CORPORATE CONTROL ALERT

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INSIDE

THE LINEUP

Takeover Defenses Exonerated in Death of Eighties M&A! Profs Finger Credit Crunch!

A study to be published later this year makes it official: the waning of the eighties M&A boom, although simultaneous with the waxing of systematic takeover defenses, did not result from their ascent. The probable leading causes of the boom's end, we are informed, were the credit crunch and the recession.

The study, "Poison or Placebo? Evidence on the Deterrent and Wealth Effects of Modern Antitakeover Measures," will appear this fall in *The Journal of Financial Economics*. The authors, Professors Robert Comment and G. William Schwert of the William E. Simon Graduate School of Business Administration at the University of Rochester, focus on the rise of three modern takeover defenses—poison pills, control-share statutes, and business-combination laws—covering companies listed on the New York or American stock exchanges.

The first business combination law, Ohio's, was adopted in 1982. The first control share law, New York's, was adopted in 1985. The poison pill, likewise, was validated in 1985. By 1991, business-combination laws covered 80% of exchange-listed companies, control-share laws 24%, and poison pills 35%. Eighty-seven percent of the companies were covered by at least one of the three defenses.

As these defenses were reshaping the corporate skyline, the control market was collapsing. The percentage of exchange-listed companies targeted for a merger or acquisition fell from a peak of 1.5% per month in 1987 and 1988 to below .5% in 1990 and 1991.

Taking this coincidence as their starting point, the authors set out to determine whether the rise of the one phenomenon caused the fall of the other, and specifically whether managers systematically made use of these defenses to deter takeovers.

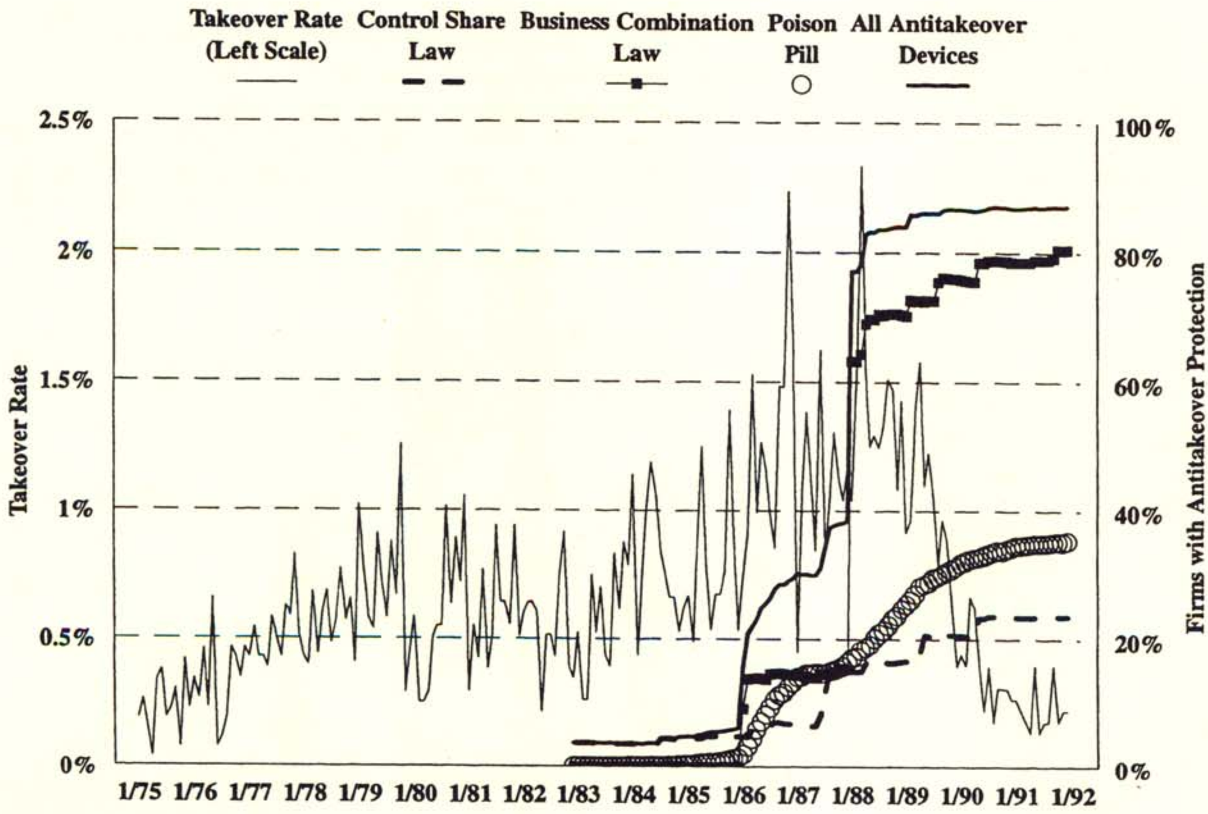
The authors begin by reviewing past studies suggesting four reasons to be skeptical that the defenses have had a deterrent effect. Management's influence over bidders predates the hostile second half of the last decade. Control share laws—providing as they do for a bidder-financed special election for target shareholders to waive or apply restrictions on the bidder's voting rights—do not present bidders with a serious obstacle. Typically, adoptions of antitakeover measures cause only a small drop in stock prices. And the slow death of Drexel Burnham Lambert Incorporated and attendant decimation of the junk bond market, together with the dramatic descent of commercial loans to nonfinancial businesses (from $33 billion in 1989 to $2 billion in 1990), suggests that the late-eighties withering of M&A was due primarily to a lending drought.

