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Closing the Disclosure Gap in Corporate Take-Overs: The Williams Amendments and the Wheat Report

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NOTES & COMMENTS

CLOSING THE DISCLOSURE GAP IN CORPORATE TAKE-OVERS: THE WILLIAMS AMENDMENTS AND THE WHEAT REPORT

The conglomerate corporation[1] has distinguished itself[2] in an era which considers the unusual commonplace. Widely regarded as a product of the nefarious "urge to merge," conglomerate growth is, if not the most common, at least the most notorious expression of recent intercorporate activity. While the myriad factors giving impetus to what has so often been termed "merger hyperactivity" surely defies any form of capsulized treatment, those elements of a more exponential genre may indeed be more deftly analyzed. This note is one such effort.

If the old adage that "necessity is the mother of invention" were empirically verifiable, one would need to turn to no other source of raw datum than the primordial environment of the conglomerate merger to establish its truth. Inhibited by the vigilant eye of government regulation, conglomerates sought, found and exploited more surreptitious, yet equally effective modes of achieving corporate control; a notable illustration of which subsists in the regulation of corporate securities.

Coinciding with the recent surge in corporate combinations has been the increasing popularity of the cash tender offer.[3] Designed to avoid the expense and delay ordinarily attending the exchange offer and proxy fight,[4] a cash tender offer is an offer by a raider (offeror)[5]

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[1] A caveat should be initially expressed. While this note adopts the conglomerate as a general frame of reference, the inference that the subject matter herein discussed is peculiar to the conglomerate firm would be clearly erroneous; indeed, the conglomerate has merely typified and aggravated widespread abuses generally attending corporate disclosure.

> [A conglomerate is] a corporate organization with two principal characteristics: a largely unrelated multi-product and multi-industry operating base, and an active acquisition program. . . .

A Guide for Buying the Conglomerates, 60 MOODY'S STOCK SURVEY 528 (Aug. 19, 1968).

[2] *See, e.g.*, A. SMITH, THE MONEY GAME 181-96 (1968); Sauerhaft, *Advice from an Aging Conglomerator to His Nephew Upon Graduating from The Harvard Business School*, DUN'S REV., Nov. 1968, at 37.

[3] Although the cash tender offer has only acquired prominence in the sixties, it has been skillfully exercised in the past. The lucrative exploits of Louis E. Wolfson and Leopold Silberstein attest to the validity of this proposition. *See generally* L. GOULD, THE MANIPULATORS 1-63 (1966).

[4] *See* Manne, *Mergers And The Market For Corporate Control*, 73 J. POL. ECON. 110 (1965). The widespread popularity of the cash tender offer is attributable to five premiums generally unavailable in other methods of acquisition: secrecy, speed, simplicity, economy and freedom from regulation by the Securities and Exchange Commission

to purchase for cash, cash and stock or other form of consideration, some or all of the shares of a "target"(offeree) corporation. While the cash tender offer itself presents an obvious "gap" in a federal regulatory scheme, merely supplementing a system of regulation does not invariably provide a panacea which miraculously and perpetually responds to difficulties as they arise. Clearly, for example, the stock-for-stock exchange, traditionally the subject of regulation, presents a problem in the timely disclosure of information. Moreover, certain stock transactions popular in effecting corporate take-overs may be exempt from disclosure requirements when shareholder votes are conducted. Nevertheless, problems have arisen since "acquisitors" gladly adopt schemes which are exempt from securities regulation. Consequently, many investors relying upon inadequate and in some cases no information concerning the transaction blindly deliver their company to the offeror.

TENDER PERSUASION

Aggressive Company wishes to expand its corporate horizons through diversification. More specifically, Aggressive wishes to take over a corporation that is already established in an unrelated line of business. Having surveyed the various prospects, Indolent Corporation is chosen because it fits well in Aggressive's diversification plan. From an operational vantage, Indolent is unimpressive and has been for several years: *e.g.*, profits and sales have shown a mild gain while the national economy and corporate sales and profits in general have shown an unprecedented expansion.[6]

The corporation also possessed a large liquidity position (that is,

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[hereinafter SEC or Commission]. *See* Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV., Mar.-Apr. 1967, at 135 [hereinafter Hayes & Taussig]. The authors note that the cash take-over bid replaced the stock-for-stock exchange during the early sixties. By 1965, cash offers were accounting for the great majority of tenders. The authors attributed the change to:

1) The superiority of the cash bid over other devices in the event of resistance, at a time when the supply of willing merger partners [had] shrunk.
2) Increasing corporate liquidity.
3) Readily available credit.
4) A new "respectability" for cash bids.

Id. at 136.

See also Sowards & Mofsky, *Corporate Take-Over Bids: Gap in Federal Securities Regulation*, 41 ST. JOHN'S L. REV. 499, 500-01 (1967).

5 The term "raider" is not used in a derogatory sense but rather is intended to denote an acquiring corporation on the acquisition trail.

6 Poor performance has generally been equated with entrenched, ineffectual management. *See* Note, *Defensive Tactics Employed by Incumbent Managements in Contesting Tender Offers*, 21 STAN. L. REV. 1104, 1107 (1969) [hereinafter *Defensive Tactics*]. *Cf.* Manne, *Cash Tender Offers For Shares—A Reply to Chairman Cohen*, 1967 DUKE L.J. 231, 236; Comment, *Economic Realities Of Cash Tender Offers*, 20 MAINE L. REV. 237, 253-58 (1968).

while a conservative ratio of cash to liabilities was two-to-one during this period, Indolent's ratio was four-to-one). It also underutilized its financial leverage — a large gap was maintained between its net worth and its debt. Indolent evidenced a management that did not bother to maximize the investment value of their shareholders' holdings. All of these factors made Indolent an attractive "target" to Aggressive.

By means of a newspaper advertisement,[7] Aggressive offered to buy a certain amount of Indolent's outstanding shares at a fixed cash price. The offer would be open for a short period of time, (*e.g.*, two weeks) and Aggressive retained the option to extend the period. The price for the tendered shares was slightly greater than present market value and Aggressive reserved the right to accept or reject shares when the limit specified was reached. The offer could have been withdrawn if unfavorable circumstances arose, but the shareholder tendered irrevocably.

Indolent's management made no recommendations concerning the offer; shareholders were neither encouraged nor discouraged to tender their shares. Consequently, an overwhelming "no confidence" vote was registered as Aggressive was tendered more shares than they had anticipated. Subsequently, with Aggressive men installed on Indolent's board of directors, a merger plan was adopted.[8]

Aggressor companies generally seek "target" companies possessing stock with stagnant market prices; or whose top executives personally hold a small amount of outstanding stock; or whose stock is apparently undervalued by the market; or those operating with any combination of these factors.[9] Once an attractive company is selected, all that the

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7 Letters to the shareholders are equally effective, where, of course, the offeror has access to a shareholders' list. *See* note 21 *infra*.

