, and which is going to be a developing area of the law, is the question of what is a tender offer. It appears to be a little bit funny for a lot of tender offer lawyers to think about, but the problem started in 1968 when the Williams Act[6] was passed. The Act contained no definition of a tender offer.

Subsequently, the SEC took the position that since tender offers were such dynamic transactions, and since they could be accomplished in many ways other than by simply putting an ad in a newspaper and soliciting anybody's shares, the SEC did not want to define the term. The Commission instead chose to attempt to define the term "tender offer" on a case-by-case basis. Its first step was to define a tender offer as something which used to be an occasional practice, but not a common practice—namely, the special bid on the New York Stock Exchange, where somebody said, "I'll buy all of your shares offered in the next fifteen minutes at such-and-such a price."[7]

The SEC's position has never been challenged in court, but, since that early day, nobody has ever made a special bid. Once again the SEC, by its rule-making power, has been very successful in accomplishing its goals in the tender offer area.[8]

The cases discussed in this memorandum point out a conflict in the law which goes in part to the dynamic nature of the transactions and the speed with which they occur. For example, suppose someone approaches a board of directors or first buys stock and then approaches a board of directors and says, "We want to take over your company." Quick decisions have to be made. Serious valuation issues come up and, when the initial approach is not friendly, you invariably have litigation. The litigation has for a long time gone in divergent and usually unreconciliable ways, with regard both to the issue of the constitutionality of the statutes and the issue of what constitutes a tender offer.

The SEC has tried to some degree, and in part with very effective and Stanley Sporkin-ish sort of enforcement policies, to be aggressive in creating a definition of a tender offer which in their view, and to a fair degree does in fact, parallel what Congress intended when it passed the Williams Act.

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6. 15 U.S.C. § 781 (1971).

7. *See* SEC Release No. 34-8392 (Aug. 30, 1968), *reprinted in* [1969-70 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,715.

8. 17 C.F.R. § 240.14d-1 (1979).

The SEC's eight-point test [9] focuses on factors which are present in both formal tender offers and other types of market transactions, the special bid being the classic example. There appears to be little difference between the special bid and the tender offer, except that with the special bid you do not get the time periods and the full disclosure provided by the Williams Act.

The SEC's test is fairly well set forth; it discusses eight factors.[10] The key one, the one which the courts have focused on, is pressure on shareholders. Shareholders are faced in tender offers, as in many open market purchasing programs, with an immediate decision as whether to sell their shares. The SEC's concern has been in the open market purchasing programs, especially when such programs are accompanied by publicity, and a premium over the current market price.

In situations like the *Wellman v. Dickinson* [11] case, and the *S.G.* case,[12] public shareholders had to make quick decisions without the benefit of full disclosure. The bottom line of these cases is that if a publicly announced intention to gain either control or a sizeable number of shares of a company is made, and the offeror wants to accomplish this goal in a relatively quick manner at a premium over the market price, then courts will look to these key factors in determining whether an open market purchasing program is a tender offer.

The key thing to recognize here is that the SEC and the courts are concerned with somebody trying to take control of a company from public shareholders very quickly, but without complying with the waiting period and disclosure requirements of the Williams Act.

The reason I discussed earlier the aggressive enforcement activity of the SEC in this area is that there has been much concern in the

9. In Brascan, Ltd. v. Edper Equities, Ltd., 477 F. Supp. 773 (S.D.N.Y. 1979), the SEC appeared as *amicus curiae* and argued that the following eight factors should be used to determine whether a particular transaction or series of transactions constitutes a tender offer: (1) active and widespread solicitation; (2) solicitation for a large percentage of the company's stock; (3) an offer of a premium over the prevailing market price; (4) firm rather than negotiable terms; (5) a requirement that a fixed minimum amount of securities be tendered; (6) a limitation of the offer to a specified period of time; (7) subjection of offerees to pressure to sell their securities; and (8) public announcement of a purchasing program preceding or accompanying a rapid accumulation. *Id.* at 791 n.13. The court noted that the SEC "refrain[ed] from specifying which of the eight factors or how many must be met or how clearly before an acquisition will be considered a tender offer." *Id.* at 791. Although the "eight factor test" was questioned in *Brascan*, it was accepted in Wellman v. Dickinson, 475 F. Supp. 783 (S.D.N.Y. 1979), and was applied with caution in Hoover Co. v. Fuqua Industries, Inc., [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,107 (N.D. Ohio, June 11, 1979).

