THE RISE AND FALL OF STREET SWEEP TAKEOVERS

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INTRODUCTION

For a fleeting moment in the mid-eighties, conditions were favorable for "street sweeps,"¹ blitzkrieg, large-scale acquisition programs in the stock markets. Bidders and targets alike found that, by combining aggressive open-market purchases with privately negotiated transactions from institutional investors and arbitrageurs, they could gain control of enough stock to end contested takeover contests.² At their most effective, street sweeps were breathtaking. In October 1986, for example, as managers of Allied Stores Corporation were basking in the news that they had just defeated a tender offer by Campeau Corporation, Campeau bought 48% of Allied's stock (5.8 million shares) in a twenty-seven-minute, \$1.73 billion street sweep.³

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1. Originally the term was "sweeping the Street." See, e.g., Cohen, *Despite SEC Opposition, "Street Sweeps" Don't Always Harm Small Stockholders*, Wall St. J., Oct. 19, 1987, at 33, col. 4. The "Street" referred, somewhat haughtily, perhaps, to the street housing the headquarters of the larger participants in our financial markets—Wall Street. The term "market sweep" also appears on occasion. See, e.g., Anderson & Bibi, *Defensive Strategies: Recapitalization and Restructuring Transactions*, in *HOSTILE BATTLES FOR CORPORATE CONTROL 1988: THE NEW MARKET ENVIRONMENT*, at 281, 294-95 (Practicing Law Inst. 1988).

2. In Hanson's acquisition of SCM, for example, Hanson made five privately negotiated cash purchases for a total of 2.5 million shares and one open-market purchase for 600,000 shares. *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 52-53 (2d Cir. 1985). An institutional investor, Mutual Shares, made an initial private purchase of 387,000 shares. *Id.* at 52. Hanson then bought 1.3 million shares from arbitrageur Ivan Boesky and another 600,000 shares in the open market. *See id.* at 52-53. Three other professional investors—John Mulheren of Jamie Securities, David Gottesman of Oppenheimer & Co., and Boyd Jefferies of Jefferies & Co.—called Hanson to offer their SCM stock after they noted reports of the Mutual Shares and Boesky transactions on the New York Stock Exchange ticker. *Id.* at 53. A mere hour and twenty-four minutes elapsed between the reports of the Mutual Shares transaction on the ticker and Hanson's last cash purchase. *See id.* at 52-53.

3. See Hertzberg & Rundle, *Campeau's Victory in Battle for Allied Signals Big Changes in Takeover Tactics*, Wall St. J., Nov. 4, 1986, at 2, col. 3; Hagedorn & Zehr, *Judge to Rule on Acquisition of Allied Stake*, Wall St. J., Oct. 27, 1986, at 3, col. 1. Other successful sweeps have been just as startling. In September 1985, Hanson Trust purchased 25% of SCM Corporation's stock, 3.1 million shares, in about 90 minutes. *Hanson Trust*, 774 F.2d at 50-52. In September 1987, Consolidated Gold Fields PLC boosted its stake in Newmont Mining Corp. from 26% to 49.7% by acquiring 15.8 million shares in 24 hours for \$1.6 billion. *See Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1336-40 (Del. 1987).

While the Second Circuit gave street sweeps life and vigor in 1985 by loosening restrictions previously created by the Securities and Exchange Commission (SEC),⁴ these market bombshells might now be history.⁵ Recent modifications to state antitakeover legislation,⁶ poison pill plans,⁷ and Federal Trade Commission (FTC) rules under the Hart-Scott-Rodino Act⁸ have all but killed street sweeps. Rules proposed by the SEC and bills pending in Congress aim, perhaps unnecessarily, to supply the coup de grace.⁹ Should we applaud the demise of street sweeps or attempt to resuscitate them? The stock markets are certainly less interesting without them.

The answer depends on whether corporate acquisitions are socially useful and, to put the issue in procedural terms, on who, among those associated with a target firm, ought to approve such acquisitions—localities, labor, bondholders, managers, or stockholders.¹⁰ Each group has its claim for consideration in the acquisition process. To some extent, each group can protect itself by privately bargaining with a target firm. Difficult questions for lawmakers arise, however, when one or more of these various groups request government protection based on claims of inherent disadvantage. When should the government grant one group the power to block an acquisition favored by other groups?

A full answer would require a sophisticated foray into economics and political theory, which is beyond the scope of this Article. Instead, the Article will assume that shareholder welfare ought to be the primary concern of any street sweep regulation. This assumption is consistent

4. See *infra* note 109 and accompanying text.

5. For amusement, one might compare the wildly euphoric contemporaneous pronouncements on *Hanson Trust*:

The newest fad on Wall Street is what we'll call the Williams Act two-step. The security regulations of this act now can be sidestepped by raiders who follow a plan approved last week by a federal court. This will mean more simplified takeovers—and more profits for shareholders. . . . [I]t could result in a new, deregulated takeover market.

A Happy Jig, Wall St. J., Oct. 7, 1985, at 22, col. 1; see also Jereski, *The Quick-Draw Takeover*, FORBES, Nov. 4, 1985, at 70 (*Hanson Trust* will "accelerate the already dizzying pace of takeovers"); Stewart, *Effects of Ruling on Hanson Purchase of SCM Shares Are Called Far-Reaching*, Wall St. J., Oct. 2, 1985, at 6, col. 1 (comments from lawyers on new "gaping hole" in Williams Act). Such predictions underestimated the power of target managers to respond to this new threat.

6. See *infra* notes 145-61 and accompanying text.

7. See *infra* notes 162-87 and accompanying text.

8. See *infra* notes 43-44 and accompanying text.

9. See *infra* notes 202-38 and accompanying text.

10. For a discussion of these issues, see Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173 (responding to Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986); Singer, *The Reliance Interest in Property*, 40 STAN. L. REV. 611 (1988)). For a contrary view, see Johnson & Millon, *Missing the Point About State Takeover Statutes*, 87 MICH. L. REV. 846 (1989).

with conventional wisdom in finance.¹¹ The conventional view assumes that labor, management, and bondholders are able to protect against street sweep contingencies through private contractual agreements with targets.¹² More importantly, shareholder welfare is the primary argument advanced by the SEC,¹³ Congress,¹⁴ states,¹⁵ and firms¹⁶ to justify proposed street sweep restrictions.

Advocates of street sweep restrictions face a substantial burden of proof when they claim that restrictions will advance shareholder welfare. These proponents, in essence, seek to protect shareholders by restricting their freedom to sell their stock; that is, they propose to protect shareholders from what they would, without protection, choose to do. Pure paternalism—overseeing the quality of individuals' investments—provides no valid justification for regulating capital markets.¹⁷ Instead, these proponents of regulation must demonstrate that street sweeps are somehow inherently exploitive of shareholders.

I argue that those who favor street sweep restrictions have not met their burden of proof: sometimes street sweeps are in the best interests of target shareholders, and sometimes they are not. Moreover, target shareholders can generally take care of themselves in preparing for street

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11. See Macey, *supra* note 10, at 175.

12. See generally Macey, *supra* note 10. As Professor Macey notes, however, a growing minority opposes this point. Nine states, for example, have modified their corporate codes to allow directors to consider not only corporate shareholders' interests, but the interests of employees, suppliers, customers, and local communities as well. *Id.* at 176 & nn.16-18; see also S. REP. NO. 265, 100th Cong., 1st Sess. 14-15 (1987) [hereinafter S. REP. NO. 100-265] (effect of some corporate takeovers on bondholders, employees, and communities supports need for Williams Act's takeover reforms, including "disclosure requirements on a bidder to describe his plans for corporate facilities prior to the takeover").

13. SEC Proposed Rules on Acquisitions During and Following a Tender Offer, Exchange Act Release No. 34-24,976, 19 Sec. Reg. & L. Rep. (BNA) No. 40, at 1545 (Oct. 7, 1987) [hereinafter Release 34-24,976].

14. *E.g.*, S. REP. NO. 100-265, *supra* note 12, at 16-17.

15. *E.g.*, *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458, 468 (D. Del. 1988) (purpose of Delaware antitakeover statute is to protect shareholders of Delaware corporations); see also *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 91 (1987) (purpose of Indiana Control Share Act is to protect target shareholders of Indiana corporations).

16. See *infra* notes 189-201 and accompanying text.

17. Many commentators have cogently argued against paternalism. Some have focused on the value of personal freedom, others on the incompetence of government decisions. See, e.g., Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964) (criticizing ineffectiveness of then-current government regulation of securities markets). Perhaps the most significant rebuttal of paternalism focuses on capital market efficiency: the vitality and health of the capital markets depend on prices that come from averages of multiple private estimates of investment instruments' value and that reflect investors' efforts at price discovery. See generally Easterbrook & Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984) (neither supporters nor opponents of federal fraud and disclosure rules have particularly good arguments regarding the rules' effects on investors).

sweeps. If given the choice, a rational shareholder would favor more, not fewer, street sweeps. In sum, proponents of government regulation ought to advocate legislation that revitalizes, not restricts, street sweeps.

This Article opens with a brief description of the street sweep phenomenon that, for a short period in the mid-eighties, rocked the investment community. Part II then introduces the basic policy questions implicated by street sweeps. In part III, the Article details the SEC's regulatory philosophy of eliminating all publicized street sweeps. Part IV explores target firms' responses to street sweeps, which have taken the form of poison pill plans and state antitakeover legislation. Finally, part V of the Article discusses pending regulatory proposals.

I. STREET SWEEPS IN PRACTICE: THE ROLE OF THE ARBITRAGEUR

Street sweeps frequently coincide with tender offers.¹⁸ In descending order of frequency, street sweeps occur in the following situations: (1) a bidder follows an unsuccessful tender offer with a street sweep acquisition; (2) a target firm uses a street sweep to repurchase its own stock and prevent a hostile tender offeror from establishing a large position in the firm; and (3) a second bidder uses a street sweep to compete with an outstanding tender offer.¹⁹ In each case, the sweep follows public announcement of a planned tender offer. Street sweeps rarely occur without a prior tender offer or as a single method of acquisition.

Since a tender offer leads to a concentration of substantial blocks of target stock in the hands of large institutional investors, successful street sweeps occur only after such announcements. A takeover announcement also attracts speculation by arbitrageurs—market professionals who speculate by purchasing large quantities of target stock, hoping to secure a portion of the premium that a bidder will pay to gain control of the target.²⁰ Arbitrageurs must liquidate quickly in order to realize a profit on their investments, which are speculative and usually financed with short-term, high-interest debt.

Once target stock is concentrated in the hands of arbitrageurs and institutional investors, a purchaser can buy a large stake through private negotiations with a relatively small number of holders. If an outstanding tender offer fails, and no other potential bidder appears on the horizon, arbitrageurs will be particularly eager to sell their shares privately to the frustrated tender offeror. Indeed, if arbitrageurs fear that a bidder will

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18. See Release 34-24,976, *supra* note 13, at 1547.

19. *Id.*

20. See *The Arbs' Best Friend*, Wall St. J., May 4, 1987, at 32, col. 1 (attributing arbitrageurs' success to Williams Act disclosure provisions); Jensen, *Don't Freeze the Arbs Out*, Wall St. J., Dec. 3, 1986, at 26, col. 4 (describing arbitrageurs' function).

abandon its takeover attempt, they might join together and approach that frustrated bidder with an offer to sell their consolidated blocks of shares.²¹

Examples of street sweeps by frustrated tender offerors include Hanson Trust's acquisition of a 25% stake in SCM Corporation in 1986,²² Campeau Corporation's acquisition of 48% of Allied Stores Corporation in 1987,²³ the Dixons Group PLC's acquisition of Cyclops Corporation in 1987,²⁴ and the Amalgamated Sugar Company's acquisition of NL Industries, Inc. in 1986.²⁵ In the SCM and Allied acquisitions, the bidders terminated their tender offers prior to scheduled expiration dates and then purchased substantial amounts of stock within hours of that termination;²⁶ in the Cyclops and NL Industries acquisitions, the bidders purchased additional shares immediately after their tender offers expired.²⁷ In most instances, however, shareholders who did not participate in the street sweeps received *more* for their shares than those who did.²⁸

The effectiveness of street sweeps following failed tender offers indicates their usefulness in forcing target managers to acquiesce in tender offers. During a tender offer, bidders can threaten a street sweep in an effort to convince resistant target managers that a takeover is inevitable and that it is in the managers' interest to cooperate by relaxing any tender offer defenses.²⁹ The bidder can accompany the threat with an

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21. See, e.g., Hertzberg & Rundle, *supra* note 3, at 2, col. 3. Reporting on the role of arbitrageurs like Jefferies & Co., a Los Angeles-based securities firm, the *Journal* noted that Jefferies quickly bought Allied stock when the company was in play and offered the stock to several bidders, one of whom, Campeau Corporation, bought it. *Id.* at 26, col. 1. The *Journal* quoted a former Jefferies executive's comment that it "doesn't take a rocket scientist to figure out who to call." *Id.* The article also mentioned Jefferies' effort to sell a block of USX stock to Carl Icahn, an investor who was considering buying the oil and steel giant. *Id.*

22. Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 51 (2d Cir. 1985).

23. See *supra* note 3 and accompanying text.

24. Release 34-24,976, *supra* note 13, at 1547 n.10.

25. *Id.*

26. *Hanson Trust*, 774 F.2d at 52 (discussing SCM acquisition); Release 34-24,976, *supra* note 13, at 1546 (discussing Allied acquisition).

27. Release 34-24,976, *supra* note 13, at 1547 n.10.

28. Cohen, *supra* note 1, at 33, col. 4 (discussing SCM and Allied acquisitions); see also Release 34-24,976, *supra* note 13, at 1552 (in four cases involving street sweeps initiated by hostile bidders, including NL Industries and Cyclops acquisitions, back-end price was at least as great as price received by arbitrageurs during sweep).

29. The events of Black & Decker's offer for American Standard are illustrative. See *American Standard Says It Is in Talks to be Bought for More Than \$2.4 Billion*, Wall St. J., Mar. 14, 1988, at 3, col. 2; *Black & Decker Says Barriers Must Go*, PR Newswire, Mar. 11, 1988. In March 1988, Black & Decker made a cash tender offer for American Standard. American Standard had a poison pill in place and refused to waive it, stating that the firm was actively trying to create an auction for control. *American Standard Disappointed That Black & Decker Will Not Join*, PR Newswire, Mar. 11, 1988. Obviously worried about a street sweep, American Standard offered to give Black & Decker

offer of a small payoff to target managers—a consulting contract with the new firm, for example. The bidder will withdraw the payoff if it has to resort to a sweep. Similarly, in multiple-bidder contests, a bidder can use the threat of a street sweep to force agreement about how to divide up the target between bidders.³⁰

Firms also have used street sweeps to defend against hostile tender offers. In 1984, Carter Hawley Hale repurchased over 50% of its own shares in a successful defense against Limited, Inc.³¹ Carter Hawley Hale purchased the shares in the open market at prices lower than Limited's tender offer price.³² Shareholders who did not participate in the open-market purchases retained stock of lesser value.³³ In 1987, Newmont Mining Corporation arranged for a street sweep by a friendly party, Consolidated Gold Fields PLC, in order to block an acquisition by Ivanhoe Partners.³⁴ Shareholders who participated in the street sweep again received more value than those who did not.³⁵

There are no examples of a second, hostile bidder using a street sweep to compete with an outstanding tender offer, although one close case exists. A bidder, Paul Bilzerian, believed he had purchased 41% of Pay N' Pak Stores, Inc. to defeat a competing tender offer from a management buyout group.³⁶ Bilzerian placed the order with Morgan Stanley & Co., his investment banker, and Morgan Stanley announced that it had purchased 4.1 million shares in an hour of trading in the open market. Settlement, the actual exchange of the stock for cash, was slated for

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confidential business information on the condition that Black & Decker would agree not to mount a street sweep. *Id.* Black & Decker responded that it would agree only if American Standard in turn agreed to refrain from using a lock-up or break-up defense and to waive its poison pill. *Black & Decker Says Barriers Must Go*, PR Newswire, Mar. 11, 1988.

In Campeau's street sweep acquisition of Allied, Campeau made good on a threat to stop its tender offer and make open-market purchases unless Allied rescinded its poison pill plan and a promise to pay a break-up fee to a rival bidder. See Zehr & Hagedorn, *Campeau Warns Allied of Action to Further Its Bid*, Wall St. J., Oct. 16, 1986, at 45, col. 1.

30. *GE to Proceed Unopposed with Offer for Roper*, Associated Press, Mar. 31, 1988 (Whirlpool Corp. threatened GE, a competing bidder for Roper Corp., with street sweep; threat induced GE to enter into agreement for division of Roper's assets).

31. *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 947 (9th Cir. 1985).

32. *Id.* at 946-47.

33. See *id.* at 947 (after Limited withdrew its offer, market price of Carter Hawley Hale fell below pre-tender-offer price).

34. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1336-37 (Del. 1987).

35. Cohen, *supra* note 1, at 33, col. 4; see Release 34-24,976, *supra* note 13, at 1547. In most sweeps to date, however, shareholders who have not participated in the sweeps have received more for their shares than those who have taken part. See *supra* note 28 and accompanying text.

36. Bianco, Crock & Tell, *The Street is Fretting Over "Street Sweeps"*, BUS. WK., Aug. 3, 1987, at 71, 71-72; Miller, *Bilzerian, After Failing to Win Control of Pay N' Pak, Gets New Court Setback*, Wall St. J., July 10, 1987, at 2, col. 3.

the following day.³⁷ Morgan Stanley, however, got cold feet and canceled the trades after belatedly seeking advice from its lawyers on whether the trades could be construed as an illegal tender offer.³⁸ The lawyers apparently informed Morgan Stanley that the particular methods employed in the trades might have overstepped the hazy bounds developed in existing precedent. This case illustrates the considerable uncertainty surrounding the legal standards applicable to street sweeps.

The only "naked" street sweep that an initial hostile purchaser has attempted in lieu of a tender offer is Sun Company's acquisition in 1978 of Becton, Dickinson & Company.³⁹ This acquisition illustrates the practical and legal problems of commencing a street sweep without an announced tender offer. Since no tender offer had been announced, takeover speculators had not consolidated Becton stock. Therefore, Sun had to solicit shares from some thirty institutions and nine individuals.⁴⁰ This solicitation, along with the mechanics of the acquisition itself, pushed Sun too close to the legal boundary of the Williams Act.⁴¹ Although Sun successfully purchased roughly 34% of Becton's stock, a federal court later found the acquisition program to be, in effect, a tender offer that violated the Williams Act.⁴² Naked street sweeps are now also interdicted by the Hart-Scott-Rodino Antitrust Improvements Act of 1976,⁴³ which the FTC has recently reinvigorated by adding anti-evasion

37. Miller, *supra* note 36, at 2, col. 3.

38. *Id.*

39. *Wellman v. Dickinson*, 475 F. Supp. 783, 790 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

40. *See id.* at 819.

41. The Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982 & Supp. IV 1986), imposes disclosure requirements on beneficial owners of more than 5% of a corporation's stock and regulates tender offers. *Id.*

42. *Wellman*, 475 F. Supp. at 826.

43. 15 U.S.C. § 18a (1982). If a corporate control transaction meets the Act's threshold firm-size and transaction-size requirements, the participants must give preacquisition notice to the Federal Trade Commission (FTC) and the Department of Justice, *id.* § 18a(a), and they may not consummate the transaction until the Act's 30-day (15 days for tender offers) waiting period expires. *Id.* § 18a(b). The thresholds are very low: for example, stock acquisitions of over \$15 million in a firm with annual net sales or assets of over \$100 million by a firm with net sales or assets of over \$10 million trigger the Act's requirements. *Id.* § 18a(a)(2)-(3). FTC rules integrate stock purchases over time ("creeping acquisitions") into these thresholds. 16 C.F.R. § 801.13 (1988).

