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The Problem With Federal Tender Offer Law

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The efficiency and effectiveness of federal tender offer law takes on added importance in light of the increased frequency of both friendly and hostile tender offers. Professor Booth suggests that federal tender offer law effectively favors the bidder at the expense of the target company and discusses potential solutions to this lack of evenhandedness. He argues that current federal law—especially the Williams Act—unduly encourages shareholders to tender, and that parties to tender offers can and often do avoid the Act altogether, thereby negating its protections.

Professor Booth considers the dangers of one potential solution, repealing the Act. He determines that the Act's repeal could prove harmful to smaller target companies. He proposes that solutions to the problem take into account the varying needs of different target companies, and weighs the merits of federal law, stock exchange regulation, and state law. He concludes that state law is at this time the most promising source of reform for takeover regulation.

INTRODUCTION

The company that becomes the target of a tender offer seldom remains independent.¹ There are several possible explanations for why

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1. 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, 1149 (1984) [hereinafter Coffee, *Regulating Market Control*] (only 20-25% of target companies remain independent following

tender offers so often succeed. The bidder may have secret information about or plans for the target, or he may be able to exploit synergies with his other operations. The bidder may simply be more competent at managing, or current management may be incompetent, opportunistic, or slack.² Or it may be that target companies have been "put in play" by their controlling shareholders (or managers) who have decided to sell out.³ Shareholders, of course, like takeovers because they typically receive substantial premiums, and, barring the prospect of a better offer, they are quick to tender whenever an offer is made.

But these theories are not completely satisfying. A takeover attempt should alert incumbent managers that changes are necessary or should alert the market that the target is undervalued. The inevitable rise in price that accompanies a bid should also cause many investors to retain their stock for its newly discovered value. That is, the price a rational bidder offers for the target will be less than the present value of the profits he expects to realize from it by instituting operating changes, selling off assets, and so on. But if incumbent management were to take the same steps the shareholders would enjoy *all* the proceeds. In short, a rational bidder will invariably offer to pay less than he thinks the target is worth. Shareholders, therefore, should often be able to reap greater gains by holding out instead of selling out.⁴ Nevertheless, shareholders seem distinctly inclined to tender. The question is: Why do shareholders decline to hold on to their shares when the offeror has identified the target as a firm more valuable than was previously supposed?

The high success rate of tender offers suggests that the assets of target companies often are not devoted to their highest and best use; otherwise, a tender offer at a typically substantial premium over market price would not arise. This hypothesis assumes that managers will often

an initial tender offer); Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153, 195 n.144 (1986) (reviewing empirical evidence on the results of tender offers).

2. See Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1178 (1981) [hereinafter Easterbrook & Fischel, *Proper Role*]. But see Coffee, *Regulating the Market*, *supra* note 1, at 1211-15.

3. See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); see also Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986) [hereinafter Coffee, *Shareholders Versus Managers*] (arguing that takeovers are often prompted by opportunities to adopt riskier strategies that favor shareholders over existing creditors including management itself).

4. Professor Kraakman has recently addressed this issue in some detail. Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891, 892 (1988). His thesis is that stocks often trade at prices persistently below the per share value of the company's underlying assets either because managers cannot be depended on to invest the available cash flows optimally (the "misinvestment" hypothesis), or because the market naturally prices stocks below asset value (the "market" hypothesis). Kraakman declines to choose between the two hypotheses, though he does argue that they have very different implications for how tender offers and defensive tactics should be regulated. The thesis of this article is, in essence, that both explanations are true. See *infra* note 32.

neglect to sell underperforming assets before a tender offer arises. But managers should be best acquainted with the actual and potential value of their firms, and it seems highly unlikely that it would not occur to anyone—let alone a sophisticated corporate manager—to sell something known or even suspected to be more valuable to others. Managers could augment their shareholders' wealth and enhance their own reputations by selling such "underperforming" assets. The very vigor of the takeover market should force even inefficient managers to seek out potential buyers for any such assets.

What then accounts for the low survival rate of target companies? One possibility is that current tender offer rules are somehow unfair to target companies.⁵ Although Congress continues to discuss proposals for further regulation of the tender offer process,⁶ I suggest in this Article

5. See, e.g., Bebchuk, *The Pressure to Tender: An Analysis and a Proposed Remedy*, 12 DEL. J. CORP. L. 911 (1987) [hereinafter Bebchuk, *The Pressure to Tender*]. Even commentators who regard target company defensive tactics as abusive seem to agree that to some extent the rules should be reformed to eliminate biases against target companies. See Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 309-13 (1983). I do not mean to suggest that tender offer bidding rules are the only reason why takeovers so often succeed. Other factors may also be at work. See Black, *Bidder Overpayment In Takeovers*, 41 STAN. L. REV. 597, 625-626 (1989) (discussing, among other theories, "winner's curse", that is, the natural tendency for the most optimistic bidder to win any bidding contest); see, e.g., Forman, *Predator Becomes Prey as Goldsmith Seeks British Conglomerate*, WALL ST. J., July 12, 1989, at 1, col. 6; see also OFFICE OF ECONOMIC ANALYSIS, SEC. AND EXCH. COMM'N, DO BAD BIDDERS BECOME GOOD TARGETS? (Aug. 25, 1988) (finding that about 60% of acquisitions resulted in decline of bidding company stock price). Taxes have also been mentioned as a reason why takeovers succeed. The idea is that a bidder can take advantage of stepped-up basis (and thus enjoy higher depreciation deductions) or can borrow to finance the bid (and thus enjoy higher interest deductions). As Professor Gilson has pointed out, however, both of these strategies are equally available to management which can perform a leveraged buyout or borrow to finance a one-time cash distribution. Moreover, management can undertake such restructurings at a much lower cost than an outsider can. Thus, taxes seem to be an unlikely explanation for why hostile acquisitions so often succeed. Remarks of Ronald J. Gilson, Association of American Law Schools, Section on Business Associations, New Orleans, Louisiana (Jan. 6, 1989); see also Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613 (1988) (collecting evidence that stock market is not efficient and suggesting that takeovers may be explained by inefficient pricing).

6. In December, the Tender Offer Disclosure and Fairness Act of 1987 was introduced in the Senate. S. 1323, 100th Cong., 1st Sess. (1987). Among other things, the bill would (1) reduce the ten-day window under § 13(d) to five days (and prohibit additional purchases prior to filing); (2) require a waiting period of sixty days in the case of a bidder who first discloses a passive investment intent and then decides to make a bid for control; (3) increase penalties for failure to disclose; (4) allow the SEC to seek civil penalties of up to 50% of the value of the stock at issue; (5) limit greenmail by allowing the paying company to recover any premium over 3%; (6) require more extensive registration of arbitrageurs; (7) give the SEC authority to promulgate regulations regarding "Chinese Walls" between various departments of brokerage houses and investment banks; and (8) increase penalties for insider trading and obstruction of insider trading investigations. See SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, TENDER OFFER DISCLOSURE AND FAIRNESS ACT OF 1987, S. REP. NO. 265, 100th Cong., 1st Sess. 19, 22, 27, 32-33, 39-42 (1987) [hereinafter SENATE TENDER OFFER REPORT].

For additional proposals and discussions on the need for regulatory reform, see *Concept Release*

that *too much* regulation is partly the problem. Indeed, I argue that federal law tips the balance in favor of bidding companies and, among other things, fosters the development of mechanisms that unduly encourage bidders, such as tender offer arbitrage and greenmail.

Part I of this Article outlines the bidding rules established under federal law and identifies their shortcomings. In particular, it contends that the rules unduly favor bidders by encouraging target shareholders to tender more readily than they otherwise would. Moreover, the rules can be easily evaded by both bidders and target shareholders, so their supposed benefits are seldom realized. In addition, the means by which the rules can be evaded lead to widely criticized defensive tactics on the part of target companies.

Part II of this Article examines the probable effect of repealing the federal bidding rules. It shows that legislation that would repeal the bidding rules but would not eliminate coercive bidding strategies might result in even more successful tender offers than occur under the current rules.

Coercive offers, however, do not affect all companies equally: they appear to be more of a threat to the independence of smaller, less well-established companies than to more mature corporations. Thus, in Part III this Article addresses the need for a regulatory scheme that is sensitive to differences between target companies. It analyzes the three potential sources of a reform: federal law, stock exchange rules, and state law. It concludes that while stock exchange rules may be the theoretically preferable source of regulatory reform, state law is presently a more promising alternative.

I

THE WILLIAMS ACT AND ITS DARK SIDE

Until 1968, cash tender offers were unregulated.⁷ While the sale of stock had been the subject of major reforms in 1933 and 1934,⁸ the

on Takeovers and Contests for Corporate Control: Advance Notice of Possible Commission Actions, Exchange Act Release No. 23,486, [1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018 (July 31, 1986) [hereinafter Concept Release] (requesting public comment); Andre, *Tender Offers for Corporate Control: A Critical Analysis and Proposals for Reform*, 12 DEL. J. CORP. L. 865, 866, 909-10 (1987) (arguing that legislative reform is necessary to address the conflict of interest between management and shareholders in the context of tender offers); *The Battle over Tender Offer Reform: From the States and the Courts to Congress*, 20 Sec. Reg. & L. Rep. (BNA) No. 2, at 60 (Jan. 15, 1988) (reviewing recent developments in the takeover process); *SEC to Impose Voting Rights Rule, Abandons Effort for Industry Agreement*, 19 Sec. Reg. & L. Rep. (BNA) No. 23, at 812 (June 5, 1987).

7. See R. FERRARA, M. BROWN & J. HALL, TAKEOVERS: ATTACK AND SURVIVAL 5-10 (1987) [hereinafter FERRARA, BROWN & HALL].

8. See, e.g., Securities Act of 1933, 15 U.S.C. §§ 77a-77bbbb (1989); Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988).

purchase of stock had not seemed problematic. In the late 1960s, however, Congress became concerned that “‘proud old companies’” were falling at the hands of upstart corporate raiders⁹ and passed the Williams Act.¹⁰ Though Congress’ desire to protect target companies prompted the legislation, the Act that emerged *appeared* to be quite evenhanded. Indeed, Congress took “‘extreme care to avoid tipping the scales either in favor of management’” or bidder.¹¹

The Williams Act was designed to fulfill two main functions: to inform shareholders about the bidder and the bidder’s plans for the target,¹² and to ensure that tender offers are procedurally fair. Prior to the Act, a tender offer could theoretically be left open for a very short time. The phrase “Saturday Night Special” was commonly used to describe such offers, which forced shareholders to tender quickly or risk losing the offered premium. In addition, tender offers could be made on a first-come-first-served basis, a tactic that effectively forced shareholders to tender first and think later. As a result, target companies may have been sold for less than might have been received in a less hurried negotiation.¹³

9. See FERRARA, BROWN & HALL, *supra* note 7, at 8 (quoting Sen. Harrison A. Williams, Jr., 111 CONG. REC. 28,257-58 (1965)); *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 28-30 (1977) (discussing legislative history behind the Williams Act).

10. Pub. L. No. 90-439, §§ 2, 3, 82 Stat. 454, 455 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988)). As originally enacted the Williams Act, named for Senator Williams of Abscam fame, consisted of five subsections added to the Securities Exchange Act of 1934: §§ 13(d)-(e), and 14(d)-(f) (codified at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988)).

11. See, e.g., FERRARA, BROWN & HALL, *supra* note 7, at 9 (quoting Sen. Williams 113 CONG. REC. 24,664 (1967)); *CTS Corp. v. Dynamics Corp. of Am.*, 107 S. Ct. 1637 (1987); *Edgar v. MITE Corp.*, 457 U.S. 624, 632 (1982); *Piper*, 430 U.S. at 31 (describing Congressional policy behind the Williams Act as one of “even handedness”).

12. See *Piper*, 430 U.S. at 26-31. While this may seem to be an uncontroversial goal, it can backfire. If the tender offer is prompted by the bidder’s innovative plans for the target, and those plans must be disclosed, the target or another bidder may steal the idea and thwart the bid by announcing its intention to institute a similar program. See Easterbrook & Fischel, *Proper Role*, *supra* note 2, at 1189. And indeed, though it may not be because of the Act, very few first bidders end up winning if a competing bid is made. See Coffee, *Regulating the Market*, *supra* note 1, at 1289. Disclosure may be warranted in connection with a partial bid in which the target shareholder faces the prospect of remaining a shareholder under new management. Yet, if the target shareholder believes the bidder will do a better job managing the target than incumbent management, she may be inclined to hold out. If, however, the target shareholder thinks the bidder will do a worse job, she may be all the more inclined to sell out quickly. See Borden & Weiner, *An Investment Decision Analysis of Cash Tender Offers Disclosure*, 23 N.Y.L. SCH. L. REV. 553, 561, 589-90 (1978). It is hardly surprising, then, that disclosure statements under the Williams Act—particularly those relating to the purpose of the tender offer and plans or proposals of the bidder—are masterpieces of non-information. See Tobin & Maiwurm, *Beachhead Acquisitions: Creating Waves in the Marketplace and Uncertainty in the Regulatory Framework*, 38 BUS. LAW. 419, 434-36 (1983).

13. See W. CARY & M. EISENBERG, *CORPORATIONS* 1563 (5th ed. 1980); Easterbrook & Fischel, *Proper Role*, *supra* note 2, at 1161-64, 1178-80, 1179 n.46; Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371, 389, 395 (1980) (shareholder returns increased from 22% to 40% with passage of Williams Act and bidder returns decreased from 9% to 6%); Kraakman, *supra* note 4, at 934.

To prevent such coercion by bidders, the Williams Act, together with rules adopted under it by the Securities and Exchange Commission, contains a set of bidding rules governing tender offers. First, a tender offer must remain open for twenty days.¹⁴ Second, a tendering shareholder may withdraw her tendered shares at any time until the end of the offer.¹⁵ Third, if more shares are tendered than the bidder seeks, every tendering shareholder is entitled to have her shares purchased *pro rata*.¹⁶ For example, if a tender offer for 1,000,000 shares attracts 2,000,000 tendered shares, then each tendering shareholder will have 50% of her shares purchased (assuming each tendering shareholder tendered all of her shares).

The Williams Act contains one other important feature designed to discourage coercive practices by bidders: it provides that if the bidder raises his price during the tender offer then every shareholder, including those who have already tendered, must receive the higher price.¹⁷ The highest price rule thus prevents a bidder from stairstepping, that is, from offering successively higher premiums in order to induce the tender of a few more shares with each increase. It seems to reflect a Congressional belief that shareholders, as a matter of fairness, should receive the same price for their shares regardless of when they tender.¹⁸ After all, a corporation cannot pay shareholders differing dividends. Why should differential treatment be allowed in tender offers, which can be viewed as merely an alternative way for investors to realize return?

Although the Williams Act may to some extent have achieved the

14. Securities Exchange Act Rule 14e-1, 17 C.F.R. § 240.14e-1 (1989). There is a separate set of rules that differs in significant respects, regarding tender offers by a company for its own shares. See *id.* Rule 13e-4, 17 C.F.R. § 240.13e-4.

15. *Id.* Rule 14d-7, 17 C.F.R. § 240.14d-7. Several of the rules adopted by the SEC under the authority of the Williams Act contradict express provisions of the Act. See Note, *The Impact of Schreiber and SEC Timing Rules*, 57 GEO. WASH. L. REV. 77, 99 (1988) (authored by Frank S. Hamblett). Rule 14d-7 is a prime example. The Act provides for withdrawal rights only during the first seven days of an offer, Williams Act § 3, 15 U.S.C. § 78n(d)(5) (1988) (amending Securities Exchange Act of 1934, § 14(d)(5)), not for the entire duration as provided by the rule. On the SEC's authority in this regard, see Pro Rata Rule, Exchange Act Release No. 19,336, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,306, at 85,652 (Dec. 15, 1982) [hereinafter Pro Rata Rule] (dissent of John S.R. Shad, Chairman, Securities and Exchange Commission); see also Amendments to Tender Offer Rules—All-Holders and Best Price, Exchange Act Release No. 23,421, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016 (July 11, 1986) [hereinafter All-Holders and Best Price] (describing adoption of withdrawal rights for duration of offer).

16. Securities Exchange Act Rule 14d-8, 17 C.F.R. § 240.14d-8 (1989). This rule also differs from the Act, § 14(d)(6), which provides for proration only during the first ten days of an offer, 15 U.S.C. § 78n(d)(6) (1988). See Pro Rata Rule, *supra* note 15 (discussing adoption of final rule).

17. Securities Exchange Act of 1934, § 14(d)(7), 15 U.S.C. § 78n(d)(7) (1988).

18. See All-Holders and Best Price, *supra* note 15, at 88,189 ("Congress intended, *inter alia*, to assure fair treatment among security holders who may desire to tender their shares"); Proposed Amendments to Tender Offer Rules, Exchange Act Release No. 16,385, [1979-1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,374, at 82,610 (Nov. 29, 1979) [hereinafter Proposed Amendments] (justifying the highest price and proration rules as a reflection of the Act's more general requirement

goal of equal treatment for shareholders, it has created a number of unforeseen problems. First, it may unduly encourage shareholders to tender. In addition, shareholders appear to place little value on the equal treatment the Act seeks to assure. In any event, the Williams Act can be easily evaded, and thus it does not in fact assure equal treatment among shareholders. Finally, the evasive bidding strategies encouraged by the Act have prompted defensive tactics that are more troubling than the bidding strategies the Act eliminated.

A. Shareholder Strategy Under the Williams Act

Even without the Williams Act, once a bid is made for her stock a target shareholder would have little reason to hold out for a better offer.¹⁹ The potential gain from a hold-out strategy to an individual shareholder is usually too small to justify the risks it presents to her, since failure to tender into a successful offer means no gain at all.²⁰ Moreover, since shareholders are well aware of these considerations and know that other shareholders are, too, all will be inclined to tender.²¹

The Williams Act exacerbates the pressure on shareholders to tender. Under the Williams Act, the tendering shareholder is assured of receiving the highest price that the bidder might offer. In addition, target shareholders know that they may withdraw tendered shares in the event another offer comes along. Furthermore, because of proration, the shareholder will not be penalized for having tendered earlier in response to the first offer. Thus, the Williams Act effectively destroyed whatever incentive to hold out that shareholders might have had.²²

If staircase offers were allowed, however, target shareholders would have more of an incentive to hold out. Proration would not be an issue

of equal treatment). *But see* FERRARA, BROWN & HALL, *supra* note 7, at 79-83 (arguing that Congress in passing the Williams Act did not intend to address issues of fairness).

19. *See* Bebchuk, *The Pressure to Tender*, *supra* note 5.

20. Of course, there are situations where large shareholders like institutional investors can affect the outcome of a bid or perhaps even dictate it. But the Williams Act does not really affect such shareholders, because they can easily contract around its provisions. Therefore, the costs and benefits of the Act are most appropriately measured by examining the Act's effect on relatively small and scattered investors.

21. *But see* Schwartz, *The Fairness of Tender Offer Prices in Utilitarian Theory*, 17 J. LEGAL STUD. 165, 172-84 (1988) (arguing that target shareholders are not at as great a disadvantage as is often thought since bidders must make public offers, bidders must worry about competitive bidders, and shareholders will probably be led by various mediating forces to focus on an equilibrium price at which the offer will succeed).

22. By tendering early, shareholders may also avoid possible delays and administrative mixups associated with the physical act of tendering. On the other hand, there may be similar advantages in holding out to see if a competing offer arises since withdrawing previously tendered shares entails the same dangers of delays and mixups. *See* Willis, *Your Money: Takeovers Pose a Tough Choice*, N.Y. Times, Mar. 26, 1988, at 42, col. 1. In addition, target shareholders can send a costless message of encouragement to the bidder by tendering early.

since a bidder would presumably start out low and buy whatever shares were offered before raising the price.²³ At lower premium levels, the risk of loss from holding out would be less, and therefore it would be less of an all-or-nothing decision than it is under the Williams Act. Moreover, the potential gain from each successive increment in the offer would be immediately available to tendering shareholders, and not dependent on the actions of other shareholders many days later.

If staircase bids are to be allowed, withdrawal rights should be eliminated, since target shareholders would otherwise be able to "roll their own" highest price rule by withdrawing tendered shares if a higher bid—even from the same offeror—came along. Moreover, the elimination of withdrawal rights may well be advisable regardless of its tie-in with the highest price rule. Withdrawal rights lower the shareholders' risks of tendering early and arguably make some bids more attractive, and therefore more likely to succeed, than they otherwise would be. For example, a bidder who does not yet have financing in place may make a bid contingent on obtaining financing and may be able to attract large numbers of shares that would not be tendered if they could not be withdrawn.²⁴ If enough shares are tendered, the bid may look more promising than it otherwise would to the lender, and the financing may materialize. In addition, competing bidders may be discouraged by the simple fact that once a shareholder has tendered, a certain inertia sets in, and it becomes difficult to induce her to withdraw her tendered stock.

In short, it would seem that contingent bids provide the bidder with an edge despite withdrawal rights because, ironically, withdrawal rights lull target shareholders into tendering. Eliminating withdrawal rights would reduce the tactical advantage that the first, but not necessarily best, contingent-offer bidder enjoys. Although some contingent bidders might still make withdrawal rights part of their bids as a way of making them more attractive, contingent bids would stand out as the exception rather than the rule and would presumably be scrutinized far more carefully for likelihood of success than they are currently.

Individual shareholders may also view the Act's equal treatment of

23. Of course, in order to take full advantage of a staircase bid, bidders would need to leave their offers open long enough to clear the market of all shares offered at any particular price. The choice would be between offering a higher initial price to attract larger numbers of shares quickly, and offering a very low price initially to attract the cheapest shares at the lowest price. The attractiveness of either alternative presumably depends on such factors as the total profit the bidder expects from a successful offer and the likelihood of competing bids. See Schwartz, *supra* note 21, at 175-79.

24. Under the Williams Act, an offeror need not have firm financing in place at the time a tender offer commences. *Newmont Mining Corp. v. Pickens*, 831 F.2d 1448 (9th Cir. 1987). In addition, although the bidder must disclose the existence of a financing contingency, it need not reveal how the financing will ultimately be arranged. See, e.g., *IU Int'l Corp. v. NX Acquisition Corp.*, 840 F.2d 220 (4th Cir. 1988).

all shareholders as a detriment rather than a benefit. For example, shareholders who would otherwise be inclined to tender early (or for less of a premium) may enjoy less of a benefit under the Act because fewer of their shares will be purchased under proration. And because of the added "pressure to tender"²⁵—or, more precisely, the elimination of reasons *not* to tender—shareholders who would not otherwise be inclined to tender may do so anyway and end up with an inadequate payment.²⁶ In other words, the Williams Act may equalize shareholder gains more than shareholders would like.²⁷ Those inclined to tender will have fewer of their shares bought, while those inclined to hold out will be pressured to tender because of the increased likelihood of the bidder's success. In short, the Williams Act seems to have distributional costs as well as allocational costs.²⁸

Thus the net effect of the Williams Act is to tip the balance subtly but distinctly in favor of the bidder. Target shareholders who cannot affect the outcome of the battle have even less reason under the Act to hold out for a higher price than they would in the absence of the Act.

B. *Avoiding the Williams Act*

I have argued that the costs of the Williams Act exceed its benefits in cases where the Act applies; in fact, both bidders and target shareholders can easily evade the Act's application altogether. Consequently, whatever benefits the Act may generate arise only when bidders choose a bid structure governed by the Act. Of course, target shareholders may insist on such benefits by holding out for a Williams Act offer. However, it appears that both shareholders and bidders prefer to avoid the Act's strictures. As a result, bidders and shareholders use a variety of strategies to avoid the Act, including arbitrage, unconventional offers, and two-step and two-tier offers.

