

THE CASE FOR FACILITATING
COMPETING TENDER OFFERS:
A LAST (?) REPLY

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L. A. Bebchuk

Abstract

Current takeover rules -- primarily, the minimum delay period provided by the Williams Act -- facilitate the making of competing tender offers. In two earlier articles I put forward, and defended against criticisms made by Easterbrook and Fischel, the case for facilitating competing offers. In an article to be soon published in the Journal of Law, Economics, and Organization, Alan Schwartz reexamines the issue of auctioneering, and he adds his voice to the antiauctioneering camp. In this paper, to be published alongside Schwartz's, I examine his criticism of the auctioneering view. I conclude that his analysis does in no way weaken the case for auctioneering.

Several years ago, Easterbrook and Fischel (1981, 1982) argued that the facilitation of competing tender offers is undesirable. They suggested that, in order to encourage prospective bidders' search for targets, it is desirable to minimize the premiums paid to target shareholders. On this view, impeding competing bids is desirable because it would sharply reduce takeover premiums. Indeed, because a target's dispersed shareholders are under pressure to tender, impeding rival bids would lead to very low premiums indeed.¹

In two articles (Bebchuk, 1982a, 1982b), I advanced an opposite position to that of Easterbrook and Fischel. I questioned the existence and magnitude of the negative effect that facilitating competing bids was argued to have on search. And I pointed out that facilitating such bids produces some significant benefits. A similar pro-auctioneering position was also expressed at the time by Gilson (1982a, 1982b).

The primary implication of this theoretical disagreement concerns the regulation of offerors. Time is crucial for competing bids, and the Williams Act, which the pro-auctioneering view endorses, provides time by prescribing a mandatory delay period. The anti-auctioneering view would have us repeal the Williams Act and return to a regime of Saturday Night Special raids -- offers that are open for a very brief period, with no withdrawal rights and on a first-come-first-served basis.

1. The pressure to tender and its consequences are analyzed in detail in bebchuk (1985a, 1985b, 1986).

The second implication of the debate concerns the role of a target's management. Easterbrook, Fischel, Gilson and I all agreed that management should be prohibited from obstructing existing bids. Easterbrook and Fischel's view, however, led them to advocate total passivity for target managements, while Gilson and I supported allowing management to provide information to potential bidders in order to solicit rival bids.

The choice, then, is between two regimes. Under a No-Auctioneering (or Saturday-Night-Special-Raids) regime, the first bidder, facing no threat of competing bids and subjecting the shareholders to the pressure of a Saturday-Night-Special raid, would be able to acquire the target for a very low, minimal premium over the pre-bid market price. Under an Auctioneering regime, in contrast, the acquirer would generally be that bidder that is willing to pay more than what rival bidders would be willing to pay.

Alan Schwartz has now subjected the issue to a systematic reexamination, and is adding his voice to that of Easterbrook and Fischel (Schwartz, 1986). As this Comment explains, however, Schwartz's analysis does not adequately address the arguments that I made in favor of auctioneering, and it consequently does not strengthen the antiauctioneering case.

I. THE EFFECT OF AUCTIONEERING ON SEARCH

Much of the debate has been concerned with the effect that facilitating competing bids will have on the number of beneficial

acquisitions. Schwartz now seeks to contribute to an understanding of this issue by developing a formal model of the search conducted by prospective acquirers. This formal model provides a rigorous demonstration of the proposition that an increase in the rewards for acquirers' search increases investment in search, and that auctions therefore reduce the level of this search. Yet, this proposition does little to resolve the issue; it has never been disputed by any participant in the debate.

While I agreed that, in comparison to the No-Auctioneering regime, auctioneering reduces prospective acquirers' investment in search, I suggested that: (A) the effect of auctioneering on prospective acquirers' search might be desirable rather than undesirable, and, even if the effect is undesirable, it is far from clear that its magnitude is substantial; and (B) auctioneering has a beneficial effect on level of search by potential targets. Schwartz does not adequately address my arguments with respect to (A) and ignores my arguments with respect to (B).