The Act poses significant obstacles for naked street sweeps. First, the Act forces early disclosure of an acquisition. Moreover, if the FTC grants an acquirer's request for an early termination of the Act's waiting period, the FTC publishes its decision. If the FTC investigates a filing, the FTC's contact with third parties will generate market rumors. Although the FTC has waived target companies' filing obligations in hostile or semi-hostile acquisitions, making it impossible for a target company to stall the Act's waiting period by not filing, *see* 15 U.S.C. § 18a(a)-(b); 16 C.F.R. § 801.30, the acquirer's waiting period begins upon the acquirer's filing. This filing notifies the target of the acquirer's intent to purchase target shares, *see id.* §§ 801.30(b)(1). 803.5, destroying the element of surprise in a naked street sweep. Second, in open-market acquisitions of publicly held com-

regulations.⁴⁴

The involvement of arbitrageurs, as speculators, in most successful street sweeps is one of the most controversial aspects of the acquisition method. Based on this arbitrageur involvement, some observers argue that street sweeps are socially harmful: first, arbitrageurs must speculate in takeover stock for any street sweep to work; second, arbitrageurs receive the lion's share of a takeover premium at the expense of smaller shareholders;⁴⁵ and third, arbitrageurs' highly leveraged positions make them poor shareholders, worried solely about short-term stock prices at the expense of a firm's long-term health. All three of these claims, however, are false.

The role of arbitrageurs in street sweeps is largely the product of SEC regulation and not independent speculation. The Becton, Dickinson acquisition⁴⁶ is a reminder that the SEC's broad interpretation of the Williams Act has skewed the present sampling of successful street sweeps. As detailed in the next section,⁴⁷ acquirers cannot use street sweeps to buy control through direct purchases from a diffuse body of shareholders because the SEC defines any broad solicitation of shareholders in a publicly held company to be a tender offer, which is subject to regulation by the Williams Act. Bidders can encourage arbitrageurs to purchase from shareholders by announcing their takeover intentions in a tender offer—an acceptable form of public solicitation. Arbitrageurs can then consolidate blocks of stock, and an acquirer, after terminating its tender offer, can commence a street sweep by soliciting a small number of shareholders (arbitrageurs and large institutional investors), a number too small for the SEC to claim that the direct solicitations consti-

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panies, an acquirer cannot condition transfer of title on expiration of the Act's waiting period. Thus, the Act, if it applies, effectively limits an acquirer's pre-disclosure purchases to \$15 million—a limit that makes a successful street sweep impossible.

44. Prior to July 1987, it was possible to avoid the Hart-Scott-Rodino Act's reporting requirements merely by using a partnership as the acquiring vehicle. Under the "flow through" rule, assets contributed to a partnership for the purpose of making an acquisition do not count toward the size-of-person threshold. Acquirers made ample use of this opportunity. R. GILSON & R. KRAAKMAN, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 336 (Supp. 1988). The FTC has narrowed this gap in the Act's coverage by amending Rule 801-1(b). If one partner owns 50% or more of an acquiring partnership, the partner's assets now count toward the size-of-person threshold. *Id.* The new regulation does not interdict acquisition partnerships comprising many limited partners and a small number of general partners, none of whom has a 50% interest. The FTC is considering new regulations to close this loophole as well. See *New H-S-R Regs Proposed to Close "Partnership Loophole,"* FTC Watch, Feb. 13, 1989, at 1. See 52 Fed. Reg. 20,058 (1987). The FTC amendments contributed to the recent demise of street sweeps.

45. For a summary of this view, see Note, *Proposed SEC Regulation of Market Sweeps: Should Market Sweeps Be Governed by the Williams Act?*, 56 *FORDHAM L. REV.* 797, 811-12 (1988).

46. See *supra* notes 39-41 and accompanying text.

47. See *infra* notes 91-119 and accompanying text.

tute a "public" offer. In essence, the SEC's broad interpretation of the Williams Act (and the effects of the Hart-Scott-Rodino Act⁴⁸), more than the mechanics of the street sweep itself, enhances the need for arbitrageur involvement in street sweeps.⁴⁹

Arbitrageurs, moreover, do not pursue self-interest at the expense of target shareholders. Arbitrageurs provide three valuable services to target shareholders.⁵⁰ First, arbitrageurs' superior information leads to value maximization for all shareholders. Many target shareholders do not have the time, the ability, or the large financial stake needed to gather information on takeover bids directed at their firms. Arbitrageurs, in contrast, can research takeover bids, enter the market, and raise bidding prices to reflect a target's value as a takeover candidate. Shareholders benefit most evidently when arbitrageur activity pushes market prices over a bidder's asking price. Such activity informs target shareholders that other potential bidders might pay more for their stock, or that the first bidder might be flexible in its asking price. Target shareholders also benefit when arbitrageur activity drives prices up from normal market levels, even if the increased market price stops short of any outstanding takeover bid. Other benefits also accrue if arbitrageur action deters target managers from self-interested actions that have a negative effect on share prices, such as defeating a bid to protect their positions. In addition, gains that arbitrageurs generate through their superior information-gathering position are generally passed back to selling shareholders: in competing among themselves to accumulate blocks of target stock, arbitrageurs bid up the price offered to shareholders.

A second service arbitrageurs provide to shareholders is their superior financial resources and market position, which allow them to assume and diversify takeover risk more effectively. Arbitrageurs give shareholders an opportunity to cash out in the middle of a takeover fray at

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48. The Hart-Scott-Rodino Act might also, in effect, encourage bidders who want to use street sweeps to announce tender offers before pursuing sweeps. First, since a bidder, to commence the Act's waiting period, must notify a target company of its intention to acquire target shares, and the target may disclose this information to the market, *see supra* note 43, the bidder may be forced to respond publicly, commencing a tender offer under Rule 14d-2. *See infra* notes 82-90 and accompanying text. Second, a bidder who seeks immediate control over the shares to discourage competitors may be forced to announce a tender offer to concentrate shares in the hands of arbitrageurs. The bidder could then withdraw its tender offer and enter into purchase agreements with the arbitrageurs, conditioned on expiration of the Act's waiting period.

49. *Cf. The Arbs' Best Friend*, *supra* note 20, at 32, col. 1 (noting that Williams Act's disclosure provisions give arbitrageurs opportunities that some Congressmen view as insider trading).

50. *See generally* Jensen, *supra* note 20, at 26, col. 4 (arbitrageurs provide three important functions: (1) they help value alternative offers; (2) they provide risk-bearing services; and (3) they help resolve collective-action and free-rider problems of small, diffuse shareholders).

prices that reflect current evaluations of expected gains.⁵¹ The expected gains are enhanced by the arbitrageurs' ability to gather large blocks of stock, which in turn enable them to negotiate more effectively with bidders.⁵² In the absence of arbitrageurs, bidders would take advantage of a diverse shareholder group's inability to act collectively. Moreover, arbitrageurs can better diversify the risks of failure inherent in *ongoing* acquisition attempts, by taking positions in stocks of other companies that are also in play. Arbitrageurs will pass some savings back to individual shareholders, by competing with other arbitrageurs for those shareholders' stock. Thus, the risk-absorption and bargaining power of the arbitrageurs benefits the target shareholders.

As a third service, arbitrageurs themselves act as desirable shareholders. Although many arbitrageurs are highly leveraged, some more conservative professional stock investors and traders—such as pension funds, mutual funds, and college endowment funds—now speculate in takeover stocks.⁵³ Arbitrageurs are no longer an esoteric group of risk-happy high flyers who operate on the edge of bankruptcy. Even if all arbitrageurs did desire quick turnover of target stock, financial economists tell us that the short-run perspective and long-run perspective are linked.⁵⁴ Both depend on the expected value of a firm's income flow over time. Investors cannot profit by trading on the view that a firm can sacrifice long-run income in favor of short-run income while maximizing its stock price, since a firm that sacrifices long-run income also reduces its value. Arbitrageurs are no different from other shareholders; they seek to invest in firms that will maximize value.

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51. See, e.g., *The Hyperactive SEC*, Wall St. J., Oct. 31, 1986, at 32, col. 1 (describing arbitrageurs' role in Hanson Trust street sweep); *A Happy Jig*, *supra* note 5, at 22, col. 1 (applauding *Hanson Trust* decision).

52. Occasionally the arbitrageurs are whipsawed. In the street sweep of Newmont Mining, for example, Newmont issued a cash dividend that enabled a friendly suitor, Gold Fields, to buy stock and defeat a hostile bid by Ivanhoe Partners. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1342-44 (Del. 1987). In addition, Gold Fields, a 26% shareholder before the street sweep, signed a standstill agreement that substantially reduced the possibility of any tender offers for Newmont Mining stock. *Id.* at 1343. Arbitrageurs who had taken positions in the stock, based on an outstanding bid by Ivanhoe at \$105 per share, found themselves faced with a \$98 offer from Gold Fields that they could not refuse. See *Ivanhoe Partners v. Newmont Mining Corp.*, 533 A.2d 585, 605 (Del. Ch. 1987). The Delaware Supreme Court, however, was "not persuaded" that the street sweep was coercive. *Ivanhoe Partners*, 535 A.2d at 1344.

53. See Salwen, *Staid Institutions Seek Takeover-Play Profits*, Wall St. J., Nov. 7, 1988, at C1, col. 5.

54. Finance textbooks explain stock valuation based on expected earnings over time. See, e.g., W. SHARPE, *INVESTMENTS* 413-41 (3d ed. 1985). The actual value of an investment will decrease if long-term earnings with a high present value are sacrificed for short-term earnings with a lower present value.

In sum, arbitrageurs' high profile in street sweeps is not an indictment of this acquisition method. Arbitrageurs provide a useful function in increasing share value and assuming the risks of takeover failure.

II. A PRELIMINARY LOOK AT THE POLICY QUESTIONS IN STREET SWEEPS

If there were no constraints on hostile acquisitions and no mandatory disclosure requirements for acquirers, acquirers would choose those acquisition methods that succeed at the least cost. One recurring scenario would be a street sweep for a toehold position in a target, followed by a tender offer for the remainder of the control block sought. Street sweeps take advantage of surprise, enabling an acquirer to maximize its return on a disappearing monopoly of information relating to its takeover: the acquirer gathers stock from shareholders who do not know that a control acquisition is imminent.

As the target stock price rises following reports of the bidder's purchases, information concerning the acquirer's identity and its plans spreads through the market. Participants begin to speculate on the final acquisition price. At this point, the acquirer can find it cheaper to gather the remainder of the desired stock through a front-end-loaded public offer, rather than chase the stock's price up in the market. A front-end-loaded offer communicates two things to the public: first, that the offer is absolutely time-limited (and in some cases amount-limited), and second, that those who sell will be better off than those who do not. The normal method of making such an offer is a conventional tender offer. However, a bidder can effect much the same pressure by publicizing that it intends to purchase stock in the market for a limited time—an "unconventional" tender offer.

The front-end-loaded offer solves the free-rider problems that plague bidders in publicly disclosed acquisition attempts.⁵⁵ Target shareholders who know of a value-increasing acquisition attempt will hold their stock, attempting to free-ride on those who sell and obtain a larger share of the gains from the consummated merger. A front-end-loaded public offer induces target shareholders to sell their stock rather than to hold it. Moreover, once the bidder announces the front-end-loaded offer, it seeks to conclude its purchasing as quickly as possible, thus preempting competitive bidders.

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55. See Bradley, Desai & Kim, *Synergistic Gains from Corporate Acquisitions and Their Division Between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 33 (1988) ("The obvious solution to the free-rider problem is for the bidding firm to make a two-tier bid and front-end load the offer.").

Target shareholders who sell in such takeovers will complain. Those who sell in the street sweep will claim that they would have held out had they known that an acquisition was in progress; those who sell in the front-end-loaded tender offer will claim that they were coerced to sell when they wanted to hold out for a higher price, either from the original bidder or from an auction among competitive bidders. Target shareholders who anticipate their dissatisfaction will collude in order to enhance their bargaining position for future takeovers. Shareholders will therefore attempt to force acquirers to disclose their takeover intentions earlier. Also, shareholders will try to act collectively in response to any public offer, since collective action neutralizes both the free-rider problem, allowing the acquisition to succeed, and the coercive effect of front-end-loaded offers, allowing collective bargaining for higher prices. To the extent that shareholders succeed in creating such a takeover climate, they will procure a larger share of the merger gains at the acquirers' expense.

The risk of using hard bargaining tactics, however, as all peddlers know, is loss of sales that ought to be made. Hard bargaining increases the risk of unfortunate deadlocks. In aggressively claiming value in a value-increasing deal, one party might destroy the deal itself.⁵⁶ A potential acquirer might refuse to bid or might walk away from an outstanding bid if convinced that a target is too aggressively defended or that a bidding process is tilted in favor of other bidders. Target shareholders must therefore balance the risk of destroying deals that should be made against the potential gains of hard bargaining with bidders.

A diversified group of target shareholders, however, is often unable either to choose or implement bargaining tactics. Because of this diversification problem, target managers inevitably interfere in both the choice and implementation processes. First, consider the problems of shareholder implementation. Shareholders cannot realistically achieve a collective response to a public offer through an instantaneous voting mechanism. The costs and time demands of voting do not permit ap-

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56. For a fine discussion of the tension between creating and claiming value in deals, see D. LAX & J. SEBENIUS, *THE MANAGER AS NEGOTIATOR: BARGAINING FOR COOPERATION AND COMPETITIVE GAIN* 33-35 (1986). The authors explain:

Value creating and value claiming are linked parts of negotiation. Both processes are present. No matter how much creative problem solving enlarges the pie, it must still be divided; value that has been created must be claimed. And, if the pie is not enlarged, there will be less to divide; there is more value to be claimed if one has helped create it first. An essential tension in negotiation exists between cooperative moves to create value and competitive moves to claim it.

Id. at 33.

proval for each series of bid prices.⁵⁷ These limitations force target shareholders to delegate broad negotiating authority to an agent, typically target managers. Those managers, however, are self-interested in every control transaction at issue: such transactions threaten the managers' firm-specific investments of human capital—i.e., their jobs. Any device that forces bidders to disclose their intentions early and that allows target managers to bargain on behalf of shareholders also maximizes the managers' ability to extract personal gains at the shareholders' expense. Target managers might resist takeovers that are in the shareholders' interest or demand payoffs in an amount that exceeds the expected value of their position with the firm. Therefore, as shareholders choose which bargaining devices to implement, they must balance the gains created by managers' superior bargaining position against the losses suffered when managers abuse that position for personal gain.

Not only do shareholders have almost insurmountable problems in implementing bargaining devices, they have problems in acting collectively to create such devices in the first place. As a diffuse body, shareholders cannot meet and rationally discuss which bargaining devices, if any, to deploy. Instead, they rely on the managers to make these determinations—the same self-interested managers who cause problems in implementation. Target managers lobby state legislatures for antitakeover legislation and create firm-specific defenses that mold their firms' responses to hostile offers. Even defenses that require shareholder ratification are easily controlled by the managers who operate a firm's proxy machinery. In short, managers have discretion to create and implement their firms' takeover defenses. Along with this discretion comes primary responsibility for implementing the cost-benefit calculus noted above; in other words, self-interested managers determine whether the losses created by their implementation of bargaining devices will exceed the advantages gained from that implementation.

If manager control of target firms' strategic decisions in takeover contests creates a bias in tactic choice, one would expect target firms to overselect the harshest bargaining tactics available. Short of completely halting bids once they appear, a tactic that most target managers now recognize as unworkable (except perhaps by radically recapitalizing a

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57. Even if we could devise a system that allowed for some sequential voting (for example, a system that involved a shareholders vote with each formal tender offer), we could not devise methods for giving voting shareholders sufficient information for a truly *independent*, informed vote. Keeping shareholders abreast of the strategic maneuvers in the negotiation dance would be very difficult, requiring disclosure of sensitive confidential information about the negotiators' positions and strategies. In essence, the shareholders would largely follow the recommendations of their agents—the target managers.

firm),⁵⁸ target managers hope to deter potential bidders from ever making an initial bid. Recognizing that a company "in play" is already lost, target managers attempt to avoid the game entirely. One method of deterring initial bids is to develop a *reputation*, all in the name of protecting shareholders, for playing hardball whenever a bidder surfaces. Managers thus threaten to select defensive tactics that allow a target to claim most of the synergistic gains created in any merger. Optimally, target managers seek to convince all potential bidders that a successful acquisition would present the acquirer with no gains and even a loss under the "winner's curse."⁵⁹ In this regard, we should expect to see target defenses that force bidders to disclose their intentions very early and then squeeze those bidders for most of the acquisition gains. Indeed, this appears to be the case.⁶⁰

Target managers have created firm-specific poison pill plans and shark-repellent amendments, lobbied state legislatures for antitakeover

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58. Once a hostile bidder makes an offer that involves a premium over market value, target managers realize that they cannot stop the bid and return to business as usual; they must meet the higher price. The "just say no" defense has not been successful. See, e.g., *Grand Metro., Pub. Ltd. Co. v. Pillsbury Co.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,104, at 91,195 (Del. Ch. Dec. 16, 1988) (directors' refusal to redeem poison pill plan held unreasonable); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 799 (Del. Ch. 1988) (same). Managers can meet the higher price only by selling the firm to another bidder who is friendlier to incumbent management, to themselves in a leveraged buyout, or through a radical recapitalization, which in essence mimics the actions that the hostile bidders would take upon acquiring the firm. See *Corporate Buyers Beat Antitakeover Defenses in 1988*, INVESTMENT DEALERS' DIG., June 13, 1988, at 16; *Where Have All the Raiders Gone?*, INVESTMENT DEALERS' DIG., Feb. 13, 1989, at 39.

The only viable possibility of a complete defense not involving a major restructuring is the *Polaroid* Employee Stock Ownership Plan (ESOP) defense. See *Shamrock Holdings, Inc. v. Polaroid Corp.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,176, at 91,921 (Del. Ch. Jan. 6, 1989) (*Polaroid* defeated offer by parking 14% of its stock in ESOP); see also Norris, *The Polaroid Defense: A Potential Classic*, N.Y. Times, Feb. 24, 1989, at D1, col. 4 (discussing *Polaroid's* ESOP). The *Polaroid* defense stems from the Delaware business combination statute's provision that a prospective acquirer may not engage in a business combination with a target for a three-year period after becoming an "interested shareholder" unless, among other exceptions, the acquirer obtains 85% of the voting stock in the same transaction that makes it an interested stockholder. See DEL. CODE ANN. tit. 8, § 203(a)(2) (Supp. 1988); *Polaroid*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,621. For ESOP shares to count toward the 85% requirement, such shares must have confidential tendering. See DEL. CODE ANN. tit. 8, § 203(a)(2)(ii); *Polaroid*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 91,621-22.

59. The winner's curse holds that in a multiple-bidder contest, the winner is the one who mistakenly pays too much. See Bradley, Desai & Kim, *supra* note 55, at 27-30. Evidence suggests that bidders might be better off losing in multiple-bidder tender offer contests. See *id.*

60. This tactic explains the disparity between studies showing that poison pill plans enable firms to claim substantially higher takeover premiums, see, e.g., *Poison Pills Boost Takeover Premiums*, *Georgeson Study Says*, 11RRC CORP. GOVERNANCE BULL., Mar.-Apr. 1988, at 31, and studies showing that the adoption of poison pill plans have a negative effect on firms' stock prices, see, e.g., OFFICE OF THE CHIEF ECONOMIST, SEC., THE EFFECTS OF POISON PILLS ON THE WEALTH OF TARGET SHAREHOLDERS (1986); Ryngaert, *The Effect of Poison Pill Securities on Shareholder Wealth*, 20 J. FIN. ECON. 377, 411 (1988).

legislation, and are, at present, lobbying Congress for changes in the Williams Act. As later sections will show,⁶¹ these antitakeover devices have two results: (1) bidders lose control over their takeover intention disclosures, and (2) once their takeover intentions are discovered, bidders must bargain with target boards over acquisition prices. The evidence is unequivocal that in the bargain, target shareholders reap the lion's share of acquisition gains.⁶²

The recent push by target managers for complete extermination of street sweeps is consistent with this theory of bias in target firms' responses to acquisition attempts. Target managers have no control over street sweeps and cannot act to extract a maximum price. Only by funneling all offers into a form that gives target managers negotiating leverage can managers effectuate their deterrence strategy of hardball negotiating tactics. State and federal legislation prohibiting street sweeps is thus misguided. With these practical considerations in mind, we can examine more critically the current legal climate for street sweeps.