25. The phrase is, of course, borrowed from Professor Bebchuk. See Bebchuk, *The Pressure to Tender*, *supra* note 5.

26. This occurs when the shareholder tenders because of the increased likelihood of the bidder's success.

27. See Booth, *The Business Purpose Doctrine and the Limits of Equal Treatment in Corporation Law*, 38 Sw. L.J. 853 (1984) [hereinafter Booth, *Business Purpose Doctrine*] (arguing that some corporate goods cannot be distributed equally); Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698 (1982) (arguing that some mutually beneficial transactions may depend on unequal distribution of gains).

28. That is, shareholders seem to lose distributionally because they are forced to share gains equally even when they would prefer another formula, and they lose allocationally because overall they are induced to tender for a smaller aggregate premium. The latter loss is "allocational" because it results in smaller investment gains and therefore leads to a higher cost of capital for business in general. To some extent, of course, distributional losses translate into allocational losses since any dissatisfaction with investment performance presumably leads to a lower level of investment.

1. Arbitrage

The most direct way for a target shareholder to avoid the uncertainties of the Act or to forgo its possible benefits in favor of a quick sale is to sell in the open market. Under current rules, the only real risks that a shareholder faces in tendering early are the complete failure of the bid and oversubscription and proration in connection with partial offers.²⁹ However, arbitrageurs often purchase shares from skittish shareholders during the pendency of a tender offer, thereby causing target stock prices to rise.³⁰ Accordingly, shareholders can avoid the risks of tendering early and still enjoy a substantial premium by selling their shares in the open market to arbitrageurs instead of tendering.³¹ Arbitrageurs can profit, of course, by later tendering to the bidder. Thus, despite the Williams Act, many shareholders do in fact experience stairstepping, while market professionals reap the benefits of the highest price rule.

Figure I depicts the situation. Assuming that stocks subject to takeover bids have downward-sloping demand curves (here depicted by line CDF),³² in a tender offer for 50% of the target shares, the bidder must

29. For a discussion of the risks of proration, see Pro Rata Rule, *supra* note 15, at 85,652 (dissent of John S.R. Shad, Chairman, Securities and Exchange Commission, in connection with adoption of revised Rule 14d-8).

30. In many cases, arbitrageurs amass a large proportion, often a majority, of target stock during a tender offer. See Comment, *Should Tender Offer Arbitrage Be Regulated?*, 1978 DUKE L.J. 1000, 1028 (authored by Jeffrey Stephen Turner); *Roundtable: The Place of Arbitrageurs in Mergers and Acquisitions*, MERGERS & ACQUISITIONS, July-Aug. 1986, at 24, 36. For example, in the offer by Hanson Trust PLC for SCM, Hanson Trust purchased 25% of SCM's outstanding stock in five transactions during an 84-minute period. *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 52-53 (2d Cir. 1985).

31. See generally Henry, *Activities of Arbitrageurs in Tender Offers*, 119 U. PA. L. REV. 466 (1971); Comment, *supra* note 30; see also I. BOESKY, *MERGER MANIA* (1982) (an "insider's" account of arbitrage activities).

Arbitrageurs have devised several strategies that allow them to avoid proration: for example, tendering borrowed stock in sufficient quantity that all of their own stock will be bought. This practice, however, was quickly prohibited by Rule 10b-4. See Adoption of Rule 10b-4 Under the Exchange Act of 1934, Exchange Act Release No. 8,321, [1968 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,558 (May 28, 1968). Thereafter arbitrageurs came up with "hedged" tendering, which involves tendering and selling short in the market. See DeMott, *Current Issues in Tender Offer Regulation: Lessons from the British*, 58 N.Y.U. L. REV. 945, 1001-02 (1983). The fact that proration can largely be avoided further suggests that the Williams Act accomplishes little that it was intended to do. Indeed, the SEC has proposed giving up its effort to craft rules to insure that proration is enforced. See *id.*

32. This is a significant assumption. A good deal of commentary assumes that because the stock market is efficient there is a single correct (or at least best-guess) price for a stock. See, e.g., Easterbrook & Fischel, *Proper Role*, *supra* note 2, at 1165-68. However, a growing body of work is based to a greater or lesser extent on the idea that different shareholders may have different perceptions of share value. See, e.g., Baysinger & Butler, *Antitakeover Amendments, Managerial Entrenchment, and the Contractual Theory of the Corporation*, 71 VA. L. REV. 1257, 1283-85 (1985); Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1719-20 (1985) [hereinafter Bebchuk, *Toward Undistorted Choice*]; Brudney & Chirelstein, *A Restatement of Corporate Freezouts*, 87 YALE L.J. 1354, 1359 (1978); Burnovski,

offer a premium of P50. If all of the target shareholders who would accept less of a premium sell as the market reaches their prices, the total premium they would receive is equal to triangle DGF. Arbitrageurs would capture the difference, which is represented by triangle DEF.³³

Arbitrage is not necessarily evil or wasteful; on the contrary, it may have certain desirable effects. The intervention of professional traders

Reverse Price Tender Offers, 56 GEO. WASH. L. REV. 295 (1988); Carney, *Fundamental Corporate Changes, Minority Shareholders and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69, 112-18; Chazen, *Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?*, 36 BUS. LAW. 1439, 1468 (1981); Coffee, *Regulating the Market*, *supra* note 1, at 1178-83; Kanda & Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429, 437-41 (1985); Levmore, *Efficient Markets and Puzzling Intermediaries*, 70 VA. L. REV. 645, 653 n.29 (1984). Professor Coffee and others recognize what he calls an upward-sloping supply curve which describes the inclination of shareholders to tender depending on the premium offered. See Coffee, *Regulating the Market*, *supra* note 1, at 1185; Carney, *supra*, at 112-15. Coffee's supply curve and my demand curve are nothing more than two different perspectives: He views the shareholders as supplying increasing quantities of shares for increasing premiums offered, while I view the shareholders as demanding higher premiums as publicly held shares are tendered and become more scarce. I must admit that I, too, originally thought of the curve in question as an upward-sloping, supply-like curve. See Booth, *The New Law of Freeze-Out Mergers*, 49 MO. L. REV. 517 (1984). However, I find it more realistic to limit the maximum tender price to that indicated by the point where supply equals zero by using a demand curve, than to suggest by a supply curve that the shareholders could continue to tender shares that do not exist at ever-increasing prices. But, whatever one calls it, the general idea is the same.

As I have argued elsewhere, the idea that stocks have downward-sloping demand curves (as other commodities do) is not inconsistent with the efficient market hypothesis: There is no reason why, other things being equal, very different equilibrium prices would not be established for the same security at different levels of supply. Booth, *Management Buyouts, Shareholder Welfare, and the Limits of Fiduciary Duty*, 60 N.Y.U. L. REV. 630, 637-38 (1985) [hereinafter Booth, *Management Buyouts*]. Numerous common phenomena support this view. In tender offers and buyouts it may be necessary to increase the offer in order to induce sufficient tenders. Companies (and their underwriters) sometimes repurchase their own stock to "support" the market price during an offering. See, e.g., *The October 1987 Market Break*, Fed. Sec. L. Rep. (CCH) No. 1271, at 6-1 to 6-15 (Feb. 9, 1988) (extra edition). And traders frequently enter orders with exchange specialists at prices away from the market. See Poser, *Restructuring the Stock Markets: A Critical Look at the SEC's National Market System*, 56 N.Y.U. L. REV. 883, 890-91 (1981); see also J. LORIE, P. DODD & M. KIMPTON, *THE STOCK MARKET: THEORIES AND EVIDENCE* 68-70 (2d ed. 1985) [hereinafter LORIE, DODD & KIMPTON] (indicating that large secondary offerings—block sales—have permanent depressing effect on stock's price).

Professor Kraakman, in his recent work regarding discounts as a motivation for takeovers, offers two possible explanations for such discounts: the market hypothesis and the misinvestment hypothesis. See *supra* note 4. The downward-sloping demand curve for stock subsumes both of these hypotheses without forcing any choice between them. Indeed, the downward-sloping demand curve suggests that Kraakman's two hypotheses are simply different ways of looking at the same phenomenon. That is, it may be that the market undervalues stock because it is necessarily sold to investors who are willing to assume the greatest risks of managerial malfeasance; and the more one wants or needs to sell, the greater the discount one must offer.

33. There are several simplifying assumptions implicit in this graph. The demand curve need not be continuous and need not be a straight line. It may also be distorted at the ends, particularly at the high end where there may be holdouts. Although any references to particular quantities—such as the size of a premium—would clearly be affected by these departures from reality, arguably the graph represents the tender offer situation on the average.

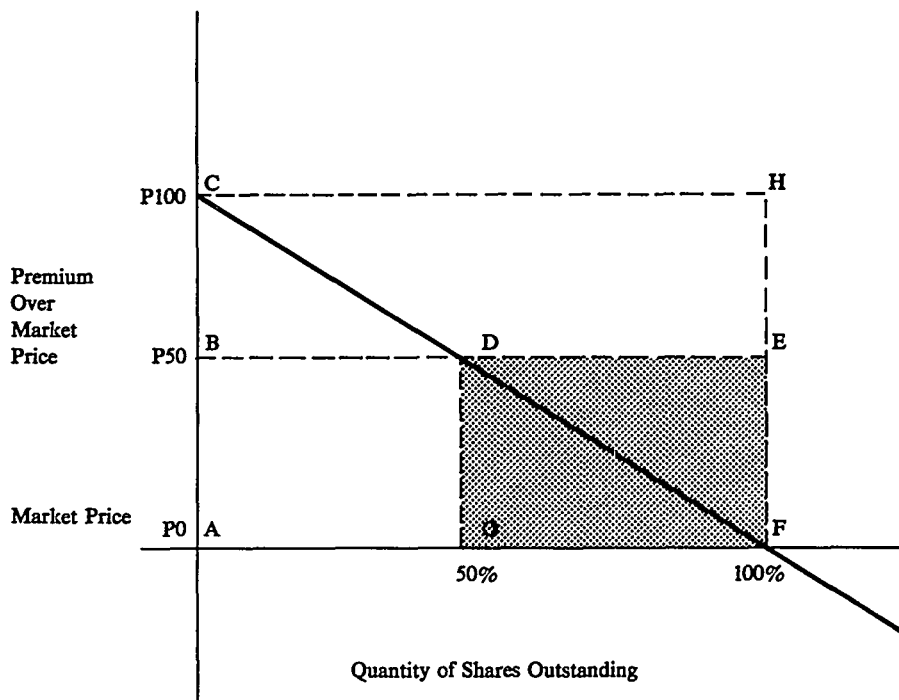


FIGURE I

may make tender offers more efficient. Because arbitrageurs hold substantial blocks of shares, they are more likely to investigate carefully and assess accurately the adequacy of a bid than thousands of scattered shareholders are. Moreover, arbitrageurs may even assist the target company that seeks to remain independent. It is no doubt far easier for target management to convince a handful of large investors rather than thousands of shareholders that its plans are preferable to those of the offeror. Arbitrage thus helps solve the problem of shareholder coordination, which many commentators have identified as a primary source of the "pressure to tender."³⁴

On balance, however, arbitrage probably decreases a target's chance of remaining independent. Arbitrageurs are inclined to sell quickly to the first adequate offeror once they have taken a position in a target, and unlike scattered shareholders they *can* affect the outcome of a contest for control.³⁵ Moreover, the profits arbitrageurs enjoy because of the highest

34. See, e.g., Bebchuk, *Toward Undistorted Choice*, *supra* note 32, at 1729-31.

35. See, e.g., *Secret Dealing Helped Paul Bilzerian Make Takeover Bids Work*, Wall St. J., May 19, 1988, at 1, col. 6 (describing bids prompted by prospect of receiving greenmail or inducing the target to find a white knight to whom the bidder's shares may then be tendered at a profit).

Arbitrageurs are not the only possible villains in this regard, however. During the past twenty years investment banks have built substantial merger and acquisition departments. When takeover

price rule are a substantial price to pay for their services.³⁶ These profits create an incentive for arbitrage to continue as an ongoing enterprise. The highest price rule thus may be doubly disadvantageous to target companies over the long run even though it appears to increase the aggregate premium paid to target shareholders.

The highest price rule also distorts the capital markets because it artificially raises the cost of bids. Consider a tender offer for all the shares of a target as depicted in Figure II. In order to induce the last shareholder to tender, the bidder must offer a premium of P100. The aggregate premium that must be paid under the Williams Act will therefore equal the area of rectangle ACHF. But if the bidder could make a staircase offer, the aggregate premium would equal only the area of triangle ACF. The highest price rule thus forces the bidder to pay twice the premium that the shareholders would demand individually.³⁷ Consequently, there will be fewer tender offers, because bidders will bid only when there is the prospect of enough gain to warrant the double premium. Investors will lose the returns that would have been available from the forgone offers. Moreover, because of lost premiums investors will insist on a higher *ordinary* return and bid down the prices of stocks generally. And with this lowering of stock prices and the consequently higher cost of capital, more companies may become targets.³⁸

activity slows, the investment banks may promote deals to their customers simply in order to remain busy and profitable. *Investment Bankers Feed a Merger Boom and Pick Up Fat Fees: Some Call Them Main Factor Behind Hostile Takeovers; Putting Beatrice in Play*, Wall St. J., Apr. 2, 1986, at 1, col. 6.

36. Some studies indicate that once a tender offer is announced target shares yield only normal returns, see LORIE, DODD & KIMPTON, *supra* note 32, at 70-73, but these studies are not necessarily inconsistent with the widely presumed profitability of arbitrage. If arbitrageurs are capable, alone or in small groups, of supporting an offer and making it succeed, they need not lose as often as they win and can outperform the market. The possibility that arbitrageurs do exact monopoly profits by conspiring in effect to determine which offers will succeed may explain the curious prosecutorial focus on the financial services industry in the current campaign against insider trading. See Booth, *The Paradoxes of Insider Trading*, IN BRIEF, Sept. 1988, at 2 (published by Case Western Reserve University School of Law); *The SEC's Fight with Itself*, Wall St. J., Mar. 19, 1987, at 32, col. 1 (editorial); *Unusual Stock Moves Continue to Raise Questions About Leaks*, Wall St. J., Feb. 6, 1987, at 17, col. 4. But see OFFICE OF THE CHIEF ECONOMIST, SEC. AND EXCH. COMM'N, STOCK TRADING BEFORE THE ANNOUNCEMENT OF TENDER OFFERS: INSIDER TRADING OR MARKET ANTICIPATION? (Feb. 24, 1987) (concluding that legitimate speculation explains much of pre-announcement run-up).

37. Again, this assertion is based on the simplifying assumption that the demand curve is a continuous straight line. See *supra* note 33.

38. See Kraakman, *supra* note 4, at 933-36. Although it may seem contradictory to suggest that enhanced premiums might simultaneously decrease and increase the potential for takeover, in fact it is not. The point is that rules that artificially raise the premium that must be paid make the process by which targets are selected more random. Some companies that ought to be taken over are not, because profit would be insufficient to warrant the double premium; and others that should remain independent are taken over due to the artificially low price of company stock. The randomness (or risk) added by such rules constitutes a deadweight loss to the capital markets, even if

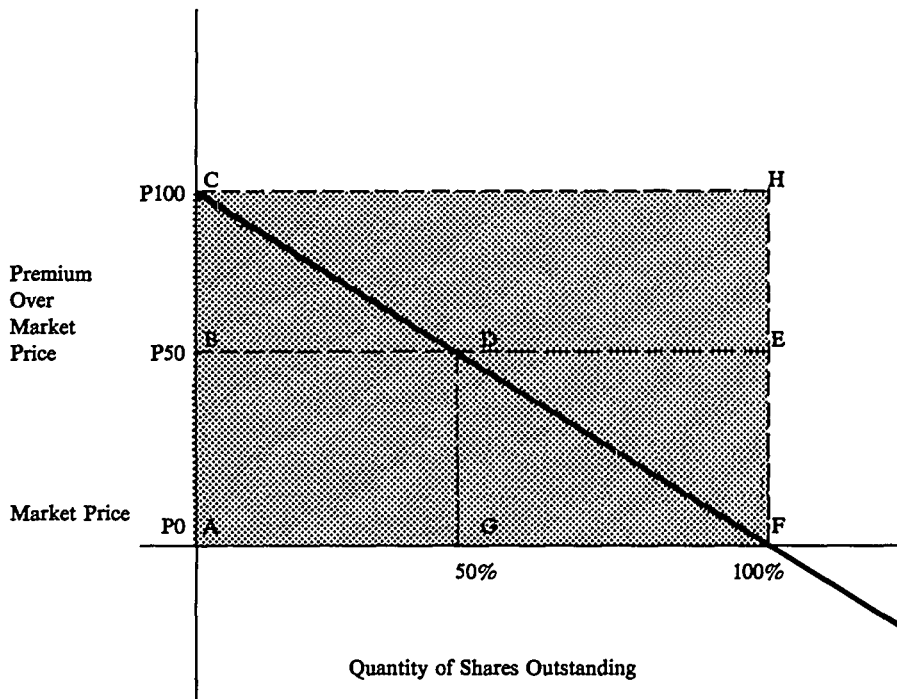


FIGURE II

2. Open Market Purchases and Unconventional Offers

The prototypical tender offer is a public offer of limited duration to all target shareholders to purchase shares at a premium over current market price, contingent upon the tendering of a minimum number of shares.³⁹ But the disclosure provisions of the Williams Act and the lack of a precise definition for tender offers have facilitated unconventional offers that either partially or completely fall outside the Act.

Although the Williams Act requires a purchaser of stock to report

in the aggregate there are the same number of tender offers under one system of rules as there are under the other.

39. But it has become common practice for companies offering to repurchase their own shares to state a range of prices allowing each tendering shareholder to state an acceptable price within the range. The offering company then determines at what price the desired number of shares can be bought. See, e.g., *Notice of Offer to Purchase for Cash by The May Department Stores Company 10,250,000 Shares of its Common Stock*, Wall St. J., Mar. 3, 1989, at C18, col. 1. While such offers are not precisely stairstep offers, they do have a flavor of stairstepping in that the bidder can presumably purchase shares for somewhat less than otherwise; shareholders who would accept a lower price have an incentive to state the lower price and cannot take advantage of a bid designed to satisfy the highest-valuing target shareholder. Cf. Schwartz, *supra* note 21, at 172-75.

For a proposed tender offer bidding scheme that would effectively allow stairstep and modified stairstep offers in third-party tender offers, see Burnovski, *supra* note 32, at 302.

to the SEC and the target company within ten days of his acquiring five percent or more of any class of the company's stock, there is no limit to the percentage of shares that he can acquire during the ten-day window.⁴⁰ This window allows him to establish a "beachhead" stock position before he falls within the requirements of the Act and, in fact, substantial open market purchases precede many tender offers.⁴¹ Accordingly, tender offers, even under the Williams Act, are often a hybrid of staircase and highest price offers. Moreover, a bidder may continue to purchase shares privately or on the open market indefinitely, so long as each purchase is reported within ten days, and thus avoid the Williams Act bidding rules altogether.

A Senate committee has identified the ten-day window as a particular problem with the Williams Act, and has suggested that the time allowed for a bidder to report be reduced.⁴² But the ten-day window is only the tip of the iceberg. Even if the window were closed, the question would remain whether private or open market bids that do not follow the Williams Act bidding rules would be allowed. It is unlikely that the Williams Act as currently written could be construed to extend to a private sale of control by a single controlling shareholder. The Williams Act nowhere defines the term "tender offer," and the SEC, not surprisingly, has been unable to forge a consensus on what constitutes a tender offer. Thus the task of defining tender offers has been left to the courts.

In one of the earliest cases to address the issue, *Wellman v. Dickinson*,⁴³ a bidder waited until the market closed one Friday afternoon then made a limited private offer to thirty-nine institutions and individuals to buy target company stock at a substantial premium on the condition that the seller agreed to sell before the evening was out. Even though the purchases were made one at a time over the phone, the court found the scheme to be a tender offer, primarily because the bidder had offered a premium price for a limited time only and the offer was contingent on his getting at least 20% of the target's shares.⁴⁴

Although *Wellman* remains the leading case on what constitutes a tender offer, courts tend to apply its definition narrowly, possibly because

40. Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d) (1988). There is, however, currently a movement afoot to require disclosure within five days because the ten day delay is considered a distinct advantage for bidders. See SENATE TENDER OFFER REPORT, *supra* note 6, at 18-19.

41. See, e.g., *Chiarella v. United States*, 445 U.S. 222, 234 (1980) (discussing practice of "warehousing" target stock before announcement of bid); see also Freund & Easton, *The Three-Piece Suit: An Alternative Approach to Negotiated Corporate Acquisitions*, 34 BUS. LAW. 1679 (1979); Tobin & Maiwurm, *supra* note 12.

42. See SENATE TENDER OFFER REPORT, *supra* note 6, at 18; Note, *Proposed Legislation to Close the 13(d) Window*, 66 WASH. U.L.Q. 433 (1988) (authored by Kimberly A. Lynch).

43. 475 F. Supp. 783 (S.D.N.Y. 1979).

44. *Id.* at 821-25.

they are increasingly skeptical of the value of Williams Act bidding rules. For example, in *SEC v. Carter Hawley Hale Stores, Inc.*,⁴⁵ a hostile tender offer prompted Carter Hawley Hale, the target, to make a standing offer to buy back its own shares in the open market at the prevailing price. When that offer was challenged, the court held that it did not constitute a tender offer because there was no premium, no time limit, and no condition that the offer would be good only if some minimum number of shareholders responded.⁴⁶ In a more recent case, *Hanson Trust PLC v. SCM Corp.*,⁴⁷ SCM resisted a Hanson Trust offer and negotiated a deal to be bought by Merrill Lynch. Hanson conceded defeat and announced it would return all the shares previously tendered to it. Later—and reportedly after two bottles of wine at lunch—Hanson officials hit upon an idea: Since a large proportion of SCM shares were held by market professionals who had purchased them during the takeover contest, Hanson might be able to buy enough shares from these arbitrageurs to block SCM's merger with Merrill Lynch. In a series of five transactions spanning eighty-four minutes, Hanson purchased 25% of SCM's outstanding shares at about a dollar over the market price.⁴⁸ SCM and Merrill Lynch, together with the SEC, sought to enjoin the purchases on the theory that together they constituted a tender offer. If Hanson had made a tender offer, it would have been illegal because, among other reasons, it did not remain open for the mandatory twenty days. The court rejected the plaintiffs' claim because the purchases had been made near the market price.⁴⁹

In many ways it is logical not to treat Hanson's offer as a tender offer. Clearly, Congress did not intend the Williams Act to govern *all* open market and private purchases of large blocks of shares. Because of arbitrage, however, open market purchases must be seen in an entirely different light. It was only because there was, or had recently been, another offer pending that Hanson could block the other merger by quickly purchasing a large number of shares from a small number of shareholders. Moreover, the Hanson offer was naturally more attractive than the pending tender offer; any arbitrageur who wanted to bail out and avoid the risk that the winning offer might still fail was free to sell to Hanson, presumably at some gain. The same was true in *Carter Hawley Hale*. In general, any shareholder could in effect "tender" to the issuer at virtually the same price offered by the outside bidder, but without the risk that the bid might fail. An unconditional offer outside the confines

45. 760 F.2d 945 (9th Cir. 1985).

46. *Id.* at 952.

47. 774 F.2d 47 (2d Cir. 1985).

48. Interestingly, the last three of those trades were initiated by large investors who correctly guessed from anonymous ticker reports that Hanson was the purchaser in the first two. *Id.* at 52-53.