10. *See* note 5 *supra*.

11. 475 F. Supp. 783 (S.D.N.Y. 1979).

12. S.G. Sec., Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114 (D. Mass. 1978).

Bar about the lack of a clear definition in an area in which multi-million dollar transactions are at stake. The long quote from Judge Lavalle in the *Brascan*[13] case is indicative of the defendant Bar's view. Most of the decisions have really focused on the public shareholder and the pressures with which he is faced.

Now I would like to briefly turn to that which has been the central theme of discussion so far and will be the theme of discussion later today: the board of director decisions which must be made by a director or corporation faced with a hostile tender offer, including the valuation decisions.

There has been a common thought that when somebody makes an any-and-all cash tender offer—that is, a tender offer to any shareholder for any and all stock which he may have at a price which is a premium over the market—such an offer is somehow *ipso facto* fair. The shareholder should be able to immediately accept it, without takeover statute type litigation or any other kind of litigation to block the offer and shareholders should be allowed the right to decide freely.

Recent cases, including *Panter*[14] case and the *Crouse-Hinds*[15] decision in New York, have suggested that this is not

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13. In Brascan, Ltd. v. Edper Equities, Ltd., 477 F. Supp. 733 (S.D.N.Y. 1979), the court held that purchase of more than 3 million shares on the American Stock Exchange was *not* a tender offer. The court stated:

> [The offeror's] conduct had very little similarity to what is commonly understood as a tender offer and what was described as a tender offer in the context of the hearings leading to the passage of the Williams Act. [The offeror] did not engage in a widespread solicitation of stockholders. . . . [T]o acquire a large amount of stock in open market purchases, bidding cautiously so as to avoid bidding up the price of the stock to excessive levels unless there was large volume available at such prices . . . is not a tender offer, even if a large volume of stock is accumulated in such fashion.

Id. at 789.

The court specifically questioned the SEC "eight factor test," stating:

> [We] have doubts as to whether [the SEC's] view constitutes either a permissible or a desirable interpretation of the statute. As to permissibility, [we] have some question whether it expands the scope of the statute beyond what Congress can reasonably be understood to have intended, depending how many and which factors are deemed necessary. [We] believe it is not desirable because the application of so vague a test would introduce a crippling uncertainty in an area in which practitioners should be entitled to be guided by reasonably clear rules of the road. The consequences of having purchased on the open-market where a court would later determine on the basis of so unpredictable a test that the provisions of Section 14(d) should have been respected could well be catastrophic beyond reason.

Id. at 791 n.13.

14. Panter v. Marshall Fields, 646 F.2d 271 (7th Cir. 1981).

15. Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690 (2d Cir. 1980). *See also* Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 161 (1981); Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231 (1980).

necessarily true; I think that is right. I would like to express a possible reason. About ten years ago, when Frank Wheat was at the SEC, the Commission released the Wheat Report. It discussed the institutionalization of markets, and it pointed out that which is inherent in the quote cited this afternoon from Bayless Manning[16] about the fiction concerning the shareholders controlling a corporation.

Today, the individual shareholder is almost nonexistent. Most individual shares, and certainly a large portion of the securities issued by any public company on the market, are held by pension fund managers, trust managers, and the like. The result is that in an any and all cash tender offer, at any reasonable premium over the market price, absent some sort of antitrust problem caused by the two companies combining, the target company is going to be acquired by somebody—either the original raider or a raider who comes along and offers a higher price. This does not necessarily ensure that the price is a fair price, and that boards of directors have applied their business judgment in deciding that this is not the proper time to sell the company or that this is not a fair offer to their shareholders.

The problem is that with the institutionalization of the market, any manager of funds is generally going to take the position that long-term values are not something that he can worry about when he is faced with an immediately available premium.