8 Austin, *Anatomy of a Tender Offer*, 17 MSU Bus. Topics, Spring 1969, at 63. The example is adapted from the 1966 take-over of the K.V.P.-Sutherland Paper Company by the Brown Company. A final touch of irony was added to the situation in 1968 when Gulf & Western Industries acquired the Brown Company by means of the cash tender offer. Professor Austin gives a thorough economic analysis of the Brown-K.V.P. take-over.

9 *See* Rukeyser, *Getting Tough with Tenders*, Fortune, Aug. 1967, at 108; Austin, *supra* note 8. *See also* Anonymous, *The Anatomy of a Raid*, Dun's Rev., Sept. 1968, at 55 where the author gives the following advice to management of potential "target" companies:

> Very broad stockholder ownership of your company makes it easy for a potential raider to quietly pick up your stock while he is forming a base for the attack.
>
> The absence of any large holdings . . . among . . . top officers and directors, means there is no strong ownership group to oppose the raider when he surfaces. . . .
>
> Understated assets may fool . . . [the Internal Revenue Service but not] shrewd Wall Street analysts who may be helping the raider pick his next pigeon.
>
> Inbred corporate managers may complete the noose around your company's neck, for in their innocence they will find it very difficult to believe that anyone would want to rope them so boldly.

Id. at 57.

aggressor need do is place a newspaper advertisement, announcing the offer at a price which includes a premium above the current market value.[10] A well-conceived plan operates with secrecy; the offeror simply buys stock on the open market prior to making his bid. As the market value is lower at this time, the raider can pick up "target" shares cheaply. Indeed, he may acquire shares sufficient to make him eligible for a shareholders' list from the "target's" management.[11] Later, in preparation for the bid, a price must be determined for the tendered shares.[12] When the price is finally fixed, the remaining terms of the offer weigh heavily in favor of the offeror.[13] The aggressor must then determine when, by revealing the offer and subsequently receiving tendered shares in accordance with his terms, to launch his campaign. The tactic is relatively fast and cheap and offers maximum satisfaction with minimum abuse.

"Target" Company in the Defense

Although poor performance may be responsible for an impending attack,[14] incumbent management is still in a powerful position, armed

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10 *See Buying Into a Company Via the Tender Offer*, Bus. Week, Feb. 26, 1966, at 38. The offers generally are contingent upon the offeror's getting enough stock in order to acquire a firm foothold or control of the "target" company.

11 Purchasing on the open market tends to drive the price of the stock up. Consequently, the offeror may well alert incumbent management of his scheme. However, the amount accumulated reduces the total number of shares necessary for ultimate control of the "target."

> Knowing when to stop buying on the open market is an important element in the bidder's strategy. Investment bankers have suggested to us that at least a month of inactivity should precede a cash tender offer to avoid an undesirable price advance. An even longer period may be warranted to lull the incumbents into a false sense of security.

Hayes & Taussig at 139.

See also Rukeyser, *supra* note 9, at 109; note 58 *infra* and accompanying text.

12 *See* Cohen, *Tender Offers and Takeover Bids*, 23 Bus. Law. 611 (1968).

> [The acquirer's] management must act quickly and secretly on the basis of whatever information is publicly available and with continuity of [the target's] management often in jeopardy, must fix its tender price high enough to assure the desired response from stockholders and to discourage any competing bid, yet must not exceed its capacity to obtain temporary and permanent financing, and in general must act responsibly toward [the acquirer's] own stockholders.

Id. at 613.

It has been noted that a 20 percent premium is the generally subscribed to level, although lower and higher premiums have been used with some consistency. The Hayes & Taussig study found the median premium to be 16 percent. *See* Hayes & Taussig at 139.

13 The offeror generally accepts tendered shares on a "first come, first served" basis. Accordingly, if the number of shares requested is received before the expiration of the offer he may refuse to accept the subsequently tendered shares. Typically, he reserves the right to renege should a specified number of shares not be tendered. *See* Hayes & Taussig at 141. Under the New York Stock Exchange rules, the acceptance of shares on a "first come, first served" basis is not allowed. New York Stock Exchange, Company Manual, at A-179 (1969). *See also* Fleischer & Mundheim, *Corporate Acquisition By Tender Offer*, 115 U. Pa. L. Rev. 317, 350 n.124 (1967) [hereinafter Fleischer & Mundheim].

14 *See* Anonymous, *supra* note 9.

It used to be said that the corporate raider performs a valuable function in with an arsenal of weapons capable of frustrating the take-over bid.[15] In addition to those preventive defense tactics[16] of a more remote nature, such as charter amendments and by-law restrictions,[17] incumbent management may resort to a barrage of tactics having a more immediate strategic and legal impact. For example, where an attractive "target" has shown poor market performance, the situation may be adjusted by announcing a stock split or dividend increase.[18] Ordinarily, the market price of stock will be favorably affected by the announcement and a renewed confidence in management will be instilled among shareholders.[19] Alternatively, management may consider repurchasing shares of the company's stock in an effort to decrease the total number of shares outstanding, thus making it more difficult for the aggressor to muster a sufficient number of shares to achieve control.[20]

Following the announcement of a cash tender offer, management

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> our economy by keeping company management on their toes and forcing them to do better jobs of running their businesses. That is as much nonsense as saying that the Red Chinese create a healthy atmosphere in the Orient by forcing the United States to take an interest in the smaller Asian nations.

Id. at 57.

15 Only about one contested tender offer in three has succeeded in giving the bidder control of the "target" company. *See* Rukeyser, *supra* note 9, at 110.

16 Obviously, management should consider remedying those conditions which render it most vulnerable to a tender offer. *See Defensive Tactics* at 1107.

17 Typical charter amendments or by-law restrictions include provisions limiting the percentage of stock to be voted, or requiring an 85 percent vote of the shareholders to consummate a merger or to amend the charter or by-laws. *See generally Defensive Tactics* at 1107-10. *See also* Abele, *Shelters Impede Takeovers*, N.Y. Times, Mar. 29, 1970, § 3 (Business and Finance) at 1, col. 1.

18 *But see* SEC Securities Exchange Act Release No. 8268 (Mar. 7, 1968). Proposed rule 10b-12 would ensure that "target" companies declaring dividends have a sufficient cash surplus to support such corporate action.

19 The success of these techniques is contingent upon a reserve of authorized but unissued shares. If such additional stock is not readily available and it is necessary to secure stockholder approval for the issuance, the technique loses its effectiveness. *See* Schmults & Kelly, *Cash Take-Over Bids—Defense Tactics*, 23 BUS. LAW. 115, 118 (1967).

Such techniques, as do most techniques, mandate consideration of the anti-fraud regulations, particularly SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1970). If dividend levels are not maintained after the increase, management will find itself vulnerable to attack for using a manipulative device in violation of 10b-5. *Cf.* Cochran v. Channing Corp., 211 F. Supp. 239, 246 (S.D.N.Y. 1962).