49. *Id.* at 57-58.

of federal tender offer regulations is thus very attractive: There is no chance that the offer will be withdrawn before the sale is completed or that the seller will suffer proration because too many shares were tendered.⁵⁰

Although both *Carter Hawley Hale* and *Hanson Trust* involved competing tender offers, the features of those offers that effectively exempted them from the Williams Act could appear in an initial bid. For instance, following the lead of *Carter Hawley Hale* a bidder might announce that he is willing to buy a large number of shares on the open market at prevailing prices. Such an offer might well cause the price of target stock to rise, and thus might pressure shareholders into tendering before the offer is withdrawn without notice and the price falls. In line with *Hanson Trust*, a bidder might purchase a block of shares privately, announce his purchase publicly (as it might even be required to do by the Williams Act), and generate speculative buying by arbitrageurs from whom he could buy the shares at will.

The success of unconventional offers further limits the efficacy of the Williams Act bidding rules. The uncertainty of when the Act will apply creates confusion among shareholders and increases risk for both shareholders and bidding companies, with a corresponding increase in cost of capital for all corporations.⁵¹ Bidders will be reluctant to incur the costs of identifying a target and mounting a conventional tender offer⁵² if a subsequent bidder can enter and "sweep" the market,⁵³ particularly since the interloper could opt not to buy the first bidder's shares.⁵⁴ Shareholders too will face greater risks in tendering; if they tender to the first bidder, they will be unable to take advantage of possibly fleeting opportunities to sell to subsequent bidders. Clearly, the safer tactic is to

50. See generally Note, *Proposed SEC Regulation of Market Sweeps: Should Market Sweeps be Governed by the Williams Act?*, 56 FORDHAM L. REV. 797 (1988) (authored by Maureen F. Baker).

51. Regarding the relationships between risk and return and cost of capital, see generally LORIE, DODD & KIMPTON, *supra* note 32, at 13-24; W. KLEIN & J. COFFEE, *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES* 207-16, 277-80 (3d ed. 1988).

52. See Easterbrook & Fischel, *Proper Role*, *supra* note 2, at 1178-79, 1189-90.

53. The SEC has proposed a rule against such market sweeps. See *Acquisitions of Substantial Amounts of Securities and Related Activities Undertaken During and Following a Tender Offer for Those Securities*, Exchange Act Release No. 24,976, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,160 (Oct. 1, 1987); Blanc, *Commission Proposes to Outlaw Market Sweeps*, Nat'l L.J., Nov. 9, 1987, at 28, col. 1.

54. See *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (noting that the initial bidder took genuine risk because there could be no assurance of purchase of shares by subsequent successful bidder); cf. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1034-38 (1982); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 871 (1981) (both noting that the initial offeror can hedge against possibility of being outbid by buying shares in the open market prior to making a public offer). However, the danger of a first bidder being stuck with shares acquired in an unsuccessful bid is reduced considerably by the new rule requiring that tender offers be open to all holders. Securities Exchange Act Rule 14d-10, 17 C.F.R. § 240.14d-10 (1989).

sell in the open market, which strengthens the hand of the arbitrageurs still further.

The obvious solution to the problem of more unconventional offers is a more flexible definition of what constitutes a tender offer. Such a definition might focus on the extent to which shareholdings have become concentrated among professional investors. Perhaps any offer that would result in the bidder owning 5% or more of any class of target stock (the current standard for requiring that tender offers comply with Williams Act bidding and disclosure rules) should be deemed to be a tender offer.⁵⁵ Such a rule is unlikely, however, for neither Congress nor the SEC is likely to prohibit or even significantly regulate private sales of control. But the line between a private sale of control and a public tender offer is inherently fuzzy and may well differ from offer to offer. Thus the SEC has never been able to generate a consensus on an explicit definition of tender offers, and, after some flirtation, the courts have clearly rejected the one promising alternative definition, namely, the rapid accumulation of shares attended by publicity.⁵⁶ While past failures to come up with a definition are not necessarily a reason to stop trying, they are an indication that success is unlikely.

3. *Two-Step, Two-Tier, and Partial Offers*

Bidders have devised still other strategies around the provisions of the Williams Act. These strategies include two-step, partial, and two-tier offers. In a two-step bid, the bidder offers to buy a controlling interest in the target company and promises to cash out the non-tendering shareholders in a second-step merger at the price at which the tender offer succeeded. In a partial bid, the offeror seeks a controlling interest but offers no assurance that non-tendering shareholders will receive a premium in a second-step transaction. And in a two-tier bid, the offeror announces that some price lower than the front-end price, perhaps as low as the pre-offer market price, will be paid to holdouts in a second-step transaction.

Consider the two-step offer depicted in Figure III. The bidder has announced a tender offer for 50% of the target shares at a premium of P50 and has announced that if the offer succeeds, it will cash out the remaining shares at the same price.⁵⁷ The Williams Act governs the tender offer, and state law governs the second-step cash-out merger. In

55. This 5% standard was suggested in Proposed Amendments, *supra* note 18, and by the SEC Advisory Committee on Tender Offers, see *Excerpts from Final Report of SEC Advisory Committee on Tender Offers*, 15 Sec. Reg. & L. Rep. (BNA) No. 28, at 1379 (July 15, 1983).

56. For example, the courts in both *Carter Hawley Hale*, 760 F.2d at 952-53, and *Hanson Trust*, 774 F.2d at 57-58, rejected the rapid-accumulation-plus-publicity definition applied in *S-G Securities, Inc. v. Fuqua Investment Co.*, 466 F. Supp. 1114, 1126-27 (D. Mass. 1978).

57. In order to gain absolute control of the target, the bidder would, of course, need to acquire

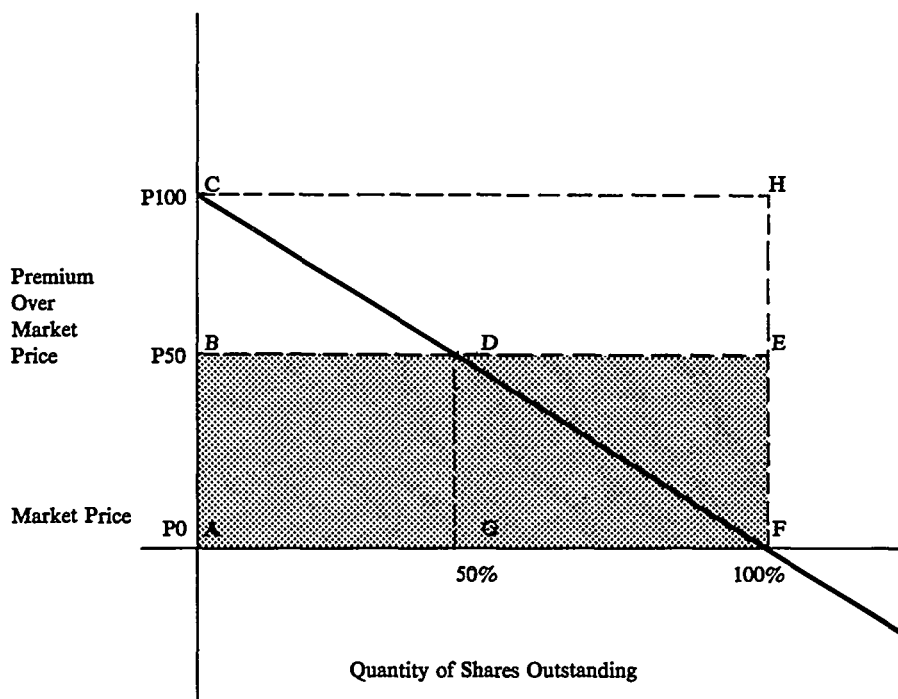


FIGURE III

the front-end tender offer, the tendering shareholders receive a premium equal to the area of rectangle DEFG. In the second-step merger, the remaining shareholders receive an equal premium represented by rectangle ABDG. In the aggregate, these premiums equal the area of triangle ACF. In other words, the bidder pays the same total premium that he would have paid if he could have stairstepped all the shareholders. The bidder avoids paying the double premium required by the highest price rule in a tender offer for 100% of the shares.

At first glance, such an offer appears distributionally unfair to target shareholders: Tendering shareholders are overcompensated, and shareholders who are cashed out in the second step are undercompensated. Since rational shareholders diversify,⁵⁸ however, an investor should not care whether in some cases she may be cashed out for too little since in other cases she will be among the tenderers. On average, a diversified shareholder will be fairly compensated if in the aggregate an adequate premium is paid.

50% +1 of the outstanding shares. For simplicity, this and subsequent figures ignore the slightly higher premium that might be needed to obtain the last share.

58. See generally LORIE, DODD & KIMPTON, *supra* note 32, at 80-87.

In some situations, however, shareholders as a group will in fact be undercompensated. In the preceding example the offeror announced in advance his plans to cash out the remaining minority shareholders at an equal price. But neither the cashout, nor the equal price, nor the advance announcement is legally required.⁵⁹ An offeror might announce that it plans to cash out the minority at the pre-offer market price, which is to say at a zero premium. Or the offeror may say nothing about what it intends to do if control is achieved. The target shareholder who holds out thus faces the prospect of owning shares in a captive company, raising the likelihood that if the offer succeeds her shares will trade at depressed prices.⁶⁰

Figure IV depicts the effect of such a two-tier or partial bid. The possibility of being stuck with the market price—that is, the absence of any assurance that the shares of non-tenderers will be purchased at as high a price as that received by tenderers—makes everyone more inclined to tender in the first place. The demand curve as a whole thus shifts downward, as indicated by the arrows. As depicted, control of the target company can now be achieved for a premium of P35. Although *tendering* shareholders are adequately compensated on average (and indeed are slightly overcompensated), the shareholders of this target as a group are undercompensated by an amount equal to DD'E'E. Moreover, if the second-step cashout is at the old market price, the bidder can acquire the target for a premium equal to D'GFE', which is less than half the aggregate premium shown in Figure III. And if the bidder simply declines to do the cashout, shareholders who declined to tender may even sustain a loss since the new market price may be lower than the old market price. This loss is depicted by rectangle AA'G'G. Though the bidder does not *gain* from the loss suffered by the holdouts, shareholders are

59. See Comment, *The Front End Loaded, Two-Tiered Tender Offer*, 78 NW. U.L. REV. 811 (1984) (authored by David J. Peterson, Jr.).

60. There are numerous reasons why the price might decline after the bidder achieves control. First, future tender offers are precluded. Moreover, the new parent company may operate the target largely for its own benefit. See, e.g., *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) (majority shareholder may dictate dividend policy as long as not harmful to corporation). But see Schwartz, *supra* note 21, at 172-84 (arguing that coercion is not a major problem).

I do not mean to suggest that the fairness of price in a tender offer should be judged by whether a "sole owner" of the same assets would have sold at the price offered (or at a higher or lower price). See Bebchuk, *The Sole Owner Standard for Takeover Policy*, 17 J. LEGAL STUD. 197 (1988); Schwartz, *supra* note 21; Schwartz, *The Sole Owner Standard Reviewed*, 17 J. LEGAL STUD. 231 (1988). Indeed, implicit in my analysis here is the idea that different shareholders might fairly receive different premiums and that the fairness of a tender offer regulatory scheme should be judged on how well it approximates this result. Thus I agree with much of Professor Schwartz' argument, but the reforms I propose are in many ways similar to the ones proposed by Professor Bebchuk. I thus suspect that the controversy over whether a sole owner standard is appropriate is something of a red herring.

the Williams Act's highest price rule contributes to the tendency of bidders to employ coercive tender offers, it arguably does more harm than good.⁶⁴

C. *Defensive Tactics*

Target company defensive tactics may in fact do more than the Williams Act to promote shareholder equality in tender offers. This may seem curious since defensive tactics incite as much, if not more, outrage than hostile bidders and arbitrageurs do.⁶⁵ Critics of defensive tactics argue that target management's efforts to thwart hostile bids deny target shareholders the opportunity to decide whether or not to sell at an attractive premium. Their argument has merit when the bid is for all of the target stock or is a two-step bid with an equal price freeze-out. But in a partial or two-tier bid, where holdouts can suffer losses that conceivably exceed the gains to tenderers, defensive tactics may serve to protect shareholders from bidder coercion.

1. *Poison Pills*

The prime example of a current defensive tactic is the evil-sounding poison pill. A typical poison pill gives the holder of each share a warrant that entitles her to buy additional shares of the company at a set price, possibly even below the market price prevailing prior to the announcement of the bid, in the event of a hostile bid against the company.⁶⁶ A bidder who purchases 50% of the shares of a company with a plan that

64. Some argue that because so few coercive offers are now being made, there is no reason to worry about them for purposes of formulating a regulatory scheme for tender offers. See Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846, 846-47 (1989). But it is impossible to tell whether the demise of coercive offers reflects shareholders' recognition of them as inferior or the effectiveness of defensive tactics installed by target companies. Booth, *State Takeover Statutes Revisited*, 88 MICH. L. REV. 120 (1989). If the latter is the case, then arguably troubling defensive tactics have arisen because of coercive tactics. It would thus seem appropriate to devise a regulatory system that eliminates coercion and prohibits defensive tactics.

65. See, e.g., Easterbrook & Fischel, *Proper Role*, *supra* note 2 (arguing that defensive tactics decrease shareholder welfare and advocating managerial passivity); see also *Amanda Acquisition Corp. v. Universal Foods Corp.*, Nos. 89-1581, 89-1712 (7th Cir. May 24, 1989) (opinion by Easterbrook, J.).

66. See generally *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985) (upholding, under the "enhanced" business judgment rule, the adoption of a poison pill); FERRARA, BROWN & HALL, *supra* note 7, at 200-03, 337-74; Dawson, Pence & Stone, *Poison Pill Defensive Measures*, 42 BUS. LAW. 423 (1987). One type of poison pill, sometimes known as a "flip-in," allows target shareholders after a merger to purchase some number of shares of the bidder company at some fraction of the market price. Though the enforceability of such options might seem questionable, the main argument in their favor is that after a merger the surviving company succeeds to all rights and obligations of the extinguished company by operation of law and without further action. See, e.g., DEL. CODE ANN. tit. 8, § 259 (1987). Moreover, flip-in pills do not differ in concept from fairly common antidilution provisions which allow the holders of convertible securities to accede to rights to convert into securities of the survivor of any merger.

allows target shareholders to buy, say, 5 additional shares at a bargain price would find that the remaining shares plus their triggered rights would constitute a 300% interest, reducing what first appeared to be an acquired 50% voting position to a 14% voting position. Faced with such a poison pill, the bidder would need to acquire between 85% and 90% of the target's stock (together with the warrants attributable to it) to be completely assured of control of the company. In effect, then, a poison pill operates like a supermajority voting requirement. The difference is that it affects the outcome not only of merger votes but of all votes including those to elect and remove directors. It thus greatly hampers a bidder's acquisition of control even via non-merger devices.

It must be emphasized that a poison pill will not block a takeover if the bidder is willing to buy a large enough percentage of target shares. From the target shareholder's point of view, exercising one's warrants in connection with a bid that is likely to succeed is equivalent to opting into the neglected end of a partial tender offer.⁶⁷ Thus, instead of absolutely barring a takeover, a poison pill allows the board of the target company to decide what percentage of stock ownership by the bidder is adequate to offset the likely harm to holdouts. From this perspective, the initially surprising judicial response to poison pills—that they are legal as long as they are appropriate to the perceived threat—seems quite sensible.⁶⁸

One may thus view poison pills as a way for the target to fight fire with fire, rather than as a sale of shares to holdouts at bargain basement prices. Partial and two-tier bids derive their coercive power from the transfer of wealth from holdouts to tenderers that they threaten. The poison pill transfers this wealth back to the holdouts—assuring equal treatment of all shareholders—by giving them more stock. This is quite apparent from Figure IV: The target company's sale or distribution of shares to holdouts for less than the stock's current market price is not

67. This consideration may lower the percentage of stock a bidder must acquire in order to avoid the effects of a poison pill, since in close cases a potential holdout target shareholder would probably decline to invest more in the target company and instead would tender.

68. In ruling on the legality of defensive tactics, the courts have been sympathetic to the possibility of shareholder losses resulting from coercive bids. In the early cases, the prevailing rule was that management must have some business purpose in undertaking any defensive move; in the absence of such a purpose, an active defense using corporate resources could be viewed only as an effort by management to entrench itself. *See, e.g., Johnson v. Trueblood*, 629 F.2d 287 (3d Cir. 1980) (plaintiff must show that the sole or primary motive of defendant managers was to retain control), *cert. denied*, 450 U.S. 999 (1981).

It is notoriously easy, however, to concoct an adequate business purpose. For example, it was frequently claimed—in spite of a substantial premium—that the offered price was too low. *See, e.g., Panter v. Marshall Field & Co.*, 646 F.2d 271 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). More recently, the courts have ruled that the propriety of takeover defenses should be judged against the threat posed by the hostile bid and, recognizing the distinctive dangers of partial and two-tier offers, have held some tactics to be legal that a few years ago probably would have been viewed as unquestionably abusive.

necessarily objectionable in circumstances in which the holdout's stock ends up being worth less than it was before the offer.⁶⁹

Because of the Williams Act's highest price rule, a poison pill that effectively requires a high percentage of shareholders to tender forces the bidder to pay too much for the company. As depicted in Figure II, this result causes bidders to make a suboptimal number of tender offers. Nevertheless, on balance investors may lose less as a result of poison pills than they do from partial and two-tier bids. In addition, the utility of poison pills directly depends on the good judgment and good faith of target managers who essentially set the percentage ownership necessary to assume control of the target. The difficulty in predicting at the time of adopting a poison pill how much harm potential holdouts are likely to suffer in a future bid makes it virtually impossible to review the judgment of management in connection with the adoption of a poison pill.⁷⁰ In addition, allowing the board to sell stock at apparent bargain prices in the context of a hostile takeover—whether in connection with a poison pill or otherwise—creates an opportunity for abuse by target managers who may be willing to defend their position at any cost to the company and shareholders. While management may have to demonstrate that the firm received a fair price,⁷¹ it remains free to make self-serving decisions motivated primarily by a desire to remain in office.

2. *Greenmail*

While poison pills are widely criticized, their notoriety pales in comparison to greenmail.⁷² Greenmail is the repurchase by a target company

69. The same argument may also justify the sale of large blocks of stock to friendly bidders who intervene in a hostile takeover or fear that competition may arise as a result of their own first bid. See, e.g., *Gearhart Indus. v. Smith Int'l, Inc.*, 741 F.2d 707 (5th Cir. 1984); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985); Note, *Lock-Up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068 (1983).

70. A distinction seems to be emerging between defensive tactics undertaken prior to the commencement of an offer and those instituted in response to a particular threat. Curiously enough, either situation can support a finding that the board acted in good faith. Compare *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985) (upholding poison pill adopted after deliberation outside context of any offer) with *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) (self tender offer excluding bidder valid because tailored to the actual threat). See also Baysinger & Butler, *supra* note 32, at 1297-1303 (arguing that shark repellents adopted prior to hostile offer are presumptively valid).

71. See *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 131-37 (1986); see also Burnovski, *supra* note 32 (proposing regulatory scheme that allows for differential offers). The sale of stock for less than the tender offer price is not conclusive proof of managerial bad faith when it is in response to a partial or two-tier offer. Note, *Corporate Auctions and Directors' Fiduciary Duties: A Third-Generation Business Judgment Rule*, 87 MICH. L. REV. 276, 284-88 (1988) (authored by Steven G. Bradbury).

72. See Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1

of the stock acquired by a bidder (or potential bidder), typically at a substantial profit to the bidder.⁷³

Arguably greenmail arises from aborted arbitrage that is encouraged in the first place by the Williams Act. That is, the Act itself may encourage greenmail by creating incentives for arbitrage and by contributing to the attractiveness of two-tier bids. Greenmail is the most direct possible defense to a takeover: it amounts to bribing the bidder to go away. But even a bribe may be called for if the bid is coercive. It may be appropriate for a company to buy back the bidder's shares at a premium if the remaining shareholders stand to gain from either a subsequent bid or the company's continued independence.

When managers use the technique to entrench themselves in their positions, however, the abusiveness of greenmail is evident. Not only are remaining target shareholders denied the opportunity to tender for a premium price, but their wealth is used for management benefit to buy off the bidder.⁷⁴ Target shareholders thus lose twice. Moreover, the price of the target's stock often declines after the repurchase to a level below that prevailing before the greenmailer began buying.⁷⁵

On average, however, the decline in price after a repurchase is a remarkably slight 5%, and in some cases the stock continues to trade at prices higher than before the greenmailer began purchasing.⁷⁶ This phenomenon is difficult to explain except as a result of the relationships depicted in Figure I. If there is a single best estimate of the value of a share of target stock, then the corporation's repurchase of one shareholder's stock at a premium clearly harms the remaining shareholders. Payments to the greenmailer in excess of the putative correct price reduce the value of the stock held by the remaining shareholders. If, however, one assumes that stocks have downward-sloping demand curves,⁷⁷ then one must analyze the issue differently.

In the situation depicted in Figure I, for example, if the target company repurchased the arbitrageur's stock at the current market price of P50, the arbitrageur-turned-greenmailer would enjoy the same gain (equal to half the shaded rectangle) that he would receive from a sale of the same stock to an outside bidder. As Figure I illustrates, greenmail

(1987); Note, *Greenmail: Targeted Stock Repurchases and the Management Entrenchment Hypothesis*, 98 HARV. L. REV. 1045 (1985).

73. See generally Macey & McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L.J. 13 (1985).

74. See, e.g., *id.* at 38-48.

75. *The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices*, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,713 (Sept. 11, 1984).

76. Macey & McChesney, *supra* note 73, at 43-48.

77. See *supra* note 32.

does not necessarily infringe on the wealth of the remaining shareholders, and it quite clearly improves the lot of shareholders who sold out to the greenmailer in a rising market, since the possibility of greenmail may contribute to some extent to the willingness of some bidders to buy in the first place. The remaining shareholders, by comparison, have declined to sell presumably because they continue to believe that the target stock is worth more than the greenmailer is offering. While there may be shareholders at the margin who will complain, particularly if the price paid to the greenmailer exceeds the new market price, Figure I suggests that greenmail may preserve the company under current management for those shareholders who place a relatively high value on the existing operation. Greenmail can thus be likened to a partial management buyout initiated from without the company, or an optional dividend paid to shareholders who disagree with the investment strategies of current management.⁷⁸

Similar arguments about the possible utility of greenmail have been advanced elsewhere. For example, greenmail can serve an important negotiating function in a longer-term auction of the target company by signalling to potential bidders that the target was undervalued in the first place and that target management believes a still higher price is warranted.⁷⁹ In other words, greenmail might be thought of as the opposite of a lock-up option: By paying greenmail the target announces that it is worth more than the greenmailer offered even after subtracting the greenmail payment.

Figure I suggests several ways to determine whether the board should pay greenmail. For example, if the aggregate premium paid to the greenmailer over the market price at successive levels of demand is less than or equal to the area of the trapezoid over the remaining shareholders, the payment is arguably proper. This analysis is depicted in Figure V. There the greenmailer acquired 20% of the target stock, raising the market price to P20, and the target then repurchased at P30, representing an additional premium over the new market price equal to the shaded rectangle D'D'''E'''E''. The true premium paid includes, of course, the amount represented by triangle D'E''F (the arbitrage gain). Nevertheless, this instance of greenmail appears to be defensible in that the value preserved for higher valuing shareholders (area AG'D''C) exceeds the total premium paid to the greenmailer and the shareholders who sold out. Where as here the percentage of shares repurchased is relatively small, the premium must be quite large in order to exceed the value remaining to the holdouts.