Comment and Schwert find no evidence that control-share or business-combination statutes deterred takeovers. The authors update the literature on the stock-price impact of poison pill adoptions to encompass all 1,577 original pills adopted through December 1991. The new evidence, the authors write, "does not suggest an economically meaningful degree of deterrence." The authors also find that takeover premiums are higher in the presence of one of the defenses (12% for control-share laws, 16% for poison pills), suggesting an increase in management's bargaining power.

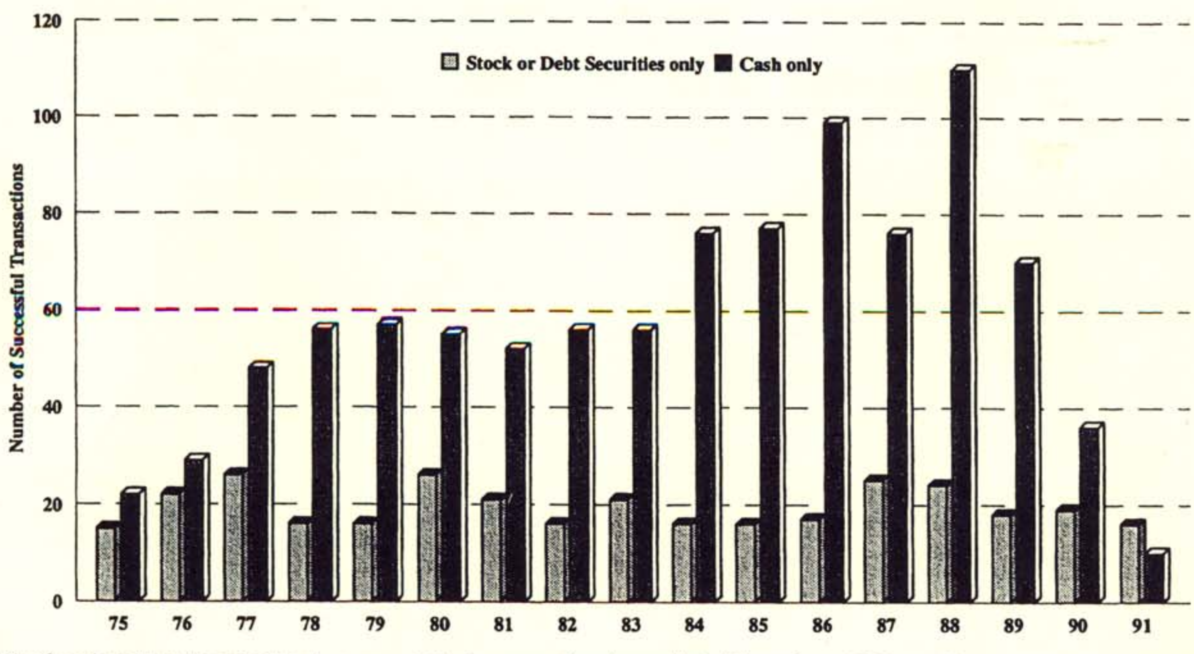
> Gregg Jarrell, former SEC chief economist, contends: "If the Delaware legislature were to repeal [the merger-moratorium law] tomorrow . . . M&A would explode."

As common-sensical as these findings seem at first blush, there is at least one economist who disputes them. Gregg Jarrell, who was chief economist at the Securities and Exchange Commission from 1984-1987 and is now a professor at the Simon business school, was a third co-author of the study in an earlier draft but withdrew over a year ago after it became apparent he interpreted the data differently from Comment and Schwert. Jarrell lauds both the study as "provocative" and Schwert (who as his tennis doubles partner is known as "the hammer") as "the best financial economic researcher in the country." But while allowing that poison pills were never a serious deterrent to takeovers, Jarrell believes the Delaware merger-moratorium law "was the real arrow in the heart" for hostile tender offers. Jarrell believes that law, according to which a hostile acquiror must either win 85% shareholder approval in a special vote or else wait three years to do a clean-up merger, is what caused banks to stop financing unfriendly acquisitions. "If the Delaware legislature were to repeal Delaware Section 203 tomorrow," Jarrell asserts, "hostile takeovers would in a year surpass the level of the eighties. That's a fairly easy prediction to make. I think M&A would explode." ❑