20 Fraud considerations under rule 10b-5 are paramount when a company is repurchasing its own shares. *See, e.g.*, O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964); Ruckle v. Roto Am. Corp., 339 F.2d 24 (2d Cir. 1964). *But see* Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967); SEC v. Georgia-Pacific Corp., [1964-1966 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,680 (complaint filed Apr. 27, 1966), ¶ 91,692 (S.D.N.Y. May 24, 1966) (final consent decree entered). *See also* Israels, *Corporate Purchase of Its Own Shares—Are There New Overtones?*, 50 CORNELL L.Q. 620 (1965) for a consideration of various state law problems in the area.

A similar method for diluting the raider's holdings is to issue more stock. Since speed is essential, this tactic must be capable of perpetration without shareholder approval or registration under the Securities Act of 1933. *See* Schmults & Kelly, *supra* note 19, at 119.

can employ a whole range of remedial defense tactics designed to thwart the raider's incursions. Management communications, for example, exhorting prospective shareholders not to tender is perhaps the most obvious course of action. Generally, this will take the form of a vigorous publicity campaign criticising both the raider and the raid, while extolling the virtues of incumbent management. Since management has access to the shareholders' list, every shareholder can be notified of the incumbents' position.[21] Moreover, the "target" company can institute legal action against the enemy, charging fraud or breach of fiduciary duty. Such suits are rarely upheld but are effective in arresting the momentum of the take-over bid.[22] The "target" may resort to a drastic, yet more effective device by arranging a merger with a third company; typically a direct competitor of the raider. The antitrust implications[23] are obvious and the company's shareholders may be impressed by the tax-free aspects of the merger as opposed to the taxable cash tender offer.[24]

All things considered, the best defense would appear to be a good offense. By keeping the company's affairs in good order, the likelihood of a raid will be greatly diminished, although not completely eliminated.[25]

"Rocks, Caves, Lakes, Fens, Bogs, Dens, and Shades of Death, . . .": Federal Regulation of Cash Take-Over Bids

Prior to 1968, there was no federal regulation specifically designed to deal with cash take-over bids.[26] Consequently, aggressor companies

21 Management thus has a considerable advantage over the raider since it has access to the shareholders' list. While the raider may also be entitled to the list, the incumbents can delay until the list's value becomes, at best, questionable. A suit to compel delivery of the list usually proves equally futile since a favorable court order will often come too late to be of any help. *See* Hayes & Taussig at 142-43; Rukeyser, *supra* note 9, at 110.

22 *See, e.g.*, Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840 (2d Cir. 1967); Moore v. Greatamerica Corp., 274 F. Supp. 490 (N.D. Ohio 1967); United Gas Corp. v. Pennzoil Co., 248 F. Supp. 449 (S.D.N.Y. 1965), *aff'd per curiam*, 354 F.2d 1002 (2d Cir. 1966).

23 *See How To Fend Off A Take-Over*, Fortune, Feb. 1969, at 83, 162. *See also* Crane Co. v. Westinghouse Air Brake Co., CCH Fed. Sec. L. Rep. ¶ 92,532 (2d Cir. Dec. 10, 1969), *petition for cert. filed*, 38 U.S.L.W. 3489 (June 4, 1970); text accompanying notes 87-88 *infra*.

24 *See* Fleischer & Mundheim at 319, 348 n.119.

25 Unless management owns or controls sufficient shares to make the company immune, the best preparation against a surprise cash takeover bid is to endeavor to correct conditions that typically render the company vulnerable to one—poor operating performance, declining dividends, excessive liquidity.

Schmults & Kelly, *supra* note 19, at 134.

26 Most tender offer suits were prosecuted under SEC rule 10b-5, which prohibits any person from engaging in "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." *See* notes 83-96 *infra* and accompanying text.

were free to utilize tender offers with only a minimum of federal regulation compelling the disclosure of present or future plans. In the absence of disclosure requirements, the raider operated in almost complete secrecy.[27] The average investor, having to make an important decision concerning his investment without available information to assist him, was faced with a dilemma. Analogous situations had prompted the promulgation of earlier legislation[28] designed to keep the average investor and the public apprised of the internal operations of corporations. "Secrecy in this area is inconsistent with the expectations of the people who invest in the securities of publicly held corporations and impairs public confidence in securities as a medium of investment."[29] Investor protection mandates that certain information be laid at the investor's disposal and Congress[30] has now enacted laws to ensure the dissemination of information necessary for informed decisions.[31]

The superior effectiveness and increased use of tender offers generated considerable concern among entrenched and often inefficient management.[32] The federal government, on the other hand, evidenced

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27 [T]he law does not even require that he disclose his identity, the source of his funds, who his associates are, or what he intends to do if he gains control of the corporation. . . . [U]nless incumbent management explains its position publicly, the investor is severely limited in obtaining all of the facts on which to base a decision whether to accept or reject the tender offer.

H.R. REP. No. 1711, 90th Cong., 2d Sess. 2 (1968). [hereinafter *House Report*].

28 *E.g.*, The Securities Act of 1933, 48 Stat. 74 (1933), *as amended*, 15 U.S.C. § 77a (1964); The Securities Exchange Act of 1934, 48 Stat. 881 (1934), *as amended*, 15 U.S.C. § 78a (1964) [hereinafter the 33 Act and the 34 Act respectively].

29 *House Report* at 3. This report, which accompanied S. 510 as it was finally enacted into law, examines other methods of attaining corporate control, *e.g.*, the stock-for-stock exchange and the proxy contest and noted that both were adequately covered by existing provisions of the securities laws; it was only the cash tender offer which escaped regulation, although the same powerful considerations which require disclosure in the former situations were noticeably present.

30 Congress was also presented with the enactment of similar laws by other countries which had acted under the pressure of the same problems which were occurring in this country in connection with cash tender offers. *See, e.g.*, Ontario Securities Act, 14 & 15 Eliz. 2, ch. 142, §§ 86, 95 (1966); Victoria, Australia Act. No. 6839, § 184 (1961); Prevention of Fraud (Investments) Act, 6 & 7 Eliz. 2, ch. 45, § 14 (1958) (England).

31 The questions which must be answered prior to the exercise of an informed investor decision in regard to a cash tender offer include:

[D]oes he want to remain with the company under the new and inspiring leadership which is sometimes offered; two, does he think that, in any event, even if he tenders all of his shares and they are not all taken he is going to continue as a member of that company. . . ?

Hearing on H.R. 14475, S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 90th Cong., 2d Sess. 21 (1968) (remarks of Mr. Cohen).