Analysis of a greenmail deal depends on the market price taken as a

78. See Booth, *Management Buyouts*, *supra* note 32.

79. See Macey & McChesney, *supra* note 73, at 16-27.

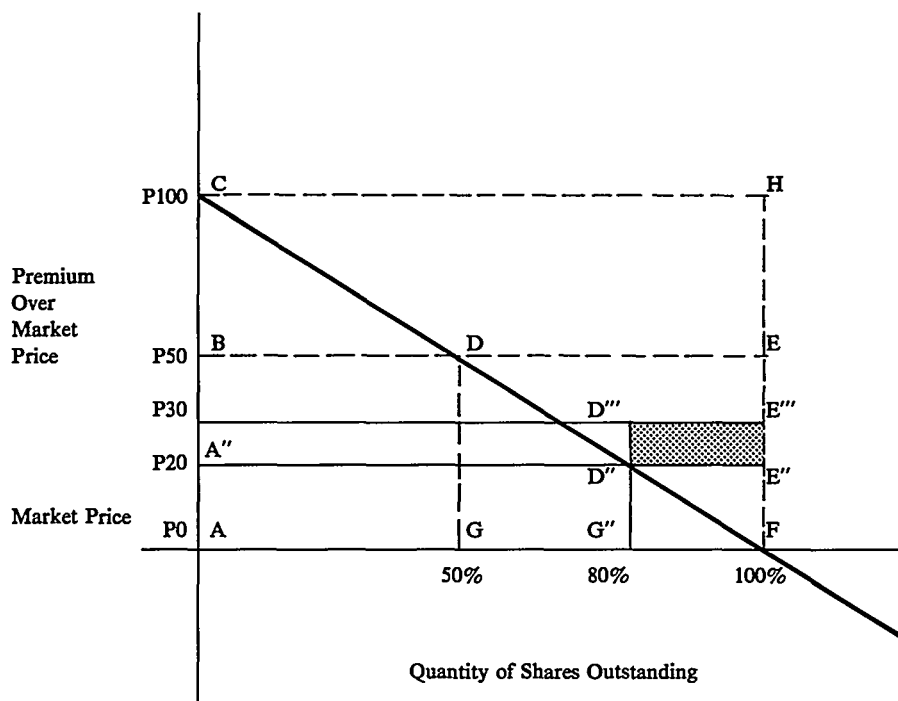


FIGURE V

benchmark for value preservation as well as the shape and slope of the demand curve for the target stock. For example, suppose that the holdout shareholders believe that the run up in the market price prior to the repurchase has established a new floor price for the stock. The question whether a repurchase preserves value must be answered by comparing the additional value perceived by holdouts, triangle A''D''C in Figure V, with the premium over the new market price paid to the greenmailer, that is, rectangle D''D'''E'''E'' alone, since the newly established floor price must hold for the greenmailer too.

Moreover, suppose that the demand curve is relatively flat. In such a case, what might appear to be a modest premium may nevertheless be abusive. For example, in Figure V(A) the greenmail premium over the newly established market price exceeds the value remaining to the holdouts. Such a result is even more pronounced if the demand curve is not a straight line, but is instead horizontal above a particular percentage, as depicted in Figure V(B). In this example, the greenmailer has bid up the price of the stock to a point at which a marginal additional premium would result in a flood of tenders. Any additional premium paid in connection with a repurchase would thus come out of the pockets of holdout shareholders.

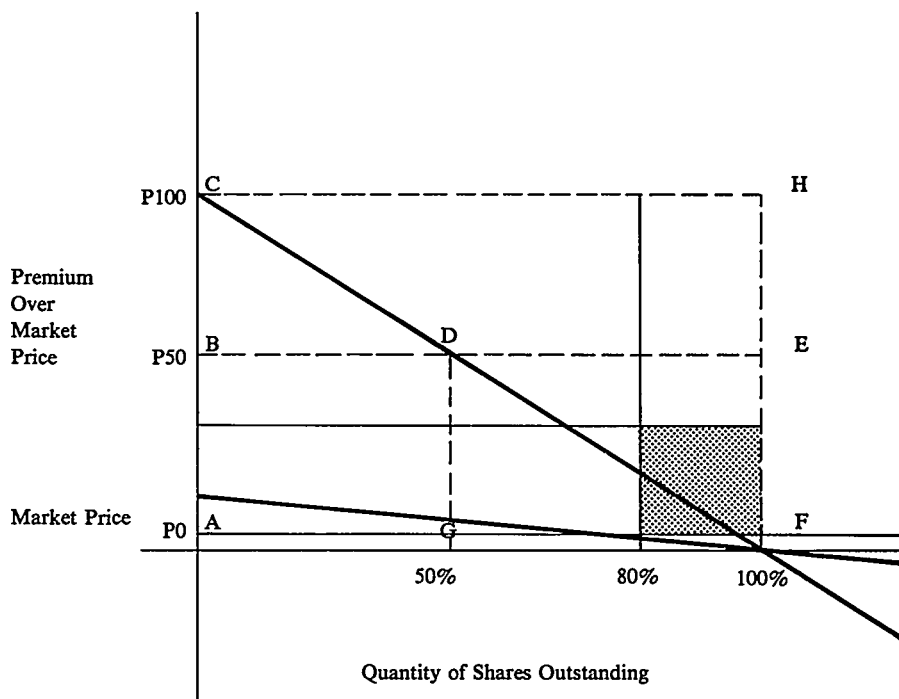


FIGURE V(A)

Where the bidder is believed to be planning a partial or two-tier offer, greenmail may be even more defensible than it appears in Figure V. If the market price available to holdouts is lower than the market price prevailing before the greenmailer began purchasing, the repurchase of the greenmailer's shares will preserve value for holdouts.

The repurchase depicted in Figure V, however, may be abusive if the greenmailer lacks either the true intent or the ability to carry out the threatened takeover. In such a case, the repurchase would be wholly unnecessary even though the payment is exceeded by the remaining value. Therefore, at the very least a corporate board contemplating a greenmail payment must in good faith factor in the risk that the greenmailer is bluffing.⁸⁰

To sum up, properly employed management defensive tactics can counteract the pressure to tender. But they pose distinct dangers as well, affording management the opportunity to make self-serving determinations and to use defensive tactics as a means of entrenchment.

80. See generally Johnson & Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 325-39 (1987) (describing duties and obligations of directors when considering mergers or tender offers).

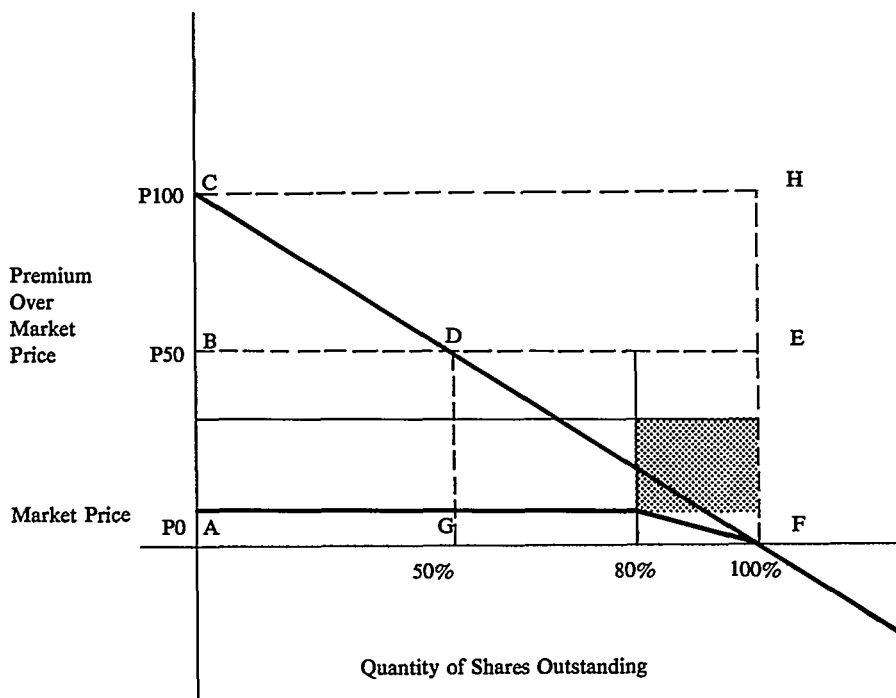


FIGURE V(B)

3. Buyouts and Recapitalizations

While poison pills and greenmail can be quite effective in resisting coercive offers, management buyouts and recapitalizations can completely eliminate the threat of takeover by either cashing out public shareholders or removing their voting power.⁸¹ Although the wisdom and fairness of buyouts and recapitalizations can be considered in isolation, they must also be addressed in any comprehensive scheme of takeover regulation.

In a typical buyout, management forms a new company, capitalizes it with management-owned stock in the target together with massive amounts of new debt, and then negotiates a merger with, or makes a tender offer for, the target.⁸² The tender offer can take any of the forms a third-party tender offer can take. Interestingly enough, two-tier offers

81. See Coffee, *Regulating the Market*, *supra* note 1, at 1195-98.

82. See Booth, *Management Buyouts*, *supra* note 32. There is a vast and growing literature on management buyouts. Until recently, the most salient issue seemed to be whether outside shareholders are adequately compensated for the stock that they are often forced to give up. See *id.* at 639-41. Lately, however, the major concern seems to be whether outside shareholders are overcompensated at the expense of creditors. See McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205 (1988); Note, *Fraudulent Conveyance Law and Leveraged Buyouts*, 87 COLUM. L.

may be used more often in connection with management buyouts than with third-party offers.⁸³

The usual object of a recapitalization is to concentrate voting stock in the hands of management and its loyalists without cashing out the public shareholders.⁸⁴ In a recapitalization, minority shareholders might be offered two shares of non-voting stock in exchange for each share of voting stock. Assuming the two types of shares are equal in other respects the offer would be quite tempting for any shareholder who has too few votes to matter much anyway. Even the shareholder who has a significant number of votes might be sorely tempted to accept the offer: If everyone else accepts, management could end up with an outright majority of the voting stock, and the votes that formerly were significant to the holdout could be reduced to a large minority interest.⁸⁵ In other

REV. 1491, 1504 n.104, 1509 (1987) (authored by Kevin J. Liss); Booth, Book Review, 57 U. CIN. L. REV. 657, 672-76 (1988) (reviewing FERRARA, BROWN & HALL, *supra* note 7).

83. See Grundfest, *Two-Tier Bids Are Now a Defensive Technique*, Nat'l L.J., Nov. 26, 1987, at 26, col. 1.

84. See generally Voting Rights Listing Standards—Disenfranchisement Rule, Exchange Act Release No. 25,891, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,247 (July 7, 1988) [hereinafter Adopting Release]; Voting Rights Listing Standards—Proposed Disenfranchisement Rule, Exchange Act Release No. 24,623, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,143 (June 24, 1987) [hereinafter Proposing Release].

Buyouts and recapitalizations are in many respects very similar. The only real difference is that outside shareholders end up with cash or debt in the case of a buyout and lower voting stock together with a one-time dividend or enhanced future dividend rights in the case of a recapitalization. See Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807, 812-15 (1987); Hart, *SEC May Kill Shareholders with Kindness*, Wall St. J., July 14, 1988, at 26, col. 3.

There are important procedural differences between buyouts and recapitalizations, however. A typical buyout, which proceeds by merger, will require a shareholder vote and will almost always trigger appraisal rights. On the other hand, recapitalization can be carried out by voluntary exchange, though it *could* be accomplished by merger or even a simple vote of the shareholders. In most jurisdictions, a voluntary exchange will not require a shareholder vote, except to authorize the new shares if necessary, and the vote to authorize new shares will not typically trigger appraisal rights. See, e.g., REVISED MODEL BUSINESS CORP. ACT § 13.02 (1984).

85. Adopting Release, *supra* note 84, at 89,216, 89,221-22. There are several other methods of effectively recapitalizing a company so as to concentrate voting control in management. One is to issue a stock dividend of super-voting stock (that is, stock with more than one vote per share) that is transferable only if first converted into ordinary single-vote common stock. Outside shareholders will eventually convert in order to sell their shares while management will continue to hold the super-voting stock which, over time, will become concentrated in management's hands and will thus gradually increase the insiders' proportion of voting control. *Id.* at 89,220-21; Proposing Release, *supra* note 84, at 88,774.

Other very direct methods are amending the corporate charter to limit the number of votes that any one shareholder may cast (a "capped voting plan"), and requiring that shares be held for a particular period of time before voting rights attach (a "tenure voting plan"). Adopting Release, *supra* note 84, at 89,220-21. In most jurisdictions, amendments that change the rights that attach even to an *outstanding* share of stock are perfectly legal. See *Bove v. Community Hotel Corp.*, 105 R.I. 36, 249 A.2d 89 (1969); REVISED MODEL BUSINESS CORP. ACT §§ 10.01, 10.04 (1984).

Still another way to exchange stock with one set of rights for stock with another set is to effect a merger with a management-controlled shell company, as in a management buyout, but pay the

words, a recapitalization, presents many of the same problems of coercion that tender offers do.

Buyouts and recapitalizations are the ultimate defenses because, once completed, they cannot be overcome by an outside bidder except by negotiating with management. Moreover, they are often accomplished without competition from the outside, since management may have significant advantages. The competition may not be ready to respond quickly enough to challenge the management offer credibly. Moreover, management presumably has superior information about the company's value, and management has access to and influence over the board. Finally, management may well have significant shareholdings. This is not to say that management can simply dictate terms or even favor itself in any negotiation, but its edge is considerable.⁸⁶ Yet despite management's advantages, data indicate that management buyouts generate premiums that are as large on average as premiums generated in hostile tender offers.⁸⁷ And recapitalizations, though they do not generate premiums that are *as* large, still benefit shareholders significantly.⁸⁸ It would thus appear that although management could take advantage of its position, for the most part it does not.

While management enjoys significant benefits from both buyouts and recapitalizations, in both cases management often must surrender significant financial rights in exchange for assured control. The key question is essentially the same as with other defensive tactics: Is the cost to outside shareholders in lost offers matched by the benefit of cash in hand? There is no single answer; whether a defense is right or wrong depends on whether the shareholder is paid enough to suffer it.⁸⁹

Thus, it is difficult to generalize about the value of defensive tactics. But as long as partial and two-tier tender offers are legal, most defensive maneuvers *can* be beneficial for shareholders. It would be preferable, however, to eliminate the abuses—both offensive and defensive—that arise from the pressure to tender by regulating offers directly rather than by scrutinizing the incredible variety of available tactics on a case-by-case basis.

To summarize, the tender offer bidding provisions contained in the

outside shareholders in lower voting stock rather than cash or debt. See Adopting Release, *supra* note 84, at 89,220 n.94. Oddly enough, although the direct amendment route was held to be illegal in Delaware, see *Keller v. Wilson & Co.*, 21 Del. Ch. 391, 190 A. 115 (Ch. 1936), the merger route to the same end was perfectly legal, see *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 11 A.2d 331 (Ch. 1940).

86. See Booth, *Management Buyouts*, *supra* note 32.

87. See Kraakman, *supra* note 4, at 908 & n.63.

88. See Adopting Release, *supra* note 84, at 89,216-17; Proposing Release, *supra* note 84, at 88,772, 88,774-75, 88,778-79; Gilson, *supra* note 84.

89. The SEC has recently adopted a rule that effectively prohibits multi-class recapitalizations. See *infra* text accompanying notes 142-155.

Williams Act and the rules promulgated under it offer little if any valuable protection for target shareholders and arguably do a good deal of harm. Because of the rules, shareholders risk little in tendering early and much in holding out, and arbitrageurs enjoy artificially enhanced profits in those offers that are subject to the rules. Moreover, bidders are induced to employ coercive bidding techniques, including unconventional offers, in an effort to circumvent the rules, and target companies are provided with a ready excuse for defensive tactics that may often serve to entrench management.

II

WHY NOT REPEAL THE WILLIAMS ACT?

The repeal of the Williams Act's highest price rule seems to offer a simple solution to many of these problems. It would lessen the pressure on shareholders to tender, and thus help targets resist inadequate or coercive offers. Repeal of the highest price rule would lead to other rule changes. For example, withdrawal rights should be eliminated, since tendering shareholders could otherwise achieve highest price treatment by withdrawing their shares upon the announcement of any increase in the offered price. The proration rule could then be eliminated, since there would be very little danger of oversubscribed tender offers.

The net effect of these reforms would be to restore the shareholder to the position of having to make a decision to sell out or hold out. But that is as it should be: As long as the target shareholder is adequately informed and is given time to think, there is little reason to tamper with a fairly straightforward market mechanism. If the shareholder holds out too long, she risks losing the opportunity for any premium. If the shareholder tenders too soon, she risks losing the opportunity for a higher premium. Such risks are a perfectly natural part of dealmaking, and there is little reason to insulate shareholders from them.⁹⁰ At the same time, coercive offers may still present a problem in some situations.

Thus, in this Part of the Article, I outline the potential dangers of eliminating the Williams Act bidding rules. In particular, elimination of the highest price rule would carry with it the danger that a bidder could achieve control of a target company at a still lower premium than at present, because it could staircase early tenderers and freeze remaining shareholders into a minority position. Indeed, such a totally free-market approach would probably result in more pressure to tender than under current law unless it *required* a bidder who gains control to cash out the remaining shareholders at the highest tender-offer price. As will be seen,

90. See Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 18-20 (1978); see also Burnovski, *supra* note 32 (proposing regulatory scheme that allows for differential offers).

such a rule would itself have problems. First, it would eliminate potentially desirable partial offers (of which there presumably are at least some), and second, it would be difficult to enforce since it is difficult to know when control of the target has been achieved and a cash-out requirement should be triggered.

A. The Problem of Cheaper Tender Offers

One potential problem with repealing the highest price rule and eliminating withdrawal rights is that partial and two-tier offers would become a still cheaper way for bidders to gain control. As depicted in Figure VI, a bidder need only pay half the premium (equal to triangle

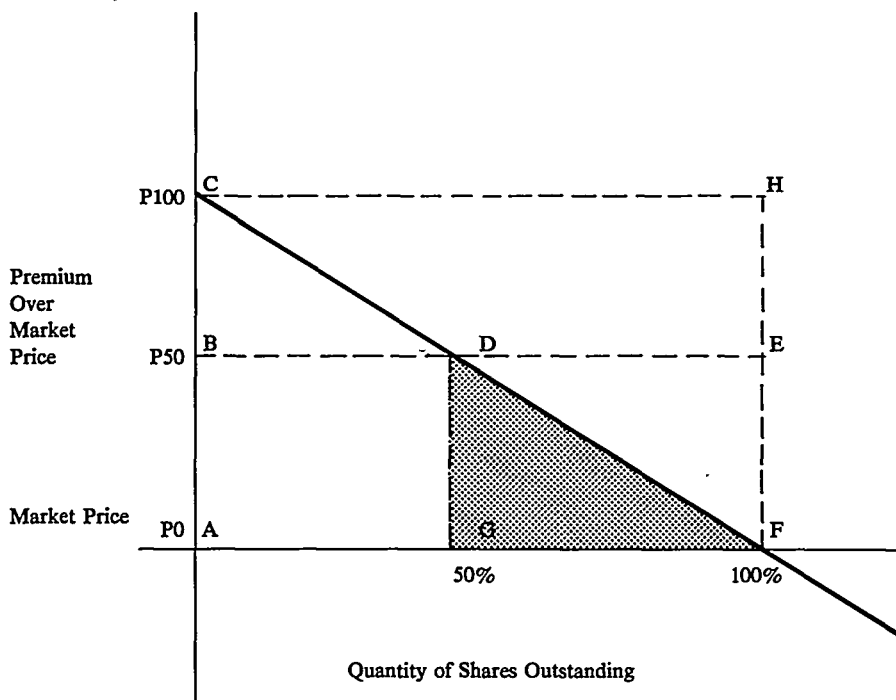


FIGURE VI

GDF) necessary under current rules. Since that rule would make a shift in control even more likely, target shareholders might be even more eager to tender, shifting the entire demand curve down and making the aggregate premium smaller. But, since partial stairstep bids are possible under current law anyway, one can argue that little would be lost by repeal of the Williams Act bidding rules.

One way to ensure that partial and two-tier offers do not become too cheap is to require the bidder who achieves control of a target to offer the

highest price to *all* remaining target shareholders. Figure VII depicts the effect of such a rule on shareholder wealth. Under this rule, target shareholders would receive an aggregate premium somewhere between that received in a two-tier bid with a second-step freeze-out at the pre-bid market price (Figure I), and the premium received in a two-step highest price bid (Figure III). The shareholders lose (as compared to the two-step highest price bid) only the premium represented by triangle DEF, which under current rules arbitrageurs appropriate anyway. In many cases both bidder and target shareholders benefit: Bidders who seek 100% ownership need not offer such large premiums and may therefore make more "any-or-all" tender offers. Moreover, the rule would standardize tender offers and render the current puzzle about their definition totally irrelevant. The less variation in the terms of tender offers, the less research target shareholders must do to determine the adequacy of the offer and the less the risk that an offer will fail or be withdrawn for unexpected reasons.

Opponents of this proposed rule might point to recent studies by the SEC which apparently confirm that target shareholders benefit from *all* kinds of tender offers. As might be expected, the greatest benefit came in the "any-or-all" offer in which shareholders received an average premium of 59.6%, while average blended premiums were 54.5% in two-tier offers and 20.1% in partial tender offers.⁹¹ The proposed rule would likely eliminate some partial and two-tier offers which arguably benefit target shareholders. There is, after all, no reason to think that every bidder who makes a partial bid intends to loot the target company. Moreover, it might be argued that in some cases bidders may not be able to afford the higher price, while in other cases, the perceived gain from acquiring the target may be too small to justify the higher price that would result from the new rule.

Notwithstanding the SEC study, the elimination of partial and two-tier offers would not harm shareholders in all cases, because shareholders are not necessarily better off as a result of the gains they receive from partial and two-tier bids. The idea that they are always made better off

91. OFFICE OF THE CHIEF ECONOMIST, SEC. AND EXCH. COMM'N, THE ECONOMICS OF ANY-OR-ALL, PARTIAL, AND TWO-TIER TENDER OFFERS at Table 4a (Apr. 19, 1985). It bears noting that these statistics support the idea that stocks have downward-sloping demand curves, although it could be argued that the difference in premiums is attributable to coercion. The SEC study does not differentiate between two-step offers in which the cash-out merger is announced in advance at a price equal to the highest tender price, and those in which the price of the cash-out merger is established in advance at a lower price than the highest tender price. The former sort of offer is not in fact coercive, though it has the potential to be. If such offers can generally succeed at lower prices than "any-or-all" offers, this would strongly support the theory that stocks do have downward-sloping demand curves. See also Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merger?*, 28 J.L. & ECON. 151 (1985) (initial litigation that provokes higher offer benefits shareholders).

by these gains rests on the premise that any premium is better than none.⁹² But if stocks do indeed have downward-sloping demand curves, target shareholders are not better off unless they receive a premium that is adequate on the average to satisfy their varying demands. Moreover, even if one ignores the possibility that shareholders have varying views of the value of target stock, it is clear that shareholders are not necessarily better off simply because more tender offers are made.