III. THE WILLIAMS ACT

Although the number of successful street sweeps in the mid-eighties was minuscule in comparison to other types of takeovers, officials at the SEC and several Congressmen viewed each new success with growing alarm. They worried that if the tactic became commonplace, it would nullify the tender offer restrictions imposed by the Williams Act.⁶³ As a consequence, the SEC developed a three-part strategy to protect the Williams Act's regulatory power. First, the agency urged that courts broadly interpret the Act to cover "unconventional" tender offers,⁶⁴ thereby narrowing the field of operation for street sweeps. Second, the agency urged courts to hold that street sweeps undertaken on the heels of a withdrawn tender offer violate SEC rules regulating market purchases of stock during the "pendency" of tender offers. Third, the agency proposed rules that would break the symbiotic tie between tender offers and

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61. See *infra* notes 183-87 and accompanying text.

62. Bradley, Desai & Kim, *supra* note 55, at 27-30.

63. See, e.g., Release 34-24,976, *supra* note 13, at 1545-46. The SEC was responding, perhaps, to the business press's wildly overstated predictions of a new unregulated takeover market after *Hanson Trust*. See, e.g., *A Happy Jig*, *supra* note 5, at 22, col. 1.

64. Articles on the issue of unconventional tender offers include Andre, *Unconventional Offers Under the Williams Act: The Case for Judicial Restraint*, 11 J. CORP. L. 499 (1986); Glenn, *Rethinking the Regulation of Open Market and Privately Negotiated Stock Transactions Under the Securities Exchange Act of 1934*, 8 J. CORP. L. 41 (1982); Note, *Defining "Tender Offer" Under the Williams Act*, 53 BROOKLYN L. REV. 189 (1987); Note, *Toward a Definition of "Tender Offer,"* 19 HARV. J. ON LEGIS. 191 (1982); Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973); Note, *The Elusive Definition of a Tender Offer*, 7 J. CORP. L. 503 (1982).

street sweeps. The following sections will detail the first two approaches; part V will detail the third.⁶⁵

A. *What Is a Tender Offer?*

Prior to 1968, bidders used short-lived public offers, known as "Saturday night specials," to buy limited amounts of target stock without full disclosure and on a first-come, first-served basis. Such offers generated maximum selling pressure on a dispersed and inadequately informed group of shareholders. To stop Saturday night specials, Congress enacted the Williams Act in 1968.⁶⁶ The SEC believes that street sweeps have an aura of overpowering urgency similar to that of outlawed Saturday night specials: street sweeps give shareholders only minutes to decide whether or not to sell their shares, under an explicit or implicit threat that if they do not sell, they will be substantially worse off than those who do.

The Williams Act regulates tender offers, which are public announcements that a bidder will buy stock tendered to a deposit agent at a set price (or in exchange for the set value of an offeror's securities), usually in excess of the current market price. Bidders generally condition their offers on receipt of a minimum number of shares, limited according to the number they are willing to accept. The Williams Act and its accompanying SEC regulations impose various structural requirements on an offer's form and also require bidders to make comprehensive and detailed disclosures when their offers commence. In addition, the Act prohibits bidders from engaging in open-market purchases during an offer's pendency.

The requirements on a tender offer's form prescribe a twenty-day

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65. See *infra* notes 202-38 and accompanying text.

66. Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454; see H.R. REP. NO. 1711, 90th Cong., 2d Sess. 2 [hereinafter H.R. REP. NO. 90-1711], reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811, 2812 (unregulated tender offers required shareholders to act quickly without adequate disclosure); see also *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 55 (2d Cir. 1985) (Congress passed Williams Act to protect shareholders from being forced to act quickly in deciding whether to sell based on limited information); *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 948 (9th Cir. 1985) (purpose of Williams Act is to remedy situation "[p]rior to the passage of the Act, [when] shareholders of target companies were often forced to act hastily on offers without the benefit of full disclosure"); *Wellman v. Dickinson*, 475 F. Supp. 783, 817-18 (S.D.N.Y. 1979) (quoting Senator Williams, who recognized that "[t]he essential problem in transfers of control resulting from cash tender offers or open-market or privately negotiated purchases is that persons seeking control in these ways are able to operate in almost complete secrecy concerning their intentions, their commitments and even their identities"), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983); M. Cohen, Address on Proposed Legislation to Regulate Tender Offers (June 28, 1966) (statement by former SEC Chairman that SEC wanted to avoid shareholder rushes to accept offers), reprinted in V. BRUDNEY & M. CHIRELSTEIN, CASES AND MATERIALS ON CORPORATE FINANCE 850 (3d ed. 1987).

minimum offering period,⁶⁷ shareholder withdrawal rights coextensive with the offering period,⁶⁸ withdrawal rights after sixty days from the initial offer if the offeror has failed to pay,⁶⁹ pro rata acceptance for oversubscribed offers,⁷⁰ nondiscrimination among offerees,⁷¹ and the extension of any price increase during the tender offer to all shareholders who have already tendered.⁷² Also, during the tender offer, purchases "otherwise than pursuant to such tender offer,"⁷³ and any short tenders⁷⁴ by

67. 17 C.F.R. § 240.14e-1 (1988). Rule 14e-1 under the Securities Exchange Act of 1934 states:

As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, no person who makes a tender offer shall: (a) Hold such tender offer open for less than twenty business days from the date such tender offer is first published or sent or given to security holders . . . .

Id.

68. *Id.* § 240.14d-7(a). Rule 14d-7(a) under the Securities Exchange Act of 1934 states in part that "any person who has deposited securities pursuant to a tender offer has the right to withdraw any such securities during the period such offer, request or invitation remains open." *Id.*

69. Securities Exchange Act of 1934, § 14(d)(5), 15 U.S.C. § 78n(d)(5) (1982).

70. 17 C.F.R. § 240.14d-8. Rule 14d-8 under the Securities Exchange Act of 1934 states in part that

if any person makes a tender offer or request or invitation for tenders, for less than all of the outstanding equity securities of a class, and if a greater number of securities are deposited pursuant thereto than such person is bound or willing to take up and pay for, the securities taken up and paid for shall be taken up and paid for as nearly as may be pro rata . . . according to the number of securities deposited by each depositor during the period such offer, request or invitation remains open.

Id.

71. *Id.* § 240.14d-10(a)(1). Rule 14d-10(a)(1) under the Securities Exchange Act of 1934 states: "(a) No bidder shall make a tender offer unless: (1) The tender offer is open to all security holders of the class of securities subject to the tender offer . . . ." *Id.* In 1986, the SEC enacted Rule 14d-10, the "all holders" rule, as a response to tactics used in cases like *Unocal Corp. v. Pickens*, 608 F. Supp. 1081 (C.D. Cal. 1985) (approving a discriminatory self-tender offer). See Amendments to Tender Offer Rules—All-Holders and Best Price, Exchange Act Release No. 34-23,421, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,016, at 88,191 (July 11, 1986); Tender Offers by Issuers, Exchange Act Release No. 34-22,199, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,798, at 87,574 (July 1, 1985); Proposed Amendments to Tender Offer Rules, Exchange Act Release No. 34-22,198, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,797, at 87,564 (July 1, 1985).

72. 17 C.F.R. § 240.14d-10(a)(2). Rule 14d-10(a)(2) under the Securities Exchange Act of 1934 provides: "(a) No bidder shall make a tender offer unless . . . (2) The consideration paid to any security holder pursuant to the tender offer is the highest consideration paid to any other security holder during such tender offer." *Id.*

73. *Id.* § 240.10b-13(a). Rule 10b-13(a) under the Securities Exchange Act of 1934 states, in part:

(a) No person who makes a cash tender offer or exchange offer for any equity security shall, directly or indirectly, purchase, or make any arrangement to purchase, any such security . . . otherwise than pursuant to such tender offer or exchange offer, from the time such tender offer or exchange offer is publicly announced or otherwise made known by such person to holders of the security to be acquired until the expiration of the period . . . .

Id.

74. *Id.* § 240.10b-4(b). The SEC has recently agreed to clarify the rule, redefining the concept of "net long," which defines an investor's maximum holdings that can be traded consistently with Rule 10b-4. See *SEC to Propose Clarifying Tendering Rule to Lift Prohibition on Hedged Tendering*,

offerees are prohibited by SEC rules as “manipulative or deceptive device[s] or contrivance[s]” and “fraudulent, deceptive or manipulative acts or practices” under sections 10(b) and 14(e) of the Securities Exchange Act of 1934.⁷⁵

A typical street sweep, if considered a “tender offer,” would violate most of these rules. Indeed, no conceivable type of street sweep could comply with some of the SEC rules. Open-market settlement procedures simply do not permit defeasible or contingent sales contracts, and the Act’s twenty-day minimum offering and withdrawal periods is fundamentally inconsistent with market-clearing procedures.⁷⁶ Moreover, privately negotiated sales are, by definition, inconsistent with the requirement that all stockholders have the right to participate in an acquisition at the same price. And, the prohibition on purchases outside of a tender offer also makes no sense when applied to street sweeps.

Since it is impossible for a street sweep to comply with the tender offer rules, a bidder’s primary concern in planning a street sweep is whether the proposed method of acquisition constitutes a “tender offer.” The Williams Act, however, does not define the term, and the drafters appear to have purposely avoided placing any useful definitional guidance in the Act’s legislative history.⁷⁷ Yet the Act contains implicit limitations on the concept’s scope. The Act does not explicitly require that all large-scale stock acquisitions be made in the form of a regulated tender offer, and no one asserts that such a requirement can be read into the Act. Thus, the Act must leave some room for large-scale stock acquisitions through open-market trades or privately negotiated deals. Indeed, Senator Williams (D-N.J.), one of the Act’s drafters, recognized this limitation on the Act’s scope.⁷⁸ Apparently, Congress expected the

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21 Sec. Reg. & L. Rep. (BNA) No. 4, at 159 (Jan. 27, 1989). The same rule also prohibits “hedged tendering,” the practice of tendering shares and then selling them before the proration deadline. The SEC has recently asked for comments on whether it should deregulate hedged tendering. *Id.*

75. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) (1982); *id.* § 14(e), 15 U.S.C. § 78n(e).

76. The Hart-Scott-Rodino Act poses similar obstacles. See *supra* note 43.

77. The House Report on the Act comes closest to providing a definition, but limits the definition’s precision by including the term “normally”:

The offer normally consists of a bid by an individual or group to buy shares of a company—usually at a price above the current market price. Those accepting the offer are said to tender their stock for purchase. The person making the offer obligates himself to purchase all or a specified portion of the tendered shares if certain specified conditions are met.

H.R. REP. NO. 90-1711, *supra* note 66, at 2, reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS at 2811.

78. A colloquy during the debate on passage by the Senate illustrates this point. Sen. Javits (R-N.Y.) stated:

And I assume there are indicia as to what is meant by the effort to obtain controlling interest, so that not everybody who goes out and buys in the open market, over a period of

SEC to define the boundaries of the Act's coverage.⁷⁹

The SEC, however, has been reluctant to provide guidance on the definition of a tender offer. For twenty years, the SEC has successfully resisted the bench and bar's requests for meaningful assistance on the issue. The SEC argues that a precise definition would enable purchasers, whose transactions should be regulated, to structure transactions in ways that would avoid any definition the agency could provide.⁸⁰ The SEC seems to fear that acquirers might follow the law if they could understand it.⁸¹

The only SEC rule relevant to the definition of a tender offer is Rule 14d-2,⁸² a product of the SEC's concern with premature tender offer

time, 10 percent of a particular issue, is necessarily required to qualify under this act; is that correct?

113 CONG. REC. 24,665 (1967). Sen. Williams replied: "That is correct." *Id.*

79. See, e.g., *id.* at 24,664 ("The bill would also authorize the Securities and Exchange Commission to adopt regulations requiring appropriate disclosure when corporations repurchase their own securities.") (statement of Sen. Williams).

80. E.g., Proposed Amendments to Tender Offer Rules, Exchange Act Release No. 34-16,385, [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 531, at F-1 to -5, F-13 to -14 (Dec. 5, 1979) [hereinafter Release 34-16,385] (SEC proposed for comment a specific definition whose scope "reflects the commission's long-standing position that the term 'tender offer embraces' [sic] not only tender offers formerly announced . . . but also offers accomplished by other means."); Tender Offers: Securities and Exchange Commission Rule and Schedule Proposals, Exchange Act Release No. 34-15,548, [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 489, at 7 (Feb. 5, 1979) [hereinafter Release 34-15,548] ("In recognition of the dynamic nature of tender offers and the need for the Williams Act to be interpreted flexibly in a manner consistent with its purposes, the Commission affirms its position that a definition of the term 'tender offer' is neither appropriate nor necessary at this time.").

81. There are several possible explanations for the agency's neglect; none of them are flattering. Is the agency insecure, unsure of its capacity to draft workable rules in its area of presumed expertise, or too proud to modify rules that, once promulgated, prove less than optimal? Is the agency protecting its prerogatives? A discretionary standard gives the SEC substantial power in its dealings with players in the takeover market. A vague standard focuses attention on the SEC's views in any particular case. Is the agency imperialistic? By seeking to maximize the number of purchasers that use tender offers covered by the Williams Act, which in turn maximizes SEC authority, the agency raises the risks for all investors who do not meet the Act's requirements. In other words, risk-averse investors, in situations on the margin of what the standard would be if clarified, will comply with the Williams Act. Or is the agency simply arrogant and despotic? In the belief that shareholders should have similar protections in all large-scale acquisitions and that the Williams Act is therefore too narrow, the agency amends the Act in practice to correspond more closely with its view of what the statute ought to say.

82. 17 C.F.R. § 240.14d-2(a) (1988). Rule 14d-2(a) under the Securities Exchange Act of 1934 states:

(a) *Commencement.* A tender offer shall commence for the purposes of section 14(d) of the Act and the rules promulgated thereunder at 12:01 a.m. on the date when the first of the following events occurs:

(1) The long form publication of the tender offer is first published by the bidder pursuant to Rule 14d-4(a)(1), 17 C.F.R. § 240.14d-4(a)(1) ("The bidder makes adequate publication in a newspaper or newspapers of long-form publication of the tender offer");

(2) The summary advertisement of the tender offer is first published by the bidder pursuant to Rule 14d-4(a)(2), 17 C.F.R. § 240.14d-4(a)(2) ("the bidder makes adequate publication in a newspaper or newspapers of a summary advertisement of the tender offer; and . . . [in]ails . . . or otherwise furnishes . . . the bidder's tender offer materials to any security

announcements:

It has become a common practice for a bidder to publicly announce the material terms of a cash tender offer in advance of the offer's formal commencement. Such announcements trigger market mechanisms, such as arbitrageur activity, which are normally attendant to the tender offer itself. This practice has become a matter of increasing concern because it causes investors to make investment decisions with respect to a tender offer on the basis of incomplete information.⁸³

Under Rule 14d-2(b)⁸⁴ and (c),⁸⁵ any public statement by an offeror, "with respect to a tender offer" paying cash or exempt securities, that discloses certain information—the offeror's identity, the identity of the target company, the securities sought in the offer, and the approximate price of the offer—constitutes the beginning of a tender offer.⁸⁶ At that moment, the offeror's disclosure obligation is triggered, unless within five days the offeror either withdraws its offer or files a Schedule 14D-1 tender offer statement as required by Rule 14d-3.⁸⁷

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holder who requests such tender offer materials pursuant to the summary advertisement");

(3) The summary advertisement or the long form publication of the tender offer is first published by the bidder pursuant to Rule 14d-4(a)(3)], 17 C.F.R. § 240.14d-4(a)(3) ("Any bidder using stockholder lists and security position listings [to disseminate a tender offer] shall comply with [either the long-form publication or summary publication rules] on or prior to the date of the bidder's request for such lists or listing . . .");

(4) Definitive copies of a tender offer, in which the consideration offered by the bidder consists of securities registered pursuant to the Securities Act of 1933, are first published or sent or given by the bidder to security holders; or

(5) The tender offer is first published or sent or given to security holders by the bidder by any means not otherwise referred to in paragraphs (a)(1) through (4) of this section.

Id.

83. Release 34-15,548, *supra* note 80, at 20.

84. 17 C.F.R. § 240.14d-2(b). Rule 14d-2(b) states, in part:

(b) *Public announcement.* A public announcement by a bidder through a press release, newspaper advertisement or public statement which includes the information in paragraph (c) of this section with respect to a tender offer . . . shall be deemed to constitute the commencement of a tender offer . . . [e]xcept, [t]hat such tender offer shall not be deemed to be first published or sent or given to security holders by the bidder . . . if within five business days of such public announcement, the bidder either:

(1) Makes a subsequent public announcement stating that the bidder has determined not to continue with such tender offer . . . ; or

(2) Complies with Rule 14d-3(a)[, 17 C.F.R. § 240.14d-3(a) (1988) (filing and transmittal of tender offer statement)], and contemporaneously disseminates the disclosure required by Rule 14d-6[, 17 C.F.R. § 240.14d-6 (1988) (disclosure requirements with respect to tender offers)], to security holders pursuant to Rule 14d-4[, 17 C.F.R. § 240.14d-4 (1988) (dissemination of certain tender offers)] . . . .

Id.

85. *Id.* § 240.14d-2(c). Rule 14d-2(c) states:

(c) *Information.* The information referred to in paragraph (b) of this section is as follows:

(1) The identity of the bidder;

(2) The identity of the subject company; and

(3) The amount and class of securities being sought and the price or range of prices being offered therefor.

Id.

86. *Id.* § 240.14d-2(a)-(c).

87. *Id.* § 240.14d-2(b).

Rule 14d-2, however, assumes a definition of tender offer and thus is not informative of the SEC's views on what constitutes a tender offer. Considering the SEC's general position on street sweeps, Rule 14d-2(d)'s safe harbor provision, which describes what does *not* constitute public announcement of a tender offer,⁸⁸ makes little sense. Under that provision an offeror can issue a press release, make a public statement, or purchase a newspaper advertisement announcing its intention to commence a tender offer for a specific company, as long as the offeror does not include the amount of securities sought and the price to be offered.⁸⁹ Research indicates that disclosure of an offeror's and target's identity is all that is necessary to stimulate substantial arbitrage activity in the target stock.⁹⁰ Therefore, the type of press release that Rule 14d-2(d) permits will put a target into play and begin takeover speculation in the target stock. If, however, a bidder made a similar public announcement about a street sweep—giving only its and the target's identity and indicating its intention to engage in a street sweep—the SEC would argue that the resulting sweep was in fact a tender offer.

In addition to Rule 14d-2, the SEC periodically stresses its position that, under the Williams Act, the scope of the term tender offer goes "beyond the conventional tender offer to include acquisition programs that present the type of abuses that Congress intended to eliminate."⁹¹ This position leaves us to speculate on what constitutes an "unconventional" tender offer and, as we shall see, on what "abuses" Congress intended to correct. In defining an unconventional tender offer, the SEC help is limited to an eight-part "flexible factors" test,⁹² set forth in ami-

88. *Id.* Rule 14d-2(d) provides:

(d) *Announcements not resulting in commencement.* A public announcement by a bidder through a press release, newspaper advertisement or public statement which only discloses . . . [(1) The identity of the bidder; (2) The identity of the subject company; and (3) A statement that the bidder intends to make a tender offer in the future for a class of equity securities . . . which statement does not specify the amount of securities of such class to be sought or the consideration to be offered therefor] concerning a tender offer in which the consideration consists solely of cash and/or securities exempt from registration under section 3 of the Securities Act of 1933 shall not be deemed the commencement of a tender offer . . . .