There is a reason why any reasonably priced premium over the market price for any and all shares is going to be a successful offer unless topped by someone else. The offer in no way assures that this is the time to sell the company. Therefore, situations will arise, even where there are competing bids, in which a company is bought at a price which might not be considered a fair price, but which reflects the true long-term value of the company.

For example, a tender offer was made about two years ago for a large midwestern company. There was, of course, the ensuing litigation, and a competing bid arose which seemed to be a relatively large premium over the original bid, which itself was at a substantial premium.

Normally, such would have ended all bidding. Some might say, as some have argued in the subsequent freezeout cases, that once a price is established which all shareholders tender into, such should be considered a fair price in a subsequent freezeout. However, in this particular transaction, there ensued an even further bidding war. The original raider said, "I'm willing to pay more than that," and finally the second bidder made a fourth bid.

16. *See* p. 567 *supra.*

Although the fourth bid was the end of the transaction, the point to be made about the bidding is: who is to say that even though nobody at that point in time was willing to pay more, the fourth bid itself was a fair price for the company? I think the answer is that it was not necessarily a fair price. The conditions involved did not necessarily indicate the right time to get the best value for the company.

Therefore, in considering the valuation issues the thought has often been expressed that once the majority of the market in a tender offer situation has determined that it is willing to sell its shares to a bidder for that company, the remaining shareholders are left to the mercy of that price. That may not be correct, and perhaps different valuation methods, ones that will be discussed later this afternoon, are helpful in determining what those fair prices might be.

MR. FENTON: I have just one question. What is the justification for non-disclosure by a company of its intention to make a tender in the period during which the company is buying up a block of five percent from which it will pay its legal and bankers' fees if it does not actually get the company—in other words, a "white knight" or a better offer comes in?

MR. BARASH: I do not know if it is a good justification, but the answer to the legal question lies in the Supreme Court's decision in *Chiarella*.[17] It is not that those facts are not material, but the Court held that no duty of disclosure exists unless there is some sort of specific duty, for example, a fiduciary duty. It has been held in *Chiarella*[18] that a market buyer who knows that it is going to make a tender offer does not necessarily have a duty—in fact, does not have a duty, although this is clearly dictum—to go out and tell the whole world that it is going to make a tender offer.

You can act on your own information if it is truly your own. Whether that is in fact a fair justification, I am not necessarily willing to say. It appears that there are very good reasons why an uninformed shareholder should have a right to what is clearly market information, particularly in the period immediately preceding a tender offer. Certainly if the information was in the hands of the target company, the informed shareholder would have it, and considering the express purpose of the securities laws, to provide meaningful and fair disclosure to all shareholders, and other rules of the Williams Act which point to that—for example, section 10(b)(13),[19] which

17. Chiarella v. United States, 445 U.S. 222 (1980).
18. *Id.*
19. 17 C.F.R. § 240.10(b)(13) (1979).

prohibits you from buying shares during the tender offer, it seems that there are good reasons (and I think the SEC has been looking at this) to try to force people, at least in the period immediately preceding the tender offer, to forebear from purchasing.

MR. FENTON: What is the period immediately preceding?

MR. BARASH: That is a good question. Of course, there is always a problem with motive and intent. It may seem odd that people make spur-of-the-moment decisions to make tender offers; at least it may seem odd to people who are not involved in this decision-making process. But the fact remains that the decisions are worked out and thought up; part of the thinking process may involve buying stock without a firm intention to make a tender offer until your lawyers are prepared to bring the first lawsuit.

It is a very, very difficult question, but there are instances in which it can be established that people do know they have a firm intention to make a tender offer. It is unfair, at least in the sense that other things are considered unfair under the Securities Act, for people to be buying shares immediately before the tender offer. Why that should be different from the period during the tender offer or immediately afterwards, I do not know.

MR. FENTON: Would you ever advise a client not to make that initial five percent purchase before he makes his tender offer?

MR. BARASH: There are certain situations in which it could not be done practically, but I would normally say that if it is a large enough company, the expenses are usually going to be so great that it is probably a good idea to cushion the possible expenses against the possibility of being defeated.