A simple example illustrates the point. Imagine a shareholder with a portfolio consisting of 100 shares each of 300 different companies. During the course of a year bids are made under current rules for 20 of those companies at premiums of \$20 over the market price, and all succeed. The shareholder receives a total premium of \$40,000. Now suppose that under the proposed rules successful bids are made for only 10 of the companies but at premiums of \$50 per share over the market price. The shareholder receives total premiums of \$50,000 and is clearly better off. Needless to say, the numbers are arbitrary: Different numbers might result in the shareholder being better off under the current regime.⁹³ The point, however, is that target shareholders are not necessarily worse off because some bids either are not made or fail. The SEC studies support this idea in a general way, in that the premium target shareholders receive depends on the form of the bid. In other words, shareholders do lose something from partial and two-tier bids.⁹⁴

92. See, e.g., Easterbrook & Fischel, *Corporate Control Transactions*, *supra* note 27, at 726-27. Professors Easterbrook and Fischel argue in effect that shareholder demand curves must be flat (perfectly elastic) because if shareholders had varying opinions of the value of the same share of stock, those who held higher values would buy from those who held lower values, even if they had to borrow to do so. But rational shareholders value diversification and would do no such thing under ordinary circumstances. That is, even if shareholders genuinely believed that a particular stock is undervalued in the market, they would not act on that belief and buy the stock beyond the point that the cost of decreasing diversification exceeded the gain of holding the undervalued stock.

Shareholder strategy changes, however, when an offer is made for the company. Then, target shareholders realize that they are in a negotiation with a bidder who seeks their shares in order to gain control and not to hold as a financial investment. In other words, they are dealing with someone who does not value diversification in the same way they do, and the situation is ripe for capturing some of the bidder's perceived gain. Moreover, there is no sacrifice of diversification by failing to tender.

93. Which scenario turns out to be correct depends on the shape of the demand curve for each target company. The steeper the curve, the more the premium will be depressed by coercive tactics, and the more shareholders stand to gain from anti-coercive rules such as those proposed here.

In a similar vein, Professor Coffee has argued that shareholder resistance to takeovers may be socially desirable if the market for corporate control is characterized by relatively inelastic demand, that is, the frequency of tender offers declines slowly as premiums rise. See Coffee, *Regulating the Market*, *supra* note 1, at 1178-92. The difficulty with this argument, however, is that it assumes that the market for corporate control is homogeneous and every target corporation has a similar demand curve. There is no reason to believe that this is the case, and a good deal of the analysis that follows here is founded on the implications of varying demand curves.

94. Professor Gilson has also pointed out that target shareholders may in fact be harmed by too small a gain, and has suggested that one way to determine whether such harm has occurred is to

Nor is it clear that bidders would be disadvantaged by the need to finance more any-or-all offers. Presumably, a bidder can always afford to buy a target company for less than it would be worth under new management. If the perceived gain is demonstrable, the bidder can borrow either from a bank or with junk bonds to finance the takeover.⁹⁵ Indeed, a bidder need not have firm financing to proceed with an offer.⁹⁶

Finally, if the perceived gain is too small to justify an offer under the proposed rules, the offer probably should not be made. If the bidder cannot afford to pay what each tendering shareholder would demand in an individual, staircase tender offer, the offer is too low. *A fortiori*, where the offeror cannot afford to pay the premium depicted in Figure VII (which is *less* than the shareholders would demand in the aggregate in a staircase offer for all the shares), the offer should not be made, and, if made, it should not succeed.

Tender offer regulations in Great Britain are similar in some respects to the solution proposed here (though the British rules regulate open market purchases somewhat more),⁹⁷ and indications are that the British rules do not unduly discourage tender offers.⁹⁸ The British rule is that, generally, any tender offer for more than 30% must be for all the shares, and anyone who acquires 30% of a target company, whether by tender offer or otherwise, must offer to buy the remaining shares.⁹⁹ The rule thus relieves target shareholders of much of the pressure to sell, because if the offer succeeds they will still be able to sell without risk of proration. It bears noting that arbitrage has been almost non-existent in Britain until recently,¹⁰⁰ which suggests that under the British rules investors rather than speculators decide the fate of target companies.

look to the gains that would have been enjoyed in a close substitute transaction. See Gilson, *supra* note 84, at 832-40.

95. See Coffee, *Shareholders Versus Managers*, *supra* note 3; *infra* note 109.

96. See *IU Int'l Corp. v. NX Acquisition Corp.*, 840 F.2d 220 (4th Cir. 1988); *Newmont Mining Corp. v. Pickens*, 831 F.2d 1448 (9th Cir. 1987).

97. See generally Brayne, *Tender Offers Involving U.K. Companies*, 21 REV. SEC. & COM. REG., No. 8, at 67 (April 27, 1988); DeMott, *supra* note 31. See also Gilson, *supra* note 54, at 876-78. Two states, Pennsylvania and Maine, have adopted takeover statutes that rely primarily on such a remedy. See Booth, *The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635, 1676-78 (1988) (criticizing "appraisal" solutions); Garrity, *Addendum: Post-MITE State Takeover Statutes: Constitutional Issues and Recent Cases*, 42 BUS. LAW. 586, 590 (1987).

98. Gilson, *supra* note 54, at 964.

99. DeMott, *supra* note 31, at 960-62.

100. *Id.* at 999; *Hostile Takeovers Are All the Rage in U.K. as Civility Declines*, Wall St. J., Mar. 16, 1984, at 1, col. 1 (noting arrival in the U.K. of arbitrageurs). A recent study by the London Stock Exchange noted that market was probably more volatile than U.S. markets because of the lower level of arbitrage. See Passell, *The Turf Fight in Crash Debate*, N.Y. Times, May 25, 1988, at D2, col. 1; see also *A Tale of Two Takeovers*, Wall St. J., July 17, 1989, at A1C, col. 1 (editorial) (arguing that British rules minimize need for shareholders to deal with arbitrageurs, reduce risk of failed bids, and avoid likelihood of numerous offenses such as stock parking and leaking of inside information).

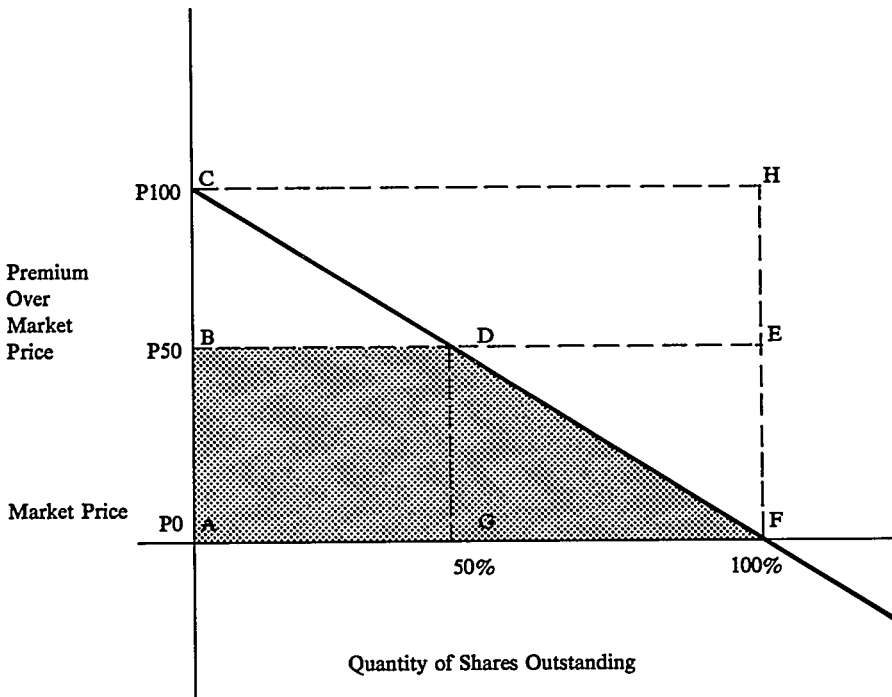


FIGURE VII

That in turn suggests that longer range considerations rather than shorter term profits may be more determinative of the outcome of takeover contests in the United Kingdom, since almost by definition arbitrageurs are more concerned with the success of takeover bids than are shareholders who also have longer term investment goals.¹⁰¹ In short, it would appear that a rule requiring any-or-all offers and a cashout in the event of a shift in control may indeed achieve the goals of tender offer regulation at a lower overall cost.

B. The Problem of Setting a Control Trigger

The rule suggested above would require a bidder who achieves control of a target to offer the highest price to all remaining shareholders. But when should a bidder be deemed to have achieved "control?" The

101. See Coffee, *Shareholders Versus Managers*, *supra* note 3. But see *Hostile Takeovers Are All the Rage in U.K. as Civility Declines*, *supra* note 100 (noting that traditional loyalty of British shareholders seems on the wane); see also OFFICE OF THE CHIEF ECONOMIST, SEC. AND EXCH. COMM'N, INSTITUTIONAL OWNERSHIP, TENDER OFFERS, AND LONG-TERM INVESTMENT (Apr. 19, 1985) (finding no statistical evidence that takeover activity leads managers to focus on short-term results).

British rules assume that 30% is often enough to establish working control.¹⁰² At first glance, the British rule may thus appear disadvantageous to investors since it does not require the bidder to raise the bid price high enough to attract shares in the 30% to 50% range. Rather than the premium depicted in Figure VII, British investors enjoy only the premium depicted in Figure VIII, where the cash-out level is set at P30.

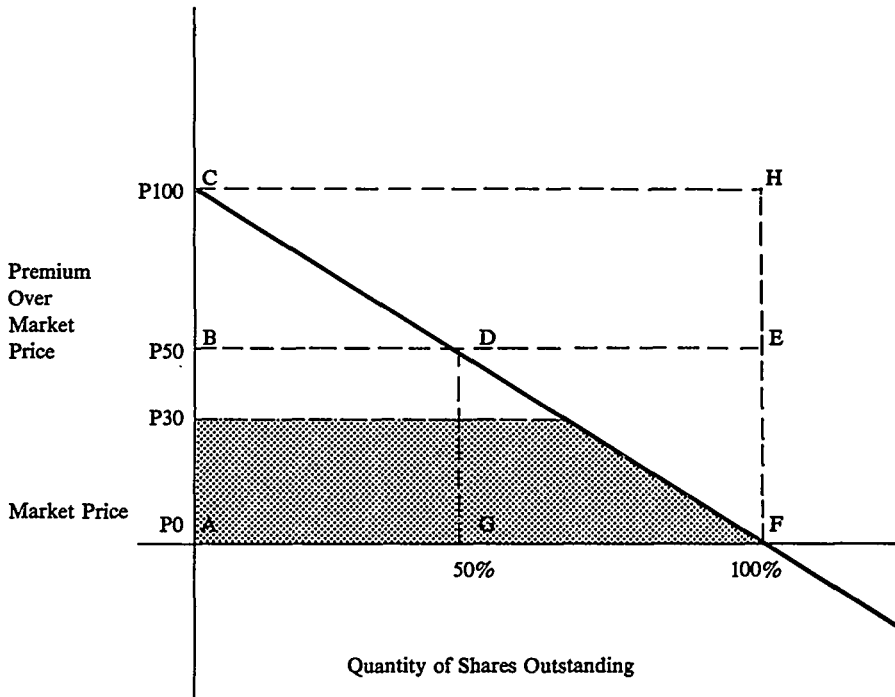


FIGURE VIII

Nonetheless, the British approach may not result in lower premiums than shareholders would otherwise receive. In the first place, if 30% is truly enough to achieve control, a bidder could stop short of a 50% trigger and still enjoy the same coercive advantages it would in a partial bid. For example, a 30% owner might have sufficient control to force a freeze-out merger at an inadequate price without ever being subject to the rule's cash-out provisions. Second, no matter what percentage is necessary to achieve control, shareholders may tender once they perceive that the bidder has purchased enough shares to achieve control. That is, once control is or seems to have been achieved, there is nothing left to force the price further up the demand curve. The same argument may well justify the British rule prohibiting tender offers for more than 30%

102. Demott, *supra* note 31, at 962.

but less than 100%. Though the rule may appear to require overcompensation of target shareholders, as in Figure II, it may be that after control passes, remaining shareholders tender quite readily. Target shareholders thus lose little if any additional premium under the British rule while they avoid the risks of partial bids.

Although a 30% control trigger may seem reasonable even if somewhat arbitrary, no single percentage figure can ever suffice as a universal index of control. For example, if a group of insiders controls 25% of target shares, a bidder who attracts tenders of 30% would hardly have achieved control. To allow for this uncertainty, the British system is somewhat flexible: the self-regulating panel of representatives from the financial community who enforce the rules possess considerable interpretive discretion—though they exercise it cautiously.¹⁰³

The prediction that target shareholders will readily tender once control has passed suggests that for many companies the demand curve to the left of the control percentage is flat.¹⁰⁴ Such a demand curve may seem at odds with the evidence that shareholders receive higher premiums in bids for all the shares than in partial or two-tier bids. Of course, the success of partial and two-tier bids at lower prices may be attributable to their coercive nature.¹⁰⁵ But there is another possible explanation. The smaller premiums paid in some bids may be attributable not to the form of the bid, but to the size of the target since coercive bids tend to be made for large companies with presumably flatter demand curves.

Thus far the Figures have generally depicted a single shareholder demand curve for all companies. In all likelihood, however, demand curves vary among targets. The relationship between risk and the slope of a company's demand curve seems apparent. Risk, after all, is nothing more than a measure of the variation in possible investment outcomes, and the greater the variation the more likely shareholders are to have differing opinions about the company.¹⁰⁶ Presumably the less risky a company is, the flatter its demand curve, since shareholders are more likely to agree on the company's prospects. One can assume that smaller companies are generally riskier than larger companies. Thus one would expect that the smaller the target company is, the steeper the demand curve and the greater the percentage premium that must be offered to

103. *Id.* at 954-58. For exceptions to the 30% rule under the British system, see *id.* at 999 n.282. Note that the British rules are more like standards of practice in the accounting profession than legal rules; that is, they are more descriptive than normative. See generally Fiftis, *Current Problems of Accountants' Responsibilities to Third Parties*, 28 VAND. L. REV. 31, 52-62 (1975).

104. See *infra*, Figure V(B), for an example of such a curve.

105. See *supra* text accompanying notes 57-64.

106. See LORIE, DODD & KIMPTON, *supra* note 32, at 13-24.

gain control. A target company with a more horizontal or inelastic curve might thus be bought, even without coercion, for a smaller premium.¹⁰⁷

Figure IX depicts the effect of differing slopes of the demand curve

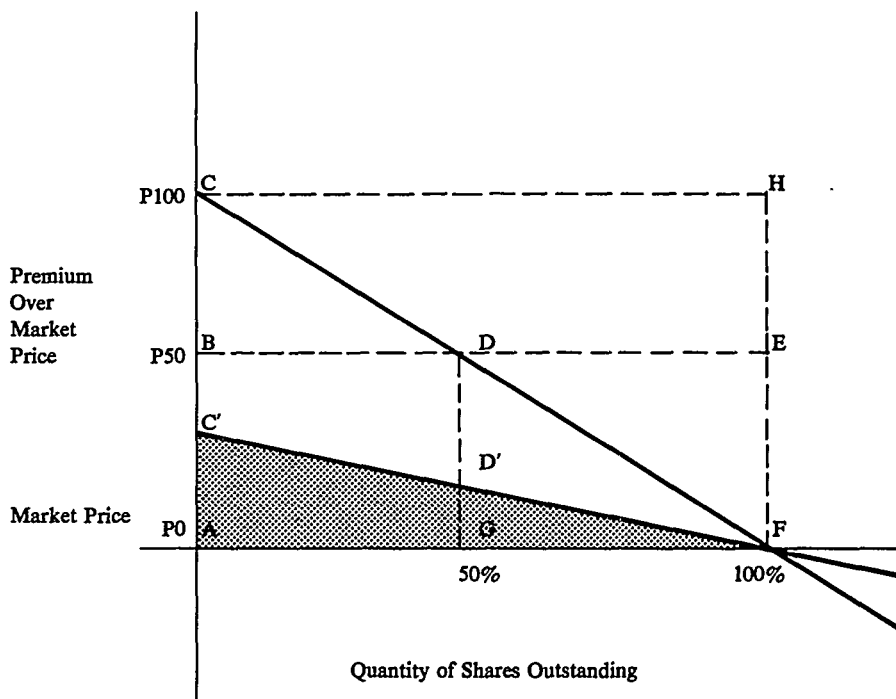


FIGURE IX

upon the size of the premium. A large, well-established company with a demand curve C'D'F, could clearly be bought for a smaller premium over the market price than could a more risky firm with demand curve CDF. As here depicted, the company could be bought in a stairstep offer for an aggregate premium equal to triangle C'AF, which is clearly less than the premium represented by triangle CAF.

Indeed, partial and two-tier bids, with their smaller blended premiums, tend to be made for larger targets, and any-or-all bids tend to be made for smaller targets.¹⁰⁸ A common explanation for this fact is the mounting difficulty of assembling financing as targets increase in size.¹⁰⁹

107. See Coffee, *Regulating the Market*, *supra* note 1, at 1178-80.

108. See SEC, Two-Tier Tender Offer Pricing and Non-Tender Offer Purchase Programs, Exchange Act Release No. 21,079, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,637, at 86,921 (June 21, 1984).

109. See *id.* at 86,923-25. As the SEC study points out, an any-or-all bid not only requires a bigger outlay of funds, but also increases the bidding company's uncertainty as to the exact amount of financing needed. *Id.* at 86,923. In theory the amount of funds needed is unimportant since the

But this theory does not necessarily imply that partial and two-tier bids pressure target shareholders into tendering for less. Instead, shareholders may simply be willing to settle for less.

Moreover, coercion is less worrisome in connection with the takeover of larger companies because larger companies generally can be controlled with a smaller percentage of shares.¹¹⁰ That fact suggests that if the demand curve flattens out to the left of the control percentage (as in larger companies), any bid for substantially more than that percentage will be less coercive than a bid designed to establish bare control. Coercion would be reduced in the bid for more than simple control because fewer shareholders are asked to tender for less than their good faith valuation of the stock, even though the bid may take a two-tier form. Moreover, the bidder's willingness to buy more than a bare controlling interest may reassure target shareholders. Some anxiety (rather than true coercion) remains because many shareholders in the flat portion of the curve will prefer to tender if control is likely to be achieved, but the shareholder's dilemma is a matter of strategy, not duress. Although the shareholder may in hindsight regret not tendering, her initial decision was in no way forced. In the end, then, the most coercive bids are partial bids for a percentage of shares that would barely establish control and two-tier bids in which bare control would be established by a successful first tier. By comparison, a bid for less than the control percentage is not coercive because those who hold out will continue to own stock for which a hostile offer can be made.

The idea that companies of different sizes may be subject to different kinds of takeover threats has recently been explored by Professor Gilson, who argues that a company's stage of development may dictate its choice of takeover defenses.¹¹¹ He notes that mature companies are more likely to go private—an advance or preemptive defense—while growing companies are more likely to issue non-voting stock or to undergo a recapitalization that reduces the voting rights of public shareholders and preserves the option to raise additional equity capital.¹¹² As Gilson points out, the

bidder should be willing to borrow whatever he needs to complete the deal, which a lender should be willing to lend, if the acquisition is economically efficient. In the real world, however, things are not so simple. Credit may not be equally available to all bidders. Moreover, lenders should generally require the bidder to put up some portion of the purchase price; otherwise, the risk of ultimate profitability falls upon the lender. See generally W. KLEIN & J. COFFEE, *supra* note 51, at 52-53. On the other hand, it appears that in practice many bidders can borrow virtually all the money needed to do a deal. OFFICE OF THE CHIEF ECONOMIST, SEC. AND EXCH. COMM'N, NONINVESTMENT GRADE DEBT AS A SOURCE OF TENDER OFFER FINANCING (June 20, 1986) (junk bond financing for all tender offers rose from 0.3% in 1981-1984 to 13.6% during first half of 1985 and was predominant source of financing for hostile offers); Grundfest, *supra* note 83.

110. See W. CARY & M. EISENBERG, *supra* note 13, at 208-11.

111. See Gilson, *supra* note 84, at 823-40.

112. See *id.* at 823-32.

two transactions are equivalent in that afterwards the outside shareholder holds an investment (or cash) that carries no vote.¹¹³

Gilson surmises that the differing preferences of mature and growing firms reflect the dissimilar agency costs that each faces. In the mature firm with few growth prospects and little need for new capital management may be tempted to shirk its duty and to extract high salaries and benefits. Management need not please its shareholders except in order to avoid a takeover. In a company with growth potential, however, management's interests are more likely to coincide with those of its shareholders. Keeping the shareholders happy and the stock price up helps management raise needed new capital at the lowest possible price. By working hard and keeping salaries and perquisites to a minimum, management in effect invests its forgone consumption in the company itself, to be withdrawn later as deferred compensation in the form of higher priced and more liquid publicly held shares.¹¹⁴ Accordingly, the shareholders in the growth company are unconcerned about management's agenda and are relatively happy to exchange their voting stock for non-voting stock, while the shareholders in the mature company require a firmer commitment from management, either in the form of junk bonds or cash, because they have reason to suspect management's enthusiasm for their concerns.¹¹⁵

The differences that Professor Gilson has outlined apply, with appropriate changes, to tender offer bidding strategies and takeover defenses generally: If indeed managers of growing companies have few conflicts of interest with their shareholders, a takeover bid for a growing company is more likely to depend on coercive techniques since the offered premium is less likely to be motivated by slack management, and management is more justified in resisting such a takeover. At the very least, it seems clear that the problem of coercion is not the same for every potential target company, and for larger companies it may be no problem at all. If smaller premiums are paid for larger companies, then the use of apparently coercive bidding techniques in connection with bids for larger companies is not necessarily troubling and should not be grounds for adopting defenses or procedural protections.

III

THE NEED FOR A VARIABLE REGULATORY SCHEME

These observations about shareholder demand curves and the reasons behind their differing shapes suggest that tender offer rules should vary depending on a company's size. For smaller, riskier companies with

113. *See id.* at 813-14.

114. *Id.* at 823-32.

115. *Id.*

steeper curves, partial and two-tier bids are potentially most coercive. Shareholders at the upper end of the curve perceive that they have more to lose or gain by holding out. Moreover, the danger of looting after the bidder achieves control seems greater because a smaller target is easier for the bidder to digest. We should thus prohibit coercive offers for such companies or at least permit more potent defenses.

In comparison, shareholders of larger companies with flatter curves are far less subject to coercion. Shareholders situated on the flat portion of the demand curve have less to lose by not tendering, and the potential for looting a large company is presumably smaller. We should thus allow a wider range of bids for larger companies and restrict permissible defensive tactics. Part III examines how to classify companies, and perhaps more importantly, who is to implement the proposed classification.

A. The Prospects for a Federal Response

One possibility for the variable regulation of tender offers is an open-ended federal rule prohibiting manipulative acts and practices. This rule would prohibit bidding strategies like partial and two-tier offers when they present a danger of coercion, but it would not absolutely bar them. Such an open-ended rule would seem by definition to require an enforcement agency: to avoid the total prohibition of practice, somebody must be vested with prosecutorial discretion. The SEC could fulfill such a function.