(A) The Effect of Auctioneering on Acquirers' Search

(1) Auctioneering is Consistent with Substantial Search by Acquirers

To examine the effect of auctioneering on acquirers' search, it might be best to start by recognizing that auctioneering is perfectly consistent with inducing a substantial level of such search. At present, when competing bids are facilitated, there is

a substantial search by potential acquirers because they do receive substantial rewards for their search. For one thing, prior to making a bid, a searcher can and commonly does make secret purchases of the target's stock. Under the present formulation of the Williams Act, the searcher can buy up to five percent of the target's shares without disclosing the purchases. Whether or not the searcher ultimately acquires the target, the searcher will usually make a substantial profit on its pre-bid purchases.² The evidence indicates that the gain that a searcher can make on its pre-bid purchases often approaches two to three percent of the target's value.

In addition to making a profit on pre-bid purchases, searchers also gain in other ways. In particular, even in an Auctioneering regime, a searcher that acquires an identified target would often not have to pay as much as its valuation of the target. Of course, the searcher would have to pay at least the competitive price -- that is, the price that other potential buyers would be willing to pay. The searcher, however, might place a higher value on the target's assets than do other potential buyers: buyers often vary substantially in the amount of efficiency gains (whether from "synergy" or from improved

2. If the searcher acquires the target, then its pre-bid purchases will enable it to save the bid premium on the stock it already owns. If another buyer acquires the target, the searcher will earn on its stock the acquisition premium paid by that buyer. And if the target's shareholders reject all available bids, then the searcher will still make a substantial gain, because in such a case the market price of the independent target's shares will probably be substantially higher than the pre-bid price for which the searcher bought its shares.

management) that they can produce by acquiring the target. In such a case, the searcher usually captures a substantial fraction of those gains from the acquisition that other buyers are unable to produce.

The existing rewards for search appear to be substantial relative to search costs. Because prospective buyers often lack appropriate in-house resources, the search is frequently done for them by investment bankers. In such cases, the search costs are a fraction of the investment bankers' total fees. These total fees, in turn, are often less than one percent of the target's value.

While the existing level of acquirers' search is thus substantial, it is important to recognize that an Auctioneering regime is consistent with even much more search by acquirers than currently takes place. A substantial increase in rewards for search could be accomplished by raising the statutory limit on the amount of the target's shares that a searcher can purchase without being required to disclose its purchases. As long as the searcher is required to stay below the threshold of effective control, an increase in the disclosure threshold would be consistent with an Auctioneering regime. Thus, since the existing disclosure threshold of five percent is far below any reasonable specification of the effective control threshold, the existing substantial rewards for search could be greatly enhanced without sacrificing the benefits (to be described) of an Auctioneering regime. Indeed, in my view those who are concerned

about the existing level of acquirers' search should, before advocating the drastic measure of repealing auctioneering, first push for -- and see the consequences of -- an increase in the statutory disclosure threshold.

(2) A No-Auctioneering Regime would Produce an Excessive Level of Acquirers' Search

While auctioneering is consistent with a very substantial level of search, adopting the No-Auctioneering regime would of course further increase the search by prospective acquirers. It is far from clear, however, that this increase would be a desirable one. As explained below, the increase in acquirers' search would overshoot the socially optimal level of that activity.

Like any other potentially beneficial activity, search is desirable only up to some point. Presumably we would not want to have most of the country's population engaged in search for takeover targets. More specifically, search is socially desirable only to the extent that the social gains from it exceed its social costs -- i.e., up to the point where the social benefit from an incremental unit of search is equal to its social cost. Because searchers bear the full costs of their search, a socially optimal level of search would be induced if and only if searchers expect to receive exactly -- no less but also no more than -- the social benefits of their activity.

Schwartz's valid concern is that an Auctioneering regime does not always provide searchers with the full social benefits

of their activity. Searchers that identify a target whose acquisition would produce efficiency gains generally cannot capture all of these efficiency gains but only part of them; consequently, acquirers' search for such potential efficiency gains is at a suboptimal level.

