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Book Review: Tender Offers for Corporate Control

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BOOK REVIEW

Corporate Warfare — New Style

TENDER OFFERS FOR CORPORATE CONTROL. BY EDWARD ROSS ARANOW AND HERBERT A. EINHORN. New York: Columbia University Press. 1973. Pp. xviii, 352. \$40.00.

1. THE BACKGROUND

Corporate warfare produces few human corpses but ample economic carnage. The traditional combat has been for markets or raw materials or financing. Sometimes the assault is not directly for any of these, but for control of a company which possesses them or some other desired booty.

Corporate control contests in the 1950's and early 1960's were often proxy fights, with insurgents battling incumbents in soliciting the votes of the shareholders. Since then the campaigns have more commonly been tender offers, with outsiders offering to buy shares (for cash or in exchange for their own securities), and incumbents fighting back with publicity, defensive mergers, injunction suits, and by other means.

The training manual—and to some extent the rule book—for proxy fights has long been ARANOW AND EINHORN, *PROXY CONTESTS FOR CORPORATE CONTROL* (1st ed. 1957, 2d ed. 1968). These battle-scarred lawyers with a scholarly bent have now provided an equally excellent volume which should serve the same purposes for tender offer contests.

The laws of war for tender offers are more complex than those for proxy fights. The latter include elements of state corporate and agency law, highly detailed SEC regulation (partly substantive and partly disclosure), and anti-fraud provisions (mostly federal). The tender offer laws have elements of state contract law, far-reaching though relatively concise SEC regulation (partly substantive and partly disclosure), and antifraud provisions (mostly federal). In addition, tender offers have significant components of state blue sky and administrative law, SEC market regulation, federal margin regulation, Investment Company Act restrictions, resale problems under the Securities Acts, and intricate tax and accounting provisions.

2. THE BOOK

This knot of rules is the subject of the new book. Aranow and Einhorn approach them descriptively and operationally: what the rules are and how to fight (or function) within them. Planning by teams of experts, and developing strategies in anticipation of countermoves, are set in this context. The technique is integrative: showing how the rules interrelate (sometimes crazily). The emphasis is legal, but one of the important strengths of the book is its conflation of business, financial, stock market, and public relations aspects of tender offers. Within the legal area, the stress is on corporate and securities subjects rather than on antitrust. The organization is logical and easy to follow. The viewpoint is mostly that of the tender offeror (or its counsel), although the authors shift to the target company's side in dealing with some issues.

The style is straightforward, except for some law review circumlocutions of the "would appear" and "might be considered" variety.

The early chapters describe the features (mostly economic) that make a company a likely target (chapter 1) and the preparations that go into making a tender offer (chapter 2). These include the diverse factors in designing and pricing the offer (pp. 29-41). Chapter 3 is a step-by-step guide to the contents of an offer: terms, contingencies, and mechanics. Chapter 4, nearly a third of the book, covers the federal regulation of tender offers, mostly from the 1968 Williams Act and 1970 amendments. Among the particularized analyses in this area are the required filings and disclosures (especially the troublesome disclosure of the offeror's plans for the target company, pp. 99-104), the substantive requirements (withdrawal rights before seven and after sixty days, extension of offer price increases to prior tenderors, and pro rata acceptance of tenders in the first ten days, pp. 134-39), and restrictions on market transactions apart from the offer (pp. 128-34, 19-29). An interesting excursion covers special federal regulation when the target is an air carrier, broadcaster, utility holding company, etc. (pp. 146-52).

The remainder of the book deals mainly with other regulatory aspects: state law, which tends to be highly obstructionist (chapter 5); the Investment Company Act of 1940, which may apply disastrously to the successful offeror (chapter 7); and problems (under the registration requirements of the Securities Act of 1933 and under the short swing insider trading provision of the Exchange Act section 16(b)) in disposing of shares acquired by an unsuccessful offeror (chapter 8).

Chapter 6 illuminates the mysteries of stock market behavior during a tender offer, principally the work of arbitrageurs. Their techniques and goals are described (pp. 173-91) and the offeror is counselled how to procure their valuable support (p. 191). The prohibitions on short tendering are explained (pp. 125-28).