Although no current federal law expressly prohibits or regulates partial or two-tier bids, implicit authority for such regulation arguably exists in the Williams Act's prohibition of manipulation in connection with tender offers.¹¹⁶ The SEC could attempt to outlaw such bids by exercising its express rule-making power under section 14(e) of the Exchange Act to "define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative."¹¹⁷ Both theory and evidence demonstrate that bidders can affect the price they must pay to gain control by choosing one form of tender offer over another. Whether that selection constitutes manipulation or simply a method of bargaining is a matter of opinion. Accordingly,

116. Securities Exchange Act of 1934, § 14(e), 15 U.S.C. § 78n(e) (1988).

117. *Id.*; see *Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 11 n.11 (1985) (section 14(e) "gives the Securities and Exchange Commission latitude to regulate nondeceptive activities as a 'reasonably designed' means of preventing manipulative acts, without suggesting any change in the meaning of the term 'manipulative' itself"); see also Johnson & Millon, *Does the Williams Act Preempt State Common Law in Hostile Takeovers?*, 16 SEC. REG. L.J. 339, 363 (1989) (arguing that the Act may preempt ad hoc defensive tactics, as well as state statutory law, if they interfere with the market for corporate control). But see Johnson & Millon, *Misreading the Williams Act*, 87 MICH. L. REV. 1862 (1989) (arguing that the Williams Act should be read much more narrowly than it commonly is and that the preemption claim even as to state statutory law is tenuous).

though there is some case law to the effect that partial and two-tier bids are not manipulative within the meaning of the Act,¹¹⁸ the definition of manipulation may be an ideal subject for rulemaking.

The biggest obstacle to an open-ended rule prohibiting undesirable coercive offers as manipulative, however, is the now well-settled precedent that manipulation ordinarily requires deception.¹¹⁹ Arguably, however, federal law *should* reach coercive bidding tactics. It seems clear that Congress intended to reach something in addition to "deception" when it outlawed *both* manipulation and deception. If Congress did not so intend, "manipulation" has no meaning in the context of the statute, a result contrary to a basic tenet of statutory construction. Moreover, since garden variety market manipulation was already prohibited by Section 9 of the Exchange Act, Congress presumably intended to reach different conduct when it passed the Williams Act. And it is difficult to imagine a practice more likely to qualify than deliberately coercive bids.¹²⁰

Recently, the Supreme Court has hinted that there may be room for

118. See *Radol v. Thomas*, 772 F.2d 244, 255 (6th Cir. 1985) (holding that U.S. Steel's two-tier acquisition of Marathon Oil was not "manipulative" under section 14(e)), *cert. denied*, 977 U.S. 903 (1986). But see *Pryor v. U.S. Steel Corp.*, 794 F.2d 52, 57-58 (2d Cir.) (target shareholders may sue offeror under section 14(d)(6) for extending proration deadline after offer had been oversubscribed), *cert. denied*, 479 U.S. 954 (1986).

119. See *Santa Fe Indus. v. Green*, 430 U.S. 462, 474-76 (1977) ("manipulation" under section 14(b) does not encompass a nondeceptive merger). For a thoughtful analysis of what constitutes manipulation generally, see *Schreiber v. Burlington N. Inc.*, 472 U.S. 1, 7-8 (1985) ("manipulation" under section 14(e) requires some sort of misrepresentation; an action that merely affects the price of the target company is not enough); *Santa Fe Indus.*, 430 U.S. at 474-76 (1977) ("manipulation" under section 14(b) does not encompass a merger in which minority shareholders were furnished with all relevant information); *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1359-63 (N.D. Tex. 1979) (opinion by Higginbotham, J.); see also *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976) ("manipulative" under section 14(b) connotes intentional conduct designed to deceive or defraud investors); Note, *Schreiber v. Burlington Northern, Inc.: Misrepresentation as a Necessary Element of a Section 14(e) Cause of Action*, 12 DEL. J. CORP. L. 645 (1988) (authored by Stephen L. Nowak); Note, *SEC Takeover Regulation Under the Williams Act*, 62 N.Y.U. L. REV. 580 (1987) (authored by Mark L. Berman).

A rule prohibiting coercive bids might be less objectionable than a rule dictating substantive tender offer terms since the former would not impose but would only prohibit particular tender offer terms. For an example of the latter type of rule, see Securities Exchange Act Rule 14d-10(a)(1), 17 C.F.R. § 240.14d-10(a)(1) (1989) (the all-holders rule, which requires that tender offers be made to all shareholders) (strongly criticized in FERRARA, BROWN & HALL, *supra* note 7, at 81-83); Note, *Creeping Federalization of Corporate Law: Unocal Corp. v. Mesa Petroleum Co. and the All-Holders Rule Under the Federal Securities Laws*, 12 DEL. J. CORP. L. 563 (1988) (authored by Mark A. Cleaves).

120. A comparison with the law of the commodities markets may be useful here. Coercive tender offers are rather like cornering a futures market. And cornering a market—though it requires no deception—is well-established as illegal manipulation. See generally 1 A. BROMBERG & L. LOWENFELS, *SECURITIES FRAUD & COMMODITIES FRAUD* § 4.6 (455) (1988).

a more creative interpretation of "manipulation." In *Basic, Inc. v. Levinson*,¹²¹ the Court adopted the so-called "fraud on the market" theory, which dispenses with the need for a plaintiff to demonstrate direct reliance on misrepresentations. It is now sufficient for the plaintiff to show that the misrepresentation affected the market price—that is, that the market "relied" on the misrepresentation—and that the plaintiff was harmed.¹²²

As for the connection with the concept of manipulation, the majority opinion in *Basic* opens by noting that "[t]he 1934 Act was designed to protect investors against manipulation of stock prices,"¹²³ and refers to manipulation three more times before concluding.¹²⁴ The repeated references here are especially odd because this was quite clearly a deception case. It may be that the majority believed "manipulation" would fit better with the fraud on the market theory of liability than would "deception", since markets are not persons and cannot, strictly speaking, be deceived. Nevertheless, characterizing a company's missteps in disclosing merger negotiations as manipulation virtually equates manipulation with any action improperly affecting the market price. Justice White apparently reads the majority opinion this way, for he bases his dissent on Congress' express rejection of a remedy for investors harmed by purchasing securities adversely "affected" by a misrepresentation.¹²⁵ Thus, in the tender offer context, the Court's opinion implies that anything that affects the bidding process and ultimately the price paid—whether it be the form of the bid or management defensive tactics—is arguably manipulation.

After *Basic*, the SEC could in theory adopt the rules necessary to regulate coercive bidding practices directly. But the numerous precedents limiting the concept of manipulation to deception, together with the difficulty in determining which companies should be subject to such a rule, make it highly unlikely that the SEC would take action absent a new statute. And indeed, the Commission does not presently support any special regulation of partial or two-tier offers.¹²⁶

121. 108 S. Ct. 978 (1988).

122. The plaintiff in *Basic* was harmed by selling at an artificially depressed price. *Id.* at 984-86.

123. *Id.* at 982.

124. *Id.* at 987, 991, 992; see also *id.* at 998 (White, J., concurring and dissenting).

125. *Id.* at 997 (White, J., concurring and dissenting).

126. *Statement of John S.R. Shad, Chairman of the SEC, Before Hearings of the House Subcommittee on Telecommunications, Consumer Protection, and Finance Concerning the Recommendation of the SEC Advisory Committee on Tender Offers*, [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,511 (Mar. 28, 1984). Indeed, the Commission has suggested, quite remarkably, that it might consider making the Williams Act optional. See Concept Release, *supra* note 6, at 88,202.

B. Stock Exchange Regulation

Another possible mode of variable regulation would be based on the percentage of stock ownership required to control any given company. Companies with a control percentage above a cutoff figure of, say, 20%, 25%, or 30% would be subject to anti-coercion rules, while those with a lower control percentage would not be. Such a scheme is problematic because any fixed percentage cut-off would necessarily be arbitrary and would undoubtedly generate a multitude of strategies designed to take advantage of it; further, determining each company's control percentage would often be quite speculative.¹²⁷

Yet another possible system would be to tailor the rules to the riskiness of each company. Risk is typically assessed by comparing the movement of individual stocks with the movement of the market as a whole. A sensible division of companies might thus be between those whose stocks are more volatile than the market as a whole and those whose stocks are less volatile. More restrictive tender offer rules would apply to riskier companies, and less stringent rules would apply to more stable companies. Again, however, setting a fixed cut-off point between "risk" and "stability" would in all likelihood be arbitrary and speculative.

Given these difficulties, a dual system of regulation based on control percentages would be most appropriately administered by the stock exchanges. Although the SEC could in theory implement and administer either scheme, precedent again gets in the way. It is well settled that federal law mandates only disclosure and leaves matters of substance and fairness to the realm of state law. The stock exchanges, on the other hand, could determine, through a quasi-administrative self-regulatory process, the type of tender offer scheme to which companies should be subject.¹²⁸ The proposed system might be achieved by the establishment of two classes of listings on each exchange. Indeed, there is no reason why more than two categories could not be established, with each category offering a different package of tender offer rules.

127. See *supra* note 103 and accompanying text.

128. Under current law, the exchanges (as well as the National Association of Securities Dealers) have substantial regulatory powers. See Coffee, *Regulating the Market*, *supra* note 1, at 1255-69; Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119 (1987); Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1 (1988); Note, *Stock Exchange Listing Agreements as a Vehicle for Corporate Governance*, 129 U. PA. L. REV. 1427 (1981). For example, under section 6 of the Exchange Act, every exchange must adopt rules designed to foster fair and equitable trading. And the SEC, under section 19, has complete authority to require such rules as are necessary. See *Gordon v. New York Stock Exch.*, 442 U.S. 659 (1975) (N.Y.S.E.'s system of fixed commission rates is beyond the reach of antitrust laws); Adopting Release, *supra* note 84, at 89,228-33; Proposing Release, *supra* note 84. On the status of the exchanges as quasi-public facilities, see generally *Silver v. New York Stock Exchange*, 373 U.S. 341 (1963) (duty of self-regulation imposed on the N.Y.S.E. by the Exchange Act does not exempt it from antitrust laws).

1. *The Position of Stock Exchanges in a Regulatory Scheme*

There is much to be said for the option of stock exchange regulation. First, exchange rules are less formal than statutes, SEC rules, or even case law, and therefore may be applied more flexibly.¹²⁹ One could object, of course, that a more flexible listing category system would not improve the position of investors; it would merely substitute exchange-level decisions for those now made by boards of directors. That argument misses the point. Currently, investors must undertake considerable research to determine what defenses are appropriate for a particular company, and indeed what kinds of defenses a company has adopted. And once the latter determination is made, the investor has no assurance that the company will not adopt additional or alternate defenses. Thus, in the end, investors probably treat most companies as if they employ the full complement of defenses.¹³⁰

The company that declines to adopt the entire array of defenses consequently enjoys no advantage in the market. It must pay as much for capital as the most heavily defended company even though its management is more disciplined. If, on the other hand, the exchanges are considered trustworthy regulators of defensive tactics, investors need not bear the expense of determining precisely which defenses a company has adopted. In short, many of the benefits of standardization can be enjoyed without suffering its confinement by installing some sort of reputational intermediary.¹³¹

Second, the exchanges' expertise in regulating the trading process best qualifies them to regulate tender offers. Arguably, tender offers more closely resemble a form of trading than do the proxy contests on which their regulation under the Williams Act is based.¹³² The implicit object of a tender offer is to determine at what price control of the target company may be bought, not simply to determine who should manage the target.¹³³ Much of the controversy surrounding coercive offers and entrenching defenses—essentially the entire controversy surrounding

129. See Adopting Release, *supra* note 84, *passim*; see also Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672 (1987).

130. See generally Akerloff, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

131. See Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 613-21 (1984) (arguing that an investment bank functions as such an intermediary in the distribution of new securities).

132. See Address by M. Cohen, Chairman, Securities and Exchange Commission, on Proposed Legislation to Regulate Tender Offers, before the American Society of Corporate Secretaries (June 28, 1966), reprinted in V. BRUDNEY & M. CHIRELSTEIN, *CASES AND MATERIALS ON CORPORATE FINANCE*, 720, 723 (2d ed. 1979).

133. See Booth, *Business Purpose Doctrine*, *supra* note 27, at 856-66 (discussing the business purpose doctrine and the price paid for corporate control in a tender offer).

tender offers—can be reduced to questions about how to allow the market to function freely in order to establish a fair price for control.

The proposition that demand curves for stock slope downward reinforces this view of tender offers as special auctions for control. As the model implies, there is no single fair price for a share of stock. Rather, investors value stock along a continuum—the shareholder demand curve. Since there is no single fair price, regulations should not focus on a substantive quest for such a price nor seek to provide investors with quantitative protections.¹³⁴ A sensible regulatory scheme should instead ensure that the market for control works as smoothly as possible. With efficient trading as the goal, the stock exchanges may be the best regulators of takeover contests, since no other institution is concerned *primarily* with the smooth and efficient functioning of the trading process itself.

The former New York Stock Exchange rule against multiple classes of common stock with different voting rights exemplifies the unique role of the exchanges in the regulatory scheme.¹³⁵ Neither federal nor state law limits the number of classes of stock or differences in voting rights. The idea behind federal law is that investors can decide for themselves whether to buy or sell as long as differences among rights are disclosed. The idea behind state law, by contrast, is that the corporation should be a flexible vehicle and that agreements among shareholders to divide up the right to control should ordinarily be enforced.¹³⁶ Both policies are valid. Nevertheless, an exchange may still reasonably seek to prohibit limited voting rights stock. If such stock is permitted, investors must inform themselves about what rights they are acquiring each time they purchase a new stock. By eliminating potential differences in the bundle of rights represented by a share of stock, an exchange can make equity capital available at the lowest possible cost. Thus, by standardizing shares, exchange rules can bring buyers and sellers of equity together more efficiently. The important point is not that the former N.Y.S.E. rules were optimal, but rather that given the conflicting missions of federal and state law, only an exchange is in a position to adopt such rules.

Such stock exchange regulation—even an essentially voluntary, self-categorizing scheme—would not only reduce information costs for shareholders, but would also act as a coordinating agent or catalyst for management. Although under the current regulatory scheme management gains little by failing to install advance defenses,¹³⁷ if there were a stock

134. See Booth, *Management Buyouts*, *supra* note 32, at 633-38.

135. For further discussion of this rule, see *infra* notes 143-148 and accompanying text.

136. See, e.g., *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964) (upholding a contractual voting control agreement on the grounds that a state should not unnecessarily restrict the freedom to enter contracts).

137. See *supra* notes 130-131 and accompanying text.

exchange listing category for fully-exposed companies, any one company could forgo such measures at far less cost. By associating with other similar companies in the competition for public capital, the fully-exposed company would presumably enjoy the most attractive terms. Some restriction on rapid switching among categories would, of course, be necessary. For example, the switch might be allowed only after a shareholder vote; the exchange could further require the subject company to include a requirement for such a vote in its articles of incorporation. Without such a restriction, investors would assume that a company threatened with a takeover would simply switch categories, and the categories would prove meaningless.¹³⁸

Although there is some danger that companies may choose an overly protective scheme of regulation, the danger may in fact be insignificant. Practically speaking, a company might be *compelled* to join a particular category. If investors care about takeover premiums, they will care about a company's listing category; a mature company that chooses the more restrictive scheme designed for growth companies might therefore find the price of its stock depressed and its cost of capital elevated.¹³⁹

138. Second generation state takeover statutes, for example, typically allow companies either to opt in or out of coverage but only after a shareholder vote. See *infra* text accompanying notes 161-164. Similarly, when the N.Y.S.E. proposed allowing listed companies to adopt multi-class capitalization schemes with differential voting rights, the proposed rule would have required a shareholder vote before any company could opt for such a scheme. See *infra* note 146 and accompanying text.

139. It was suggested in connection with the SEC's consideration of a uniform voting rights listing standard that issuers would be attracted to the exchange that offered them the most desirable set of rules and that marketplace competition would therefore lead the exchanges to adopt the appropriate rules. See Proposing Release, *supra* note 84, at 88,779 & n.86. The Commission dismissed this argument claiming that managers do not always do what is best for their companies. The Commission did assert, however, that any rule adopted *should* leave room for competition among the exchanges—but only in the areas of price and service, not in the provision of safe havens from takeover. See *id.*; see also Fischel, *supra* note 128, at 131-32.

There is considerable disagreement as to whether listing a company on an exchange (or on a particular exchange) affects its stock prices. See Proposing Release, *supra* note 84, at 88,773 n.50 (summarizing studies which indicate that listing and delisting do not result in gains and losses in share prices). Compare *Norlin Corp. v. Rooney, Pace, Inc.*, 744 F.2d 255, 267-68 (2d Cir. 1984) (threatened delisting by N.Y.S.E. constitutes irreparable harm for purposes of granting injunction) with *Gearhart Indus. v. Smith Int'l, Inc.*, 741 F.2d 707, 725-26 (5th Cir. 1984) (contra). The proposition that listing categories *could* generate real gains remains arguable because evolution in the trading market has proceeded at such a rapid pace over the past twenty years that most studies are outdated. Recent studies do indicate that stocks that are added to the Standard & Poor's 500 Index enjoy an immediate and permanent gain, presumably as a result of being associated with the other 499 stocks. See Schleifer, *Do Demand Curves for Stocks Slope Down?*, 41 J. FIN. 579 (1986). This gain no doubt arises at least in part because investors and traders depend on the S&P 500 to formulate portfolios and thereby generate more demand for the included stocks. The same would probably hold true of stock exchange listing categories if they reliably represented the unique characteristics of the included companies. Since the exchanges have more or less abdicated this function in recent years (if indeed they ever performed it), existing studies cannot be expected to reflect a significant price effect associated with listing on an exchange or on a particular exchange.

Moreover, causing the company to pay more than necessary for capital could theoretically constitute waste, and management could be held personally liable.¹⁴⁰

To sum up, the idea behind a scheme of exchange regulation of tender offers is to provide clear, standardized choices that act as focal points for both management and investors. The contemplated stock exchange rules would serve as a catalyst, encouraging listed companies to commit themselves to an optimal set of takeover defenses. A system of stock exchange categories would do little directly to increase or decrease the array of possible defenses a company could adopt. Rather, it would simply group defenses into identifiable packages, making costs and benefits much easier to recognize. Such a scheme would give the company that chooses exposure some assurance that it would not be alone, that its exposure would not go unrecognized, and that the potential benefits of its choice would be realized.¹⁴¹

2. *The One-Share, One-Vote Rule as a Model for Tender Offer Regulation*

Despite these benefits, the stock exchanges seem reluctant to adopt additional tender offer regulations. The recent controversy over the one-share, one-vote rule provides a telling case study in the dynamics of regulatory change. In 1984, several N.Y.S.E. companies, fearful of increasing their takeover exposure, issued low-voting or non-voting stock to acquire

140. Cf. *Joy v. North*, 692 F.2d 880 (2d Cir. 1982) (bank directors may be held liable for making a loan at inadequate interest rate given risk of project being financed), *cert. denied*, 460 U.S. 1051 (1983); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (directors may be held liable for selling a company at inadequate price).

141. Cf. Baumol, *The Stock Market and Economic Efficiency* (1965), quoted in V. BRUDNEY & M. CHIRELSTEIN, *supra* note 132, at 1191-93. Baumol notes that the pricing of securities may depend on traders' perceptions of what other traders are doing, and that a sort of unconscious parallelism (to borrow a phrase from antitrust law) may develop under which most traders tend to focus on the same few indicators of value or changes in value as a way of reducing information costs. A similar argument is made in Gilson & Kraakman, *supra* note 131. See also Gordon & Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985) (criticizing the efficient markets hypothesis); Wang, *Some Arguments That the Stock Market is Not Efficient*, 19 U.C. DAVIS L. REV. 341 (1986) (distinguishing "information-arbitrage" efficiency from "fundamental-valuation" efficiency).

The point in this Article is that standardized packages of tender offer defenses would be easier, and therefore cheaper, for investors to analyze and hence would be more likely to be accurately reflected in a stock's price. Under the current unstandardized system, takeover exposure appears to be assessed by analysts who typically follow only a few companies in a fairly narrow line of business. See Fisher, *How Good Are Wall Street's Security Analysts?*, *FORTUNE*, Oct. 1, 1984, at 130. This fact suggests that takeover exposure may not be valued similarly across industries, although the trading activities of arbitrageurs who follow potential targets without regard to industry may be an equalizing force. As takeover exposure is an increasingly standardized and comparable component of a company's worth, the market can more easily value it.

other companies.¹⁴² The New York Stock Exchange, worried about losing business to exchanges more hospitable to takeover defenses, suspended its rule against listing companies with multiple classes of common stock while it sought, with the help of the SEC, to induce or force the other exchanges to adopt similar rules.¹⁴³

The SEC proposed and adopted a new uniform rule, Rule 19c-4, applicable to all exchanges and to most over the counter stocks. The rule prohibits the listing of any company that undertakes a transaction that would have "the effect of nullifying, restricting or disparately reducing the per share voting rights of holders of an outstanding class . . . of common stock."¹⁴⁴ The rule is aimed in particular at recapitalizations — modifications in the rights of existing shareholders — but allows listed companies to issue new stock with lesser voting rights,¹⁴⁵ the practice which, ironically, led to the controversy in the first place.¹⁴⁶

The N.Y.S.E.'s position is certainly understandable. It legitimately feared that by retaining its former rule it might drive away current and potential listings.¹⁴⁷ The Exchange is, after all, a business as well as a self-regulatory organization, and competition among exchanges for listings is fierce. Other exchanges declined to adopt rules similar to the old N.Y.S.E. rule.¹⁴⁸

Nonetheless, the N.Y.S.E.'s fear of losing business may have been

142. The most notable examples were General Motors' purchases of EDS and Hughes Aircraft, in connection with which GM issued the celebrated Class E and Class H common stock with one-half vote per share.

143. Adopting Release, *supra* note 84, at 89,209-10. See generally Gordon, *supra* note 128; Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687 (1986); Karmel, *Is One Share, One Vote Archaic?*, N.Y.L.J., Feb. 26, 1985, at 1, col. 1. Though GM was not threatened with delisting, lesser companies have not always fared so well. See, e.g., *Norlin Corp. v. Rooney, Pace, Inc.*, 744 F.2d 255 (2d Cir. 1984); *Gearhart Indus. v. Smith Int'l, Inc.*, 741 F.2d 707 (5th Cir. 1984).

For an overview and analysis of the state law aspects of this issue, see Easterbrook & Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 408-15 (1983) [hereinafter Easterbrook & Fischel, *Voting*]; Ratner, *The Government of Business Corporation: Critical Reflections on the Rule of "One Share, One Vote"*, 56 CORNELL L. REV. 1, 5-10 (1970). See also *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69 (1987); Herzel & Katz, *Investors Can Weigh Voting Rights*, Wall St. J., Feb. 13, 1986, at 26, col. 5.

144. Securities Exchange Act Rule 19c-4(a), 17 C.F.R. § 240.19c-4(a) (1989); see *SEC Approves Rule to Bar Companies from Diluting Investors' Voting Rights*, 20 Sec. Reg. & L. Rep. (BNA) No. 27, at 1051 (July 8, 1988).

145. Securities Exchange Act Rule 19c-4, 17 C.F.R. § 240.19c-4 (1989).

146. The new rule, which itself was criticized as beyond the SEC's authority, was adopted with the recognition that it would implicitly prohibit coercive recapitalizations even when carried out by a merger legal under state law, and would be flexibly applied by the various exchanges so as to allow multi-class capitalization when justified by a bona fide business purpose. Adopting Release, *supra* note 84, at 89,213, 89,216-18.

147. See *id.* at 89,217.

148. See *id.* at 89,210. It should be noted that the N.Y.S.E. had attempted to persuade other exchanges to adopt a uniform rule. See Proposing Release, *supra* note 84, at 88,771.

misplaced. Its old one-share, one-vote rule arguably reduced the cost of information concerning the least risky stocks and thus increased their liquidity. The fact that some issuers might have forgone listing because of the rule is not necessarily dispositive: Repeal of the rule might well have driven other issuers away. If in fact the rule benefits the mature companies that issue only one-vote stock, those companies will seek a trading medium with such a rule. Moreover, the least risky companies might not offer their shares publicly at all if forced to bear the increased cost of capital caused by the takeover fears of risky companies seeking stock exchange protection. This is not to say that every exchange or other trading medium should necessarily adopt similar rules. Indeed, it should have been apparent to the N.Y.S.E. that if such rules were universally imposed it would no longer be the exchange of choice for the least risky issuers.