There is, however, another valid concern -- that adopting the No-Auctioneering regime would produce socially excessive incentives to search. Under that regime, searchers would be able to acquire a target for a minimal premium over the target's pre-bid market value. Thus, searchers that identify a target whose acquisition would produce efficiency gains would capture the full value of these efficiency gains. Thus far, all is well. But the problem is that, in addition to such efficiency gains, searchers would also make some substantial private gains that would not fully reflect social gains.

Most importantly, searchers would make substantial gains from foreknowledge-motivated takeovers -- takeovers motivated by the searcher's possession of private information suggesting that the target is currently undervalued by the market.³ Searchers would consequently invest considerable resources in foreknowledge-motivated search -- search aimed at identifying

3. Another type of private gains that do not reflect social gains are tax savings. While tax savings produced by an acquisition do increase the combined wealth of the acquirer's and the target's shareholders, they do not of course represent social gains but simply come at the expense of tax revenues. As I pointed out in my earlier articles, while tax savings are unlikely to be the dominant motive for acquisitions, they are likely to motivate some acquisitions and are likely to be present in a significant number of others.

targets whose shares are currently undervalued. Such identified undervalued targets would be acquired through a Saturday-Night-Special raid with a minimal premium -- and the searcher would thus capture the full gap between the target's true value and its pre-bid market value.

Foreknowledge-motivated takeovers, to be sure, are not entirely devoid of social value. When a searcher discovers and acquires an undervalued target, the acquisition process might lead the market to "correct" (at least partially) its valuation of the target. While this adjustment would eventually take place anyway, accelerating it is socially beneficial (as it might in the meantime provide better signals to investment decisions). The crucial point is, however, that the social value of this adjustment in valuation is smaller -- and presumably much smaller -- than the amount of the undervaluation. For example, suppose that a searcher discovers a target that has a true value of three billion dollars, and acquires it for a minimal premium over the two billions market price. Even assuming that the takeover would fully and immediately correct the market's valuation of the target's assets (which, as discussed below, might not always happen), the social value of this correction would be presumably much smaller than one billion; for one billion would be the social value of an acquisition that would increase the target's real value by one billion (rather than merely alert the market to the existence of such a value).

Some have argued that many current takeovers are

foreknowledge-motivated (e.g., Lowenstein (1983)), while others have suggested that current takeovers cannot be well explained by such a motive (e.g., Bradley, Desai, and Kim (1983)). It is thus important to emphasize that my argument does in no way depend on the existing incidence of foreknowledge-motivated Takeovers. As I will later explain, the existing Auctioneering regime discourages foreknowledge-motivated takeovers much more than it discourages takeovers motivated by the prospect of efficiency gains. I therefore do not wish, nor do I need, to make any assertion about the current incidence of foreknowledge-motivated takeovers. All that I suggest is that, if the No-Auctioneering regime is adopted, there will be a substantial and excessive incidence of such foreknowledge-motivated acquisitions. And this proposition directly follows from the observing that under that regime there would be very considerable profits to be made from looking for and making such acquisitions.

It is worth noting that, whether or not foreknowledge-motivated takeovers occur under the existing Auctioneering regime, there is no doubt that a substantial foreknowledge-motivated search does currently take place. Arbitrators and other market professionals expend considerable resources to acquire private information that will enable them to identify which companies are likely to be undervalued by the market. At present, however, since Saturday-Night-Specials are not possible, these searchers derive their profits mainly by purchasing on the market the shares of undervalued companies. Indeed, such market

purchases by market professionals eventually drive prices up toward true values, and are one of the main mechanisms that contribute to the relative efficiency of market prices (see, for example, Gilson and Kraakman, 1984).

It is unclear how the existing level of foreknowledge-motivated search compares with the desirable level of such search. The existing level might be excessive, because, as just explained, the social benefits produced by such search are significantly smaller than the identified gaps between the true value and market value of identified, undervalued targets. The existing level might also not be excessive, however, since foreknowledge-motivated searchers can currently capture only a fraction of the gaps that they identify. Whether the current level is excessive or suboptimal, however, clearly the level of foreknowledge-motivated search under the Auctioneering regime would be excessive; for in that regime searchers' gains would be virtually equal to the value of the identified gaps between true and market values, and these gains would substantially exceed the social benefits from their search activity.