Id. (material in brackets appears later in Rule).

89. See *supra* note 84.

90. See Macey & Netter, *Regulation 13D and the Regulatory Process*, 65 WASH. U.L.Q. 131, 146-47 (1987).

91. See Release 34-24,976, *supra* note 13, at 1548.

92. The factors that indicate a tender offer are: (1) an active and widespread solicitation of public shareholders, (2) for a substantial percentage of the issuer's stock, (3) at a premium over prevailing market price, (4) on firm rather than negotiable terms, (5) contingent on the tender of a fixed minimum number of shares and with a ceiling of a fixed maximum number of shares, (6) open for a limited period of time, (7) putting pressure on offerees to sell their stock, (8) and using public announcements of the purchasing program. See *id.* at 1548 n.16.

cus briefs condemning particular acquisitions.⁹³

The SEC's eight-part test is hopelessly inadequate. The SEC describes each factor in the test only vaguely, and some of the factors appear to overlap.⁹⁴ The SEC also routinely attaches a catchall equivocation to the test: "The Commission repeatedly has cautioned that not all eight factors are entitled to equal weight and that neither all, nor even a majority, of the eight factors need be present."⁹⁵ The SEC has not, however, indicated which of these factors are determinative or which can be missing in a determination. The test is useless.

There was a fleeting moment of hope in 1979. In that year, a federal district court admonished the agency for failing to provide proper guidance for investors and rejected the agency's flexible-factor approach.⁹⁶ The SEC grudgingly responded with two attempts to define tender offer, one in a proposed rule⁹⁷ and the other in a proposed legislative amendment.⁹⁸ Predictably, the definitions in these proposals were overly broad and drew harsh criticism.⁹⁹ Some critics were so desperate for clarification, however, that they were willing to accept these overly inclusive definitions in order to achieve some predictability.¹⁰⁰ In any event, the SEC

93. See, e.g., *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773, 791 (S.D.N.Y. 1979); *Wellman v. Dickinson*, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

94. Compare, for example, factors one and eight. See *supra* note 92.

95. Release 34-24,976, *supra* note 13, at 1548.

96. *Brascan Ltd.*, 477 F. Supp. at 791; cf. *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1207 (2d Cir. 1978) (stating narrower construction of tender offer than that advanced in test).

97. Release 34-16,385, *supra* note 80, at F-13 to -14. Under the proposal, tender offer means one or more offers to purchase . . . securities of a single class . . . [if they are] directed to more than 10 persons and seek the acquisition of more than 5% of the class of securities . . . , or . . . (A) are disseminated in a widespread manner, (B) provide for a price which represents a premium in excess of the greater of 5% of or \$2 above the current market price and (C) do not provide for a meaningful opportunity to negotiate the price and terms.

Id.

98. *Proposed Bill to Amend Williams Act*, [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 542, special supp., exh. D, at 20-23 (Feb. 27, 1980); *SEC Asks Congress to Strengthen Williams Act, Define "Tender Offer" As Offer for 10 Percent of Target*, [Jan.-June] Sec. Reg. & L. Rep. (BNA) No. 542, at A-1 to -3 (Feb. 27, 1980) (discussion of proposed bill).

99. See, e.g., Fogelson, Wenig & Friedman, *Changing the Takeover Game: The Securities and Exchange Commission's Proposed Amendments to the Williams Act*, 17 HARV. J. ON LEGIS. 409, 426-39 (1980) (criticizing both proposed rule and proposed amendment); Froine, *Expanded Definition of Tender Offer*, N.Y.L.J., Feb. 29, 1980, at 1, col. 1, 2, col. 3 (criticizing proposed rule for not including most of eight factors previously identified); Note, *Toward a Definition of "Tender Offer,"* *supra* note 64, at 205-27 (criticizing both proposed rule and proposed amendment).

100. See, e.g., Note, *Defining Tender Offers: Resolving a Decade of Dilemma*, 54 ST. JOHN'S L. REV. 520, 543-550 (1980) (advocating adoption of definition to resolve inconsistency in caselaw); Note, *Cash Tender Offers: A Proposed Definition*, 31 U. FLA. L. REV. 694, 715-18 (1979) (suggesting that SEC adopt a definition because "[t]here exists a need for a generic definition to be used as a

has withdrawn both proposals¹⁰¹ and returned to its eight-factor test.¹⁰²

Judicial interpretations of the SEC's eight-factor test fall all over the map. One district court interpreted the test to include in its definition of tender offer "all methods of takeover by a large-scale stock purchase program."¹⁰³ While this interpretation is reasonable, and the SEC commonly cites the case favorably, the judge erred in even accepting the test as a legitimate interpretation of the Williams Act. Indeed, one court has explicitly rejected the test as too vague.¹⁰⁴ Finally, other courts have viewed the test as a shapeless authority, finding in it whatever they want to find.¹⁰⁵

The common thread throughout these opinions, if one can be found, is the notion that street sweeps do not violate the Williams Act unless, prior to a sweep, a purchaser publicizes its intention to use a sweep to gain control of a target. Publicity can take the form of general press releases, public announcements aimed at all shareholders, or communications to a large number of individual shareholders.¹⁰⁶ Courts view (or ought to view) such publicity, when followed by large-scale private and open-market purchases at premium prices, as too close to traditional

planning tool for persons contemplating an acquisition program as well as for those arranged in opposition").

101. Release 34-24,976, *supra* note 13, at 1548.

102. See, e.g., SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945, 948 (9th Cir. 1985). As an alternative to the eight-factor test, the SEC also argued in *Carter Hawley Hale* for the broader definition of tender offer enunciated in *S-G Sec., Inc. v. Fuqua Inv. Co.*, 466 F. Supp. 1114, 1126-27 (D. Mass. 1978). 760 F.2d at 948. The Ninth Circuit, however, refused to adopt the *S-G Securities* test, labeling it "vague and difficult to apply." *Id.* at 953.

103. *Wellman v. Dickinson*, 475 F. Supp. 783, 825 (S.D.N.Y. 1979) (quoting Lipton, *Open Market Purchases*, 32 BUS. LAW. 1321, 1321 (1977)), *aff'd on other grounds*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983).

104. *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 773 (S.D.N.Y. 1979). Judge Leval stated:

The SEC refrains from specifying which of the eight factors or how many must be met or how clearly before an acquisition will be considered a tender offer. I have doubts as to whether this view constitutes either a permissible or a desirable interpretation of the statute. . . . I believe it is not desirable because the application of so vague a test would introduce a crippling uncertainty in an area in which practitioners should be entitled to be guided by reasonably clear rules of the road.

Id. at 791.

105. See, e.g., SEC v. Carter Hawley Hale Stores, Inc., 587 F. Supp. 1248, 1252-57 (C.D. Cal. 1984), *aff'd*, 760 F.2d at 945; *cf.* *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195, 1206-07 (2d Cir. 1978) (selectively citing Williams Act's legislative history).

106. See, e.g., *S-G Sec.*, 466 F. Supp. at 1126 (buying program, in which three widely publicized press releases outlined program's details, held to be tender offer); *Cattlemen's Inv. Co. v. Fears*, 343 F. Supp. 1248, 1251-52 (W.D. Okla. 1972) (widespread solicitation of public shareholders in person, by phone, and through mails held to constitute tender offer). For publicity to occur through individual shareholder solicitations, bidders must tell each shareholder that the bidders are also soliciting other shareholders. See *Wellman*, 475 F. Supp. at 820-21 (series of transactions with select group of shareholders is not a privately negotiated purchase, but a tender offer). This sets up the threat of the front-end-loaded acquisitions.

tender offers. This judicial approach has legitimate underpinnings: street sweep publicity creates the same shareholder uncertainty as tender offer publicity—i.e., the uncertainty of whether shareholders will lose the premium values offered in the acquisition if they hold their shares.

The SEC also distinguishes between privately negotiated purchases and open-market purchases. In privately negotiated purchases, the SEC focuses on the number of direct solicitees and, to a lesser extent, the sophistication of those solicitees, as critical variables.¹⁰⁷ Apparently, if the acquirer solicits enough shareholders, the SEC considers the street sweep to be a tender offer, even when general publicity of the sweep is absent. The general market notification (which creates the pressure to sell) results from the large number of individual contacts, rather than a simple press release. The SEC's approach finds support in some judicial opinions.¹⁰⁸ On its face, though, this approach seems inconsistent in that it allows an acquirer to purchase from sellers, regardless of sophistication and number, in the open markets with no public comment and the enticement of a steadily rising price, but prohibits the same acquirer from directly contacting shareholders with an unadorned offer to purchase at a price slightly in excess of market.¹⁰⁹

The inconsistency, though, is more theoretical than real. The fundamental problem with direct solicitations is the communication that normally accompanies face-to-face offers. An acquirer usually, if not always, tells each solicitee that it intends to stop purchasing once it acquires a set amount of target stock, and urges the solicitee to tender in order to participate in the acquisition and collect any part of the acquisition premium.¹¹⁰ If this kind of sales dialogue occurs, the number and

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107. See *supra* note 92 (factors one, two, and three of SEC test encompass number and sophistication of direct solicitees). See generally Fletcher, *Sophisticated Investors Under the Federal Securities Laws*, 1988 DUKE L.J. 1081, 1127-30 (discussing relevance of investor sophistication to determination whether stock purchase plan involves tender offer).

108. See, e.g., *Cottleman's Inv. Co.*, 343 F. Supp. at 1251-52 (legislative intent of Williams Act describes widespread solicitation of shareholders as equivalent to tender offer); see also Andre, *supra* note 64, at 541-46.

109. The irony is perhaps best evident in *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985). In *Hanson Trust*, the court stated that it would define a tender offer using as guidance the principles that define a private offering under the Securities Act of 1933. The acquisition program in *Hanson Trust* involved both privately negotiated transactions and open-market purchases. Focusing solely on the privately negotiated transactions, the court found that the number of solicitees was "minuscule." *Id.* at 57. One might ask how this finding squares with the 600,000 shares that Hanson purchased in the open market. Were those shareholders who sold in the open market not solicitees? The court assumed, without explanation, that they were not. Presumably, this assumption hinged on the absence of any contemporaneous public communication of Hanson's intent to sweep the street.

110. See, e.g., *University Bank & Trust v. Gladstone*, 574 F. Supp. 1006, 1011 (D. Mass. 1983) (discussing typical sales talk).

sophistication of the solicitees becomes important. As the number increases, notification of the sweep becomes more public and the solicitees' collective ability to resist decreases. As the solicitees' sophistication increases, the less susceptible they become to this type of sales talk. Informed traders who know about a firm, a buyer, and some of the practices in the acquisition market are better able to decide when to call the buyer's bluff and, indeed, when to run their own bluffs. If acquirers could avoid such sales talk and make only pure, unadorned offers to shareholders, the face-to-face acquisition programs should be indistinguishable from straight open-market acquisition programs. In sum, the communication to potential sellers that a one-time acquisition program of limited duration is in progress creates the pressure to sell. That communication is also the key variable in equating street sweeps with privately announced tender offers.

Even assuming that a private negotiation could take place without such sales talk and with the buyer's disclosure that a street sweep acquisition was in progress, a distinction between a series of private solicitations and a public solicitation nevertheless remains. The distinction hinges primarily on the number of individuals solicited: how many solicitations makes an offer public? With respect to publicly held companies, courts have consistently held that solicitation of twenty-five or fewer large shareholders does not constitute a tender offer, but the solicitation of fifty or more does make a tender offer.¹¹¹ Solicitations of twenty-five to fifty shareholders represent the gray area. Courts, under the guidance of the Supreme Court's decision in *SEC v. Ralston Purina Co.*,¹¹² find that solicitee sophistication tips the balance one way or the other.¹¹³

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111. Compare *Hanson Trust*, 774 F.2d at 51 (solicitation of six out of 22,800 shareholders is not public solicitation) and *Beaumont v. American Can Co.*, 621 F. Supp. 484, 502 (S.D.N.Y. 1985) (solicitation of 6 out of over 2000 shareholders is not public solicitation), *aff'd*, 797 F.2d 79 (2d Cir. 1986) and *University Bank & Trust*, 574 F. Supp. at 1011 (solicitation of 49 out of 650 shareholders—22% of the outstanding stock—not a tender offer) and *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 449 F. Supp. 951, 961 (S.D.N.Y. 1978) (open-market purchases, plus solicitation of 50 shareholders and 12 institutional investors "off the floor," not a tender offer), *aff'd in part and rev'd in part*, 584 F.2d 1195 (2d Cir. 1978) and *Nachman Corp. v. Halfred, Inc.*, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,455, at 95,592-93 (N.D. Ill. July 13, 1973) (solicitation of no more than 40 shareholders not a tender offer) with *Mid-Continent Bancshares, Inc. v. O'Brien*, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,734, at 93,709 (E.D. Mo. Dec. 11, 1981) (solicitation of at least 60 shareholders is a tender offer).

112. 346 U.S. 119, 124-25 (1953) (private offering under Securities Act of 1933 depends on offer-ees' sophistication and access to material information).

113. See, e.g., *Hanson Trust*, 774 F.2d at 57-58 (noting that at least five of the sellers were "highly sophisticated professionals"); *Kennecott Copper Corp.*, 449 F. Supp. at 961 (noting that sellers were "large institutions who were unlikely to be forced into uninformed, ill-considered decisions"); *D-Z Inv. Co. v. Holloway*, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,771, at 96,562 (S.D.N.Y. Aug. 23, 1974) (transactions involved "highly sophisticated" financial institu-

In one case, for example, a court held that a solicitation of forty shareholders was not a tender offer because each of the solicitees was either a director, manager, or substantial shareholder and was thus able to bargain effectively on his own behalf.¹¹⁴ Other courts might not be as generous. As this case demonstrates, when the number of solicitees climbs uncomfortably above twenty-five, some courts will use sophistication as a tie-breaker. The use of seller sophistication as a tie-breaker seems odd, however, because it ought to be used very rarely. If the number of solicitees in a street sweep is small, it must be because each of them holds a large block of target stock. Generally, large-block shareholders are sophisticated—they are institutional investors, arbitrageurs or insiders.

The SEC, along with some courts, also places significance on the form of offers made in private negotiations. The SEC maintains that offers made to even a restricted number of solicitees with conditions similar to those contained in tender offers may be “tender offers.”¹¹⁵ In such cases, the SEC considers these conditions most important: (1) that offers are contingent on receipt of a minimum number of total shares within a set time period, (2) that the offer’s terms are fixed and nonnegotiable, and (3) that the offer is open for only a limited period of time.¹¹⁶

The SEC’s position on offer form seems to have backfired, and in any event makes little sense. Most acquirers who use street sweeps are cognizant of the SEC’s stance and are careful not to impose such conditions in their solicitations *explicitly*. Nor do they need to do so; all sophisticated traders understand the *implicit* threats in many private offers. Courts have nevertheless viewed the absence of explicit conditions as strong evidence that street sweeps are not tender offers.¹¹⁷ Even if the SEC’s position has effectively reduced the number of implicit or explicit conditions in offers, that position might also stop deals that ought to be

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tions); *Nachman Corp.*, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 95,592 (noting that solicitees were powerful and knowledgeable enough not to be pressured).

Under Regulation D, which quantifies the private offering exemptions under the Securities Act of 1933, the magic number for unsophisticated investors is 35, with sophisticated investors not counting toward the total. Regulation D, 17 C.F.R. §§ 230.505(b)(2)(ii), .506(b)(2)(i), .501(e) (1988); cf. Securities Act of 1933, § 4(6), 15 U.S.C. § 77d(6) (1982) (exemption for sales to one or more “accredited investors”).

114. See *Nachman Corp.*, [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 95,592.

115. In announcing its eight-factor test, the SEC made it clear that the first factor (active and widespread solicitation of public shareholders) is not a necessary condition if other factors are present. See *supra* note 95 and accompanying text.

116. See factors four, five, and six in the SEC’s eight-factor test, set forth *supra* note 92.

117. See, e.g., *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 950-52 (9th Cir. 1985) (upholding district court’s ruling that purchase involved no tender offer when offer was not contingent on tender of fixed number of shares, its terms were not firm, and it was not for a limited time).

made. If we assume that the number of solicitees is small and that they are all sophisticated,¹¹⁸ then an offer's conditional form should not be sufficient to transform essentially private negotiations into a public offer. At most, the conditions might increase the pressure to sell in a private exchange. But without such conditions, acquirers might not extend private offers to large shareholders, or they might be forced to offer substantially less value to individual buyers. The result might be to stop beneficial arrangements between otherwise willing parties. Large shareholders (the subject of the SEC's protection), if given the choice, would probably prefer a rule *allowing* buyers to make contingent offers, because such a rule would allow shareholders to get more and higher-priced offers. Moreover, as larger shareholders, they have sufficient bargaining power in most cases to counteract any undue pressure created by the conditions.¹¹⁹

B. *When Is a Tender Offer Over?*

When Campeau Corporation, within thirty minutes of terminating a tender offer for Allied stock, used a street sweep to buy 48% of Allied, SEC attorneys filed an amicus brief in support of Allied's request for an injunction forcing Campeau to rescind the purchases.¹²⁰ The SEC argued that the purchase was a "de facto continuation" of a terminated tender offer and thus violated Rule 10b-13,¹²¹ which prohibits market purchases or "any arrangement to purchase"¹²² negotiated during a tender offer.¹²³ An agreement between Campeau and Allied mooted the case.¹²⁴

The SEC apparently supported Allied's claim that Campeau had arranged to purchase blocks of stock from arbitrageurs prior to terminating its tender offer. Since the arbitrageurs made their purchases during the offer's pendency pursuant to arrangements with Campeau, in essence Campeau made those purchases through an agent, in violation of Rule

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118. If the number of solicitees is high, however, some of these conditions might be necessary in order to create the front-end loading essential to a successful public offer.

119. They can contact all the other large shareholders and form a bargaining coalition. Then they can simply call the buyer's bluff and refuse the conditions, hoping that the coalition is large enough to force the buyer to capitulate.

120. Ingersoll, *Campeau's Purchase of 48% of Allied Was Illegal, SEC Will Argue in Court*, Wall St. J., Oct. 30, 1986, at 8, col. 2.

121. 17 C.F.R. § 240.10b-13 (1988).

122. *Id.*

123. See Ingersoll, *supra* note 120, at 8, col. 2. The SEC made a similar argument in *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 58-61 (2d Cir. 1985) (discussing whether Hanson's purchases should be treated as a de facto continuation of its earlier tender offer).

124. Hertzberg & Rundle, *supra* note 3, at 2, col. 3.

10b-13.¹²⁵

Thus, when a street sweep follows a tender offer, the SEC will carefully scrutinize any contacts between arbitrageurs and bidders during the tender offer and construe any hints of a deal as "an arrangement to purchase" in violation of Rule 10b-13. The SEC believes, and will urge courts to hold, that the term "arrangements" (which can be made "indirectly") refers to nonbinding understandings, in addition to legally enforceable contracts.¹²⁶ In other words, the SEC will invoke Rule 10b-13 when, during a tender offer's pendency, bidders contact arbitrageurs directly and create mutual expectations of a sale upon termination of the tender offer.

Less clear, however, is the situation when a bidder threatens a recalcitrant target that, unless the target board capitulates in removing takeover defenses, it will terminate its tender offer and commence a street sweep. It is questionable whether this tactic runs afoul of Rule 10b-13. Such a threat sends an implicit signal to arbitrageurs that their accumulation of large blocks of target stock might lead to a deal with the bidder in a street sweep. Does the announcement of such a threat then constitute an indirect arrangement to purchase stock? Those who lamented the effect of *Hanson Trust* presumably would answer in the negative.¹²⁷ The SEC's proposed street sweep rules also appear to recognize a distinction between an "arrangement or understanding" and either an "offer to purchase" or an "offer to sell."¹²⁸ In sum, an "arrangement" seems to require that a bidder and arbitrageur establish a mutual expectation of a future sale.

