THE DELAWARE TENDER OFFER STATUTE

BY RODMAN WARD, JR.*

PROFESSOR LEVIN: The next item on the agenda is the procedures under the new tender offer statute, and we have both Mr. Rodman Ward and Frank Balotti who are going to present this particular topic. We are going to call first upon Mr. Ward to discuss the procedures under the new tender offer statute.

MR. WARD: This is, I guess, the second new statute we have talked about this afternoon. The ideal or prototype common lawyer would probably like there to be but one law and that is "all fair things are legal." As you develop complexities beyond that, you eventually get into areas such as securities laws which are thoroughly regulatory and very defined. It is on top of this complex scheme that the states have legislated in the area of tender offers. The statute I'm going to be talking about is Delaware's contribution to this field of law. 1 Delaware wasn't even in the blue sky law area until a couple of years ago. Although we did have a statute in that area which said, in effect, "all unfair things are illegal." But insofar as state tender offer legislation is concerned, as I think Frank [Balotti] will be talking about primarily later, 2 we may now have the only constitutional statute left in the field, except perhaps Nevada, that other state that passes Delaware corporation law. The importance of tender offers at this point in the economic life of the country couldn't be exaggerated. There are many successful companies, as you know, whose stock is selling at multiples below seven or eight and which represent prime takeover candidates. You can turn to many services which list companies that are selling well below book and at small and low multiples which are listed as takeover candidates. Other companies with large amounts of cash are often well satisfied to offer premiums of 20, 30, 40% over the market price to enlarge their asset base. As you know, this prospect chills the hearts of many who fear they may, as a result, be looking for work. This trend can't be said to be an unmitigated disaster for stockholders who have already, however, suffered at the hands of the lessening demand for equity securities, which with other causes has led to the reduction of market prices for securities. A stockholder

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2. See address by Mr. Balotti, this issue, p. 230 infra.
has a piece of property which some day he may want to sell for a premium.

At least two of the desiderata for an efficient sale or bidding competition are full knowledge of the product and adequate time within which to negotiate. I think that we can assume in this audience a fair familiarity with the Williams Act\(^3\) passed by Congress in the late 1960's which requires informational filings by an offeror who plans a tender offer and requires, as well, the publication of an offering circular which provides a great deal of material information both as to the offeror and as to what is commonly called the "target" corporation. And then there is a fair body of case law which has grown up over a period of time interpreting disclosure requirements contained in section 14(d) of the Securities Exchange Act\(^4\) which requires, in essence, full disclosure of material facts relative to the offer and the parties to it. The problem with the Williams Act which Delaware saw was that it permits an announcement of an offer by publishing in the paper, filing with the Securities and Exchange Commission and then the offer may close seven days later.\(^5\) It might be that corporate executives should all be master strategists in crises, but if your company is about to be sold out from under you in seven days by somebody who has been craftily scheming to do it for months in advance, there is not only a near impossibility of getting people calm enough to focus on all of the problems, but you really don't have time to get what you need to get done to defend yourself. It is not an easy thing. You have to have an investment banker and you have to have a lawyer who is skilled in the field. You have to have what used to be called proxy solicitors. You've got to get all these people lined up and doing something coherent. These terrors, of course, have led an awful lot of companies, when they seemed like targets, to sign on experts on a permanent retainer basis — solicitors, bankers, expert lawyers such as Joseph Flom and Martin Lipton in New York, and others — on kind of a permanent basis with game plans as to what to do when it all happens. All this confusion, it seemed to lawyers in Delaware, was not a particularly desirable situation. The evidence of the confusion and market pressure were the primary things that the Delaware statute did or was intended to do. Our topic is called "Procedures under the Delaware Tender Offer Statute," and the procedures under the Delaware tender offer statute are set forth in


\(^5\) Id. § 78n(d)(5).
the tender offer statute and you can read them. But the key thing that was of concern to the Delaware Bar Association Committee which considered this was the panic which the Williams Act permits in the short offer. There are other provisions, but that's really the key one.

I want to say something nice here about a note that is coming out in the Delaware Journal of Corporate Law, written by Alene Berkowitz of the Delaware Law School. I'm not sure that it's been published yet. I have a copy of it here and it's a very thorough and careful analysis of the background of the law and comparison with other legislation in other states. It alone is a good reason to buy this volume of the Delaware Journal of Corporate Law. The Delaware legislature exercised its customary prudence in passing this law. Professor Cary, who has been somewhat critical of Delaware law, wrote some years back that since managements were being threatened with being taken over and since Delaware was obviously such a protectionist state that we would rush out and draft a law that would be particularly protectionist of management. That's not what happened. What happened was, initially we felt that protection would be adequate under the existing state of the law and then when a lot of other states started passing statutes and all of them of a highly protectionist nature, I think it was the judgment of the Corporation Law Committee and the subcommittee charged with this responsibility that the one area of great concern should be dealt with by our law. And so, section 203 was drafted. As you may know, laws in most of the other states — I think there are twenty-three or twenty-four — administrative hearings are called for, which can be, and in some cases must be, held to determine the fairness of the offering price and various other circumstances.

I must say a tender offer, we recognize, is very important to shareholders. The Delaware law, as is pointed out in the Resource Document, is as concerned for stockholders as it is for management. An administrative hearing is a method by which delay can be effected in the home town of the corporation. In practice such delay can, by itself, kill the tender offer. We did not, therefore, involve ourselves with a hearing on fairness, although presumably if there is something terribly unfair in the offer a stockholder can question that under the common law. So that what we did was require a twenty

day period prior to the announcement to the target company with a delivery to the target company of certain information.\textsuperscript{10} That information is not dissimilar from the information which has to be published under the Williams Act. It involves the number of shares to be purchased, what’s going to be offered, stock or cash, the names and addresses of the offeror and its directors and principal officers, whether the offeror will unconditionally accept or pay part of the equity securities offered, and matters of that sort. If less than all is going to be taken, if the offer \textit{is} for less than all or \textit{can} be less than all, then the financials of the offeror must be delivered so that somebody who might hold would know who he was going to be in bed with if he remained as a minority stockholder.