Schwartz suggests that foreknowledge-motivated takeovers would not take place even in the No-Auctioneering regime, and provides several reasons for holding such a view. First, he doubts that any prospective bidder could ever acquire a piece of favorable information about a target that is not already fully reflected in the market price of the target's stock. Any favorable private information that a bidder could acquire,

Schwartz says, is presumably known to the target's management; the management, interested in enhancing share value, would have presumably already revealed it to the market, and the market price therefore must already reflect it.

Schwartz's view implies that market prices reflect not only all publicly available information but also all private, including insider, information.⁴ This claim is stronger than that which is usually made even by strong supporters of the efficient capital markets hypothesis. The version of the hypothesis that has significant academic support (and significant though not unambiguous empirical support) is that market prices fully reflect all publicly available information -- but not necessarily all private information held by anyone (whether insider or outsider).

Indeed, it is generally believed that market prices do not fully reflect all such private information. Inside information, for example, is believed not to be fully reflected in market prices, because, for one thing, managers cannot continuously reveal their information in a costless and credible way. The view that at any time some private information is not fully reflected in prices and might thus enable its possessor to make profits is strongly supported by both theory and evidence. On a theoretical

4. Although Schwartz's explicit assumption is only that managers will reveal to the market all favorable inside information, it can be shown that, if managers can and do credibly reveal all favorable information, then all insider information, good and bad, will become known to the market. See Ross (1979: 184-188).

level, if prices reflected all private information, then no profits could be ever made from the possession of private information, and the acquisition of information would come to a halt. As to the evidence, it suffices to note that insider trading was found to provide insiders with significant abnormal returns (see, e.g., Jaffe, 1974), indicating that inside information is not fully reflected in prices.

Alternatively, Schwartz argues that, even if a target happens to be temporarily undervalued and is identified as such by a prospective bidder, the bidder would be unable to acquire it for less than its true value. Whatever are the reasons for the target's undervaluation, Schwartz says, this undervaluation would go away once a bid is made. The target's managers would then have a very strong incentive to convey the target's true value to the market. The market price would consequently go up to the true value, Schwartz suggests, and the bidder would be therefore unable to acquire the target for less than its true value.

It appears doubtful that management could always credibly convey the target's true value in the very brief period left to it by a Saturday-Night-Special raid. For one thing, the verification, digestion and evaluation of information takes time: that is after all one of the main reasons why a delay period is so crucial for competing bids. Let us assume for a moment, however, that management could indeed respond to a foreknowledge-motivated Saturday-Night-Special raid by convincingly reporting the target's true value. It is far from clear that this response

would prevent the bid from succeeding.

As already noted, in the face of a Saturday-Night-Special raid, the shareholders of a target would be under a substantial pressure to tender (and, given the likely first-come-first-served structure of the bid, under a pressure to tender as early as possible). Consequently, shareholders would likely tender their shares and the bid would likely succeed even if shareholders believe management's announcements that the target's value is high and that rejecting the bid would be thus value-maximizing. Indeed, once the Saturday-Night-Special raid is launched, the market price would be unlikely to reflect subsequent revisions in the shareholders' estimates of the target's independent value; the market price would be likely affected by the looming presence of the bid and the expectations of a takeover, and consequently it might well be capped by the bid price. (See Bebchuk ,1985a: 1727-29; Bebchuk, 1985b: 34-35.) ⁵

Finally, Schwartz suggests that, even assuming that under the No-Auctioneering regime a bidder would be able to acquire an undervalued target for less than its true value, the bidder would

5. Indeed, Schwartz's analysis itself assumes that shareholders would not be always capable of rejecting a Saturday-Night-Special raid even if doing so would be the their value-maximizing course of action. Schwartz assumes that under the No-Auctioneering regime acquisition premiums would be significantly lower than under the Auctioneering regime, where mandatory delay is provided. But if shareholders are able to reject Saturday-Night-Special raids when that would be value-maximizing, then the No-Auctioneering regime would not have the effect of reducing premiums; for then shareholders would reject the Saturday-Night-Special raids in every case in which it appears that they would be able to receive subsequently a higher offer from a rival bidder.