Although the one-share, one-vote rule has been replaced by a uniform SEC rule, the Exchange could have adopted a voluntary two-tier listing system that should have satisfied all of its customers. As Professor Gilson notes, mature companies with little need for further access to the equity market suffer from higher agency costs than growing companies that may need additional higher-risk capital, do.¹⁴⁹ A growing company's management has many incentives to please its non-voting shareholders. Thus, a recapitalization in which most public shareholders in such companies are offered a financially attractive package of non-voting securities is not likely to be abusive.

Conversely, a company that has no need for additional equity capital has few incentives other than the threat of takeover to induce management to keep the price of its stock high. A mature company should not recapitalize: It is better advised to undertake a management buyout in which the shareholders escape more or less completely from the agency costs associated with a mature firm. As Professor Gilson asserts, since both strategies can be mutually beneficial for appropriate companies, both should be legal. The danger, of course, is that mature companies will adopt a strategy appropriate for growing companies simply as a way of insulating management from the threat of takeover. Gilson therefore, concludes that an optimal rule would allow companies to start out with multi-class capitalization but would preclude companies that are already publicly held from recapitalizing.¹⁵⁰

Gilson's analysis demonstrates why the New York Stock Exchange

149. See *supra* notes 111-115 and accompanying text.

150. See Gilson, *supra* note 84, at 844; see also Adopting Release, *supra* note 84, at 89,215-20. The SEC did acknowledge that there may be legitimate business purposes for multi-class capitalization. See *id.*

had a voting rule different from other exchanges: Since most of the companies whose stock is traded on the N.Y.S.E. are mature, a rule that precludes them from entering into transactions that are perfectly legal but nevertheless inappropriate for mature companies is sensible. Setting up a uniform voting rights rule for all exchanges, however, may well represent a loss for shareholders as well as for capital-hungry companies and ultimately for the exchange itself, which will enjoy less investment activity in mature companies than it would otherwise. In short, the SEC's new uniform voting rights rule is likely to disserve smaller companies and to eradicate whatever positive attraction alternative exchanges may have had.

The arguments for differential voting rights regulation apply equally to tender offer regulation. Again, agency costs vary among companies of differing sizes and maturities. Coercive tender offers are far more of a threat to smaller, growing companies that are less actively traded and, because of their smaller size, are more susceptible to being operated as a captive subsidiary. Shareholders in such companies are likely to differ more in their opinions of what constitutes an adequate offer than shareholders in a large company since the market for the stock is less efficient. Small-company shareholders also justifiably fear the consequences of a partial bid and are thus more likely to tender early for what they perceive to be a less attractive offer.

The history of the exchanges' reaction to voting rights regulation thus suggests that the exchanges are not likely voluntarily to adopt different tender offer rules even though it might well be in their interest to do so. The question remains, however, whether the SEC should require the exchanges to adopt appropriate rules. Under the Securities Exchange Act of 1934, the SEC clearly has the power to do so, as was amply illustrated in the recent adoption of the uniform voting rights listing standard, Rule 19c-4.¹⁵¹ It may not, however, be possible for the SEC to force one exchange to adopt rules different from those of other exchanges. The SEC's inability to target individual exchanges argues in favor of some form of self-regulation by the exchanges, which would be less tied to notions of due process and equal protection than equivalent SEC action.

Commentators have also suggested that interference by the SEC in connection with voting rights is an unwarranted intrusion into an area traditionally left to state law.¹⁵² The argument does not apply to substantive tender offer regulation, however, because efficient trading is not a primary concern of state law. That concern is peculiar to the stock exchanges and is thus ultimately a concern of the SEC. Admittedly,

151. See Adopting Release, *supra* note 84, at 89,228-33.

152. See *id.* at 89,214; Proposing Release, *supra* note 84, at 88,775-77, 88,781-85.

neither voting rights rules nor the sorts of tender offer rules suggested here relate primarily to the SEC's central responsibility, disclosure, but neither does much existing market regulation.¹⁵³ Indeed, there is a long history of substantive regulation by the markets themselves and by the SEC through the markets.¹⁵⁴ Therefore, the very powerful arguments against additional direct substantive regulation of tender offers by the SEC do not apply with much, if any, force to indirect regulation through market intermediaries. Thus, to the extent that substantive rules are appropriate, practice dictates that the markets be the ones to adopt them, whether voluntarily or through the persuasive powers of the SEC.

153. See generally Werner, *The SEC as a Market Regulator*, 70 VA. L. REV. 755 (1984).

154. *Id.* The Commission stated that it decided to apply rule 19c-4 to all registered companies traded either on an exchange or by an automated quotation system because the Exchange Act's regulation of voting rights evidenced Congressional concern with, and therefore Commission jurisdiction over, this one area of substantive corporation law. Although at the time the Exchange Act was passed, only the securities of exchange-traded companies were broadly enough distributed and held to draw Congress' attention, the Commission reasoned the development of the over-the-counter markets now justified extension of the same concern to the stocks of companies traded there. See Adopting Release, *supra* note 84, at 89,231-33.

While the Exchange Act clearly had a substantive impact on the proxy process (for example, by requiring annual reports and giving shareholders limited access to the proxy machinery), its statutes and rules could for the most part be readily justified as furthering the cause of disclosure. Rule 19c-4 cannot be so justified. The Commission implicitly acknowledges this weakness in its repeated references to the purported intent of the Exchange Act to ensure fair corporate suffrage, conveniently omitting any qualification such as "through disclosure." See, e.g., *id.* at 89,230-33. The Commission went so far as to suggest that its authority would even extend to reviewing the business purpose of mergers that result in existing shareholders' voting rights being diluted. See *id.* at 89,219-22. Odder still, the Commission dismissed the argument that in nearly every case a recapitalization requires a shareholder vote to approve the new class of shares to be issued, with the observation that shareholder voting was an undependable check on such proposals, even while asserting that retaining her vote might be the only way a target shareholder would ever be offered a premium for her shares. See *id.* at 89,216.

Were this legislative intent the only authority for the new rule, it would be unlikely to withstand judicial scrutiny. See *supra* note 118. The rule was also justified, however, as pursuant to the Commission's authority under section 19(c) to adopt and amend exchange and N.A.S.D. rules. Commentators criticized this rationale as well, arguing that the exchanges and the N.A.S.D. have no authority to enforce compliance with their own rules. See Adopting Release, *supra* note 84, at 89,229-30. While that argument may be too clever to be convincing, the Commission's authority under section 19(c) is nonetheless questionable. The issue is not whether the Commission has any authority over listing standards—which clearly it does, see *id.*—but rather whether this rule furthers the purpose of disclosure—which it does not. (As I have argued elsewhere, the central rationale for substantive market regulation by the Commission is that without the imposition of various professional duties on broker-dealers and other actors in the securities business, the goal of disclosure could never be attained. See Booth, *Self-Regulation in a Democratic Society*, 50 J. AIR L. & COM. 491, 507-09 (1985).)

Moreover, none of the SEC's arguments, with the exception of the misstated notion that the Commission has the authority to protect voting rights, is consistent with a *uniform* voting rights listing standard for all exchanges. Indeed, a uniform standard suggests the very opposite of competition. Similarly, the idea that the 1975 amendments to the Exchange Act, which sought to assure fair competition through equal regulation of the various stock markets, indicated that Congress authorized the SEC to eliminate any differing rules of those markets that might arise, see Adopting Release, *supra* note 84, at 89,232-33, is nonsense.

In summary, although the optimal solution to the problems of tender offer regulation may be separate stock exchanges for companies with different characteristics (which, of course, is what has traditionally been the case), the exchanges for one reason or another appear to have lost sight of their self-interest,¹⁵⁵ and the SEC may be legally precluded from imposing such a scheme.

C. State Regulation

The remaining alternative is state law. Unlike federal or stock exchange reform, a state law solution remains a realistic possibility. There is now ample precedent for state takeover regulation. Several states have adopted so-called second-generation takeover statutes,¹⁵⁶ which satisfy the Commerce Clause requirements established in *Edgar v. MITE Corp.*¹⁵⁷ In that case, the Court held that a state statute that required advance notification of tender offers was an unconstitutional state infringement on interstate commerce. Though the new statutes have taken several forms, they all seek to regulate hostile acquisitions by focusing on aspects of corporate governance that have traditionally been matters of state law.¹⁵⁸

The Indiana Control Share Acquisitions Chapter,¹⁵⁹ recently upheld by the Supreme Court,¹⁶⁰ holds some promise. The Indiana Act applies

155. See Proposing Release, *supra* note 84, at 88,787 (concurring statement of Commissioner Fleischman). While the Commission noted the argument advanced by at least one commentator that a scheme of variable regulation might be preferable, the Commission clearly concluded that a uniform rule is preferable, though it gave no very satisfying reason why. See Adopting Release, *supra* note 84, at 89,230-33; Proposing Release, *supra* note 84, at 88,771-72, 88,775, 88,777. On the other hand, the Commission also seemed to recognize the need for flexibility and even competition among the exchanges, so long as the competition did not degenerate into a race to the bottom to protect companies from takeover. See Adopting Release, *supra* note 84, at 89,215-18. The Commission's idea, which is consistent with existing market regulation rules, is that the various exchanges will give the general rule against disparate voting schemes specific content, and will decide, for example, whether a particular transaction has an adequate business purpose to justify an exception. See *id.* at 89,219-20.

156. See Block, Barton & Roth, *State Takeover Statutes: The "Second Generation,"* 13 SEC. REG. L.J. 332, 333 (1986); Garrity, *supra* note 97, at 587.

157. 457 U.S. 624 (1982).

158. See Block, Barton & Roth, *supra* note 156, at 340.

159. IND. CODE ANN. §§ 23-1-42-1 to -11 (West Supp. 1988). The chapter is referred to hereinafter as the Indiana Act or simply the Act.

Control share statutes have also been adopted in Arizona, Florida, Hawaii, Idaho, Louisiana, Massachusetts, Minnesota, Missouri, Nevada, North Carolina, Ohio, Oklahoma, Oregon, Utah, and Wisconsin. See, e.g., Block, Barton & Roth, *supra* note 156, at 345 (detailing provisions of the Ohio Control Share Acquisition Statute). For a general discussion of state control share statutes, see Booth, *supra* note 97, at 1678-81. See also NASAA *Adopts Model Control Share Act*, 20 Sec. Reg. & L. Rep. (BNA) No. 18, at 669, 708-19 (May 6, 1988).

160. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

only to companies incorporated in Indiana that have headquarters or significant assets there and 10% or 10,000 shareholders resident in Indiana.¹⁶¹ In essence, it prohibits an acquirer of 20% or more of the shares of a covered company from voting those shares unless a majority of the other shareholders (other than management shareholders) votes to restore the acquirer's voting rights.¹⁶² The Indiana Act requires a new vote when the acquirer's interest increases to over one-third or one-half of the total voting power of the corporation.¹⁶³

The Indiana Act obviously solves the coercion problem by rendering the bidder's shares sterile. No matter how many shares the bidder amasses, he cannot assume control of the target or force the remaining shareholders to sell in a cash-out merger unless the remaining shareholders first agree to allow the bidder to vote. Presumably, the shareholders will not do so unless the bidder makes known in advance whether he plans to force a merger and, if so, at what price. In this sense, the Indiana Act functions very much like a poison pill.¹⁶⁴

While the Indiana Act unfortunately includes a number of provisions that detract significantly from its positive effects,¹⁶⁵ its control share vote could stand alone. As will be seen, shareholder voting is a remarkably intelligent approach to the problem of fairness in tender offers. First, the shareholder vote may eliminate coercive offers. This of course assumes that shareholders will actually vote intelligently. Despite the traditional wisdom that shareholders do not care about voting, however, there are very good reasons to trust the process. Second, the Indiana Act does not preclude partial and two-tier offers that for idiosyncratic reasons may be attractive to shareholders. Third, and perhaps most significantly, the Indiana Act may with minor modifications provide a self-executing mechanism that tends to assure that companies that need defenses against coercive offers can have them cheaply, discourages companies that do not need protections from adopting them, and gives the market a relatively easily read label to indicate which is which.

1. Shareholder Voting As a Means of Protecting Against Coercive Offers

Generally speaking, shareholder voting makes a good deal of sense

161. IND. CODE ANN. §§ 23-1-42-4(a), (West Supp. 1988). It should also be noted that the Act does not apply to corporations with fewer than 100 shareholders, a curious provision in light of the fact that the smaller the corporation, the more susceptible it is to coercive tender offers.

162. *Id.* §§ 23-1-42-1, -5, -9.

163. *Id.*

164. See *supra* text accompanying notes 66-71.

165. See Note, *Second Generation State Takeover Statutes and Shareholder Wealth: An Empirical Study*, 97 YALE L. J. 1193 (1988) (authored by Jo Watson Hackl and Rosa Anna Testani).

in a takeover situation. Putting the issue to a vote relieves any pressure for shareholders to sell for fear of being relegated to the minority. The shareholder can vote according to whether she believes the offer being made is sufficiently attractive—whether it is simply to allow the acquirer to be a fully enfranchised shareholder with whatever risks attend the bidder's status as such or whether it is to cash out all remaining shareholders. If it turns out that the shareholder has voted with the losing side, there is no economic loss as there is when she declines to tender because the offer is too low. The vote allows shareholders to indicate their desire to sell or hold out without risking the significant loss that accompanies tendering the wrong way.¹⁶⁶ Moreover, the control share vote is self-executing: It requires the intervention of no outside agency, and it does not purport to set up any hard and fast rules about what is fair.

One genuine worry is that shareholders simply will not care about their vote, or will vote however management instructs. Though that once may have been true, it is difficult to believe that a shareholder with any significant stake in a target company will fail to cast a serious vote on the question whether the company should be sold at the particular premium a bidder offers. For example, institutional investors control a majority of disinterested shares in many if not most companies and, as previously noted, arbitrageurs frequently amass a majority of the target stock in takeover situations. It thus seems likely that a few individuals—who may even be in touch with each other and thus capable of concerted action—would be in a position to decide the outcome of the vote. Indeed, recent reports indicate that institutions are taking an ever more active part in corporate decisions such as the deployment of advance takeover defenses.¹⁶⁷

For those shareholders without a significant stake in the target, the vote may provide a focal point for grassroots organizing that would not be likely to arise if shareholders were forced to choose among tendering, selling in the open market, or holding out for a higher bid.¹⁶⁸ At the very

166. See Booth, *Management Buyouts*, *supra* note 32, at 658. See generally Bebchuk, *The Pressure to Tender*, *supra* note 5 (proposing to alleviate shareholder risk by allowing certain voting rights); Bebchuk, *Toward Undistorted Choice*, *supra* note 32 (proposing a procedure to make takeovers contingent on approval by tendering shareholders); Easterbrook & Fischel, *Voting*, *supra* note 143, at 415-18 (discussing the value to shareholders of the right to vote on extraordinary actions).

167. See generally PRACTICING LAW INST., SHAREOWNER ACTIVISM: THE EMERGING ROLE OF INSTITUTIONAL INVESTORS (1987); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 176-80 (1987) (considering whether shareholder composition affects decision of company to adopt fair price charter amendment); Rohatyn, *Institutional "Investor" or "Speculator"?*, Wall St. J., June 24, 1988, at 14, col. 4; *Investors Make Headway: Proposals on Poison Pills, Greenmail Garner Higher Tallies*, N.Y.L.J., June 16, 1988, at 5, col. 2; *Holder Resolutions Against Poison Pills Win More Support at Annual Meetings*, Wall St. J., May 13, 1988, at 4 col. 2; *"Poison Pill" Challenge Loses*, N.Y. Times, Apr. 15, 1987, at D1, col. 3.

168. For an extended discussion of the significance of focal points as a way for target

least, management and bidder will present their best cases to the shareholders without the coercion and strategic behavior that necessarily attends a tender offer.¹⁶⁹ It is, as the Supreme Court recognized in *CTS Corp. v. Dynamics Corp. of America*,¹⁷⁰ a benefit for shareholders to be able to coordinate their decisions whether to sell. Since the bidder's biggest advantage is precisely the shareholders' inability to coordinate their response in a straightforward tender offer, shareholder voting is more trustworthy than commonly acknowledged.¹⁷¹

2. *Preservation of Attractive Partial Bids*

Perhaps the most appealing feature of the Indiana Act is that it does not necessarily preclude all two-tier or partial bids. The problem with such bids is that shareholders in the aggregate may end up worse off after a shift of control even though tenderers are better off. That is, losses to holdouts may exceed gains to sellers. But it is also possible for holdouts

shareholders to coordinate their responses to an offer, see Bebachuk, *supra* note 60, at 217-18; Schwartz, *supra* note 21, at 181-83; Schwartz, *supra* note 60, at 232-33.

169. Moreover, voting can operate as a negotiating mechanism between shareholders and management. A vote's value to someone else affects its value to a shareholder. See Booth, *Management Buyouts*, *supra* note 32, at 657-61 (discussing shareholder voting as a mechanism to ensure the legitimacy of a management buyout). Since a vote is clearly valuable to the bidder and to management, who can use it to control the company, the shareholder probably will not give it away without insisting on top dollar for it even though she cannot use it to control the company. In other words, even though a shareholder may hold a fully diversified portfolio and may care very little about the ups and downs of particular companies, the shareholder will not ignore the opportunity to realize an additional gain by treating the decision to accept or reject an offer as outside the logic of diversification, at least where there is nothing to be lost. That is, the shareholder will approach the voting decision very much as management would.

In addition, voting may act as a bonding mechanism by which management proves that there are no significant objections, and through which it risks added liability to demonstrate that full disclosure has been made. For example, in a transaction such as a management buyout, the shareholder vote can reassure public shareholders that they are receiving an appropriate premium in a transaction that could not be put to a market test because of management's controlling interest.

170. 481 U.S. 69 (1987).

171. Professors Easterbrook and Fischel have pointed out that the very survival of shareholder voting indicates that it is a valuable institution, and they surmise that its value lies in reducing contracting and agency costs by giving shareholders discretionary power over transactions that affect their interests as residual claimants on the wealth of the firm. Easterbrook & Fischel, *Voting*, *supra* note 143, at 401-06. This explanation is consistent with the observation that there are very few shareholder votes of consequence: Presumably management either consults with larger shareholders in advance or simply does not propose transactions that are not likely to be approved. Accordingly, there is little reason to expect many contested votes and little reason to worry that the institution of shareholder voting appears on the surface to be a rubber stamp. In short, whether shareholders care about voting or actually bother to exercise their vote is very much beside the point, for the vote will induce the bidder to offer a fair price in the first place. While there are obvious problems in proving their theory, Easterbrook and Fischel point to several phenomena, such as shareholder opposition to shark-repellant amendments, that support the view that voting has value even though shareholders tend to ignore it. *Id.* at 406-08, 416-17; see also Cole, *Talking Deals: Behind Icahn Loss in Texaco Fight*, N.Y. Times, June 23, 1988, at D2, col. 1; *Texaco Claims Defeat of Icahn in Proxy Fight*, Wall St. J., June 20, 1988, at 3, col. 1.

to enjoy some gain, even though sellers enjoy more. Suppose, for example, that following a successful \$150 per share bid for a bare majority of a target trading at \$100, the remaining target stock trades for \$120. Though the holdout may regret not tendering, and there may be some unfairness in leaving the shareholders who valued the company more highly with the smaller gain, even the holdout is better off than if there had been no offer.

There is no good reason to prohibit all two-tier and partial bids. While many potential holdouts may feel coerced by the possibility that target stocks will trade for less than the offered price after a successful partial bid, such coercion is not necessarily unfair. Takeover battles are conducted in the real world where things take time, circumstances change, and new information comes to light. A bidder who in good faith believes a target to be worth \$150 per share may discover upon gaining control that in fact the company was really only worth \$130 at the time of the bid, or the market as a whole may have fallen in the interim such that \$130 is now an equivalent price.

It is, of course, possible that a bidder may obtain enough shares to control the target, and may be enfranchised by shareholder vote after representing that the shares will be held for investment only, and may then, claiming some change of circumstances, cash out the remaining shareholders at a loss. Similarly, the bidder may assume control of the target having convinced the shareholders that it has superior management skills or a more promising business strategy than old management, and may then proceed to run the company as a captive subsidiary, making it just profitable enough in its dealings with the parent to avoid the charge of looting.

These scenarios, however, should not be of serious concern. Presumably the courts can easily deal with those few cases in which bidders misrepresent their intentions. Moreover, it seems unlikely that shareholders will readily vest control of the company in a bidder who does not offer substantial assurances against taking such advantages. For example, the bidder may offer the remaining shareholders an option to compel him to repurchase minority shares at some fixed price at some point in the future.

In any event, it is conceivable that shareholders will sometimes approve partial and two-tier bids, since at least in some cases the bidder really does offer superior management or plans.¹⁷² There is no good reason to require a bidder who faces considerable risk in the first place to

172. Although one of the most desirable features of the Indiana Act is that it leaves open the possibility of a fair partial or two-tier offer, Indiana also adopted a so-called fair-price statute which requires that any second-step merger be done at the highest price paid to any first-step tenderer. IND. CODE ANN. § 23-1-43-19(3) (West Supp. 1988). Far from providing additional shareholder

assume still more risk by enshrining the initial bid as a floor for any future merger. The result would only be to make it more expensive than necessary for bidders to do takeovers. Potential target shareholders would in the end suffer lower overall returns from inefficient management and too few attempted takeovers.

3. *Identifying Targets Susceptible to Coercion*

Finally, control-share statutes are self-executing and with minor changes could be made self-adjusting for companies with greater or lesser exposure to coercive bids. Consider how the shareholders of a covered company might react to a partial or two-tier bid. The control share vote leaves open the possibility that holdout shareholders can approve partial and two-tier bids even when they are paid less than those who tender or sell in the first step.

On the other hand, a control-share statute entails the danger—as with the similar poison pill—that it will force bidders to offer higher premiums than they otherwise would, reducing the number of takeovers proposed and in turn reducing management efficiency. In the absence of a control-share statute a bidder need only offer enough to satisfy a majority of the target shareholders, including the bidder, to obtain control. But with a simple control-share statute providing for a single vote when the bidder acquires a majority of target shares, he must also satisfy a majority of the remaining half of the shareholders (or a total of three-quarters of the shareholders as measured before the bidder began purchasing) in order to be enfranchised. The bidder can, of course, buy a bare majority and try to convince the holdouts of the wisdom of conferring voting rights. But the risk of losing the vote may outweigh the cost of offering a premium sufficient in the first place to satisfy the three-quarters whose consent must eventually be had.

It is possible that bidders, who know the cost of winning voting rights from holdout shareholders, will offer less to early tenderers so that the net cost of the takeover will remain unchanged. What seems more likely, however, is that the remaining shareholders will demand in exchange for their approval a payment high enough that the bidder will incur a greater cost. The bidder may, of course, be able to avoid much of the risk by conditioning a bid on receiving shareholder approval. Still, the requirement of a vote upon acquisition of a majority of shares seems to encourage holdout shareholders to insist on at least equal or perhaps

protection, this provision only obviates the desirable flexibility of the companion control-share statute which otherwise would allow shareholders to accept a bid they find attractive, even a bid lower than the front-end bid. Still more unfortunate is that Indiana also opted for a five-year merger ban, which eliminates the possibility even of an equal-price merger unless it is planned and approved before the bidder ever gains a 10% stake in the target. *Id.* § 23-1-43-18.

better treatment than early sellers receive, even though shareholders would sometimes approve partial or two-tier bids but for the bargaining power conferred by the statute itself.