32 It should be noted, however, that it has more recently been demonstrated that tender offers are also made in situations characterized by efficient management. *See* Comment, *supra* note 6, at 253. Generally, the stock of the corporations involved is undervalued vis-à-vis comparable corporations, and raiders, recognizing a profit potential, are goaded into making an offer for shares. *Id.* at 254.

a similar consternation over the intense popularity of the take-over bid and, in many cases, the fierce battles that generally ensued between the raiding company and the "target." By 1965, sufficient prodding had moved Congress to action, and several bills engaging this newest device for acquiring corporate control were introduced. Incorporating SEC recommendations prompted by this earlier legislation, and in an effort to blunt the edge of the raider's position while providing increased disclosure, Senator Harrison Williams of New Jersey introduced Senate Bill 510 during the closing days of 1967. As introduced

> [t]he measure [was] not aimed at obstructing legitimate takeover bids. In some instances, a change in management will prove a welcome boon for shareholders . . . . [Rather] [e]very effort [was] made to avoid tipping the balance of regulatory burden in favor of management or in favor of the offeror. The purpose of the bill is to require full and fair disclosure for the benefit of stockholders while at the same time providing the offeror and management equal opportunity to fairly present their case.[33]

To this end the Act, while structurally detailed, would seem, as some have suggested, more of a license to police the area than a compilation of specific congressional mandates.[34]

A. *Section 13(d) — Acquisitions of More Than 10 Percent of a Class of Registered Securities*

As enacted, section 13(d)[35] deals with the acquisition of more than 10 percent of a class of registered securities. It is applicable to any person[36] who acquires beneficial ownership of any equity security regis-

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33 113 CONG. REC. 854-55 (1967).

34 [T]he Act might be viewed as little more than an indication of Congressional concern over the surprising increase in cash takeover bids, leaving it largely up to the Securities and Exchange Commission to adopt rules that will provide the appropriate regulation. In fact, Section 10 of the 1934 Act has always given the Commission ample authority to regulate this field.

See Schmults & Kelly, *Disclosure In Connection With Cash Take-Over Bids: The New Regulations*, 24 BUS. LAW. 19 (1968).

In fact, the day following enactment, the SEC promulgated regulations implementing the law. *See* SEC Securities Exchange Act Release No. 8370 (July 30, 1968) (adopting temporary rules and regulations under §§ 13(d),(e) and 14(d),(f)). These rules and regulations were later amended in SEC Securities Exchange Act Release No. 8392 (Aug. 30, 1968). They were finally adopted and are now codified as Regulation 13D, 17 C.F.R. § 240.13d-1 *et seq.*; Regulation 14D, 17 C.F.R. § 240.14d-1 *et seq.* (1970).

Commentary on the early bills and the provisions as enacted has been prolific. *See, e.g.*, Brudney, *A Note On Chilling Tender Solicitations*, 21 RUTGERS L. REV. 609 (1967); Hamilton, *Some Reflections On Cash Tender Offer Legislation*, 15 N.Y.L.F. 269 (1969); Note, *Cash Tender Offers*, 83 HARV. L. REV. 377 (1969); Comment, *Regulation of Contested Cash Tender Offers*, 46 TEXAS L. REV. 915 (1968); Comment, *Senate Bill 510 And The Cash Tender Offer*, 14 WAYNE L. REV. 568 (1968).

35 82 Stat. 454 (1968), 15 U.S.C. § 78m(d) (Supp. IV, 1969).

36 For purposes of both section 13(d) and 14(d), "person" is deemed to include "two or more persons . . . [acting] as a partnership, limited partnership, syndicate, or other

tered pursuant to section 12 of the 34 Act[37] (or any issue of a closed-end registered investment company under the Investment Company Act of 1940)[38] if after such acquisition he will beneficially own more than 10 percent of the securities of that particular class.[39] Once it is determined that the section is applicable, the person involved must file a statement with the issuer of the security, the various exchanges upon which the issue is traded and the SEC. This filing must occur within 10 days following the acquisition.[40] The section provides certain information that could be filed and authorizes the Commission to issue supplementary regulations requiring additional information necessary to effect the underlying purpose of the provision. The background and the identity of all persons by whom or on whose behalf the purchases have been made; the source and amount of funds used in making the purchase; if the purpose behind the purchase is to acquire control, any plans the acquirer may have to liquidate, sell the assets or merge the company or any other major change he might have in mind could all be required information. Furthermore, the SEC could require the "person" to note the number of shares he beneficially owns and the number of shares which he has a right to acquire, as well as any con-

group for the purpose of acquiring, holding, or disposing of securities of an issuer. . . ." § 13(d)(3), 82 Stat. 455 (1968), 15 U.S.C. § 78m(d)(3) (Supp. IV, 1969). Notice must also be taken of SEC rule 13d-3, 17 C.F.R. § 240.13d-3 (1970), which provides that a person shall be deemed the beneficial owner of the securities represented by presently exercisable options, warrants or rights, or through the conversion of presently convertible securities. These securities are also regarded as "outstanding for the purpose of computing the percentage of outstanding securities of the class owned by such person," but not for computation of the percentage owned by any other person.

37 48 Stat. 892 (1934), *as amended*, 15 U.S.C. § 78*l* (Supp. IV, 1969). This section provides the general requirements necessary for registration under the 34 Act. Generally speaking, the 34 Act extends disclosure requirements for investor protection to issuers who have securities listed and traded over-the-counter and on the national securities exchanges. Section 12 requires companies which list and register their securities for public trading on such an exchange to file a registration application with both the exchange and the SEC.

38 54 Stat. 789 (1940), *as amended*, 15 U.S.C. § 80a-1 (Supp. IV, 1969). This Act provides for regulation of the so-called "mutual funds" or open-end management companies. These companies are usually easy to identify because they clearly state that they are companies whose business is investment. The problem area is in identifying the closed-end investment company, that is to say a company which purchases shares in various companies and does not redeem them. A great deal of confusion arises between this type of company and a company which holds and from time to time buys and sells securities of other corporations. The Act distinguishes between these in order to alleviate the confusion. In any event, companies subject to the Act must register with the SEC as investment companies. Failure to do so results in strict penalization. *See generally* 1 L. Loss, Securities Regulation 144-53 (2d ed. 1961) [hereinafter Loss].

39 The underlying purpose of section 13(d) is to "require disclosure of information by persons who have acquired a substantial interest, or increased their interest in the equity securities of a company by a substantial amount, within a relatively short period of time." *House Report* at 8. The section is addressed to a situation which typically attends the cash take-over bid.

40 *House Report* at 8.

tracts, arrangements or understandings regarding the securities.[41] The Act further provides that any changes which may occur following the original disclosure shall be revealed by way of an amendment which is to be forwarded to the issuer of the securities, the exchanges upon which the securities are listed and to the SEC.[42] In arriving at the 10 percent figure, all securities of the particular class which are beneficially owned are included except those which are held by or for the account of the issuer or the issuer's subsidiary.[43] Finally, section 13(d) provides exceptions from its coverage.[44]

B. *Section 13(e)—Purchases by an Issuer of Its Own Securities*

In the ordinary course of events, a corporation engaged in repurchasing its securities is serving a legitimate business purpose; the corporation may simply wish to have stock available for stock option or employee purchase plans. However, such a measure may well be a ploy designed to place stock in friendly hands. The virtues of such a defensive measure are obvious; the more stock known to be in friendly hands, the less likely a tender offer will be attempted. Moreover, such repur-

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41 82 Stat. 454 (1968), 15 U.S.C. § 78m(d)(1) (Supp. IV, 1969). Eight copies of the statement are required to be filed with the Commission. Rule 13d-1, 17 C.F.R. § 240.13d-1 (1970). The required form to be filed is the schedule 13D, 17 C.F.R. § 240.13d-101 (1970).