be unable to profit from such a foreknowledge-motivated takeover (and therefore would presumably not attempt it in the first place). As just discussed, Schwartz believes (mistakenly) that acquiring an undervalued target for less than its true value would be possible only if, subsequent to the bid, the target's management fails to convince investors that the target has been thus far undervalued. If management fails to change the market's valuation of the target's assets, Schwartz asks, how would the acquirer succeed in doing so? Following the takeover, Schwartz reasons, the market would continue to undervalue the target's assets and the takeover would consequently fail to produce an appreciation of the acquirer's stock.

But, even assuming that the market would initially continue to undervalue the target's assets (and thus also the combined assets of the target and the acquirer), this undervaluation would not permanently persist. Clearly, even if the target were to remain independent, its true economic value would have been eventually revealed. Indeed, when a bidder is said to possess private information that a target is undervalued, the meaning of this statement is that the bidder's private information suggests that the market's current valuation of the target's assets is lower than the valuation that the market is expected to attach to these assets at some future date. Of course, following a foreknowledge-motivated takeover, the acquirer would try (often with some success) to accelerate the upward revision in the market's valuation of the target's assets. But even if the full

adjustment takes time it would eventually occur, and there can be thus no doubt that acquiring an undervalued target through a minimal-premium Saturday-Night-Special raid would be a very good investment indeed.

In sum, it can be confidently concluded that under the No-Auctioneering regime there would be, alongside the substantial incidence of efficiency-motivated takeovers, also a substantial incidence of foreknowledge-motivated takeovers. These foreknowledge-motivated takeovers would enable searchers to capture the gap between the true value and market value of identified undervalued targets. And these gains would consequently induce a very considerable and socially excessive level of foreknowledge-motivated search.

(3) Evaluating the Effect of Auctioneering on Acquirers' Search

Neither the Auctioneering regime that I support nor the No-Auctioneering regime advocated by Schwartz are likely to produce a socially optimal level of search. On the one hand, as was just explained, the No-Auctioneering regime would clearly produce an excessive level of search; in particular, it would produce substantially more foreknowledge-motivated search than is socially desirable. On the other hand, in an Auctioneering regime, the level of search for targets whose acquisition would produce efficiency gains, though substantial, is still likely to be suboptimal.

It follows that the effect that adopting the No-

Auctioneering regime would have on prospective acquirers' search might or might not be desirable. Would we be better off having the excessive search of the No-Auctioneering regime or the possibly suboptimal search of an Auctioneering regime? We of course do not have enough empirical information to provide a definite answer.

In evaluating the desirability of the Auctioneering regime's effect on acquirers' search, though, there is an important feature of the regime that should be borne in mind. The Auctioneering regime has a different effect on foreknowledge-motivated search than it has on efficiency-motivated search: the regime reduces the rewards for the former more sharply than it reduces the rewards for the latter. When the motivation for acquiring the target is the current undervaluation of the target's stock, the value of the target is presumably the same for all potential buyers. Consequently, under the Auctioneering regime, the first bidder cannot hope to purchase the target for significantly less than its valuation of the target. In contrast, when the motivation for acquiring the target is the prospect of realizing efficiency gains, prospective acquirers might substantially vary in the amount of efficiency gains that they can produce and thus in the value that they attach to the target. Consequently, in such a case, the identifying searcher might well expect that, if it ends up acquiring the target, it is likely to pay significantly less than its valuation of the target and to be thus left with a significant surplus. Hence, the Auctioneering

regime discourages foreknowledge-motivated search more strongly than it discourages efficiency-motivated search. It follows that adopting the No-Auctioneering regime would encourage efficiency-motivated search less than it would boost foreknowledge-motivated search.

Finally, the above evaluation of the effect of auctioneering on acquirers' search suggests that, even if this effect is desirable, it is far from clear that it is significant in magnitude.