Defensive tactics, including contingency planning, are examined in depth in chapter 9. A final chapter summarizes SEC and private enforcement of the federal securities laws. There is an appendix consisting of the full text of statutes, rules and releases, and a better than average index.

In each section, the reader will find the text of relevant statutes and rules, references to law reviews, a rather full statement of leading cases (judicial and administrative) with citations of the others, a probing and operationally oriented discussion of the main problems, and (usually) the authors' answers, with supporting reasons, to the questions which have not yet been answered by judicial or administrative bodies. These include a discussion of what is a tender offer (pp. 69-76), and when a potential "group" must file a tell-all Form 13D with the SEC (pp. 83-93).

Various themes weave skillfully across the basic organization. Thus, the protean federal fraud provision, Rule 10b-5, and its tender offer analogue, Exchange Act section 14(e), are treated at various points in terms of substance (pp. 23-24, 116-25, 237-44) and remedies (pp. 277-98). The move elusive Rule 10b-6, which prohibits buying while distributing, is traced into

various situations, for example (1) the possibility that it prohibits an arbitrageur, who is also a broker-dealer, from receiving a soliciting dealer's fee from the offeror for the shares he tenders (pp. 187-91; the authors argue convincingly that it does not), and (2) the probability that a target company planning a defensive merger (a "distribution") is barred from buying its own shares in the market (pp. 240-42), or that the proposed merger partner, if it will issue its shares in the merger, is so barred (p. 243).¹ The authors, as befits proxy experts, note that the early warning provisions of the takeover rules may have an impact on proxy contests by requiring nascent groups to disclose their plans on 13D forms before they have begun to solicit proxies (pp. 93-94).

While the proxy contest is by nature hostile, the tender offer is not, and it is in fact often used for friendly takeovers. By titling and structuring their new book to parallel the old one, the authors highlight the hostile offer. But much of what they say is equally applicable to the negotiated tender offer supported by target company management. Similarly, parts of the book are germane to takeovers through open market or private purchases which do not involve tender offers (pp. 77-105, 114-16).

3. THE CRITIQUE

The burst of tender offers by conglomerates in the late 1960's produced an abundance of articles by lawyers, economists, and businessmen. This book is the first to pull it all together. It is an excellent, functional, thoughtful book and deserves a wide following among corporate lawyers and their clients and judges.

No book reaches perfection, at least in the eyes of a reviewer. The imperfections I see in this book are omissions rather than commissions. They fall into three categories: technical, practical, and policy.

Since this is a technical book, I would like to see fuller treatment of a number of technical points, for example, when (if at all) an unsecured loan may be used to finance a tender offer without violating the margin requirements.² I feel the need for a better illustrated connection between the disclosure, in the offer, of the offeror's plans for the target company and whether the offeror becomes an Investment Company on completion of the offer.³ Trouble-

¹ The related problem of the applicability of Rule 10b-13 (prohibiting purchases by the offeror outside the offer) to the merger partner is explored at pp. 133-34.

² P. 42 at n.92. Part of the problem is determining whether various constraints on the securities, short of a formal pledge, are in fact a security interest. Cf. *Cooper v. Union Bank*, 354 F. Supp. 669, 675, 677-80 (C.D. Cal. 1973), giving a very broad interpretation to the Federal Reserve's definition of "indirectly secured."

³ On the one hand, claims of control made to avoid investment company status, may have to be disclosed in the offer. See *Colonial Realty Corp. v. Baldwin-Montrose Chem. Corp.*, 312 F. Supp. 1296 (E.D. Pa. 1970) (proxy statement for merger of company into 34% parent was misleading in failing to disclose that parent had control of company; parent had represented to SEC, in seeking Investment Company Act exemption, that it held working control of the company). On the other hand, claims of intent to obtain control—which may support Investment Company Act exemption—will trigger the required disclosure of "plans" for the target company, which may easily become misleading because of the high level of contingency of any plans in a hostile takeover. See 1 A. BROMBERG, SECURITIES LAW: FRAUD Sec. 6.3(463) (1971).

some problems of disclosure of tax consequences deserve consideration.⁴ The exemption from Securities Act registration for exchange offers approved by certain state administrators⁵ merits mention although it is unlikely to be very helpful in a contested offer.⁶

There is a good discussion of whether target company management must take a stand for or against an offer (pp. 219-22) and a treatment of conflict of interest in their opposing an offer (pp. 229, 249). But there is only a brief reference to the more pervasive problem of conflict of interest when the same management accepts salary increases, options, and other personal benefits to support an offer (pp. 221-22 n.10) and no discussion of the disclosure then required. The catalogue of defensive responses to a tender offer is comprehensive, but there are a few possibilities I didn't see covered, such as inspiring a suit by shareholders of the offeror, or making a counteroffer for the offeror's shares.