Of course, that can work in other ways. For example, if there are other possible defenses to the tender offer besides that of a competing bid—that is, if there is an antitrust defense which might be successful—you are not involved in a sure-win situation and you may find yourself being, in effect, on the losing side of what is called an arbitrage transaction. You have bought the shares in advance; you have made the tender offer; the price of the stock now goes up; the tender offer is somehow defeated; and there is no competing bid—you have spent all that money and you are losing your antitrust suit, or whatever, but you have taken a large loss on a big block of stock.

Sometimes this can be ameliorated. Because companies do not like large blocks of their stock being dumped onto the marketplace, you can sometimes sell the stock back to the company, at least at

the price at which you originally purchased it. Generally speaking, it is a good practice if you can do it in a manner which does not tip the target's hand to buy the stock, so that you will make a profit if there is a competing bid and you are unsuccessful.

In discussing the mechanics of the tender offer, I should mention that the key to tender offers is the element of surprise. This is one of the reasons for the state statutes and the recent amendments to the SEC rules governing tender offers. Prior to the Williams Act there was absolutely no regulation of the timing of tender offers. One could say, "I will buy all the stock of a company at X price," and there was no reaction time for a corporation subject to such a bid.

If such a bid was made and effectively publicized, the bidder was almost assured of gaining control of the corporation at a price which, almost invariably, would not reflect what could be considered the true value, because there was no opportunity for a competing bid. The Williams Act remedied this to an extent by giving a minimum of seven days. Subsequently, several state statutes were adopted, and some of them gave sixty or more days for the target company management to consider the offer and to attempt to pursue various alternatives.

The Williams Act was intended to protect shareholders but not unduly inhibit tender offers, since tender offers also benefit shareholders to some degree, and because tender offers sometimes provide shareholders with premiums which could not otherwise be realized. The SEC therefore took the position that the Act should preempt those state statutes which did unduly inhibit tender offers by providing too much time.

Subsequently, the SEC adopted the rules previously referred to. For an any-and-all cash tender offer these rules increased the time during which a tender offer had to remain open to twenty-six days. The SEC also created rules which specifically preempted any statute which provided a longer period of waiting prior to the commencement of the tender offer.[20] The courts have upheld these rules.[21] That is the type of statute Delaware has. The Delaware statute requires that the target company be informed of the tender offer twenty days before it is made. Since the enactment of the new SEC rules, the courts have uniformly held that these statutes are invalid.

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20. 17 C.F.R. § 240.14d-2 (1979).

21. *See, e.g.*, Kennecott Corp. v. Smith, 637 F.2d 181 (3d Cir. 1980); Canadian Pac. Enterprises (U.S.), Inc. v. Krouse, 506 F. Supp. 1192 (S.D. Ohio 1981).

Corporations now have twenty-six days to consider an any-and-all cash tender offer.[22] There is an anomaly in this rule. Because of a quirk in the SEC rules, in a partial offer situation where shareholders probably need a little more disclosure and a little more time to consider the offer for less than all of the shares of the company, there are only fifteen days in which the shareholder really has time to make his decision.[23]

The reason more disclosures or more than fifteen days is needed in a partial offer is that in an any-and-all offer, the raider is probably going to get the majority of the shares and, if not, he is probably going to get squeezed out eventually; so one way or another he will not be involved in the tender offer or the company any longer. In a partial tender offer, the shareholder will either decide to remain in the minority or, if he tenders, very likely his shares will be prorated, so that he will have to consider what the new management of the company is going to be like in order to determine whether he wants to sell his shares on the market and get out. The shareholder has even less time to decide in that situation than he has in the situation of a full offer, an any-and-all offer.

That is an anomaly in the rules, and I get the indication that the SEC is somewhat concerned about it, and is therefore considering its options.

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22. 17 C.F.R. § 240.14e-1(a) (1979).

23. The reason for this anomaly is that in a partial tender offer, the offeror may purchase shares after the pro-ration and withdrawal periods have ended. Since the Williams Act itself requires the pro-ration period to be 10 days, 15 U.S.C. § 78n (d)(6) (1970), and the rules require that shareholders may withdraw their shares within 15 days, 17 C.F.R. § 240.14d-7(a)(1) (1979), the offeror can purchase shares on the latter of those two days.