(B) The Effect of Auctioneering on Targets' Search

Even assuming that adopting a No-Auctioneering regime would have a desirable effect on the search by potential acquirers, the overall effect of the regime on the number of beneficial acquisitions might be negative. For the regime would have an undesirable effect on the search by potential targets.

Corporate acquisitions are of course the result not only of search by potential buyers for a target but also of search by potential sellers for a prospective buyer. If acquisition of a company can produce efficiency gains, its management may look for an appropriate buyer and try to negotiate an acquisition.

Now, a No-Auctioneering regime would sharply reduce premiums not only in hostile takeovers but also in negotiated acquisitions. Premiums in such acquisitions are negotiated against the background of a possible unfriendly tender offer by the prospective acquirer. And the No-Auctioneering regime would greatly strengthen the prospective acquirer's negotiating

position: the acquirer would have no reason to pay more than the low premium it would have to spend to acquire the target through an unfriendly offer.

Because the No-Auctioneering regime would curtail the premiums in negotiated acquisitions, it would all but eliminate the incentives to search by potential targets, and would thus greatly diminish the number of buyer-initiated beneficial acquisitions. This reduction in potential targets' search would be clearly undesirable, because such search is presumably never motivated by an undervaluation of the target's stock.

II. OTHER EFFECTS OF AUCTIONEERING

After questioning the argument that auctioneering has a substantial negative effect on search, my earlier articles went on to describe three efficient effects that auctioneering has: (A) Allocating target assets to their most valuable uses; (B) Improving the information underlying acquisition decisions; and (C) Providing appropriate incentives to investments in given companies. Schwartz disputes my view with respect to effect (A) and ignores effects (B) and (C).

(A) Allocating Target Assets to their Most Valuable Uses

In a world without transaction costs, so taught us Coase (1960), assets would always promptly reach -- through one or many contractual transactions -- the party that can use them most efficiently and therefore values them most highly. In such a world, legal rules would be irrelevant to attaining efficient

allocation of assets: such allocation would promptly result no matter what the initial allocation is. In our imperfect world, however, friction unfortunately exists. For this world, the lesson of the Coase Theorem is that legal rules might serve a beneficial role of facilitating a relatively direct assignment of assets to their most valuable uses, thus avoiding the frictional and imperfect process of transfer and resale.

Such a role, I argued, is served by the Auctioneering regime. Acquirers might substantially vary in the value that they attach to a given target's assets: the magnitude of synergistic gains clearly depends on the "fit" between the acquirer and the target, and acquirers may well differ in their ability to improve the target's management. An Auctioneering regime ensures that a target will be acquired by the buyer that is the highest-valuing user of its assets. In contrast, under the No-Auctioneering regime, the target would be always acquired by the first bidder -- which might or might not be the highest-valuing user.

Schwartz disputes this point and relies on the possibility of a resale -- if the first bidder acquires the target but is not the highest-valuing user, then it might resell the target's assets to the highest-valuing user. Schwartz suggests that: (1) this resale is virtually certain and involves little friction; and (2) the Auctioneering regime, in any event, is likely to produce more friction than relying on a series of resales.

(1) Friction in the Resale Process

It is doubtful that, in the circumstances under

consideration, a resale by the first bidder is virtually certain and involves little friction. This resale process is presumably no more perfect than the common process of one proprietor's negotiating to sell assets to another proprietor; and, ever since the Coase Theorem, law-and-economics scholars have been spending much of their time examining how legal rules could be designed to avoid reliance on such sales. For example, like any other negotiated sale, a resale by the first bidder might not take place due to strategic behavior -- the parties might not reach agreement concerning the division of the gains from the resale; as game theorists have taught us, such a deadlock is quite possible in situations (like the one under consideration) where each of the parties is uncertain as to the other's valuation of the object to be sold. This problem does not exist, of course, in an Auctioneering regime. Another problem that might be worth noting with respect to the resale scenario is that it might involve a significant delay; for one thing, after the first bidder gains control it might well prefer not to attempt a resale right away but rather effect a takeover first (which takes time), so as to be in the position to sell the whole target rather than a controlling interest.⁶

6. In my earlier articles I noted among the problems of the resale process that it might be distorted by a preference that the acquirer's managers might have for expanding (or not reducing) the size of their company. Schwartz correctly points out that managerial preference for size might also distort the outcome of auctions, and that it therefore does not provide a good reason for preferring the Auctioneering regime. I accept this point, and am grateful to Schwartz for pointing it out.