42 82 Stat. 454 (1968), 15 U.S.C. § 78m(d)(2) (Supp. IV, 1969). Eight copies of the amendment must be filed with the Commission. Rule 13d-2, 17 C.F.R. § 240.13d-2 (1970).

43 82 Stat. 455 (1968), 15 U.S.C. § 78m(d)(4) (Supp. IV, 1969). A 10 percent beneficial owner of securities who acquires more securities of the same class from the issuer pursuant to preemptive subscription rights in an offering made to all the shareholders of the particular class to which the preemptive rights pertain and does not acquire more than his pro rata share of the securities offered and reports the acquisition pursuant to § 16(a), 48 Stat. 896 (1934), *as amended,* 15 U.S.C. § 78p(a) (1964), is exempt from the provisions of section 13(d). Rule 13d-4, 17 C.F.R. § 240.13d-4 (1970).

44 82 Stat. 455 (1968), 15 U.S.C. § 78m(d)(5) (Supp. IV 1969). Section 13(d) is inapplicable to:

> (A) any acquisition or offer to acquire securities made or proposed to be made by means of a registration statement under the Securities Act of 1933;
> (B) any acquisition of the beneficial ownership of a security which, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, does not exceed 2 per centum of that class;
> (C) any acquisition of an equity security by the issuer of such security;
> (D) any acquisition or proposed acquisition of a security which the Commission . . . shall exempt . . . as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

The important aspect of section 13(d) will be the determination of control groups subject to the filing requirements. Ostensibly, the courts will look to the circumstances of each case and place great weight upon shareholder relationships whether these be personal or business connections. In the first judicial opinion on this point, Bath Indus., Inc. v. Blot, CCH FED. SEC. L. REP. ¶ 92,521 (E.D. Wis. Nov. 3, 1969), *aff'd,* ¶ 92,665 (7th Cir. May 20, 1970) the court discovered a control group where shareholders had planned to pool their voting interests, to acquire additional stock and to obtain the support and votes of other large shareholders in order to force the company's president to resign. Subsequently, a schedule 13D was filed but the court would not dissolve the temporary injunction until the sufficiency of the filing would be determined.

chase programs, as well as more sophisticated versions of the selective distribution of outstanding shares (*e.g.*, employee plans and management purchases) tend to inflate stock prices and also remove stock from shareholders who might otherwise have tendered.

While congressional interest did not focus solely upon market manipulation, such repurchases, if substantial, will affect the market price. It is to the remedy of this evil that section 13(e) is directed. The section declares unlawful any such repurchase which contravenes SEC rules designed to prevent fraudulent, deceptive or manipulative acts and practices. Furthermore, the Commission has the authority to promulgate regulations which will provide information concerning a corporation's repurchase program. In addition to being cast in an antifraud context, with the SEC defining proscribed conduct, the section contains congressional suggestions of requisite disclosure items. The issuer could be required to disclose the reasons prompting the repurchase program, as well as the source of the funds to be paid for the securities and the method of purchase.[45]

C. *Section 14(d) — Tender Offers*

The amendments to section 14 are specifically addressed to the regulation of cash take-over bids, commonly referred to as "tender

[45] 82 Stat. 455 (1968), 15 U.S.C. § 78m(e) (Supp. IV, 1969). The section also defines a purchase by the issuer to include "a purchase by or for the issuer or any person controlling, controlled by, or under common control with the issuer, or a purchase subject to control of the issuer or any such person."

Acting upon its rule making authority, the Commission promulgated rule 13e-1, 17 C.F.R. § 240.13e-1 (1970). This rule prevents a corporation from repurchasing its own shares during a registered tender offer unless the issuer files eight copies of a statement regarding the proposed purchase with the SEC. The statement must include: 1) the title and amount of securities to be purchased; the names of the sellers and the market in which the purchase is to be made; 2) the purpose of the purchase and whether the securities are going to be retired or held or otherwise disposed of; and, 3) the source and amount of funds to be used in making the purchase and if any part of the amount is going to be borrowed.

If there is to be a loan, the transaction and the parties thereto must be described. The rule also demands that the shareholders of the company have had this information revealed to them within the preceding six months. *See* National Union Elec. Corp. v. National Presto Indus., Inc., CCH FED. SEC. L. REP. ¶ 92,460 (W.D. Wis. July 8, 1969) (court refused to enjoin "target's" repurchase program because of drastic quality of the relief and insufficient proof of deceptive practices to artificially inflate the market price).

The *Presto* case illustrates that courts, in the absence of actual fraud or manipulation, may tend toward leniency in "target" repurchases. Curiously, where the raider is utilizing an exchange offer, as in *Presto*, section 13(e) may be inapposite as the entire tenor of the Williams Act sounds in the area of cash tender offers. However, it will be a rare occasion wherein the "target" will be attempting to defeat the exchange offer since the success of the device depends upon cooperation between the two companies. Ordinarily, the raider in the exchange situation will not proceed absent the allegiance of incumbent management. *See* note 119 *infra*.

offers." Section 14(d) requires any person who makes a tender offer for any class of securities registered under section 12 of the 34 Act (or any equity security issued by a registered closed-end investment company) to file a statement with the SEC and the issuer, if after the consummation of the offer the offeror would be a beneficial owner of more than 10 percent of the particular class of security. The required filing is to be accomplished prior to or contemporaneous with the announcement of the tender offer. Once again, the SEC is granted rule making authority in connection with the information that must be disclosed. The section specifically requires that all requests and invitations to tender shares, whether by newspaper advertisement or otherwise, be filed. This mandate applies with equal force to subsequent offers which must be filed as they are published. The offeror must send the material to the issuer as well.[46] On the other hand, any recommendations which are made concerning the acceptance or rejection of a tender offer must be made in accordance with SEC rules and regulations.[47]

[46] 82 Stat. 456 (1968), 15 U.S.C. § 78n(d) (Supp. IV, 1969). The applicable form to be filed is schedule 13D, 17 C.F.R. § 240.13d-101 (1970). Additionally, all material changes which may occur in the original statement must be amended by means of filing the appropriate information with the Commission and the issuer. The tender offer itself must contain the name of the offeror; the exact dates prior to which and after which the depositing shareholders may withdraw their shares pursuant to section 14(a)(5) or otherwise (see note 49 *infra* and accompanying text). When the offer is for less than all the outstanding shares of a class and the offeror need not purchase every share tendered, the offer must also contain the date upon which the pro rata acceptance period expires. (The pro rata period is governed by section 14(d)(6), see note 50 *infra* and accompanying text.) Subsequent amendments to the original schedule may omit material already furnished. The SEC requires eight copies of every filing. Rule 14d-1, 17 C.F.R. § 240.14d-1 (1970).