C. *The Anomalous Effect of the Current Tender Offer Definition*

If we assume that the SEC is sincere in claiming that it does not intend to stop all street sweeps, but rather that it intends to leave room for non-abusive street sweeps, then the courts' and the SEC's focus on bidder publicity of a large stock acquisition as the primary characteristic of a tender offer is problematic and inconsistent. These problems not only demonstrate the impracticability of the SEC's approach to street sweeps, but might also indicate that the SEC's actual intention is to elim-

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125. The largest arbitrageur involved in the case, Jefferies & Co., denied that it acted as Campeau's agent in gathering Allied stock, claiming that it also offered the stock to Campeau's rival bidder, Paul Bilzerian. *Id.* at 26, col. 1.

126. See Adoption of Rule 10b-13 Under the Securities Exchange Act of 1934, SEC Release No. 34-8712, [1969-1970 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,745, at 83,708, 83,708-09 (Oct. 8, 1969).

127. See, e.g., Jereski, *supra* note 5, at 70 (*Hanson Trust* case will "accelerate the already dizzying pace of takeovers").

128. Release 34-24,976, *supra* note 13, at 1553-54 (proposed Rule 13e-2).

inate all street sweeps, using rules that are politically less offensive than an outright ban.

The first problem with the current tender offer definition is that a rule based on publicity is somewhat extraordinary in light of the federal securities laws' general purpose—to require and police public disclosure by market insiders. Rather than encouraging public disclosure in street sweeps, the courts and the SEC, in effect, discourage acquirers from disclosing their true intentions. If acquirers may undertake street sweeps on the condition that they are careful not to reveal their intentions to the market, then those who sell their stock during a street sweep might not even know that a street sweep is under way. In other words, in the name of helping target shareholders, the SEC is encouraging acquirers to disclose less.

The existence of a street sweep is surely material to those trading in a target's stock. Yet the SEC encourages acquirers to withhold this information, not because the information is false or misleading, but because the information is too important—it creates pressure to sell. In its paternalistic approach to street sweeps, the SEC considers that shareholders are better off not knowing of an ongoing street sweep despite the shareholders' desire to know that information and the acquirer's desire to disclose it. Whether the SEC is correct in its assessment of street sweep dangers will be discussed later in the context of the SEC's newly proposed rules.¹²⁹

The second problem with the current definition is that a policy of discouraging acquirers from publicizing street sweeps is doomed in practice. The SEC recognizes this problem in its proposal to ban street sweeps during or following tender offers. Any notification to the market of an impending tender offer creates opportunities for street sweeps. Even if the SEC rule were adopted, acquirers could still mount street sweeps with methods that would satisfy a no-publicity rule. Word that a company is in play can come from a variety of sources and travels very fast through the markets. For example, word that an acquirer is making an ostensibly friendly offer to another company's board (a "bear hug") for a merger or purchase of all its assets can have the same effect on the market as notification of a tender offer.

Even street sweeps that commence in total secrecy do not remain secret for long. At a minimum, market reporting tapes inform market professionals of the first large trades in a street sweep, and discovering a purchaser's identity is not difficult. Even more likely is immediate dispersal, among a network of market professionals, of information that an

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129. See *infra* notes 204-38 and accompanying text.

acquirer had given to a few initial solicitees. Perhaps the SEC could consider initial solicitees as agents of the acquirer in spreading the news, but an information trail would be very difficult to reconstruct in an enforcement proceeding. In sum, any rule that acts to suppress valuable information in the capital markets is likely to be honored more in the breach than in the observance.

Third, the current tender offer definition might contradict some disclosure requirements established in the Securities Exchange Act of 1934.¹³⁰ Section 13(d)¹³¹ and its accompanying rules¹³² require that anyone acquiring more than 5% of a registered firm's equity securities must disclose that acquisition to the issuer, the markets, and the SEC. The purchaser must also disclose the "purpose . . . of the acquisition," and the existence of any plan to acquire additional securities, in a Schedule 13D filing.¹³³ If acquirers had to disclose immediately upon acquisition of a 5% stake, then Schedule 13D would require every acquirer in a street sweep to inform the market that a street sweep was in progress. Section 13(d)'s ten-day window, however, allows acquirers to comply with both the Williams Act and Schedule 13D,¹³⁴ since most street sweeps conclude in a shorter period. Despite the ten-day window, though, it remains unclear whether an acquirer that chooses to file a Schedule 13D promptly, rather than waiting the full ten days, mounts an illegal tender offer in violation of the Williams Act, since it will have given specific public notice of the street sweep in the Schedule. If so, it seems odd that an acquirer violates one rule by following another. If not, a Schedule 13D filing becomes a safe method of avoiding the basic prohibition against street sweep publicity.¹³⁵

This problem, moreover, will get worse before it gets better. Congress, with the support of the SEC and the New York Stock Exchange, is intent on closing the window to a few days.¹³⁶ If such legislation suc-

130. The SEC faces a similar problem in defining the "commencement of a tender offer" under Rule 14d-2. See *supra* note 82. If an offeror discloses an intention to make a tender offer in a Schedule 13D or proxy materials, does it commence a tender offer?

131. 15 U.S.C. § 78in(d) (1982).

132. Rules 13d-1 to -7, 17 C.F.R. §§ 240.13d-1 to .13d-7 (1988); Schedule 13D, 17 C.F.R. § 240.13d-101. For a devastating criticism of Regulation 13D, see Macey & Netter, *supra* note 90.

133. Rule 13d-1, 17 C.F.R. § 240.13d-1; Schedule 13D, item 4, 17 C.F.R. § 240.13d-101.

134. See Rule 13d-1(a), 17 C.F.R. § 240.13d-1(a).

135. See *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 58 (2d Cir. 1985) ("liability for solicitation may not be predicated upon disclosures mandated by Stock Exchange Rules"); Letter from Sullivan & Cromwell to SEC (Dec. 11, 1987) (suggesting that present rules, even as modified by SEC's proposed rules, do not prohibit acquirers from announcing in Schedule 13D filing an intent to buy control and following that announcement with street sweep).

136. See *SEC Should Have Authority To Preempt Some State Takeover Laws*, Ruder Says, 19 Sec. Reg. & L. Rep. (BNA) No. 37, at 1383, 1384 (Sept. 18, 1987) [hereinafter *SEC Should Have Authority*] (SEC Chairman David Ruder expresses support for various congressional bills that would

ceeds, street sweeps that comply with both the Williams Act and section 13(d) may soon be impossible to mount. Amending section 13(d), however, is an odd and underhanded way to eliminate street sweeps, if that is Congress's intent.

Other Exchange Act provisions that mandate early disclosure of street sweep plans include section 14(d)¹³⁷ and its accompanying rules. The SEC rules require a tender offeror to disclose all material information in a Schedule 14D-1.¹³⁸ If the offeror intends to mount a street sweep upon the tender offer's failure, the offeror should arguably include this intention in the Schedule. Similarly, when an issuer intends to mount a street sweep to defend against a hostile bidder, the issuer should disclose this intention in filings under Schedule 14D-9¹³⁹ and Rule 13e-1.¹⁴⁰ These intentions might also be material information that an issuer must disclose under Rule 10b-5's general antifraud provisions.¹⁴¹ In the context of tender offers and issuers' large-scale stock repurchases, a rule discouraging public announcement of information that the market considers important will invariably conflict with many rules mandating disclosure of material information.

One added incongruity in the current definition of tender offer is the effect that such an expansive definition has on other provisions incorporating the term. For example, whether an individual receives notice of an

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close 10-day window in section 13(d)); *Firms Should Provide Takeover Updates Without Being Asked*, NYSE Chairman Says, 19 Sec. Reg. & L. Rep. (BNA) No. 31, at 1119 (July 31, 1987) (comments by NYSE Chairman John Phelan, Jr., expressing support for the Dingell-Markey bill that would close the § 13(d) window to 24 hours); *Supreme Court Decision on Indiana Law Remains Prime Topic at Takeover Hearings*, 19 Sec. Reg. & L. Rep. (BNA) No. 28, at 1011 (July 10, 1987) (discussing bill, introduced by Reps. Dingell and Markey, that would require 24-hour notification under § 13(d)); *Proxmire to Offer Bill to Require Prenotification of Bidder's Purchases*, 19 Sec. Reg. & L. Rep. (BNA) No. 15, at 507 (Apr. 10, 1987) (discussing Sen. Proxmire's proposal requiring prepurchase notification); *Simon Proposes Bill to Limit § 13(d) Window, Prohibit Greenmail*, 19 Sec. Reg. & L. Rep. (BNA) No. 7, at 219 (Feb. 13, 1987) (discussing Sen. Simon's bill to close § 13(d) window); *Kassenbaum Introduces Bill to Close § 13(d) 10-Day Window*, 19 Sec. Reg. & L. Rep. (BNA) No. 5, at 170 (Jan. 30, 1987) (discussing Sen. Kassenbaum's proposal of 24-hour notification requirement). The one bill reported out of committee was S. 1323, the Tender Offer Disclosure and Fairness Act of 1987. See S. REP. NO. 100-265, *supra* note 14; see also *infra* note 202. The bill narrows the 10-day window to 5 days and prohibits any additional purchases until disclosure has been made. *Id.* at 3-4. Acquirers must disclose any additional acquisitions of substantial size within one day. *Id.* at 3. Finally, if an acquirer claims no takeover intent in a Schedule 13D, the acquirer cannot make a subsequent takeover bid until 60 days after it amends its filing to announce its takeover intent. *Id.* at 4.

137. 15 U.S.C. § 78n (1982).

138. See 17 C.F.R. § 240.14d-100 (1988).

139. *Id.* § 240.14d-101, item 4 (requiring disclosure of "other action" that subject company is suggesting in solicitations or recommendations to shareholders regarding bidder's tender offer).

140. *Id.* § 240.13e-1(a)(2) (mandating that target company disclose purpose of its share repurchases during bidder's tender offer).

141. *Id.* § 240.10b-5.

acquisition from an acquirer or its insiders, Rule 14e-3 prohibits any trading on advance notice of a tender offer.¹⁴² Assuming Rule 14e-3 does not apply to street sweeps, individuals who trade on advance notice of a street sweep might still find themselves in violation of that Rule if the acquirer is too public about its acquisition plans. Arbitrageurs who have bought stock in anticipation of a street sweep will be at risk if their information about the potential sweep came from the acquirer or its insiders. If the acquirer has contacted too many solicitees, such an arbitrageur becomes an inside trader. Thus, the SEC's expansive definition of tender offer has possibly unforeseen rippling effects on other provisions of the securities laws.

IV. THE DEATH OF STREET SWEEPS: STATE ANTITAKEOVER LEGISLATION AND POISON PILL PLANS

Managers of potential targets, anxious to protect against nonconsensual acquisitions, have erected defenses at the firm level and lobbied for legislation at the state level. At the firm level, poison pill plans have emerged as the most successful tactic.¹⁴³ At the state level, legislators have been willing to enact whatever legislation managers of resident corporations have drafted.¹⁴⁴ Not surprisingly, the resulting state legislation often merely embodies popular firm-level defenses. The following sections, therefore, consider together the effect of firm-level and state-level takeover defenses on street sweeps.

A. State Antitakeover Legislation

Thirty-four states, including those that incorporate the nation's largest firms, have legislation designed to retard hostile takeovers.¹⁴⁵ There is some doubt whether the more extreme forms of these statutes are constitutional.¹⁴⁶ There is no doubt, however, that some forms of antitake-

142. *Id.* § 240.14e-3(a).

143. See Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 30-31 (1987) (The poison pill is "a very effective defensive mechanism in the age of abusive takeovers."); see also OFFICE OF THE CHIEF ECONOMIST, SEC, *supra* note 60, at 1-2.

144. See Macey, *State Anti-takeover Legislation and the National Economy*, 1988 WIS. L. REV. 467, 468 (antitakeover statutes enacted to protect interests of individual firms rather than the public); Oesterle, *Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced*, 13 DEL. J. CORP. L. 879, 930-31 (1988) (states "have shown little hesitancy" in enacting statutes that "one suspects . . . may have been drafted in targeted company board rooms"); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111, 113 (1987) (firm managers often able to obtain statutory protections from legislators that would not have been approved by shareholder vote).

145. *Six More States Adopt Antitakeover Laws; Total Now 34*, IRRRC CORP. GOVERNANCE BULL., May-June 1988, at 61.

146. See, e.g., *Tyson Foods, Inc. v. McReynolds*, 865 F.2d 99, 102-03 (6th Cir. 1989) (Tennessee antitakeover law held unconstitutional as applied to foreign corporations); *RTE Corp. v. Mark IV*

over statutes are within constitutional limits and that states will adopt the most onerous forms that federal courts will allow.¹⁴⁷ Antitakeover statutes are legislative embodiments of private defensive programs frequently used by firms. Although firms initially designed these programs, and lobbied for state statutes legitimizing them, primarily out of concern over hostile tender offers, these programs also affect private acquisitions. Antitakeover statutes apply to all acquisitions, either through open-market or privately negotiated purchases, of 15% to 20% of a target's stock.¹⁴⁸

State antitakeover legislation attaches harsh consequences to any large-scale acquisition that a preexisting board of directors does not in some fashion approve. For example, control-share statutes take away an acquirer's right to vote its acquired shares without a majority vote of preexisting shareholders;¹⁴⁹ business combination¹⁵⁰ and fair price¹⁵¹ statutes prohibit second-stage mergers between an acquirer and a target firm unless the acquirer satisfies stringent price or shareholder-vote conditions; redemption statutes,¹⁵² the most severe of all, give target-firm shareholders the right to sell their shares to the target at the acquisition price. Although firms may opt out of most antitakeover statutes, the majority of firms choose not to do so.

Antitakeover statutes, in theory, do not stop street sweeps. In practice, however, many such statutes severely curtail street sweeps. Paradoxically, the SEC, although intensely distrustful of street sweeps, also opposes state antitakeover statutes.¹⁵³ The paradox is compounded by

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Holdings Inc., No. 88-C-378, slip op. (E.D. Wis. May 6, 1988) (Westlaw, 1988 WL 75453) (holding Wisconsin's antitakeover law unconstitutional), *vacated as moot*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,789, at 98,722 (E.D. Wis. June 22, 1988); see also *Wisconsin Takeover Law Ruled Unconstitutional by District Court*, 20 Sec. Reg. & L. Rep. (BNA) No. 20, at 774 (May 20, 1988) (discussing *RTE Corp.*).

147. See Oesterle, *supra* note 144, at 930-32.

148. See, e.g., IND. CODE ANN. § 23-1-42-1 (Burns Supp. 1988) (20% trigger); DEL. CODE ANN. tit. 8, § 203 (Supp. 1988) (15% trigger).

149. See, e.g., IND. CODE ANN. § 23-1-42-9.

150. See, e.g., DEL. CODE ANN. tit. 8, § 203 (prohibiting business combinations with interested stockholders (15%) for three years, unless two-thirds of disinterested shareholders consent).

151. See, e.g., MD. CORPS. & ASS'NS CODE ANN. §§ 3-601 to -603 (1985 & Supp. 1988) (requiring that two-thirds of disinterested shareholders consent once acquirer gains 10% of company's shares, unless offer meets statutory fair price definition).

152. See, e.g., PA. STAT. ANN. tit. 15, § 1910 (Purdon Supp. 1988) (granting shareholders a right to receive payment for shares following a control transaction).

153. The SEC filed an unsuccessful amicus brief against the Indiana Control Share Act in *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 100 (1987), and also has lobbied unsuccessfully against state statutes. See Oesterle, *supra* note 144, at 929-30 & 930 n.196. The current SEC Chairman favors federal preemption of state antitakeover legislation. *Ruder Defends Position on Preemption of State Takeover Laws*, 19 Sec. Reg. & L. Rep. (BNA) No. 40, at 1525 (Oct. 9, 1987); *SEC Should Have Authority*, *supra* note 136, at 1383.

the fact that the statutes are far more effective in limiting sweeps than the SEC's rules and court briefs. Indeed, the effectiveness of state legislation has allowed the SEC to dawdle on its proposed rules, which appear, as time goes on, less and less necessary.

The SEC's distaste for state antitakeover statutes stems primarily from their adverse effects on tender offers.¹⁵⁴ In the agency's view, the Williams Act provides sufficient protections for public tender offers. Presumably the SEC would be more equivocal about state antitakeover statutes if they were aimed exclusively at private acquisition programs. In any event, little doubt remains that the state statutes constrain street sweeps more effectively than other mechanisms.

Redemption statutes, although few in number, are the most debilitating.¹⁵⁵ An acquisition covered by such a statute triggers a redemption right for all shareholders at the highest acquisition price. The acquirer must in essence make a tender offer for *all* the target stock.

Fair price and business combination statutes operate on the second stage of takeover acquisitions. A large acquisition triggers conditions that prohibit an acquirer from eliminating minority shareholders in a squeeze-out merger. Since many acquirers need nearly complete control of a target firm's assets in order to pay down or restructure their acquisition financing, such prohibitions can be disabling. The prohibitions, however, are typically not absolute. Fair price statutes generally condition second-stage mergers on a price that equals the highest price paid in the first-stage acquisition, and business combination statutes tend to condition mergers on a supermajority shareholder vote.

Control-share statutes are the only type of antitakeover statute that the Supreme Court has explicitly declared constitutional.¹⁵⁶ These statutes seem less innocuous than redemption and business combination statutes because, unlike these other types of statutes, they do not give target managers primary authority to approve a takeover. Control-share statutes allow an acquirer to vote its shares only if approved by a majority of the preexisting shareholders (excluding shares held by officers or managers).¹⁵⁷ Dissenting shareholders have appraisal rights, and if the acquirer loses the right to vote its shares, the firm can call the acquirer's stock at fair market price.¹⁵⁸ The Supreme Court, in approving the Indiana Con-

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154. *Ruder Defends Position on Preemption of State Takeover Laws*, *supra* note 153, at 1525.

155. They are also known as appraisal statutes. *See, e.g.*, ME. REV. STAT. ANN. tit. 13-A, § 910 (Supp. 1988); PA. STAT. ANN. tit. 15, § 1910.

156. *See Dynamics Corp.*, 481 U.S. at 93-94 (holding that Indiana Control Share Act not unconstitutional or preempted by Williams Act).

157. *See Booth, The Promise of State Takeover Statutes*, 86 MICH. L. REV. 1635, 1678 (1988).

158. *Id.* at 1678.

trol Share Act, was clearly impressed by the Act's protection of shareholder "autonomy."¹⁵⁹

Control-share statutes might be the least offensive form of antitakeover legislation with respect to tender offers, but their effect on street sweeps is much more severe. While a tender offeror can minimize the risks of an adverse shareholder vote by conditioning its offer on a favorable vote, an acquirer using an open-market purchase program has no such protection. Control-share statutes thus have two effects: first, they make open-market purchase programs excessively risky; second, they discourage partial acquisitions through street sweeps—the method's predominant use.

In a conditional tender offer for 40% of a target's shares, shareholders who tender but whose tenders have not yet been accepted can vote in favor of an offeror at a shareholder meeting.¹⁶⁰ Since tender offers are often oversubscribed, the offeror ought to do well in such a vote. In a street sweep, however, neither the shareholders who have sold nor the acquirer can vote the shares acquired in the sweep.¹⁶¹ Thus, in a successful street sweep for 40% of the target's shares, only those left out of the acquisition can vote, and they will vote against the acquisition unless they receive some compensation from the acquirer. As a result, the acquirer might be forced to purchase some of those residual shares at a market premium. The acquirer, however, cannot be certain of how many shares it must buy or the price it must pay in order to gain approval under the control-share statute triggered by the street sweep. The uncertainty created by control-share statutes has a devastating impact on street sweeps.

B. *Firm-Specific Defenses: Poison Pill Plans and Other Devices*

During the time when most state antitakeover statutes were assumed to be unconstitutional, companies developed firm-specific takeover defenses.¹⁶² The most effective of these defenses is a poison pill

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159. *Dynamics Corp.*, 481 U.S. at 91.