There have been two litigated cases under the statute which have resulted in opinions. One unreported decision, \textit{Telco v. Libco},\textsuperscript{11} and one case which was reported both in chancery and in the supreme court, \textit{Royal v. Monogram}.\textsuperscript{12} First I want to talk about \textit{Royal. Royal v. Monogram} involved a tender offer by Monogram Industries for Royal Industries. Both of them were New York Stock Exchange companies, both were fairly large, both about the same size. In delivering the section 203 notice, there is a requirement to deliver it to the principal place of business and the registered agent in Delaware. For some unaccountable reason, the material was delivered to the chief executive officer and his lawyer in his lawyer’s office but not at the principal place of business. The other issue in the case surrounded Royal’s claim that the income statement and balance sheet of the offeror referred not to the consolidated financials which were delivered but rather to the financials of the parent company only. The first issue was of some concern but the second issue did not, at first seem likely to be a problem. The statute does say to deliver the information to the principal place of business, but there are a number of cases which say that actual knowledge is the equivalent of statutorily prescribed notice and in defending the attack on Monogram’s compliance with section 203 that argument was made. The chancellor looked at the statute and he looked at the financials and he said that “here it says that the income statement shall be that of the offeror, and the offeror is Monogram; you provided financials which not only include Monogram but all of its subsidiaries.” On that basis, he enjoined Monogram from going forward. Monogram appealed.

\textsuperscript{11} No. 5129 (Del. Ch. July 29, 1976).
\textsuperscript{12} Monogram Indus., Inc. v. Royal Indus., Inc., 372 A.2d 171 (Del. 1977), rev’d 366 A.2d 839 (Del. 1976).
The supreme court reversed the chancellor and did it rather promptly. The supreme court issued an order three days after argument. But now that it's all over it was a healthy thing because in ruling as it did the supreme court called for what I would characterize as a "common sense" reading of the statute and said the defenses were hypertechnical based more on target company defense tactics than on sound principles of statutory construction. Of course, that made the advocates feel a lot better, although they would have felt better if they had never gone to the supreme court in the first place. I think the statute will be construed on that basis henceforth as a result of that decision of the supreme court.

Now, actually there is something very good about that opinion, too, for another field of the law. The Delaware Corporation Law tries to be flexible and tries not to be too detailed and tries to deal with principles rather than too many specific, tiny applications. One of the places you can really get in trouble if you are a lawyer is to try to be an accountant. For instance, in the dividend test, it's a wise thing that the statute simply says "surplus." What surplus means in the accounting profession may change, but that's a fact, and you can go to that fact and prove it by expert testimony. I suppose it would have been unthinkable some time ago to consider paying a dividend out of a surplus of a consolidated subsidiary. I think that it is pretty clear that you can do that now, but at any rate it seems to be a very wise thing that the supreme court has referred us to expert testimony to prove the meaning of accounting terms.

I want to talk about one specific other point that is involved in Telco v. Libco. Here is a problem, it seems to me, which is of great difficulty. What is a tender offer? That problem also exists under the Williams Act. Increasingly, in efforts to take over companies, people with cash are buying blocks of stock one way or another. The really extraordinary example of it that's recently come to light involves a large American company which is buying huge blocks of stock in a great number of the largest companies in America. The company hires a broker, he lets it be known that his client is anxious to buy blocks, and then insurance companies and various other people who want to sell such blocks sell them to his client. Now a potential offeror can get a large percentage of a potential target by doing that, and the question is whether the offeror has started a tender offer by doing it. That is a question that really hasn't been litigated under the federal securities laws, and it has clearly not been litigated in Delaware under the tender offer statute. On "creeping tender offers" under the Securities Act, Cattlemen's Investment Co. v. Fears was

13. Id.
the leading case, but there have been some subsequent ones. In the Cattlemen's case there was a broad reading given to tender offer. In some subsequent cases, however, the court has looked to impact and said the real reason of the Williams Act is to protect some people being driven into tendering quickly and said if you buy blocks over a period of time, that really isn't a tender offer which the statute is attempting to regulate. This problem has yet to be litigated under Delaware law. We have a market exception, of course, in the statute which says that if you buy stock in regular purchases in the market those transactions are excepted. But what is a normal transaction in the market and what is abnormal? That question remains to be litigated in Delaware.

There was, in Telco, a situation where Libco, the offeror, had bought 28% of Telco's stock over several months. Then Vice Chancellor Marvel expressed doubt that that was a tender offer under the statute. If you read the statute, it really focuses on a tender offer which is "opened and closed." It reads a lot like a classic tender offer. If somebody's trying to take over a company, the fact that he does it over a period of time, part of it fairly covertly, doesn't seem very different to the target itself. Nevertheless, the Chancellor said in some dicta, "I'm not fully convinced that the defendant's recent purchases of plaintiff's stock constitute an offer for tenders of stock as defined by the Delaware Code, Section 203(c)(2), such purchases having been made in part in the market, as well as from an undetermined number of individuals rather than through a public offering," which indicated at least at that time that the Chancellor was giving a fairly narrow reading to the words tender offer. A lot of things have happened in the Delaware Corporation Law since that opinion was written, some of them by our supreme court and some of them which could be read by a trial court as requiring broader reading of statutory language — among them the Monogram case, the Singer case, perhaps Vickers, some of the cases which I am sure you are familiar with. It seems to me that if there is going to be a case on that subject, it will be very interesting to see how it comes out.