The definition of "person" for purposes of section 14(d) is the same as that provided in section 13(d), see note 36 *supra*. Similarly, the method used for computing the percentage of securities held is identical to that utilized for purposes of section 13(d), see text accompanying note 43 *supra*.

Pursuant to its rule making authority, the SEC has exempted certain communications from the coverage of the rules and regulations which it has promulgated under section 14(d). These communications include certain brokers' offers to purchase securities in connection with a distribution; calls and redemptions of securities; offers to purchase which are evidenced by script certificates or order forms representing a fractional interest in a security; offers to purchase dissenting shareholders' securities when pursuant to statutory procedure; advisors who are not participating in the tender offer may furnish their customers advice concerning it if the request is unsolicited or pursuant to a general contract for advice; the issuer may contact its shareholders and report that a tender offer has been made, that the management is studying the matter and will forthwith advise the shareholders of their recommendation; the issuer may also request that the shareholders defer any action until the recommendation is made (this recommendation must be made no later than 10 days prior to the last day upon which tenders will be accepted by the offeror); finally, offers to purchase securities in transactions exempted by the 33 Act from registration under section 3(a)(10), 48 Stat. 75 (1933), *as amended*, 15 U.S.C. § 77c(a)(10) (1964) are exempted communications for purposes of section 14(d). Rule 14d-2, 17 C.F.R. § 240.14d-2 (1970).

[47] 82 Stat. 457 (1968), 15 U.S.C. § 78n(d)(4) (Supp. IV 1969). The Commission has

This subsection devotes itself to eliminating the secrecy attendant upon a cash tender offer. Under the law as presently structured, a raiding company must file the 13D schedule when he announces his offer. The form becomes available to the shareholder who will thus be better equipped to make a decision concerning the disposition of his shares. Pursuant to the congressional policy of "strict neutrality," the management of the "target" company is required to file the 14D schedule before recommendations concerning the tender offer can be made.[48]

A more direct form of investor protection provided by section 14(d) permits the tendering shareholder to withdraw his shares at any time within seven days after the tender offer is first published and at any time after 60 days has elapsed.[49] If the tender offer is for less than all the outstanding shares of a class and more than the requested amount is tendered within 10 days of the offer's publication, (assuming that the offeror is unwilling to accept all that are tendered) the shares must be taken up pro rata according to the number of shares deposited by each shareholder.[50] In this manner, the offer is kept open for at least 10 days. Should the offeror decide to increase the consideration for tendered shares, the 10 day period begins to run from the time of the announcement. In the event that the terms of the tender offer are changed during the life of the offer, *e.g.*, the consideration is increased, the extra amount must be paid to every tendering shareholder even if the shares were tendered before the increase was announced.[51] Finally, the section provides exemptions from its coverage.[52]

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designed schedule 14D, 17 C.F.R. § 240.14d-101 (1970) which must be filed with the SEC before any recommendation or solicitation is made in regard to a tender offer. The schedule was created for the use of incumbent management when they wish to make recommendations during a tender offer. The raider or any other person besides the issuer does not have to file a schedule 14D when they make a recommendation if a schedule 13D has been filed by them pursuant to rule 14d-1. However, these recommendations can be no more extensive than the information provided in the 13D filing. When a schedule 14D is filed, it must be kept current by means of filing amendments when material changes occur. Rule 14d-4, 17 C.F.R. § 240.14d-4 (1970).

[48] However, an aperture in the coverage similar to that in section 13(e) is present in regard to stock-for-stock exchanges. By virtue of section 14(d)(8), (see note 52 *infra* and accompanying text), tenders of securities pursuant to a 33 Act registration statement are exempt.

> . . . the exemption for registered offerings would mean that, although the offeror would be limited in his solicitations by the disclosure requirements of the Securities Act, solicitations in opposition would be unregulated except to the extent that the general antifraud provisions of the securities laws might apply.

Hearing, *supra* note 31, at 18 (remarks of Mr. Cohen).

[49] 82 Stat. 457 (1968), 15 U.S.C. § 78n(d)(5) (Supp. IV 1969).

[50] *Id.* § 78n(d)(6).

[51] *Id.* § 78n(d)(7).

[52] *Id.* § 78n(d)(8). Section 14(d) is inapplicable to any offer for or request for tenders of any security:

D. *Section 14(e) — Fraudulent Transactions; Section 14(f) — Changes in Boards of Directors*

In order to ensure the full disclosure of material information, the Williams Act provides a general anti-fraud provision — section 14(e) — which makes it unlawful "to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders."[53] Most importantly, acceding to the aforementioned congressional policy of "strict neutrality," the section contemplates and proscribes with equal force and effect such chicanery in solicitations both for and against a tender offer. The provision affirms the concept that raiders, defensive "targets" and anyone who seeks to influence an investor's decision *must* "make full disclosure of material information to those with whom they deal."[54]

Equally important to investor protection and the prevention of fraud is section 14(f) which directs itself to the wholesale disposal of directorate control resulting from arrangements between the raider and the "target's" management. That section provides[55] that where directors are to be elected absent a vote of the shareholders, pursuant to an arrangement between the incumbents and the acquiring parties, in a transaction subject to section 13(d) or 14(d), and these directors in turn will encompass a majority of the board, the issuer must file with the SEC and all shareholders the information ordinarily required[56] when directors are elected at a shareholders meeting.

A Period of Reflection

Inasmuch as a schedule 13D[57] need not be filed prior to the announcement of a tender offer, the raider's ability to act in secrecy

(A) proposed to be made by means of a registration statement under the Securities Act of 1933;
(B) if the acquisition of such security, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, would not exceed 2 per centum of that class;
(C) by the issuer of such security; or
(D) which the Commission . . . shall exempt. . . .

53 82 Stat. 457 (1968), 15 U.S.C. § 78n(e) (Supp. IV 1969).

54 *House Report* at 11.

55 82 Stat. 457 (1968), 15 U.S.C. § 78n(f) (Supp. IV 1969).

56 § 14(a),(c), 48 Stat. 895 (1934), *as amended*, 15 U.S.C. § 78n(a),(c) (1964). These are the proxy solicitation sections which require that prior to any request for a proxy (or if no proxy is solicited prior to the corporation's annual meeting) certain information must be sent both to the shareholders and the SEC. Accordingly, the SEC requires that certain items of schedule 14A, 17 C.F.R. § 240.14a-101 (1970), be filed when arrangements regarding the selection of directors occur in connection with the acquisition of securities covered by section 14(d). The information must be filed not later than 10 days prior to the date upon which the office is to be assumed. Rule 14f-1, 17 C.F.R. § 240.14f-1 (1970).