160. These stockholders hold stock as of the meeting's record date. See, e.g., DEL. CODE ANN. tit. 8, § 213 (Supp. 1988) (fixing record date for shareholders' voting rights).

161. The acquirer will hold the stock as of the meeting's record date, but is disqualified from voting under the control-share acquisition statute. See, e.g., IND. CODE ANN. § 23-1-42-9 (Burns Supp. 1988) (control shares must be given voting rights by a vote that "exclud[es] all interested shares").

162. More than 600 companies currently have poison pill plans in place. See *1988 Proxy Season Gives Shareholders a Mixed Bag*, IRRRC CORP. GOVERNANCE BULL., July-Aug. 1988, at 93.

plan.¹⁶³ Although companies aimed their poison pills primarily at unwanted public tender offers, private acquisition programs such as street sweeps can also trigger the pills.¹⁶⁴ Indeed, firms now routinely market poison pill plans to their shareholders precisely on the claim that they stop street sweeps.¹⁶⁵

A poison pill gives either stockholders or debtholders rights that are contingent on a large acquisition of the firm's stock, typically over 20%.¹⁶⁶ Although there are several kinds of poison pill plans, distinguished by the kinds of rights that vest following a triggering acquisition, the most effective are discriminatory "flip-in" plans.¹⁶⁷ Once triggered, such plans give all shareholders other than the triggering acquirer the right to purchase treasury shares at half the market price.¹⁶⁸ An acquirer foolish enough to trigger the plan would find its stock severely diluted, both in value and in voting power. Most large firms now have such plans in place.

Flip-in plans, however, are not foolproof. Much to the disappointment of Irving Bank Company, a New York trial court and an intermediate appellate court declared the Bank's flip-in plan unlawful.¹⁶⁹ In May 1988, Irving Bank resisted Bank of New York's tender offer by amending

163. See OFFICE OF THE CHIEF ECONOMIST, SEC, *supra* note 60, at 2 ("As an obstacle to hostile takeover attempts, the poison pill is unmatched except by dual-voting recapitalizations or direct majority share ownership by incumbent management.").

164. Examples are numerous. In 1988, Lucky Stores, Inc. responded to a takeover bid from American Stores Co. by adopting a warrant dividend plan expressly aimed at preventing a street sweep. See *Lucky Rejects American Stores Takeover Bid*, United Press International, Apr. 8, 1988. The rights plan gave American Standard shareholders the ability to exchange one share for five shares, paying less than market value for the new shares. *Id.* The Lucky Stores board later agreed to withdraw the plan if more than 50% of the company's shares were purchased in a tender offer, but would not withdraw the plan for any street sweeps. See *American Standard Says It Is in Talks to Be Bought for more than \$2.4 Billion*, Wall St. J., Mar. 14, 1988, at 3, col. 2; see also *John-Fluke Mfg. Co. Inc. Adopts Stockholder Rights Plan*, Business Wire, July 11, 1988 (describing Fluke's adoption of rights plan designed to discourage abusive takeover tactics); *Chemlawn Directors Reject Tender Offer*, PR Newswire, Mar. 5, 1987 (describing Chemlawn's adoption of a 120-day interim safeguard rights plan designed to deter street sweeps).

165. Texaco recently announced a poison pill plan designed to stop "coercive takeover tactics" like street sweeps. See *Cole, Texaco Sets New "Pill" to Block Takeovers*, N.Y. Times, Mar. 17, 1989, at D4, col. 1.

166. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 177 (Del. 1986) (Purchase Rights Plan for target's preexisting shareholders had trigger of 20% stock acquisition). See generally Yablon, *Poison Pills and Litigation Uncertainty*, 1989 DUKE L.J. 53, 57-60 (discussing mechanics of poison pill plans).

167. See OFFICE OF THE CHIEF ECONOMIST, SEC, *supra* note 60, at 9-16.

168. If shareholders have a right to redeem their stock at favorable rates, rather than a right to buy more common stock, the plan is known as a "back-end" plan. *Id.* at 13.

169. *Bank of N.Y. v. Irving Bank Corp.*, 536 N.Y.S.2d 923, 925 (Sup. Ct.) (flip-in plan impermissibly discriminates among shareholders of same class, in violation of N.Y. BUS. CORP. LAW § 501(c) (McKinney 1986)), *aff'd*, 143 A.D.2d 1074, 533 N.Y.S.2d 167 (1988). Back-end plans are also discriminatory, and *Irving Bank* would appear to condemn them as well.

its poison pill plan to prevent a street sweep.¹⁷⁰ Irving Bank had feared that Bank of New York would terminate its tender offer and begin open-market or privately negotiated stock purchases. As a result, Irving Bank added to its poison pill a "flip-in" provision that would be triggered once any purchaser acquired more than 20% of the Bank's stock.¹⁷¹ When the New York courts invalidated the provision, Irving Bank was unable to resist Bank of New York's outstanding tender offer.

Unlike the New York courts, Delaware's Supreme Court has approved discriminatory flip-in plans.¹⁷² The New York legislature has also responded to *Irving Bank*, passing legislation that explicitly approves flip-in poison pill plans.¹⁷³ Six other states have similar legislation.¹⁷⁴

In any event, other types of poison pill plans are also effective in stopping most street sweeps. Nondiscriminatory flip-over,¹⁷⁵ back-end,¹⁷⁶ and "repo"¹⁷⁷ poison pill plans, which are triggered by private acquisitions as well as tender offers, survive any challenge based on unequal treatment of shareholders. A flip-over plan, for example, gives all shareholders rights that can effectively block most second-stage business combinations between acquirer and target. Since many acquirers need full control of the target in order to service their acquisition financing, these plans can effectively thwart unwanted acquisitions.¹⁷⁸

I have previously disagreed with courts' use of equal-treatment analysis. See Oesterle, *The Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court*, 72 CORNELL L. REV. 117, 131-32 & 131 n.58 (1986).

170. See *Irving Alters Takeover Defense*, N.Y. Times, Mar. 29, 1988, at D5, col. 2.

171. *Irving Bank*, 536 N.Y.S.2d at 924.

172. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 177, 180-81 (Del. 1986).

173. See 1988 N.Y. LAWS ch. 743 (amending N.Y. BUS. CORP. LAW §§ 501, 505 (McKinney 1986)). This legislation also permits target boards to consider factors other than price to shareholders when evaluating bids. *Id.*

174. Hawaii, Idaho, Kentucky, Ohio, Pennsylvania, and Wisconsin have enacted such legislation. *New Jersey Moves Toward Poison Pill Bill*, INVESTMENT DEALERS' DIG., Feb. 27, 1989, at 3. New Jersey and Illinois are on the verge of passing such legislation. *Id.*

175. In the event of a second-stage merger, flip-over plans give target shareholders the right to purchase stock in the acquiring corporation, at an exercise price below market value. See OFFICE OF THE CHIEF ECONOMIST, SEC, *supra* note 60, at 9. See generally Yablon, *supra* note 166, at 58-59 (discussing flip-over plans).

176. See *supra* note 168. A nondiscriminatory back-end plan is similar to a flip-over plan in that the redemption right is triggered for all stock subject to exchange in a second-stage merger, that is, a merger following a successful tender offer for less than all of the outstanding stock.

177. In a "repo rights" plan, once an acquirer triggers the plan, shareholders receive a right to sell half their shares back to the company at a specified multiple of current market value after five years. See Metz, *Promoter of the Poison Pill Prescribes Stronger Remedy*, Wall St. J., Dec. 1, 1988, at C1, col. 3, C2, col. 3 (Martin Lipton describing "Share Price Protection Repurchase Rights").

178. Flip-in and back-end plans, however, are roughly twice as successful in completely stopping unwanted bidders. See OFFICE OF THE CHIEF ECONOMIST, SEC, *supra* note 60, at 23, 26 ("two-

With the exception of a few court decisions invalidating flip-in plans, most courts have decided that firms have the power to adopt poison pill plans without shareholder approval and that a board's decision to adopt such a plan is not a per se breach of its fiduciary responsibility.¹⁷⁹ A court will, however, evaluate the board's use of its plan when a hostile bidder does surface.¹⁸⁰ If the board successfully blocks a hostile bidder, or favors one bidder over another, the court might conclude that self-interest tainted the board's choice.¹⁸¹ As noted below,¹⁸² the ultimate effect of such court decisions is to allow target managers to influence an acquisition's form but not necessarily its success.

C. *The Effect of Antitakeover Statutes and Poison Pill Plans*

The effect of firm-specific defenses and state antitakeover statutes is to limit most acquisitions that remain unapproved by a target board to a share amount less than the triggering percentages. Following the acquisition, acquirers then make additional stock purchases that are contingent on target board approval and waiver of relevant firm and statutory defenses. To avoid the harsh effects of such defenses, an acquirer can mount a proxy contest to depose the target board and, if victorious, seek the new board's approval for additional acquisitions of target stock. This process, however, is expensive, time-consuming, and often unnecessary.

Usually the acquirer need only pressure the target board with an offer for a "friendly" acquisition. The acquirer releases to the public the amount that it is willing to pay above market price for the acquisition

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thirds of the 14 discriminatory cases [flip-in and back-end plans] resulted in total defeat [of the takeover contests], compared with only one-third of the 13 flip-over plans").

179. See, e.g., *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1356-57 (Del. 1985).

180. See *id.* at 1357 ("The ultimate response to an actual takeover bid must be judged by the Directors' actions at that time . . .").

181. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1986) (when bidders make similar offers, directors cannot fulfill fiduciary duties by playing favorites among contenders); *Grand Metro., Pub. Ltd. Co. v. Pillsbury Co.*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. ¶ 94,104, at 91,191, 91,195 (Del. Ch. Dec. 16, 1988) (target required to redeem pill despite its contention that price was inadequate); *City Capital Assocs. v. Interco Inc.*, 551 A.2d 787, 798-801 (Del. Ch. 1988) (requiring board to redeem poison pill and allowing shareholders to choose between managers' proposed restructuring and hostile bid); *Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1246 (Del. Ch.) (target company's defensive restructuring, which entrenched management, not protected by business judgment rule), *appeal dismissed*, 548 A.2d 498 (Del. 1988); *Tate & Lyle PLC v. Staley Continental, Inc.*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,764, at 98,585 (Del. Ch. May 9, 1988) (board must show "entire fairness of the transaction" in determination of propriety of directors' actions when directors act in self-interest); *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986) (self-interested corporate fiduciary who set terms of takeover will be required to establish transaction's fairness to court's satisfaction).

182. See *infra* notes 198-201 and accompanying text.

and conditions its offer on the target board's approval.¹⁸³ The board knows that if it refuses to agree but then cannot find another bidder or otherwise prop up the stock's value by radically restructuring the firm's capital, its stock will trade at levels below the price offered by the acquirer. This situation creates shareholder discontent, which naturally results in litigation, and in such cases judges have sided with bidders.¹⁸⁴ As a consequence, when a hostile bidder acquires close to 20% of a firm's stock, a takeover or radical recapitalization becomes almost inevitable.

A bidder can effectively pressure a target board into accepting its offer, by announcing a conditional tender offer.¹⁸⁵ The bidder offers a premium for a controlling block of target stock and conditions its acceptance of tendered stock on the target board's approval of the plan and waiver of firm-specific or statutory defenses. When a substantial number of target shareholders tender, the bidder puts irresistible pressure on the target board to approve the offer. If the target board refuses, it must face the discontent of those shareholders who tendered but could not sell their stock.¹⁸⁶

The SEC's tender offer definition, when combined with firm-specific and statutory defenses, has an aberrant effect: an acquirer who succeeds in pressuring a target board into approving its acquisition cannot thereafter

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183. Examples are numerous. Grand Metropolitan made a conditional tender offer for Pillsbury, and nearly three-fourths of the shareholders tendered. Gibson & Lublin, *Grand Met Says Pillsbury Offer Is 75% Complete*, Wall St. J., Nov. 10, 1988, at A3, col. 4. Grand Met then announced: "It is time for Pillsbury's management and board to act in accordance with the wishes of their shareholders." *Id.* at A3, col. 5. Pillsbury was later unable to justify in court its refusal to redeem the poison pill. *Id.* at A16, col. 5.

184. Professor Coffee concludes:

[A]ll Delaware Court of Chancery judges have reached a consensus: the poison pill can be used to run an auction, but not to block a non-coercive bid, at least not based simply on the prediction that share value will in time reach a level higher than the tender offer price.

Coffee, *Opinion*, 1 Mergers & Acquisitions L. Rep. (Computer L. Rptr.) No. 5, at 981, 987 (Jan. 1989).

Bass also demonstrates the trend toward making poison pill triggers lower and lower. In *Bass*, the board reduced the trigger from 30% to 15% once a hostile bidder appeared. *Bass*, 552 A.2d at 1232. As a consequence, managers are presently attempting to push the triggering thresholds down to 10% and lower.

185. For example, in the recent battle between Campeau and Macy's for control of Federated, Campeau conditioned its tender offer on the Federated board's redemption of its poison pill. See *Campeau Warns Allied of Action to Further Its Bid*, Wall St. J., Oct. 16, 1986, at 45, col. 1; cf. *BNS, Inc. v. Koppers Co.*, 683 F. Supp. 458, 461 (D. Del. 1988) (tender offer conditioned on a subsequent judicial holding that Delaware Business Combinations Act, DEL. CODE ANN. tit. 8, § 203 (1988), is unconstitutional).

186. At the vanguard of new defenses is an attempt to reverse the leverage of conditional offers. In December 1988, Santa Fe Corporation's board agreed *in advance* that it would redeem its poison pill only if a supermajority of its shareholders tendered to a hostile bidder. See Coffee, *supra* note 184, at 989. The board's stipulation thus delegates authority to redeem the pill to any minority shareholder group that can accumulate enough strength to block. *Id.*

ter mount a street sweep to consummate the deal. As a result of the publicity surrounding the acquirer's negotiations with the target board, the subsequent street sweep might be classified as an illegal tender offer under the Williams Act. To be safe, the acquirer must instead use a tender offer or some form of statutory merger or asset sale—methods that can take longer and cost more to execute. Interestingly, target boards probably favor this prohibition on street sweeps even in friendly deals; those boards commonly accept a takeover only on condition that a bidder agree not to use a street sweep.¹⁸⁷

In sum, state legislation and private defenses have effectively limited the use of street sweeps as a major acquisition tool, relegating them to a small table-setting role if used at all. Bidders make private purchases of target stock up to the triggering percentage of poison pills or state statutes and then proceed to make a public offer to the target board—an offer that the target board cannot afford to refuse.¹⁸⁸ This method is undoubtedly more expensive than a straight street sweep. Since the bidder cannot discriminate among sellers by price, it is unable to buy selectively from those shareholders willing to sell at a lower price than others. Also, public offers enable target shareholders to extract premium prices by making a collective response to the offer. The bidder thus faces a more formidable opponent in acquisition negotiations.

D. *Is the Impact of State Legislation and Poison Pill Plans on Street Sweeps Socially Harmful?*

Some commentators believe that state antitakeover legislation and poison pill plans are management protection plans.¹⁸⁹ In their view, incumbent managers use these devices, at shareholders' expense, to either block takeovers or extract bribes from successful acquirers. Proponents of this view have called for federal preemption of both devices.¹⁹⁰ In

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187. Cf. *Razorback Prepared to Increase Offer for Arkansas Best*, PR Newswire, May 23, 1988 (Razorback Acquisition Corp. made cash tender offer, asked Arkansas Best board to waive its pill plan, and offered not to undertake a street sweep once plan was withdrawn); *American Standard Disappointed that Black & Decker Will Not Join*, PR Newswire, Mar. 11, 1988 (American Standard offered to give Black & Decker confidential information on condition that Black & Decker agree not to engage in a street sweep).

188. If the FTC succeeds in closing the partnership loophole in the Hart-Scott-Rodino Act, see *supra* note 44, the Act will have much the same effect.

189. See, e.g., *Institutions Oppose Greenmail and Poison Pills 10-to-1*, IRRG CORP. GOVERNANCE BULL., Sept.-Oct. 1988, at 123 (institutional investors oppose poison pill plans); *Anti-Poison Pill Proposals Draw Strong Shareholder Vote*, IRRG CORP. GOVERNANCE BULL., May-June 1987, at 66 (institutional investors oppose poison pill plans).

190. See *SEC Should Have Authority*, *supra* note 136, at 1383 (SEC Chairman David Ruder expresses view that SEC should have rulemaking authority to preempt state antitakeover laws that jeopardize securities transactions on national markets).

contrast, supporters of state legislation and poison pill plans contrive to defend the devices, providing three basic justifications. Only one of these justifications, however, is compelling, and even it does not justify the prohibition of street sweeps.

Two of the theories offered to justify antitakeover defenses apply to street sweeps as well as to tender offers, but are less than convincing when applied to street sweeps. First, the discount theory claims that the stock market can fail to price securities accurately in light of all *public* information.¹⁹¹ Thus, target managers ought to protect shareholders from hostile acquirers when the market has "underpriced" the target stock. Second, the redistributional theory claims that target shareholders and acquirers can collaborate to alter long-term promises between the firm and other corporate constituencies, principally management and nonmanagement employees.¹⁹² Target managers ought to intercede, under this view, to protect the nonshareholder constituencies from shareholder opportunism.¹⁹³ Otherwise, the cost of contracting with these constituencies will rise, eventually reducing the value of all firms.¹⁹⁴

The discount theory is not fully convincing. It lacks a cogent explanation of why discounts can occur in a liquid market,¹⁹⁵ and even if such an explanation could be developed, neither target managers nor acquirers necessarily identify with any accuracy when such discounts occur. Since target managers are inherently biased, in their view the stock's market value will always underestimate the firm's true worth (as well as the target managers' efforts). Acquirers, moreover, often miscalculate merger gains.¹⁹⁶

The redistributional theory is not convincing either. The theory assumes that important contracts between a firm and nonshareholder constituencies are not enforceable in court once breached. However, courts enforce even the most undefined contracts under an evolving doctrine of

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191. For a summary of the evidence, see Kraakman, *Taking Discounts Seriously: The Implications of "Discounted" Share Prices as an Acquisition Motive*, 88 COLUM. L. REV. 891 (1988). Excluded is the case in which insiders have valuable confidential information about a target firm. In most cases, insiders can protect themselves from takeovers based on stock prices that do not include the value of the confidential information by simply revealing the information to market participants. See *id.* at 909.

192. For an application of this view, see Coffee, *supra* note 10, at 91. I have written elsewhere to disagree. See Oesterle, *supra* note 144.

193. See Coffee, *supra* note 10, at 92-93.

194. See *id.*

195. We might be witnessing current shortcomings in our econometric modeling rather than shortcomings in our theory of efficient markets.

196. See generally OFFICE OF THE CHIEF ECONOMIST, SEC, DO BAD BIDDERS BECOME GOOD TARGETS? (1988) (indicating that firms making poor acquisitions are themselves likely to become takeover targets).

good faith.¹⁹⁷ The theory also assumes that contracts will lack express provisions that could serve as liquidated damage clauses, but a simple severance clause will often suffice for that purpose. Finally, the theory surely does not rectify the problem of contract enforcement by broadly delegating to all target managers the power to block or hinder takeovers. Such delegations merely allow target managers to behave opportunistically, extracting payments from acquirers that ought to go to shareholders. The cure becomes worse than the disease.

The third justification for these antitakeover devices makes the modest claim that dispersed target shareholders are at a distinct disadvantage in negotiating with bidders.¹⁹⁸ This claim takes two alternative forms: first, shareholders are at an informational disadvantage; second, even if they are not at an informational disadvantage, bidders can still take advantage of their inability to act collectively.