Since this is a highly practical volume, concerned with making and resisting tender offers, and not just analyzing the law, I am surprised at the absence of forms. Although there are examples of answers to particular disclosure items in the SEC forms (e.g., p. 99 on "plans" for target companies), there is no complete model (real or hypothetical) of a Form 13D or of a tender offer or transmittal letter. Such models, although seldom suitable for direct copying, would be helpful to the harried lawyer who finds himself in a tender offer.

Policy analysis is hardly obligatory in a book like this. But the authors have made some evaluations of the controversial legislation of recent years. They are critical of state "local interest" statutes (p. 172) and of the "free ride" given investors who tender at one price and receive the benefit of a later

⁴ The courts have indicated that an offeror need not disclose that a cash offer will result in a taxable transaction. See *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840, 843 (2d Cir. 1967), noting the wide awareness of tax consequences and availability of tax advice. But see Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, 21 STAN. L. REV. 1104, 1114 (1969).

An exchange offer could be materially misleading for failure to disclose adequately that it will be taxable (1) if it is for debentures, warrants or non-voting stock, (2) if the offeror obtains less than 80% of the target company's shares, INT. REV. CODE of 1954, §§ 368(a)(1)(B), 368(c), or (3) if other consideration, perhaps long-term employment contracts to target company officer-shareholders, is considered "boot" which destroys the "solely for voting stock" requirement of INT. REV. CODE of 1954, § 368(a)(1)(B). See B. BITTKER & J. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* 14-37 (3d ed. 1971).

Then there is the fascinating question whether IT&T sufficiently divested itself of an 8% block of Hartford Fire, previously acquired for cash, to avoid integration of the prior acquisition with the later exchange offer that would destroy the "solely for voting stock" proviso. See Rev. Rul. 72-354, 1972-2 CUM. BULL. 216 (unconditional sale to unrelated party permits later "B" reorganization). For the details of the IT&T transaction, which may have been neither unconditional nor to an unrelated person, and for the private ruling obtained from the Internal Revenue Service, see *Wall St. J.*, Oct. 12, 1972, at 1, col. 6. For Prof. Bittker's questioning of the ruling, and the IRS reply, see *id.* Nov. 1, 1972, at 1, col. 5 and Nov. 29, 1972, at 1, col. 5. The IRS later announced that it was reconsidering the ruling, *id.* Apr. 19, 1973, at 4, col. 3.

Nondisclosure, in the offer, of a serious tax question like this could make the offer rescindable by holders who accepted it, even if the IRS never challenged the transaction. A pending shareholder suit against IT&T so alleges. *Id.* Oct. 12, 1972, at 1, col. 6.

⁵ Securities Act § 3(a)(10), 15 U.S.C. § 77c(a)(10) (1970). CAL. CORP. CODE § 25142 (West Supp. 1973) provides a basis for this exemption, as do some of the insurance company takeover statutes mentioned by the authors at pp. 169-71.

⁶ However, the IT&T-Hartford offer, note 4 *supra*, was apparently made under the § 3(a)(10) exemption although contested by some parties.

increase in the tender price (pp. 135-37). They fairly present the main arguments against the current federal law of tender offers (*e.g.*, that it protects incumbent management more than investors, pp. 64-69), and note the effectiveness of litigation as a defensive tactic (pp. 266-68), but conclude that the overall impact has been salutary for investors (p. 69). This seems to me to ignore the evolved realities that (1) it is virtually impossible to make a hostile tender offer without at least a temporary restraining order on a claim of securities violation,⁷ (2) many offers do not survive the judicial process, and (3) many others are undoubtedly deterred by these prospects.

It would be interesting to have the authors' thoughts on whether this is the inevitable consequence of hard fought offers (how do proxy contests compare in this respect?), or whether Congress has given the besieged company too much ammunition.