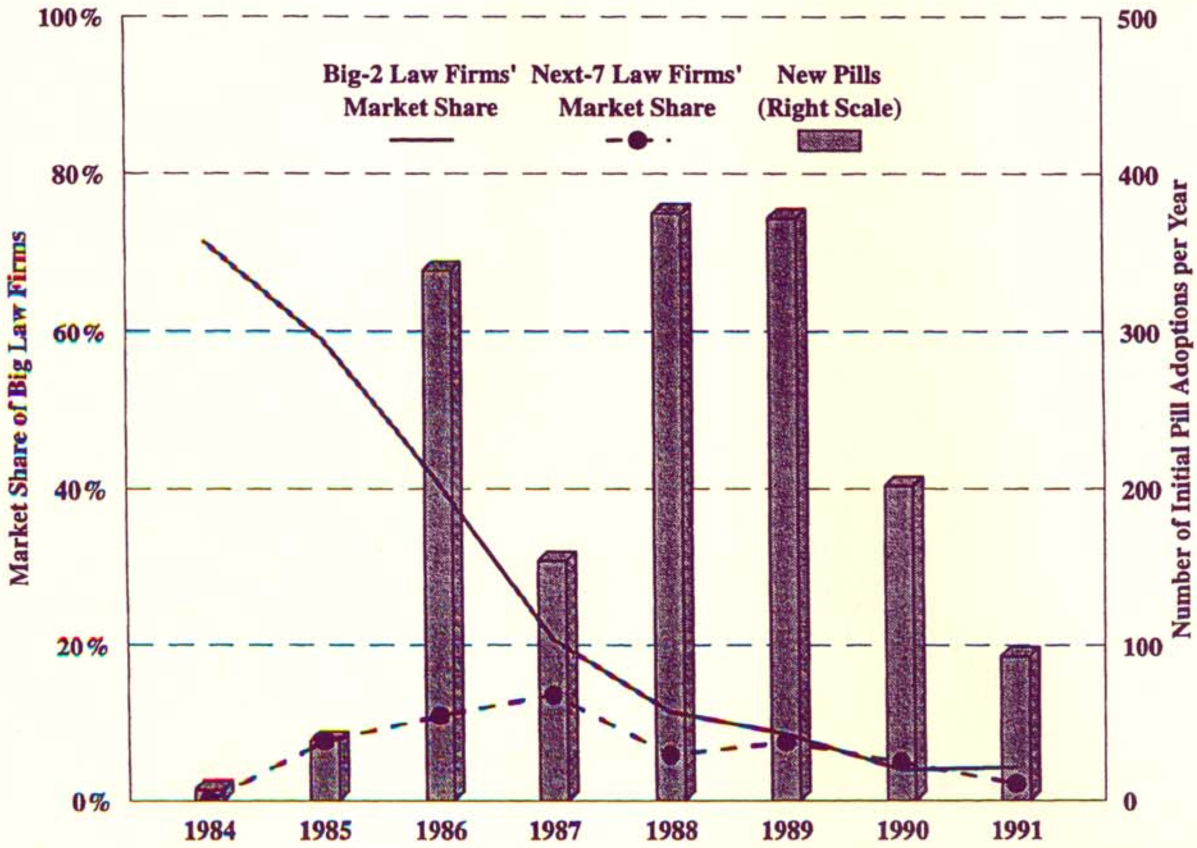
The following charts are reprinted by permission of the authors and of *The Journal of Financial Economics*, in which they will appear later this year.



Monthly time-series plot of the proportion of all exchange-listed firms that are covered by (1) control share laws, (2) business combination laws, (3) poison pill rights issues, (4) any of the above, and (5) the proportion of all exchange-listed firms that received initial merger proposals, merger agreements, or interfirm tender offers each month from 1975 to 1991 (left-hand scale).



Number of cash-only and non-cash-only successful takeovers of exchange-listed firms from 1975 to 1991, by year of announcement.



Number of initial poison pill adoptions by year for exchange-listed firms from 1984 to 1991. Also, market share of large law firms used in pill adoptions. The "Big 2" law firms are Wachtell, Lipton and Skadden, Arps. The "Next 7" law firms are Fried, Frank; Sullivan & Cromwell; Cravath; Paul, Weiss; Willkie Farr; Shearman & Sterling; and Jones, Day.

Chancellor Allen On Corporate Boards

The Delaware judge examines what directors should and should not do

Editor's note: *The following is the text of a speech given by Chancellor William Allen of the Delaware court of chancery at a recent Stanford University conference.*

The institution of the corporate board of directors is just now the subject of enormous interest. Last fall, an eminent group of Canadian business and finance leaders issued an extensive draft report on the subject of corporate governance in Canada. It is entitled "Where Were The Directors." In 1992, the Cadbury Report provided a similar review of corporate governance for Great Britain, and in the U.S., the Business Roundtable, the American Bar Association's Section of Business Law and others, including Martin Lipton and Jay Lorsch, Ira Millstein and Elmer Johnson, have recently addressed this subject. All commentators agree that the governance of our large public corporations is a matter of intense interest and some contention, and at the center of that governance stands the board of directors.

In theory the board has always occupied a vital and important role in the public corporation. It is, of course, the board, elected by the shareholders, that has ultimate legal power to deploy the assets of a corporation and direct its employees. But, as everyone has long acknowledged, that theory falls short of explaining the empirical reality. For a long time, that reality was that boards were, in effect, hand-picked by the corporation's senior management and, except in a crisis, were largely passive advisers to the CEO.

For reasons that are well-known, things are changing.