By sterilizing the bidder's shares, then, the holdouts' shares are made more valuable than they otherwise would be, and tender offers are unduly discouraged. The operation of the Indiana Act upheld by the Court in *CTS* is, of course, more complex than the single vote majority trigger statute described above. The Indiana Act requires a bidder to estimate how many shareholders must be satisfied at three different ownership levels. For example, assume the bidder buys 20%. Ignoring the possibility of any management shares being sterilized—and in some cases there may be relatively few—the vote required to re-enfranchise the bidder is 40% plus one. That means that any proposed cashout must in effect satisfy just over 60% of the shareholders as measured before the bidder began purchasing (that is, the 20% who sold out to the bidder plus the 40% who voted in favor of the bidder). The bidder is thus forced to pay more for the target than the shareholders would have demanded in an uncoerced negotiation or stairstep offer. Similarly, if the bidder purchases one-third of the shares, the statute effectively requires two-thirds approval. And if the bidder purchases 50% of the shares, a total of 75% of all target shareholders must be satisfied that the shift in control is wise.

Accordingly, at least where management itself controls few shares, the Indiana Act probably increases the price a bidder must pay to effect a takeover. That, in essence, is the reason why most courts and commentators have been highly critical of state takeover legislation. (It bears noting, however, that the same criticism has been leveled at the Williams Act,¹⁷³ though it can also be argued—as I do here—that the Williams Act on balance lowers the price of takeovers.)

Nevertheless, the fact that the Indiana Act apparently makes it more expensive for a hostile bidder to gain control does not lead inexorably to the conclusion that the Act is bad for business. Inasmuch as the Indiana Act is similar to a poison pill, it may well be appropriate for a company that is susceptible to a coercive bid. That is, if there is a peculiar danger that a potential target company may be subject to a bid in which holdout shareholders will lose more as a result of looting than tenderers will gain or in which no competitive bidding will arise, then the (effectively 75%) control requirement of the Indiana Act may make sense.

The question is whether on balance the Indiana Act prevents coercive bids or instead protects incumbent management against beneficial

173. See, e.g., Jarrell & Bradley, *supra* note 13.

takeovers. For some companies, a control-share statute serves only to entrench incumbent management, but for smaller companies, such a statute may perform a valuable function.¹⁷⁴ Professor Romano has thus suggested that the central problem in assessing the desirability of a takeover statute may be determining which companies have the sort of shareholder population for which a takeover statute makes sense and whether those companies are predominant in each jurisdiction.¹⁷⁵ Presumably a

174. See *supra* text accompanying notes 110-115.

175. Romano, *supra* note 167, at 180-87. Arguably, the Indiana Act does leave some room for a larger shareholder to insist on a bribe in connection with the control-share vote. After all, what is to keep a larger shareholder from striking a private deal with a bidder for a vote in favor of enfranchising the bidder in exchange for the bidder's later purchase of the shares at a larger premium than the premium (if any) offered to the remaining shareholders?

There are several answers. In the first place, a deal made with the intent to defraud other shareholders would likely be viewed as illegal vote selling. See *Schreiber v. Carney*, 447 A.2d 17 (Del. Ch. 1982); *Chew v. Inverness Management Corp.*, 352 A.2d 426 (Del. Ch. 1976); see also Easterbrook & Fischel, *Voting*, *supra* note 143, at 410-11 (discussing reasons for prohibition against vote buying); Note, *The Standstill Agreement: A Case of Illegal Vote Selling and a Breach of Fiduciary Duty*, 93 YALE L.J. 1093 (1984) (authored by Steven A. Baronoff) (arguing that standstill agreements violate public policy by forcing shareholders to vote for reasons other than the best interests of the corporation).

Second, even if legal, the deal would need to be disclosed if ever reduced to any enforceable form. See Sec. Exch. Act Sched. 13D, Item 6 (entitled Contracts, Arrangements, Understandings or Relationships with Respect to Securities of the Issuer). Third, and probably most importantly, such a deal would presumably render the subject shares unvotable under the Act itself, which sterilizes interested shares. IND. CODE ANN. §§ 23-1-42-2, -3 (West Supp. 1988).

There is, of course, a danger that regular players in the takeover game might share their gains with larger holdouts, perhaps in return for future favors, or that large "yes"-voters may be given the option to remain shareholders in an attractive successor corporation. In any event, some shareholder will probably have holdup power and the ability to command a higher premium in ways that are difficult to predict. It is thus far from clear that the Indiana Act will succeed in eliminating all favored treatment of better-organized shareholder groups.

There may be reasons for allowing some shareholders to capture larger benefits. Unless there is a particular shareholder or group which is a real threat, there may be no genuine incentive for management to please any of the shareholders. See generally Coffee, *Shareholders Versus Managers*, *supra* note 3, at 16-24 (arguing that shareholders and management have different priorities and different interests). Compare Easterbrook & Fischel, *Corporate Control Transactions*, *supra* note 27 (arguing that unequal treatment of shareholders may sometimes be necessary to accomplishing mutually beneficial transaction) with Bebchuk, *Toward Undistorted Choice*, *supra* note 32, at 1780-88 (arguing that unequal treatment is unfair) and Easterbrook & Fischel, *Voting*, *supra* note 143, at 409-10.

Furthermore, small shareholders get a free ride on the larger shareholders' monitoring of corporate management. Unless the larger shareholder can command (or capture) extra return in excess of a pro rata benefit for monitoring, there may be insufficient incentive to perform the service. Indeed, it is unreasonable not to pay the monitoring shareholder something extra for valuable services rendered. And since the benefit inures to the shareholders, it should come out of their pockets. In other words, it may be that some level of disproportionate treatment is beneficial for all concerned. Thus, there is some danger that the Indiana Act may have done the job of equalizing shares too well.

In the grand scheme of things, however, slightly lower incentives to monitor are probably a small price to pay for eliminating the distortions by bribery. Larger shareholders may even find other ways to increase their return to compensate for monitoring. The important point is that the

state in which most of the publicly traded companies are susceptible to a coercive takeover ought to adopt an opt-out statute (and vice versa).¹⁷⁶

The danger, of course, is that any scheme of differential takeover regulation is likely to be wholly voluntary under state law, and larger companies would thus be free to choose the anti-coercion rules intended for smaller companies. However, there would probably be significant disincentives for doing so. Any company that inappropriately chose to prohibit partial and two-tier bids would effectively raise its own cost of capital, since its shareholders would not enjoy the protections against management inefficiency that come with full exposure to hostile takeovers. In other words, the forces of the marketplace should induce companies to do the right thing. Nevertheless, the current system of company-by-company defenses under state law is essentially a voluntary scheme. And the perception is that it is abused despite the same disincentives. In addition, there is reason to worry that the market is not *that* efficient. Unlike a state control-share statute, takeover protection methods (such as poison pills) are devised and adopted one company at a time. Therefore, the market can strictly discipline any company that adopts a pill that is overprotective (and perhaps any company that adopts a pill at all). But because a statute like Indiana's applies to all state corporations that do not opt out of it, the market is much less likely to respond when any one company fails to opt out.

In the case of an opt-in statute, the market may be somewhat more responsive. The company that dares to adopt a takeover defense not knowing whether others will follow may indeed find that others do not. If so, the lonely leader may become the focus of adverse shareholder reaction and may suffer discounting in the market, making it an even more likely target. But if all companies adopt measures that shareholders dislike, there may be no significant market reaction at all unless there is a reasonably close substitute investment to which investors may turn at relatively little cost. Nonetheless, the very existence of an opt-in feature may provide enough coordination for many companies to risk opting in,

Indiana Act appears to eliminate disproportionate—indeed virtually unchecked—compensation for larger shareholder-monitors in the absence of such a statute.

176. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* 369-72 (3d ed. 1986) (function of corporation code is to provide standard form contract between shareholders and management). However, Professor Romano found no convincing evidence of a correlation between the kind of shareholder population a state's corporations had and the adoption of a takeover statute (or the speed with which the statute was adopted). Neither did she find any evidence that the market value of companies incorporated in states which adopted takeover statutes either rose or fell (though this inquiry was complicated by the difficulty of determining exactly when the market would react). Romano, *supra* note 167, at 181-86; cf. Gordon, *supra* note 128, at 45 (reporting relatively small institutional ownership in companies proposing dual class recapitalization, which is an effective method of entrenching management).

possibly on the assumption that others are likely to opt in, so that most will eventually opt in.¹⁷⁷

It may thus appear that anti-takeover statutes are abusive because they allow target companies to circumvent a vote of their own shareholders and perhaps even to avoid market discipline (at least in the sense of being *singled out* for discounting). But the vote of shareholders may not always create the fairest, most efficient outcome. There may be occasions when larger or better coordinated shareholders will be able to veto shark repellent amendments and will be motivated to do so because they expect to be paid a disproportionate amount (a bribe) for their shares if a tender offer arises.¹⁷⁸ If so, such companies (or, to be more exact, their smaller shareholders) may benefit from a control-share statute precisely because it can be adopted without a shareholder vote.¹⁷⁹

Thus, the worry remains that companies that ought not adopt takeover defenses will be able to take advantage of the statute. Several factors make this problem less serious than it might appear. First, even though investors who could keep a company from opting in will not necessarily be able to force it to opt out,¹⁸⁰ management will have an incentive to opt out, since by doing so it will stand out from the crowd in a

177. See generally Coffee, *No Exit?: Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies*, 53 BROOKLYN L. REV. 919 (1988). See also *supra* note 168 (regarding significance of focal points as means by which disparate actors can coordinate behavior). It has been argued by virtually everyone who has written on the subject that managers are (quite naturally and perhaps to some extent rightly) most concerned about protecting their jobs and deferred compensation arrangements. For a survey of these arguments, see Coffee, *Shareholders Versus Managers*, *supra* note 3, at 16-24. Raising the value of the company stock by methods that threaten job security is quite unattractive to managers. If indeed managers do typically seek to entrench themselves, a takeover statute which obviates the need for shareholder approval would be a particularly attractive device.

178. There is a good deal of anecdotal evidence that more powerful shareholders seek and often get such favored treatment. For example, it appears that some groups are routinely favored over others in connection with the allocation of attractive new issues of securities. See *The Obligations of Underwriters, Brokers and Dealers in Distributing and Trading Securities, Particularly of New High Risk Ventures*, Exchange Act Releases Nos. 33-5275, 34-9671, 2 Fed. Sec. L. Rep. (CCH) ¶ 4506B (July 26, 1972); see also *Trading at Time of Stock Offerings Raises Questions of Manipulation*, Wall St. J., Apr. 1, 1987, at 31, col. 4.

179. See *Shark Repellants: The Role and Impact of Antitakeover Charter Amendments*, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,714, at 87,182 (Sept. 7, 1984) (recognizing the possibility, among others, that institutional shareholders vote for shark repellent charter amendments because they expect future consideration from management for doing so). The implication is that the holdup power of institutional investors should be neutralized to the fullest extent possible. Control share statutes do just that. Since a bidder who acquires a 20% position cannot vote, there is no incentive to bribe early tenderers. In other words, the control share vote renders all votes equal. It eliminates the holdup power that larger or well-organized shareholder groups can exercise in connection with a transfer of control, and thus it eliminates their ability to negotiate for a bribe.

180. See Romano, *supra* note 167, at 186-87.

positive way in the eyes of investors and will thereby enjoy cheaper capital. Not only will opting out expose the company to the threat of takeover and the discipline that goes with it, it will also signal to investors management's high level of confidence in the job it is doing.

Second, it is unclear that a control share statute operates as much of a deterrent to the takeover of a larger company with more diverse shareholders. It is presumably the smaller company, which can be controlled with a few relatively large shareholders, that is most susceptible to a coercive offer or one that directs a bigger premium to key shareholders. Moreover, larger companies can in many cases be controlled with an even smaller percentage of shares than is required to trigger the control share statute. Shareholders of large companies are less likely to have widely differing opinions of the target's value than are shareholders in smaller companies which are less heavily traded and more susceptible to dramatic changes of fortune. And larger companies are much less susceptible to the kind of advantage-taking or quasi-looting by a prospective parent that can drive down the price of shares after control has passed. In short, it is probably not that damaging to shareholder wealth for a company that should *not* be subject to a control share statute to opt in or fail to opt out.

Finally, in certain circumstances the control share statute will produce the same result an unregulated market would. Consider again the situation in which a bidder has acquired a 20% stake in the target company. If management—which cannot vote its shares on a control-share question under the Indiana Act—also controls 20% of the company's shares, then the bidder need only woo a majority of the 60% which neither it nor management owns. That 30% plus one, in addition to the 20% which the bidder has already bought, adds up to just a majority of the shares as measured before the bidder began buying. In such a case the Indiana Act produces an eminently fair result—but only accidentally, because bidder and management happen to own the same number of shares.

Despite these mitigating factors, Indiana's statute does work some real disadvantages on a bidder. In larger companies in which management controls relatively little stock, sterilization can harm the bidder. Not only is the bidder precluded from voting, but the bidder has already bought the shares most likely to be voted to enfranchise him. Of course, management too is precluded from voting its shares which are presumably the ones most likely to vote against the bidder. Yet where management owns fewer shares than the bidder, the bidder is put at a distinct disadvantage because more of the votes likely to be cast in his favor have been sterilized. It seems backwards, to say the least, to make it more difficult for a bidder to proceed the more shares he acquires.

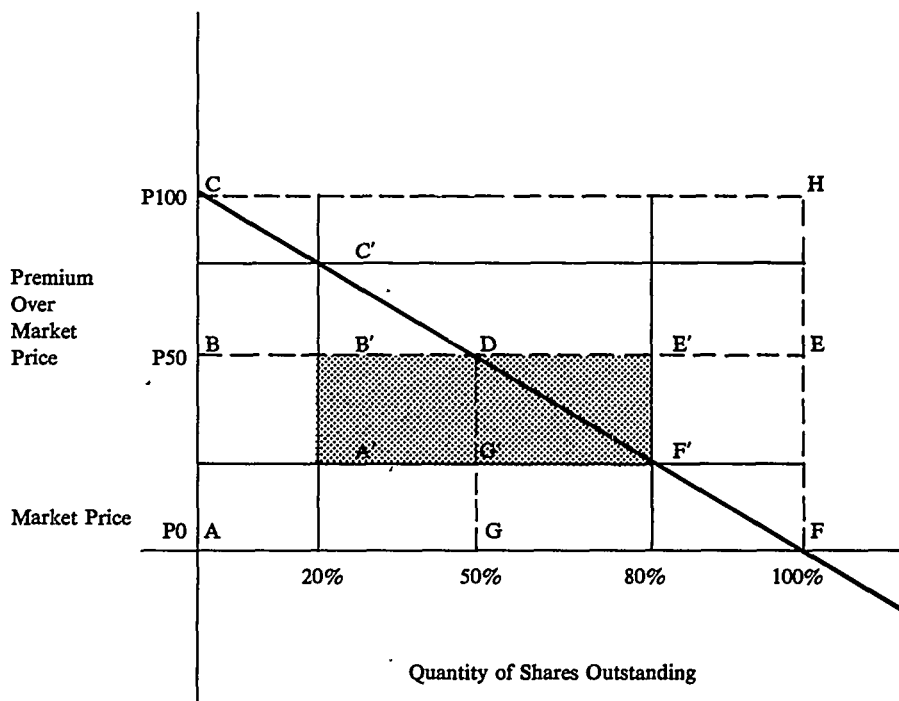


FIGURE X

Where management and bidder have a roughly equal stake in the company, however, the vote is an elegant solution to the problem of coercion. This suggests a possible improvement in the Indiana statute. Rather than requiring a vote upon the acquisition of arbitrary percentages as under the current Indiana statute, it might be more sensible to hold a single vote when the bidder acquires the *same* percentage of the target's stock as is controlled by pre-bid management, thus insuring that a bidder will gain control when it gets support from a majority of shareholders. With the trigger percentage so determined, a vote of the disinterested shareholders would reflect the true median view of non-management shareholders regarding the desirability of a continued battle for control. Figure X depicts this relationship. The assumption is that both incumbent management and bidder control 20% of the stock of the company. Thus the shares on the segments CC' (management shares) and F'F (bidder shares) cannot be voted. The disinterested shares lie on the segment C'F', and in order for the bidder to be enfranchised these shareholders must be offered a premium of P50 or be convinced that the company will be worth more than P50 as a result of new management. In short, the result is the same as if a two-step highest price bid were required (as depicted in Figure III), with the important difference that

the shareholders have the option to participate in the venture under new management.

It is open to question, of course, whether the median view of disinterested shareholders as to the value of the company is in fact the optimum standard by which to determine whether a takeover should proceed. At least intuitively, a majority vote would seem to have merit because if the median voter approves the bid price, then at worst, half of the target shareholders will be overcompensated and half will be undercompensated. Moreover, assuming that the shareholder demand curve is a relatively straight and continuous line, the aggregate amount of overcompensation would roughly equal the aggregate amount of undercompensation. Well-diversified shareholders would be perfectly happy with such an outcome, since sometimes they would receive more and other times less but on the average a fair price, by their valuation, for their stock.¹⁸¹

A simple majority vote will not, however, reflect whether those who vote in favor of the merger perceive the gain to be greater than the loss perceived by those who vote against the merger. It is possible, after all, that the range of values perceived by the shareholder population (or by discrete groups) is not a smoothly sloping line but rather increases (or decreases) in jumps from one shareholder or group to the next. If, for example, a bare majority of the shareholders are barely satisfied by the offered price, while the remaining shareholders perceive the value of the company to be considerably higher, the lost gain for the holdouts could far exceed the enjoyed gain to those voting in favor of the bid.

This would seem to be a serious problem if institutional investors are indeed much more inclined to accept a bid than are other shareholders. But institutional investors often may be willing to settle for smaller premiums only because they enjoy the opportunity to sell earlier or sell more shares than other target shareholders. Since a control share vote determines whether there will be any further sales to the bidder, institutional investors will ordinarily be denied any preference over other target shareholders and will have no peculiar incentive to vote in favor of the bid. Of course, there may be other as yet unidentified reasons why institutional investors or other groups of investors are more or less inclined to tender. At this juncture, however, there is no particular reason to think that a majority vote is not the optimum standard.

Admittedly it may be difficult, for purposes of enforcing a one-vote control-share statute, to determine which shares should be regarded as under management control. Similarly, problems may arise in determining precisely which shares are controlled by the bidder. The easy answer

181. See Booth, *Management Buyouts*, *supra* note 32.

is that the same problem attends the Indiana Act as it currently stands. Under the current statute, management has every incentive to minimize the number of shares that are deemed to be under its control. And it seems fair to assume that there will be a good deal of litigation over whether shareholders friendly to target management are in fact controlled by management.

These controversies would be discouraged under a modified statute requiring a single vote upon a bidder's acquisition of the same percentage as management. Under such a statute, management would be faced with conflicting incentives. Although management would still be tempted to understate its control in order to count the votes of friendly shareholders, management would also be tempted to overstate its control in order to postpone the vote, clear the market of shares most likely to vote in favor of the bid, and shift additional risks onto the bidder who is forced to acquire a larger percentage of target stock without the benefit of knowing whether the bid can proceed. It seems likely then that on balance, target managers would be inclined to state their control percentage accurately in order to avoid the possibility of a vote that is either too early or too late. Alternatively, the statute could actually require each covered company to state in advance in some sort of public record exactly what it considers its control percentage to be and to update the number as circumstances change.¹⁸²

Holding a single vote upon the bidder's acquisition of the control percentage differs from the law as it now stands. The current statute contemplates as many as three separate votes as the bidder crosses each statutory threshold. (Again, it is unclear whether the bidder must be re-enfranchised as to all shares at each vote or simply as to newly acquired shares.) While this scheme is perhaps understandable because, among other reasons, control may often be exercised with less than a majority of the stock, it nevertheless seems extremely wasteful to allow target shareholders three chances to decide and, practically speaking, management as many as three chances to thwart a single takeover. No doubt the reason for requiring three votes was that different companies can be controlled with different percentages of shares. If, however, there is a reliable and relatively inexpensive way of determining, company by company, the percentage necessary for control, the sensible approach would seem to be to hold a single vote at the time the bidder reaches that percentage of stock ownership. And what better evidence could there be

182. For example, the SEC might require such disclosure annually in 10K reports and require any changes to be reported in an 8K. See Securities Exchange Act Rules 13a-1, -11, 17 C.F.R. §§ 240.13a-1, -11 (1989). This might be particularly helpful in light of the fact that relatively few companies meet all the criteria for coverage under many second generation statutes. See *supra* note 161.

of the percentage needed to control a company than the percentage management itself controls?

It seems unlikely, in any event, that a second or third vote would turn out differently from the first. More importantly, however, the idea is to achieve an efficiently functioning takeover mechanism which takes shareholder preferences into account in an optimal way. The idea is not to assure that no shareholder will be dissatisfied with the outcome of any particular control contest, but rather that on average shareholders—as well as bidders and target managers—are fairly treated. It thus misses the point to argue in favor of multiple votes by claiming that shareholders have an inalienable interest in holding onto their shares and that only after *repeated* expressions of approval by the ever smaller majority of remaining disinterested shareholders can a bidder have full access to ownership rights.¹⁸³

On balance, then, and despite their nearly universal condemnation, control share statutes appear to be a quite promising possible solution to several pressing problems clustered about so-called coercive tender offers. But existing control share statutes should be reworked to eliminate their biases in favor of target management. To put it simply, the ideal control share statute would provide for a single vote as of the bidder's acquisition of shares equal in number to management controlled shares.¹⁸⁴ Finally, it is not at all clear that there would be much need for anything more than a pure disclosure statute at the federal level once a well-crafted control share statute became readily available.¹⁸⁵

Admittedly, reliance on state law for purposes of regulating tender offers carries with it the danger that states will not adopt uniform laws and that, even if they do, they will not enforce them uniformly. The danger is probably not significant, however. It is, after all, notoriously easy for corporations to switch their state of incorporation, and therefore the pressures for a uniform rule to evolve are considerable. Moreover, enforced uniformity, as noted at some length in this Article, has its downside. Were it not for state-level experimentation with ways to regulate the takeover process, such innovative solutions as the control-share statute might never have been devised.

183. See *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983) (business purpose is not required for cashout; shareholders have no vested right to hold shares forever). The SEC, quite incredibly, has suggested that the new voting rights listing standards rule may require review of the business purposes of various transactions that appear incidentally to decrease shareholder voting rights. See *supra* note 154.

184. The other varieties of state takeover statutes that have been adopted alone or in combination with control-share statutes are for the most part misguided attempts to achieve the sort of bargaining balance that control-share statutes effectively establish.

185. See Leebron, *supra* note 1, at 221-22.

CONCLUSION

Although the Williams Act was intended to protect shareholders, it seems clear that in the end, shareholders would probably gain from its repeal since the costs associated with the highest price rule, namely, profits for arbitrageurs, would likely be redistributed to shareholders who hold out for higher prices. Bidding companies would be encouraged to bid because more shares could be bought for each dollar of premium. Shareholders would also be encouraged to hold out in appropriate cases, and target companies might well find it less necessary to resort to manipulative defensive tactics. For some companies, coercive tender offers—which are not regulated in any significant way by federal law anyway—would continue to constitute a threat. Though federal law or exchange regulation could in theory reach such offers, neither source of reform appears likely. State control-share statutes, however, may, with appropriate refinements, provide an elegant solution to the need for takeover regulation that is sensitive to the relevant differences among companies. In view of all this, there seems little reason to perpetuate the current system of substantive federal tender offer regulation.