Part of the difficulty, I suspect, stems from the legislative effort to assimilate tender offers to proxy contests. Both seek to bypass management and have the issues decided by shareholders. But there is a critical difference: the tender offeror is buying shares, and votes that go with them; the proxy solicitor is merely asking for votes without recompense. Correspondingly, investors get out (sell their shares) when the offeror accepts their tenders, but stay in (continue to be shareholders) when they give proxies. Thus, "bad" things about the offeror-outsider aren't very relevant to shareholders who take his cash, although they may be relevant to holders who don't tender, whose tenders are not fully accepted, or who receive the offeror's securities in exchange.⁸ I would welcome the views of the authors, who are masters of both proxy contests and tender offers, on this and related issues, and on the ultimate question of whether

⁷ Recently enjoined cash offers include: *Ronson Corp. v. Liquifin Aktiengesellschaft*, CCH FED. SEC. L. REP. ¶ 94,088 (3d Cir. July 24, 1973); *Sonesta Int'l Hotels Corp. v. Wellington Associates*, CCH FED. SEC. L. REP. ¶ 94,041 (2d Cir. July 3, 1973), *rev'g id.* ¶ 94,007 (S.D.N.Y. May 28, 1973); *Gulf & Western Indus., Inc. v. Great Atlantic & Pac. Tea Co.*, 476 F.2d 687 (2d Cir. 1973), *aff'g* CCH FED. SEC. L. REP. ¶ 93,765 (S.D.N.Y. Feb. 11, 1973); *Corenco Corp. v. Schiavone & Sons*, CCH FED. SEC. L. REP. ¶ 94,099 (S.D.N.Y. Aug. 9, 1973), *extended and amended offer allowed, id.* ¶ 94,108 (S.D.N.Y. Aug. 15, 1973); *General Host Corp. v. Triumph Am., Inc.*, CCH FED. SEC. L. REP. ¶ 93,946 (S.D.N.Y. Apr. 2, 1973); *Elco Corp. v. Microdot Inc.*, CCH FED. SEC. L. REP. ¶ 94,157 (D. Del. Mar. 23, 1973).

See N.Y. Times, Nov. 7, 1972, at 47, col. 5, and at 49; Wall St. J., Nov. 7, 1972, at 7, col. 1 (Rheingold withdraws opposition to, and injunction suit against, PepsiCo. cash offer; suit charged, among other things, nondisclosure of risk to holders of Rheingold shares not acquired by Pepsi, which had bid for 51%; Pepsi, as part of settlement, agreed to buy all shares tendered if it bought any).

Contra, *Hanover v. Zapata Corp.*, CCH FED. SEC. L. REP. ¶ 93,904 (S.D.N.Y. March 16, 1973) (preliminary injunction denied).

See N.Y. Times, June 28, 1973, at 67, col. 3 (temporary restraining order against proposed Reksten offer for Zapata not renewed).

On the other side of the battlefield, the target company and its allies are sometimes found in violation, and enjoined. *See, e.g.*, *H. K. Porter Co. v. Nicholson File Co.*, CCH FED. SEC. L. REP. ¶ 94,083 (1st Cir. July 30, 1973), *aff'g* 353 F. Supp. 153 (D.R.I. 1972); *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, CCH FED. SEC. L. REP. ¶ 93,816 (2d Cir. Mar. 16, 1973).

In fairness to the authors, we should note that their manuscript was completed in August 1972 (p. vii), before this great outbreak of tender offer injunctions.

⁸ For further development of this argument, see 1 A. BROMBERG, *SECURITIES LAW: FRAUD*, Secs. 6.3 (220) and 6.3 (832) (1971). For my views on the policies involved, see Bromberg, *Tender Offers: Safeguards and Restraints—An Interest Analysis*, 21 CASE W. RES. L. REV. 613 (1970).

investors are protected by being deprived of a higher price for their shares than would otherwise be available.

To return to the martial language with which we began, the old corporate combats (proxy fights) were between generals, with no immediate benefits—and only conjectural future benefits—for the troops (shareholders). The new conflicts (tender offers), are unique in offering immediate benefits to the troops in the form of premium prices for their shares. It begins to look as if Congress has effectively outlawed these benefits for the troops, and has decreed a return to the old order, where only generals benefit.

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