(2) Friction in the Auctioneering Regime

I disagree with Schwartz's claim that the Auctioneering regime is likely to involve more friction than a regime of resales. To assess this claim one should consider the two ways in which the Auctioneering regime ensures an efficient allocation of target assets.

(i) Uncontested Bids. It is important to recognize that the Auctioneering regime performs its allocational role not only in those cases where an auction actually takes place but also in the more numerous cases where no bidding contest occurs. For the Auctioneering regime substantially increases the likelihood that the first bidder for a given target will be the acquirer to which the target's assets are most valuable.

Suppose for example that, as often happens, an investment banker studies a target on its own initiative, planning to interest a potential buyer later in the idea of an acquisition. Since bankers' fees are contingent on the success of the acquisition attempt, the Auctioneering regime provides the banker with a strong incentive to look for the highest-valuing user; for the banker will realize that buyers other than the highest-valuing user will fail to acquire the target. In contrast, because under the No-Auctioneering regime the first bidder would always succeed in acquiring the target, that regime would sharply reduce the banker's incentive to look for the highest-valuing user.

Or suppose that a target is identified by a searcher, say,

Carl Ichan, that currently gains mainly by making profits on the initial stakes that it acquires in identified targets. Under the Auctioneering regime, Ichan will purchase a block of the target's stock, attract the market's attention to the target, induce a bid by the highest-valuing user, and thus earn the takeover premium on its block. In contrast, under the No-Auctioneering regime, Ichan would not seek to induce a bid from the highest-valuing user. Rather, Ichan would launch an immediate Saturday-Night-Special raid, acquire the target for a minimal premium, and then resell the target to the highest-valuing user; in this way, Ichan would be able to earn a substantial premium not on a limited block but on all of the target's stock.

The above analysis is supported by the evidence that in the existing Auctioneering regime most tender offers are not contested (see, e.g., Bradley (1980)). Thus, there are probably many cases at present where the first bidder is the highest-valuing user only because of the existing auctioneering rules. In these cases, the Auctioneering regime produces an efficient allocation of target assets without any transaction costs being incurred beyond the unavoidable costs of the first bid. And the advocated No-Auctioneering regime would necessarily add friction in these many cases, no matter how limited the friction involved in a resale.

(ii) Contested Bids. The above analysis suggests that, overall, the Auctioneering regime is likely to minimize the friction involved in moving assets to their most valuable uses

even if actual contests, which occur in a minority of the cases, were as costly as Schwartz thinks they are. Nonetheless, it is worth noting that having auctions is not as costly as that.

Schwartz thinks that a Williams Act auction is bound to be quite costly because it "is conducted by target managers, who have an incentive to cause the auction to fail altogether, or to use it to bargain with bidders about the security of their own jobs." (Draft, p.25) Under the Auctioneering regime that I put forward, however, management would be prohibited from obstructing bids, and would therefore be unable to cause the auction to fail altogether or otherwise to abuse the time provided by the Auctioneering regime. The point is that the costs of auctions should not be judged by the example of past bidding contests. Most of the friction and waste that accompanied these contests were the result of obstructive defensive tactics (and bidders' responses to them), and banning such tactics would hence eliminate these costs. The only costs that are intrinsic to the operation of the Auctioneering regime are the costs of making competing bids, and these costs are a small price to pay for ensuring an efficient allocation of target assets.

(B) Information Underlying Acquisition Decisions

A prospective acquirer that has imperfect information about a target might err in estimating the efficiency gains that acquiring the target would produce: the acquirer might mistakenly believe that efficiency gains would result even though that particular acquisition would produce no efficiency gains or even

efficiency losses. The Auctioneering regime improves the information that underlies information decisions, and it thus reduces the likelihood of such an erroneous, inefficient acquisition.