Since public offerors make substantial public disclosures, this collective-action argument provides the most common justification for poison pills and state legislation affecting tender offers. According to this argument, unless shareholders coordinate their response to a public bid, a bidder can front-end load its bid and coerce individual shareholders to sell when, acting collectively, they would hold out for a higher price. The bidder's ability to pressure shareholders depends on a communication that the offer is limited in time and for an amount substantially greater than the future value of any nontendered shares. Such a communication will pressure a shareholder, even if convinced that the offer is too low, to sell anyway, because of fear that enough other shareholders will sell to make the offer successful and thus leave that shareholder in an inferior back-end position. According to the collective-action argument, shareholders can break this pressure by coordinating their decisions to sell and empowering managers to act as bargaining agents.

Street sweeps, however, present an exception. In an open-market purchase program that complies with SEC directives, a bidder cannot threaten market participants that they must sell or suffer the back-end price. The bidder cannot create the pressure to sell that characterizes a tender offer. Privately negotiated purchase programs, in which the bidder approaches a few institutional investors and arbitrageurs with an of-

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197. See generally Hillman, *An Analysis of the Cessation of Contractual Relations*, 68 CORNELL L. REV. 617, 629-42, 645 (1983) (courts consider such things as comparative equities, harm avoidance, reasonableness, reciprocity, etc., when enforcing undefined contracts).

198. See Oesterle, *supra* note 169, at 124-31 (target managers might be best agents for shareholders' negotiation with bidders: managers might know more about the company's value; using them provides alternative to coercion of front-end-loaded tender offer; and other methods might lead to leaks of confidential information in process of informing shareholders).

fer to buy their stock, do allow bidders to try to create selling pressure by distinguishing front-end and back-end prices, but those sellers are small in number and highly sophisticated, and they have much less trouble in acting collectively to establish a unified answer. Thus, most true street sweeps (street sweeps not following publicly announced tender offers) lack the potential for the level of shareholder coercion that is present in tender offers. Indeed, evidence from recent street sweeps seems to support the conclusion that prohibitions on street sweeps are not necessary to protect shareholders from coercion: shareholders who did not sell in street sweeps invariably fared better than those who did sell.¹⁹⁹

Furthermore, prohibitions on street sweeps have no value to shareholders. One might justify state legislation and poison pill plans directed at unpublicized street sweeps, because those sweeps place shareholders at an informational disadvantage in bargaining with potential bidders. In such street sweeps, shareholders sell without knowledge that a takeover is underway and often lack the ability to demand disclosures in the bargaining process. Ideally, selling shareholders would like to know why any particular buyer solicits their shares. Such information might have only marginal value: if the purchaser's disclosure contains merely an evaluation of public information, the disclosure might change the sellers' evaluation of the same information but usually will not. Other information, however, ought to change how shareholders evaluate their stock. If the buyer discloses its intention to buy the firm, the selling shareholder might revalue its stock at a higher price.

Of course, the buyer will not disclose its intentions unless forced to do so in order to close the deal. Theoretically, large shareholders have some bargaining power to demand that the buyer disclose its intentions, because a block sale would save the buyer significant transaction costs and few large blocks exist. In practice, however, even large shareholders have only a limited ability to demand disclosure, and small individual shareholders have no such ability. If the small shareholder requests disclosure and refuses to sell without it, the buyer can simply turn to other shareholders who do not demand disclosure. The collective action problem again works to the shareholders' disadvantage. All small shareholders might want to demand disclosure, but each is convinced that it will be left out if it refuses to sell when the buyer refuses to disclose.

In sum, state legislation and poison pill plans can force bidders to disclose their intentions and bargain with shareholders as a group. Whether a potential target should force disclosure requires that a target balance potential gains from bargaining for higher prices against poten-

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199. See *supra* note 28 and accompanying text.

tial losses from deterring potential bidders. One could argue, perhaps, that the evidence noted above—that shareholders who hold in street sweeps do better than those who sell²⁰⁰—implies that forced disclosure is in the shareholders' best interests. (The higher value of the nonsellers' stock reflects the publicity following a successful street sweep.) As also noted above,²⁰¹ however, the shareholders' problem is not only the difficulty of assessing costs and benefits, but also the identity of those calculating the balance: target managers are not disinterested decisionmakers.

V. COMMENTS ON CURRENT REGULATORY PROPOSALS

Five bills that prohibit or restrict street sweeps have recently been introduced in Congress. Four of the bills require that all acquisitions of substantial amounts of stock be undertaken through tender offers regulated by the Williams Act.²⁰² Two of the bills prohibit a frustrated tender offeror from acquiring any stock within thirty days of the offer's termination.²⁰³ In addition, two rules proposed by the SEC would prohibit anyone from mounting a street sweep within ten days of the sched-

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200. *See id.*

201. *See supra* pp. 213-14.

202. Senator Proxmire (D-Wis.), Chairman of the Senate Banking Committee, introduced a bill that would require any bidder wishing to purchase more than 15% of a company's outstanding stock to do so only through a tender offer regulated by the Williams Act. *See* S. 1323, 100th Cong., 1st Sess. § 7, 133 CONG. REC. S7594-95 (daily ed. June 4, 1987). The bill was reported out of committee. S. REP. NO. 100-265, *supra* note 12, at 4-5 (1987). A bill introduced by Reps. Dingell (D-Mich.) and Markey (D-Mass.), among others, would have lowered the threshold acquisition to 10%. *See* H.R. 2172, 100th Cong., 1st Sess. § 13 (1987), *reprinted in Tender Offer Reform (Part 1): Hearings Before the Subcomm. on Telecommunications and Finance of the House Comm. on Energy and Commerce on H.R. 2172*, 100th Cong., 1st Sess. 26-28 (1988). Senator D'Amato (R-N.Y.) introduced a bill that would prohibit a 20% owner from any further large-scale open-market purchases, which are defined as acquisitions of over 2% within a 12-month period. S. 227, 100th Cong., 1st Sess. sec. 4(a)(7), § 78n(i), *reprinted in Regulating Hostile Corporate Takeovers: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs on S. 227, S. 678, S. 1264, S. 1323, and S. 1324*, 100th Cong., 1st Sess. 9-11 (1987) [hereinafter *Senate Banking Committee Hearings*].

These bills follow the example set by the "dawn raid" rules in England. *See* DeMott, *Current Issues in Tender Offer Regulation: Lessons From the British*, 58 N.Y.U. L. REV. 945, 975-82 (1983) (regulations on offers affect all acquisitions of 5% or more of a target's shares in a seven-day period if after the acquisition acquirer will have 15% or more of the outstanding stock). The dawn raid rules, however, allow a choice that these bills do not. The rules permit qualifying acquisitions to be made either through a partial tender offer or through a regulated offer on a national stock exchange. *Id.* at 975. The regulated offer must be open for seven days and may be at a "maximum price." *Id.* at 976. The rules allow bidders to fill oversubscribed maximum price bids by accepting the lowest bids first, thus allowing some price discrimination. *Id.* at 976.

203. Both S. 1324, introduced by Sen. Sanford (D-N.C.), and H.R. 2668, introduced by Rep. Lent (R-N.Y.), would prohibit any bidder who has terminated a tender offer from acquiring any additional shares within 30 days after the public offer's termination. S. 1324, 100th Cong., 1st Sess. sec. 9(a)(1), § 78n(d)(3)(D), *reprinted in Senate Banking Committee Hearings, supra* note 202, at 58-59; H.R. 2668, 100th Cong., 1st Sess. § 105, *introduced*, 133 CONG. REC. H4558 (daily ed. June 11, 1987).

uled expiration of a tender offer for 10% or more of the stock.²⁰⁴

The SEC proposal is ostensibly a compromise. It does not prohibit all street sweeps, but fills one of the gaps in the SEC's current position against publicized street sweeps.²⁰⁵ As noted above,²⁰⁶ a tender offer an-

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204. Proposed Rule 14d-11(b) attaches a long cooling-off period if a bidder commences a tender offer by public announcement under Rule 14d-2(b). SEC Release 34-24,976, *supra* note 13, at 1554. Under subsection (b) of the proposed Rule, a bidder's acquisition of 10% or more of a target's stock must comply with the Williams Act, until 30 days after the announcement's withdrawal. *See id.* Paragraph (c) of the proposed Rule provides four exceptions: (1) offers or sales of more than a 5% interest in a target if acquired by the shareholder more than one year prior to the offer or sale; (2) binding contracts of sale entered into before the tender offer's announcement; (3) purchases pursuant to a merger agreement approved by shareholders; and (4) purchases directly from the issuer. *Id.*

Similar restrictions apply to issuer affiliate repurchases during a tender offer. The cooling-off period, however, is slightly shorter—ten days. *See* Release 34-24,976, *supra* note 13, at 1553-54 (proposed Rule 13e-2(b)). The exceptions are the same as provided for in proposed Rule 14d-11, except that purchases from the issuer, in order to fall within the exception, must have been approved in advance by the required vote under state law. *See id.* at 1554 (proposed Rule 13e-2(c)(1)).

The proposals stemmed from a concept release issued by the SEC in July 1986. *See* Concept Release on Takeovers and Contests for Corporate Control, Exchange Act Release No. 34-23,486, 18 Sec. Reg. & L. Rep. (BNA) No. 32, at 1187 (July 31, 1986) [hereinafter Release 34-23,486]. This release sought comments on whether the SEC should take any action to modify two court of appeals decisions that had permitted street sweeps, *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945 (9th Cir. 1985), and *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985). *See* Release 34-23,486, *supra*, at 1188-89.

The American Bar Association's Federal Regulation of Securities Committee's Subcommittee on Proxy Solicitations and Tender Offers responded by arguing that the SEC was not authorized to adopt the proposed rules. *Lawyers Challenge Proposed "Sweep" Rules as Beyond SEC's Jurisdiction*, 20 Sec. Reg. & L. Rep. (BNA) No. 1, at 14 (Jan. 8, 1988). Moreover, the ABA subcommittee argued that a "carefully designed" definition of a tender offer would address many of the SEC's concerns, thus renewing the bar's oft-heard request for a concrete definition. *Id.*

The length of the cooling-off period also received critical comment. The New York Bar Committee on Securities Regulation stated that the period was far too short and should be extended to thirty days. *SEC Should Increase Cooling-Off Period for Sweeps, N.Y. Bar Says*, SEC. WK., Dec. 14, 1987, at 5; *see also* Letter from John W. Hetherington, Chairman of the Tender Offer Committee of the American Society of Corporate Secretaries, to SEC (Dec. 10, 1987) (copy on file in offices of the *Duke Law Journal*) (cooling-off period should be at least 30 days). The ABA subcommittee, on the other hand, argued that the 10-day period was too long and should be shortened to two days. *SEC Proposal to Curb Street Sweeps Is Misguided, ABA Group Says*, SEC. WK., Jan. 18, 1988, at 12.

205. In refusing to follow the format of the pending bills, the SEC rejected the advice of its Advisory Committee on Tender Offers. The Committee proposed the following language: "No person may acquire voting securities of an issuer, if, immediately following such acquisition, such person would own more than 20% of the voting power of the outstanding voting securities of that issuer unless such purchase were made (i) from the issuer, or (ii) pursuant to a tender offer." SEC ADVISORY COMM. ON TENDER OFFERS, REPORT OF RECOMMENDATIONS recommendation 14, at 23, reprinted in 15 Sec. Reg. & L. Rep. (BNA) No. 28, at 1375, 1376 (July 8, 1983).

In its release announcing the proposed rules, the SEC noted that the pending bills "would go far beyond regulating these unconventional tender offers . . . to [a] regulation of transfers of control, regardless of whether a tender offer, conventional or unconventional, is involved." Release 34-24,976, *supra* note 13, at 1545, 1546 n.6. Commissioner Cox was more specific in his criticism of the bills. He argued that the proposals would impose "significant costs on both purchasers and sellers of blocks of shares, regardless of whether any change of control was involved." *Cox Opposes Requiring Bidders to Use Tender Offers for Large Acquisitions*, 19 Sec. Reg. & L. Rep. (BNA) No. 16, at 548,

nouncement attracts speculators and leads to consolidation of the target stock in the hands of large investors. If the tender offer fails or is withdrawn, the conditions are ripe for a street sweep. Since, in the SEC's view, the injustices of publicized street sweeps are the same as those of an unregulated tender offer prior to the Williams Act, a bidder who uses a street sweep after a terminated tender offer frustrates the purposes of the Act.²⁰⁷ Worse yet, SEC officials worry that bidders will eventually avoid the Williams Act's regulations by making sham public tender offers only to prepare the market for a subsequent street sweep.²⁰⁸ Although a bidder using a tender offer, sham or real, must comply with the Williams Act's rather substantial disclosure requirements, the bidder can avoid the stringent form requirements that the Act imposes on the offer itself.

The current proposal thus employs two regulatory models: (1) a model that requires all large-scale acquisitions of outstanding stock to take the form of tender offers that comply with the Williams Act, and (2) a model that requires all publicized (but not private) large-scale acquisitions of outstanding stock to take the form of tender offers that comply with the Williams Act. An evaluation of either model must begin with an evaluation of the Williams Act.

Some commentators believe that the Williams Act should be re-

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549 (Apr. 17, 1987) (Address by Commissioner Cox at the Annual Business Conference of Association for Corporate Growth, Naples, Fla. (Apr. 6, 1987)).

The SEC has long prohibited any market purchases by issuers for ten days after termination of an issuer tender offer. See Rule 13e-4(f)(6), 17 C.F.R. § 240.13e-4(f)(6) (1988). Moreover, in 1979 the SEC proposed a similar prohibition for third-party bidders, but never carried through on the proposal. See Release 34-16,385, *supra* note 80, at F-10 to -12, F-15 to -16. The current SEC proposal might also be stillborn. Though the comment period has expired, the SEC has said nothing further about the proposed rules.

The SEC may just be playing politics. One could argue, for example, that the SEC is cleverly doing just what the Advisory Committee recommended: leaving the prohibition of naked street sweeps to the Hart-Scott-Rodino Act, see *supra* notes 43-44, and prohibiting only what is left. Thus, the SEC can argue that it has a "compromise" or "balanced" approach to the controversy, when in fact it does not.

206. See *supra* note 20 and accompanying text.

207. Release 34-24,976, *supra* note 13, at 1545-46. For a summary of the views of the SEC commissioners and staff, see *SEC to Propose Rules Aimed at Curbing Market Sweeps That Skirt Williams Act*, 19 Sec. Reg. & L. Rep. (BNA) No. 37, at 1384 (Sept. 18, 1987). The proposals passed four-to-one, with Commissioner Cox dissenting on the grounds that there was inadequate evidence to justify the proposal. *Id.* at 1385. The staff also split on the vote: the divisions of Market Regulation, Corporation Finance, and Enforcement supported the proposal, while the Office of the Chief Economist opposed the proposal. *Id.*

208. Acting SEC Chairman Charles C. Cox stated: "Market sweeps could render the tender-offer process a sham device to concentrate shares in relatively few hands, where they can be acquired without the costs and competitive risks of complying with the tender-offer rules." Bianco, Crock & Tell, *supra* note 36, at 72.

pealed and presumably would reject both regulatory models.²⁰⁹ In their view, a street sweep makes a justified end-run around the Williams Act's unnecessary and inefficient restrictions on tender offers.²¹⁰ Some commentators go further, arguing that governmental regulation of street sweeps is appropriate, if at all, only to disable states or target firms from erecting their own street sweep defenses.²¹¹ These commentators think the federal government or federal courts should preempt state antitakeover legislation and bar firm-specific takeover defenses. They premise their argument on the positive effect of hostile takeovers in policing the managers of potential target firms (in essence, all firms).²¹² If managers were more responsible, stock prices across the board would be higher and diversified shareholders would be better off.

Williams Act supporters focus on one or both of the Act's two goals. Indeed, opinions on the congressional bills and SEC proposals are tied to which of these goals one accepts as legitimate. The Act's first goal is to enable target shareholders to evaluate an offer's merits more effectively. The Act thus requires disclosures by bidders and relaxes deadline pressure.²¹³ The provisions mandating a minimum offering period, withdrawal periods, and pro rata acceptance for oversubscribed offers all act to delay any tender offer's closing date in order to ensure that target shareholders have time to consider and act on the offer's merits.

The goal of protecting shareholder evaluation, however, does not justify the SEC's proposed rules, which prohibit street sweeps that follow on the heels of a canceled tender offer. Upon a tender offer's announcement, the bidder files the disclosure documents required by the Williams Act, and all shareholders therefore have time to consider whether to sell

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209. To commentators with this perspective, the Act unfortunately forces firms to use, at increased cost perhaps, street sweeps instead of unregulated tender offers. For an example of this view, one need only turn to the editorial page of the *Wall Street Journal*:

We called this regulation-sidestepping maneuver [the Hanson Trust street sweep] the Williams Act two-step.

The most likely explanation for the SEC's hostility to this tactic is that it resents the market's discovery of a way around the regulators. Regulation that interferes with the free market for no reason is bad policy. This regulation for its own sake could lead people to wonder whether, on the whole, the SEC does more harm than good.

The Hyperactive SEC, *supra* note 51, at 32, col. 1; see also *The Arbs' Best Friend*, *supra* note 20, at 32, col. 1 (arguing for repeal of the Williams Act).

210. *The Hyperactive SEC*, *supra* note 51, at 32, col. 2.

211. See, e.g., Davis, *Epilogue: The Role of the Hostile Takeover and the Role of the States*, 1988 WIS. L. REV. 491, 509-15, 522 (arguing for some form of federal preemption of state laws on tender offers). But see Macey, *supra* note 144, at 487-90 (arguing that federal law might be worse than the state law it preempts).

212. See, e.g., COUNCIL OF ECONOMIC ADVISERS, ECONOMIC REPORT OF THE PRESIDENT 198-99 (1985) ("restraints on takeover activity can protect inefficient managers from the discipline of the marketplace").

213. See *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 79-80 (1987).

at the tender offer price. Only if a tender offer were announced and immediately cancelled would time pressure be a significant concern in a follow-up street sweep, but such cases are rare and perhaps even nonexistent. A successful street sweep also depends on arbitrageurs, and arbitrageurs must have some time after a tender offer's public announcement to enter the market. Even if the cancelled tender offer price and the follow-up street sweep price differ significantly, the fact that the firm has been in play and under careful market analysis for some time as a takeover candidate avoids any need for extended consideration of the new price.

Moreover, the SEC proposal has a gaping hole. Under Rule 14d-2(c), a press release announcing that a bidder intends to make a tender offer for a specific target does not "commence a tender offer" as long as the release does not disclose the price and quantity of securities sought.²¹⁴ Thus, the bidder could carefully soften the market with such a press release under Rule 14d-2(c) and then, perhaps based on the target board's defensive maneuvers, announce that it had changed its mind and undertake a street sweep. Of course, the bidder could not disclose its intention to engage in a street sweep in announcing the tender offer's cancellation, because the SEC would characterize such a disclosure as a public solicitation and therefore an unconventional tender offer in violation of the Williams Act.

The Act's second goal, which is independent of and not necessary to the first, is to protect shareholder equality in control changes.²¹⁵ Bidders must include all shareholders in an offer, must accept oversubscribed offers pro rata, may not purchase in the markets during an offer's pendency, must give any price increases to all those who tendered before the increases, and must legally commence their tender offer on the date of the first offer-specific public announcement.²¹⁶ Moreover, the Act prevents those who tender from avoiding the pro rata limitations through short tenders or hedged tenders.²¹⁷ These provisions prohibit price dis-

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214. See *supra* note 88 and accompanying text. If a bidder adds information on the identity of the securities sought and the price, then the announcement starts a tender offer. See Rule 14d-2(b)-(c), 17 C.F.R. § 240.14d-2(b)-(c) (1988). The proposed rule would stop all large acquisitions within 30 days of the cancellation of a tender offer that had been so announced. Release 34-24,976, *supra* note 13, at 1554 (proposed Rule 14d-11(b)(2)).

215. See SEC All-Holders and Best Price Rules for Tender Offers, Exchange Act Release No. 34-23,421, 18 Sec. Reg. & L. Rep. (BNA) No. 29, at 1078, 1079 (July 11, 1986) (discussing policies behind Rule 14d-10, the all-holders rule).