57 Schedule 13D, 17 C.F.R. § 240.13d-101 (1970). The schedule may be prefiled if the acquiring company so desires and this may be ultimately beneficial to the raider because

remains relatively untarnished. During the interim, the raider is free to pick up stock on the open market provided its beneficial ownership remains below the 10 percent level.[58] Admittedly, the forced compliance with a statute which requires the preparation of a disclosure document, makes it more difficult to maintain secrecy. However, a raider who is capable of planning a successful take-over should be equally adept at maintaining secrecy, even in the preparation of required disclosures. If the preparation period is lengthened, the additional time may be used to acquire up to 9½ percent[59] of the "target's" stock at a more favorable price.[60]

The Act was not intended to improve the offeror's position[61] and

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it will provide an SEC opinion as to the sufficiency of the filing before the total commitment is made. The information required to be filed includes: the class of securities sought and the name and address of the issuer; the identity and background of the offeror; the source and amount of funds to be used in the purchase; if control is sought, any plans or proposals for subsequent liquidation, asset sales or merger or any major structural changes; the number of beneficially owned shares the offeror already has; any options the offeror has to acquire such securities; and a list of the offeror's representatives empowered to make solicitations or recommendations to the "target's" shareholders.

58 Professor Mundheim has noted that this situation arises as a result of the definitional problem in the legislation, *i.e.*, the term "tender offer" is not defined. In a very real sense, the offer can be considered to commence when the acquirer starts picking up shares on the open market. *See* Mundheim, *Tender Offers*, 2 Rev. Sec. Reg. 953, 955 (1969). *See also* 6 Loss 3669. Commenting upon the definitional problem in the Act, Professor Loss wonders whether an offer to buy a controlling block from a limited group would be exempt. Rule 14d-2, relating to exempted communications, was explained by the SEC as follows: "The exclusions relate to matters such as offers to no more than ten security holders during any period of twelve months." SEC Securities Exchange Act Release No. 8392 (Aug. 30, 1968). Yet, the exclusion was not embodied in the rule.

59 It is wise to keep the acquired number of shares below 10 percent for another reason. In the event of an aborted take-over bid, the corporation will be able to sell these shares without coming into conflict with section 16(b) of the 34 Act, the so-called "short-swing" provision. The effect of this section is that any profits an officer, director or 10 percent shareholder receives through transactions in the company's stock within a six month period from the time of acquisition must be returned to the company's treasury. Section 16 is an area of complexity and its provisions are meant to be considered completely apart from the provisions of section 13(d). *See generally* 2 Loss 1040-87. *See also* Lowenfels, *Section 16(b): A New Trend In Regulating Insider Trading*, 54 Cornell L. Rev. 45 (1968); Note, *Extension of Liability Under Section 16(b)—A Whole New Can of Worms*, 11 Ariz. L. Rev. 309 (1969); Note, *Stock Exchanges Pursuant to Corporate Consolidation: A Section 16(b) "Purchase Or Sale"?*, 117 U. Pa. L. Rev. 1034 (1969).

60 Whether the safe limit of 9½ percent will remain viable in light of Senator Williams' renewed efforts to provide investor protection in the area of tender offers is doubtful. Recently, he has introduced a bill which would reduce the disclosure requirement level from 10 percent to 5 percent. The bill also endeavors to extend disclosure requirements to take-over efforts involving "target" insurance companies. *See* S. 3431, 91st Cong., 2d Sess. (1970); 116 Cong. Rec. 1533-34 (daily ed. Feb. 10, 1970). *See also* N.Y. Times, Mar. 26, 1970, at 71, col. 3.

61 This congressional intention remains axiomatic, although some have and undoubtedly will continue to adhere to a position which condemns the legislative "neu-

although it appears that the new regulation does not greatly affect the raider's plans, the original problems attending a cash tender offer remain. When the required disclosure is additionally considered, the virtues of the method are significantly mitigated.

By maintaining secrecy, the offeror will be greatly limited in his investigation of the "target."[62] When the offer is publicly announced the market price will tend to seek the level of the offer. Consequently, the cost of the venture will increase if success is to be attained. As a result of the Williams Amendments, the offeror must also allow a tendering shareholder to withdraw his shares anytime within the week following the offer and anytime after 60 days, if by that time the offeror fails to accept the tendered shares. This provision, temporarily at least, does lend an element of instability to the offeror's plans. After that time, the major concern is the pro rata requirement, should the offeror decide not to accept all the shares tendered.[63]

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trality" policy in favor of "laissez-faire." Prior to enactment, Professor Manne made the following observation:

> . . . public investors should *not* be on an equal footing with individuals who have created *new* information and are performing a function which necessarily benefits everyone. If we put the completely passive shareholder on the same footing as this individual, the latter will have little incentive to take over control of a poorly run company and thereby protect noncontrolling shareholders from bad management.

Manne, *supra* note 6, at 241.

See also Comment, *supra* note 6 which contains a compilation of data concerning cash tender offers leading the author to conclude that regulation is unwarranted both for the reason that tender offers rarely succeed without the support of incumbent management and that even unsuccessful tender offers inure to the shareholders' benefit by driving up the stock price.

62 An attractive "target" may be easily identified by its low earnings, low dividends, cash accumulations and unhappy shareholders but this identification in no way takes the place of a thorough investigation of the company's legal background and corporate history. The timing of the tender offer necessarily suffers when the offeror is unfamiliar with the internal climate of the "target." This is to say that incumbent management may be on the verge of announcing new corporate developments or dividend decisions which may ultimately scourge the effectiveness of the tender offer. Furthermore, this ignorance of the "target" company may well lead the offeror into offering an unsubstantial premium for tendered shares. Consequently, the offer will fail due to opposition from management, shareholders and even alien companies that have engendered interest in the "target" as a result of this tender offer. *See* Swanson, *S. 510 And The Regulation Of Cash Tender Offers: Distinguishing St. George From The Dragon*, 5 HARV. J. ON LEG. 431, 434 & n.12, 439-40 (1968) [hereinafter Swanson].