Under an Auctioneering regime, a prospective buyer that identifies a potential target might well approach its management, initiate acquisition negotiations, and request certain information about the target. When management agrees to negotiate and provides the requested information, the acquirer is likely to receive nonpublic information that it could not otherwise obtain and that will make the acquirer better able to evaluate whether an acquisition will be beneficial.

Under the No-Auctioneering regime, in contrast, a prospective buyer that identifies what seems to be a promising target will be induced to launch an immediate unsolicited bid. By launching such a bid, the buyer would eliminate the possibility of competing bidders entering the picture. Thus, the buyer would avoid approaching the target's management because it would have much to lose from doing so: management might start looking for and bringing in rival bidders.

(C) Incentives to Efficient Investment in Given Companies

When the ownership of a given property does not enable the owner to capture the full social gains resulting from the property, investment in this property will be suboptimal. This familiar point implies, in particular, that, to induce an optimal level of investment in a given company, it is necessary that

potential investors in the company expect to fully capture the social gains that will result from their investment.

Now, the gains produced by an acquisition of a target are attributable not only to the preceding search but also to the target's existence, and thus to individuals' prior decisions to establish the target and invest in it. Thus, by ensuring competitive acquisition prices, an Auctioneering regime provides target shareholders with a larger share of the gains that are attributable to the target's existence.

Note that, to the extent that an acquirer has any unique characteristics that enable it to produce from an acquisition greater gains than other acquirers, an Auctioneering regime does not deny the acquirer's shareholders those acquisition gains that are attributable to the acquirer's unique characteristics and thus to the acquirer's existence. The presence of rival bidders would require such an acquirer to pay only slightly more than the target's value to other potential buyers: thus, the acquirer will capture the difference between its own valuation of the target and the target's value to other potential buyers -- a difference that represents those gains from the acquisition that only the acquirer can produce.

In sum, an Auctioneering regime moves us closer to providing the shareholders of given companies with those acquisition gains that are attributable to the existence of their companies. Consequently, it moves us closer to inducing optimal levels of investment in given companies.

III. CONCLUSION

As this comment has shown, Alan Schwartz's article does not refute or weaken any of the elements of my earlier analysis of the effects of an Auctioneering regime. The conclusions of this analysis might be summarized as follows.

(1) There is a strong basis for questioning the existence-- and of course the magnitude -- of the adverse effect that auctioneering is alleged to have on the number of acquisitions. (i) Auctioneering is consistent with a substantial amount of search: at present target searchers receive substantial rewards relative to search costs and they consequently search a great deal; and the existing rewards can be further enhanced, if such an enhancement is deemed desirable, without impeding competing bids. (ii) Adopting the No-Auctioneering regime would lead to an excessive level of search. (iii) In light of propositions (i) and (ii), the effect of a No-Auctioneering regime on prospective acquirers' search might be undesirable rather than desirable; and even if the effect would be desirable, it is far from clear that its magnitude would be substantial. (iv) Even assuming that the effect of an Auctioneering regime on prospective acquirers' search is undesirable, this effect is counterbalanced by the clearly beneficial effect that auctioneering has on search by potential targets.

(2) Auctioneering produces significant efficiency gains in three ways. (i) It minimizes the friction involved in the allocation of targets' assets to their most valuable uses. (ii)

It improves the information underlying acquisition decisions.
(iii) It provides incentives to appropriate investment in given companies.

As I emphasized in my earlier articles (1982a: 1051; 1982b: 49), no conclusive proof can be offered that the beneficial effects of auctioneering must outweigh its possibly negative effect on prospective acquirers' search. Yet, on policy questions of this kind, a conclusive proof in favor of any position is very rare indeed, and society must usually choose on the basis of the best judgment that can be formed. In light of the above conclusions, my own judgment is that impeding competing bids would likely be undesirable, and that we should therefore not return to a regime of Saturday-Night-Special raids.

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