216. See *supra* notes 67-73 and accompanying text.

217. Rule 10b-4, 17 C.F.R. § 240.10b-4; see Final SEC Rule Amendments on Short Tendering, Exchange Act Release No. 34-20,799, 16 Sec. Reg. & L. Rep. (BNA) No. 14, at 628 (Mar. 29, 1984) (to combat hedged tendering, "amendments will impose additional ownership requirements for persons tendering securities in response to tender offers"); Proposed Amendment to SEC Rule 10b-4,

crimination among shareholders once a tender offer has begun, arguably to protect small shareholders who otherwise could not command the premiums that large shareholders could command.²¹⁸ The Act's shareholder equality goal, however, is much less defensible than the shareholder evaluation goal.

The protection of shareholder equality in large stock acquisitions is the driving force behind the bills pending in Congress to outlaw all street sweeps. Shareholder equality also motivates the SEC's proposed rules. The bills, if passed, would force bidders to make all large-scale stock acquisitions through tender offers in order to protect the right of all shareholders to participate in an acquisition and claim a part of the acquisition premium. The SEC's proposed rules are, in effect, not far removed from the bills. The SEC designed the rules to shore up the most significant leak in its policy of prohibiting publicized street sweeps, a policy that covers nearly all street sweeps anyway.

The debate over an equal-opportunity rule for shareholders has a long history.²¹⁹ Caselaw, with the exception of the now discredited *Perlman v. Feldmann*,²²⁰ rejects the rule.²²¹ Only in the SEC's implementa-

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Exchange Act Release No. 34-14,157, [July-Dec.] Sec. Reg. & L. Rep. (BNA) No. 428, at E-1 (Nov. 16, 1977) ("the proposed amendments would provide definitions, and substantive antifraud provisions for the purpose of protecting investors" from short tendering); Adoption of Rule 10b-4 Under the Exchange Act of 1934, Exchange Act Release No. 8321, [1967-1968 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,558, at 83,184 (May 28, 1968) (explanation of Rule 10b-4, prohibiting short tendering).

218. See Schwartz, *Editor's Headnote to Block & Schwarzfeld*, Curbing the Unregulated Tender Offer, 6 SEC. REG. L.J. 133, 133-35 (1978). The facts of *Swanson v. Wabash*, 577 F. Supp. 1308 (N.D. Ill. 1983), are illustrative. In *Swanson*, target shareholders charged that an acquiring company violated Rule 10b-13 by purchasing stock options from target executives and stock from selected shareholders on terms that differed from the price in the pending tender offer. *Id.* at 1316. The executives received tax bonuses as compensation for taxes they had to pay on the sale of their options, and some larger stockholders were allowed to postpone sale of their stock in order to qualify for long-term capital gains treatment. *Id.* The court held that the claims stated a valid cause of action. *Id.* at 1316-17.

219. See Hazen, *Transfers of Corporate Control and Duties of Controlling Shareholders—Common Law, Tender Offers, Investment Companies—and a Proposal for Reform*, 125 U. PA. L. REV. 1023, 1024-26 (1977) (citing authorities); see also R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 588-624 (1986) (citing and partially reprinting authorities).

220. 219 F.2d 173, 178 (2d Cir. 1955) (under Indiana law, controlling shareholders' sale of control to potential customer is equivalent to appropriating a corporate asset for their own benefit).

221. See ALI, *PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS* § 5.11 comment c, at 163 (Tent. Draft No. 3, 1984) (rejecting "the rule proposed by some commentators, but not supported by judicial decisions, that a controlling shareholder must share with other shareholders any premium received from a sale of a controlling block of shares or provide an opportunity for all shareholders to sell their shares on the same terms"). Both the Second Circuit and the Indiana courts have rejected any broad reading of *Perlman*. See *Essex Universal Corp. v. Yates*, 305 F.2d 572, 576 (2d Cir. 1962) ("A fair generalization from [*Perlman*] may be that a holder of corporate control will not, as a fiduciary, be permitted to profit from facilitating actions . . . which are detrimental to the interests of the . . . shareholders."); *Yerke v. Batinan*, 176 Ind. App. 672, 678-

tion of the Williams Act and some state antitakeover legislation does the principle have a broad application. The language of the Williams Act itself contains no equal-opportunity rule. Despite that fact, the steady addition of rules has established an equal-opportunity requirement for tender offers. The SEC proposal for street sweeps is simply an extension of this unfortunate tradition.

The statutory language of the Williams Act does not require that all tender offers for more than 5% of any equity security registered under section 12 of the Securities Exchange Act of 1934 go to all shareholders, nor does the Act prohibit a tender offeror from privately buying shares during a tender offer. The SEC added those obligations by rule.²²² The statute requires only that all shareholders be allowed to participate proportionately in oversubscribed offers and that all receive the highest price offered to any shareholder.²²³ The provision on proportionate participation is necessary not as an equal-opportunity rule, but to relieve deadline pressure on target shareholders. A minimum offering period does not relieve a rush to tender if at the end of the period the bidder accepts stock on a first-tendered basis. The provision on price increases also encourages shareholders to tender during the offer period rather than wait until the last minute before the offer expires.

Absent SEC regulatory interference, a bidder could comply with the Act even if it purchased stock outside the tender offer before, during, and after the tender offer and at prices differing from the tender offer price. The Act's language also allows a bidder to discriminate among shareholders in the tender offer itself.²²⁴ The theory of the Williams Act, absent SEC rules, could be solely to slow down tender offers and mandate disclosures *once a bidder has chosen to make a public offer*, and nothing more.

The SEC, however, has characterized purchases before a tender offer as unconventional tender offers,²²⁵ prohibited private purchases during a tender offer, and now seeks to prohibit private purchases for ten days after a tender offer. The SEC has also prohibited discrimination

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79 & 678 n.1, 376 N.E.2d 1211, 1215 & n.1 (1978) (majority shareholder who was also corporate director and officer had no fiduciary duty to minority shareholders in sale of control, absent fraud or action detrimental to the corporation; distinguishing *Perlman* as case involving sale of control that was "not . . . in the best interest of the corporation").

222. See *supra* notes 71, 73 and accompanying text.

223. Securities Exchange Act of 1934, § 14(d)(6)-(7), 15 U.S.C. § 78n(d)(6)-(7) (1982).

224. Section 14(d)(7)'s best-price rule does not literally require inclusion of all shareholders in any one tender offer. One could comply with the statute by excluding some shareholders from a tender offer completely or by making two tender offers at different prices for mutually exclusive groups of shareholders.

225. See *supra* notes 91-116 and accompanying text.

among offerees. The only methods of price discrimination that remain, assuming the SEC adopts its street sweep proposals, would be private acquisitions before a tender offer that do not qualify as tender offers, successive private purchases and tender offers at various prices that the SEC does not integrate,²²⁶ and private purchases more than ten days after a tender offer that do not qualify as an unconventional tender offer. The congressional bills are more straightforward; they just prohibit acquisitions outside of tender offers and apply the equal-opportunity rule to all large acquisitions of registered stock.

Thus, at the core of the SEC street sweep proposals and the pending congressional bills is an extension of the equal-opportunity rule to protect shareholders in acquisition targets. Professors Easterbrook and Fischel have directly challenged rules that require the gains in control transactions to be shared.²²⁷ They argue that target shareholders would prefer a rule that allowed unequal division of control acquisition gains if the total gains produced in such acquisitions were maximized in the aggregate, regardless of how the gains were distributed in any one transaction.²²⁸ Through diversification, according to their view, shareholders can eliminate the risk of adverse discrimination in any one control transaction and enjoy a proportionate share of the larger aggregate gains that such a rule would produce, a share that would exceed their share of the gains under an equal-division rule.²²⁹

Arguments favoring an unequal division of control transaction gains must answer two charges. First, some might claim that unequal-division rules would consistently advantage insiders and that small shareholders would be unable to diversify against such a systematic risk.²³⁰ Second, others might claim that if an unequal-division rule produced aggregate gains exceeding those produced by an equal-division rule, then that merely shows a broader problem in need of correction. According to this

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226. This characterization can be tricky if a bidder announces and withdraws a tender offer before attempting to close the private acquisition. See *Field v. Trump*, 850 F.2d 938, 944 (2d Cir. 1988) (after withdrawal of one offer and commencement of second offer, bidder cannot privately purchase target stock unless withdrawal is genuine when announced), *cert. denied*, 109 S. Ct. 1122 (1989). The bidder presumably cannot plan to use a series of partial tender offers at increasing prices to buy stock in a target without disclosure of the plan in its Schedule 14D. Disclosure would probably defeat the program, because the SEC would integrate the offers.

227. Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 698-700 (1982).

228. *Id.* at 711-14. Recent empirical evidence suggests that transfer of control at a premium benefits minority shareholders, a finding that supports the Easterbrook and Fischel thesis. See Holderness & Sheehan, *The Rate of Majority Shareholders in Publicly Held Corporations: An Exploratory Analysis*, 21 J. FIN. ECON. 317, 327-33 (1988).

229. Holderness & Sheehan, *supra* note 228, at 327-33.

230. See, e.g., Brudney, *Equal Treatment of Shareholders in Corporate Distributions and Reorganizations*, 71 CALIF. L. REV. 1072, 1099-102 (1983).

second charge, unequal-division rules would produce gains only if the law were lax and allowed insiders to exploit their control positions to the detriment of other shareholders.

When the SEC proposed its rules on street sweeps, it was motivated by a belief that small shareholders could not diversify against the systematic risk of unequal division. Small shareholders, the SEC argued, were always left out of street sweeps, because bidders only solicited large shareholders.²³¹ The SEC's belief, however, is counterfactual. Stock rapidly accumulated by arbitrageurs in street sweeps must come from non-insiders and often represents an aggregation of shares from many small shareholders. With various arbitrageurs bidding for stock, the competition will cause some of the premium to be filtered down to small shareholders. Shares accumulated by buyers through aggressive open-market purchase programs also can come from small shareholders, and issuers will most likely compete with arbitrageurs for the trading, thus driving prices up and filtering down some of the acquisition premiums. Moreover, if small shareholders know that they are unable to respond quickly to market pressure to sell in street sweeps, that is, if they do not watch the market with enough vigilance to take advantage of street sweeps, they can diversify by holding shares in investment firms that are vigilant on their behalf. These investment firms in turn become the large shareholders that bidders solicit in street sweeps, and those firms can therefore command higher stock prices. Indeed, if the existence of street sweeps convinces small shareholders to diversify appropriately through financial intermediaries, then sweeps have a hidden benefit.

In addition, it is hard to see how a rule that channels all acquisitions into tender offer form can help small shareholders. Consider those small shareholders who do not watch the market. In tender offers, only those who know enough to tender or sell to an arbitrageur during a tender offer get a proportionate share of the tender offer premium. Evidence shows that between 3% and 5% of target shareholders never tender,²³² presumably because they have not taken steps to keep informed. Perhaps the SEC could argue that in tender offers, small shareholders have a better chance of participating: because in a tender offer shareholders get individualized mailings and have more time to respond, some small shareholders who do not follow the market in the newspapers will get jolted into action. One can only speculate, however, on the size of this group.

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231. Release 34-24,976, *supra* note 13, at 1546.

232. Letter from SEC Commissioner Joseph A. Grundfest to David A. Brown — (Dec. 18, 1987), reprinted in C. SMITH & C. FURLOW, GUIDE TO TAKEOVER LAW OF DELAWARE 179, 184 (1988).

Those small shareholders who do watch the market might sell *before the tender offer is announced* to the issuer who is acquiring its 5% stake or to arbitrageurs who detect the upcoming offer. An SEC study has gathered evidence demonstrating that shareholders gain up to half the tender offer premium before a tender offer's announcement.²³³ The SEC study found that average trading volume in the stock of a firm later subject to a tender offer increases as early as ten days before the offer's public announcement, rises to three times normal two or three days before the announcement, and five times normal one day before the announcement.²³⁴ As pre-announcement prices rise, shareholders with superior information sell. This pre-offer trading must come at the expense of small shareholders, as the larger players enter the market early based on superior information. In sum, small shareholders might not fare significantly better in tender offers than they do in street sweeps.

An equal-treatment rule designed to protect small shareholders is not an unqualified good.²³⁵ Such a rule allows small shareholders to benefit from gains created by others *outside* the firm itself (although not from insider trading). Bidders create information (i.e., that they will bid), and speculators with superior market-monitoring capabilities first disclose that information. Both bidders and speculators invest resources in order to create or discover such information in the trading markets. If we allow small shareholders to free-ride on these investments, under the rubric of equal protection, then bidders and speculators will underinvest, and the entire stock market will be poorer as a result. Not only will the market's price discovery function be compromised, but investors will also have less incentive to invest in large blocks of stock. Large block holders are better able to monitor managers' actions and reduce the transaction costs of control changes. The reason that the market works fairly well now is because the equal-protection rule has seen so much slippage from theory to practice. Vigilant egalitarians, though, are always pushing to reduce this slack.

The second charge made by equal-opportunity advocates is that an unequal-division rule allows shareholder control groups to exploit other

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233. OFFICE OF THE CHIEF ECONOMIST, SEC, STOCK TRADING BEFORE THE ANNOUNCEMENT OF TENDER OFFERS: INSIDER TRADING OR MARKET ANTICIPATION? 3 (1987). The SEC concludes that much of the increase arises not from insider trading, but from normal market price discovery activities. *Id.* at 1.

234. *Id.* at 3.

235. It is surprising that the antidiscrimination rule is so uncritically accepted in this area, when it has met with so thorough a rebuke in others. See, e.g., DEPARTMENT OF JUSTICE, REPORT ON THE ROBINSON-PATMAN ACT 251-59 (1977) (Robinson-Patman Act's price discrimination provisions, which embody "equality of opportunity" principles, cannot be justified in light of great economic inefficiencies that Act imposes on society).

shareholders.²³⁶ According to this argument, if control-group stock has more value than other stock solely because control-group shareholders can divert a disproportionate share of the firm's income to themselves, then an unequal-division rule would allow control groups to sell this right of exploitation, presumably to a new control group that will be best able to maximize its disproportionate share of corporate income—the highest-valued user.²³⁷ The need for an unequal division rule is thus a symptom of an inadequate system of insider controls. If the law, or firms, better regulate insider behavior, the unequal-division rule becomes superfluous.

In the context of street sweeps, however, this argument makes no sense. Most street sweeps respond to insiders' refusal to sell a company. Acquirers accumulate stock from noncontrolling shareholders in order to form a control group that can oust a preexisting control group. Hence, in a street sweep, the acquirer is not buying out the existing control group, but ousting it.²³⁸ Such street sweeps do not reward control groups holding disproportionate shares of firm income, but rather act as a check on such groups.

The unequal prices that acquirers pay to shareholders in accumulating a control block reflect (1) transaction-cost savings when acquirers can buy a block of stock rather than having to pursue individual solicitations, (2) informational disparities among shareholders, and (3) different price evaluations by those with similar information. The first and third reasons for unequal price should trouble no one, but the second reason might trouble some. It ought not, however, since acquirers who create

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236. See Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505, 522-24 (1965).

237. See *id.* at 523.

238. Even if an acquirer purchases a preexisting control block in a street sweep, the claim against an unequal division of the gains has two answers. First, assuming that control groups can extract some disproportionate share of the gain to the rest of the shareholders' disadvantage, one could not characterize all acquirers as paying a premium solely because they can better exploit small shareholders. Many acquirers only exploit small shareholders to the same extent that the preexisting control group can. Thus, the premium paid for control is not based on an expectation of enhanced minority shareholder exploitation, but on an expectation that the acquirer can create socially useful gains, such as economies of scale. Second, the assumption that all disproportionate shares of gains enjoyed by shareholder control groups are inappropriate is not necessarily true. As Professor Gilson notes, minority shareholders might be better off giving a disproportionate share of the gains to a shareholder control group if the group effectively monitors managers to the advantage of all shareholders. R. GILSON, *supra* note 219, at 618. This argument assumes, however, that the agency cost that firm managers visit on a diverse group of shareholders is larger than the agency cost generated by managers monitored by a control group of shareholders plus the agency cost generated by the control group itself. If managers and a shareholder control group simply gang up on all other shareholders to divert corporate income, minority shareholders might be worse off.

this valuable information—i.e., their intent to buy—ought to be able to exploit that information.

In this regard, the SEC allows rather than penalizes street sweeps that take advantage of information disparities among shareholders. Indeed, the SEC penalizes acquirers who publicize their intentions, by labeling their offers illegal tender offers. The new SEC proposals operate to prohibit street sweeps only after public tender offers, with attendant public disclosures of a bidder's intentions.

CONCLUSION

The word among knowledgeable participants in the mergers and acquisitions business is that the balance has shifted in favor of the bidder.²³⁹ Statistics show that an initial bidder will probably win control of a target and that, if the target survives, it will have undergone a radical restructuring or recapitalization, taking on massive debt and selling key firm assets.

These statistics do not mean, however, that poison pill plans and state antitakeover legislation are toothless failures. Although poison pills originated as a method to stop hostile acquisitions, and have been unsuccessful in that regard, they have taken on a new significance as a method of regulating the *forms* that hostile acquisitions take,²⁴⁰ and this function is sufficiently important to promote the continued use of poison pills. Both poison pills and state antitakeover legislation will continue to focus bargaining power in a target board's hands and leave courts with the ultimate responsibility of deciding whether the board appropriately exercised its power. The devices will effectively control the form of hostile offers although perhaps not their outcomes, even though some studies suggest that target shareholders receive higher premiums if either or both of these devices are in place.²⁴¹

The most significant casualty of poison pills and state antitakeover legislation is the street sweep. These antitakeover devices have completely stopped the street sweep acquisition. The SEC's proposal to regu-

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239. *Bidders Winning Most of the Time, Takeover Specialist Tells Gathering*, 20 Sec. Reg. & L. Rep. (BNA) No. 41, at 1589 (Oct. 21, 1988) (speech by Charles Mulaney, Jr., of Skadden, Arps, Slate, Meagher & Flom to Corporate Counsel Institute (Oct. 12, 1988)).

240. The Hart-Scott-Rodino Act also influences the *form* of an acquisition. See *supra* notes 43-44 and accompanying text.

241. See Jarrell & Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371, 404 (1980) (Williams Act and first generation of state antitakeover statutes increased control premiums paid to target shareholders); Lee, *Poison Pills Benefit Shareholders by Forcing Raiders to Pay More for Targets, Study Says*, Wall St. J., Mar. 31, 1988, at 55, col. 3 (study by Georgeson & Co., proxy solicitation firm, concluded that poison pills are effective in raising sale prices of stock during hostile takeovers).

late street sweeps out of existence is therefore moot, an ironic development in light of the SEC's undisguised antipathy for both pills and state legislation. Should we mourn the passing of this swashbuckling tactic? That depends on our assessment of whether giving target managers control over takeover defenses is in shareholders' best interest. Target managers now have the power to pursue a "second-strike deterrent" defense: "If you bid for my firm, we will probably have to sell eventually (losing our positions) to you or someone else, but we will make sure that the price is so high that whoever buys will be a cursed winner with no profit and perhaps even a loss on the deal." If a bidder appears, target shareholders do extremely well, but these gains must be balanced against the effectiveness of these defenses in stopping potential bidders from bidding at all. Given the currently high levels of takeover activity, it is hard to push the point that the second-strike deterrent defense has been effective.²⁴²

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242. See Hilder, *Takeover Scene Shakes RJR Hangover*, Wall St. J., Mar. 20, 1989, at C19, col. 1 (reporting surge in merger and acquisition activity). But see Note, *Second Generation State Takeover Statutes and Shareholder Wealth: An Empirical Study*, 97 YALE L.J. 1193, 1215 (1988) (finding that despite overall increase in takeover attempts, increase for firms subject to second-generation takeover statutes was smaller than for firms not subject to such statutes).