63 Financing the cash tender offer may cause the offeror additional consternation if the margin requirements of regulations G, T or U are violated. 12 C.F.R. §§ 207, 220, 221 (1970). Prior to the Williams Amendments, such violations were difficult to discern because of the inaccessibility of information as to the financier of the offeror's bid. With this information required to be furnished not only will the "target" company be able to allege possible margin violations but the Federal Reserve Board will be able to give these matters closer scrutiny. In the alternative, the "target" has an excellent defensive technique by accosting the lender with the possible violation in the hope that he will withdraw his financial support. *See* SEC v. Madison Square Garden Corp., CCH FED. SEC. L. REP. ¶ 92,493 (S.D.N.Y. Oct. 6, 1969) (complaint filed); ¶ 92,649 (S.D.N.Y. Apr. 29,

In order to implement the congressional intent of avoiding favoritism toward either side, the SEC has created the compulsory filing of schedule 14D[64] when the "target" makes recommendations concerning the tender offer. This provision, however, constructs an uninvited delay into a scheme, the very existence of which depends upon speed. While there is nothing in the legislation which requires management to communicate with its shareholders and thereby be forced to file with the Commission, such a course of action is not recommended since it gives the raider an easy conquest. Consequently, incumbent management must eliminate the element of surprise in the raider's plan.[65] This necessity demands that a company continually prepare for a possible attack; a battle plan must be prepared.[66] The corporation's charter or by-laws should be amended with a view toward making control more difficult to attain.[67] Additionally, the corporation should keep the

1970) (consent decree entered). *See also* Kennedy, *Tender Moment*, 23 BUS. LAW. 1091, 1103 (1968) [hereinafter Kennedy]; Note, *Application Of Margin Requirements To The Cash Tender Offer*, 116 U. PA. L. REV. 103 (1967).

Ostensibly, the problem may be circumvented if the offeror procures his financing through foreign lending institutions, which are not within the purview of the aforesaid regulations. *Accord*, Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., CCH FED. SEC. L. REP. ¶ 92,471 (S.D.N.Y. Aug. 8, 1969).

64 Schedule 14D, 17 C.F.R. § 240.14d-101 (1970). The information required by this schedule includes: the identification of both the security sought and the offeror; the reasons for the recommendation to accept or reject the offer; the identity of the filer of this statement plus any agreements that may exist between him and the issuer or the offeror; and a list of the persons employed by the filer to make solicitations or recommendations to shareholders. Copies of such solicitations must also be filed.

65 *See* Sauerhaft, *And Now—A Raid on the Raiders?*, DUN'S REV., May 1969, at 56.

66 This plan should include early warning procedures which will put the "target" on notice before the actual offer is made. Shareholder lists should be analyzed to see where large holdings are located. Letters to shareholders should be prepared advising them to make no decision prior to management's recommendation (an exempt communication under rule 14d-2). At the same time, management should be preparing its recommendations and possible courses of action. *See generally Defensive Tactics*.

67 Amending these instruments must be done in accordance with the applicable state law procedures. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(d) (1967); N.Y. BUS. CORP. LAW § 704 (McKinney 1963) (classifying the board of directors, providing a staggered election system making control more difficult to achieve); DEL. CODE ANN. tit. 8, § 214 (1967); N.Y. BUS. CORP. LAW § 618 (McKinney 1963) (cumulative voting); DEL. CODE ANN. tit. 8, § 216 (1967); N.Y. BUS. CORP. LAW § 616 (McKinney 1963) (require extraordinary requirements for shareholder action particularly in regard to approving a merger and amending the by-laws or charter). When utilizing defensive tactics which involve amending charters to change voting rights, it is essential to consider stock exchange policies. *E.g.*, NEW YORK STOCK EXCHANGE, COMPANY MANUAL, at A-280-A-282 (1969) (the exchange will not list a nonvoting stock which is, in effect, a common stock or preferred stock, or stocks with unusual voting privileges). *But see* New York Stock Exchange Press Release, Feb. 12, 1970 wherein the Exchange expresses approval of the listing of long-term stock warrants for trading.

It is also feasible to have inserted in all outstanding loan agreements a triggering device which will accelerate maturation of the indebtedness in the event of a merger.

information required for a schedule 14D filing readily available. When a raid materializes, a great deal of time will be saved and management's recommendations will almost immediately be in the hands of the shareholders.

Significantly, one of the incumbent's most potent weapons has been affected, *i.e.*, the repurchase of the company's own shares. Broadly speaking, this tactic has a double-barreled effect insofar as it reduces the amount of shares available for tendering and concomitantly increases the market price of the target's stock: (1) it impedes the offeror's attempt to gain control, and (2) it inhibits the shareholders incentive to tender. However, it is now impossible for the issuer to repurchase its shares during a cash tender offer unless the information required by rule 13e-1 is filed both with the SEC and the shareholders.[68]

From the investor's viewpoint, the situation has proceeded to a point where information is made available to him; whether he has the ability of comprehending it is another problem.

PRACTICAL PROBLEMS: FRAUD AND MANIPULATION

Electronic Specialty Co. v. International Controls Corp.

The heart of any securities regulation is necessarily that portion which allows redress of grievances. Section 10(b)[69] and the ubiquitous rule 10b-5[70] promulgated thereunder have historically been the watchdogs in the purchase and sale of securities, keeping both the transactors and the transactions honest. Although theoretically the SEC had the power under section 10(b) to regulate cash tender offers, it never brought them within the ambit of regulation.[71] The Commission waited for the congressional authority which finally came in the form of section 14(e).

See A. CHOKA, BUYING, SELLING, AND MERGING BUSINESSES 3 (3d ed. 1969) [hereinafter A. CHOKA].

Defensive mergers are still available as a thwarting device against an unwanted take-over. In their preparations, incumbent managements are well advised to keep their eyes open for possible candidates for this purpose. The problem in this area is the necessity of stockholder approval for such action in many states and under stock exchange rules. *See, e.g.*, N.Y. BUS. CORP. LAW § 910 (McKinney 1963); NEW YORK STOCK EXCHANGE, COMPANY MANUAL, at A-284. *See also* Sauerhaft, *supra* note 65; Abele, *supra* note 17.

68 *See* National Union Elec. Corp. v. National Presto Indus., Inc., CCH FED. SEC. L. REP. ¶ 92,460 (W.D. Wis. July 8, 1969). *See also* note 45 *supra*.

69 48 Stat. 891 (1934), *as amended*, 15 U.S.C. § 78j(b) (1964).

70 17 C.F.R. § 240.10b-5 (1970).

71 *See* Note, *The Regulation of Corporate Tender Offers Under Federal Securities Law: A New Challenge for Rule 10b-5*, 33 U. CHI. L. REV. 359 (1966).

Electronic Specialty Co. v. International Controls Corp.,[72] is the first appellate consideration of the 1968 Amendments. Defendant, International Controls Corporation (ICC), a manufacturer of valves, controls, computer and aircraft parts had initiated unproductive merger negotiations with plaintiff, Electronic Specialty Company (ELS), a manufacturer of electronic and aerospace components and systems, as part of the former's acquisition program. When these preliminary discussions aborted, ELS announced that it had agreed instead to merge with a third corporation, Carpenter Steel Company. ICC, on being apprised of the pending merger, orally agreed with ELS that the latter would repurchase at $42 per share up to 50,000 shares of its own stock that ICC had acquired on the open market prior to their merger negotiations. Advised that the agreement was unenforcible, ICC went to the market in an effort to dispose of the stock and managed to sell a small percentage.

Unfortunately for ELS, the market reaction to its proposed merger was unfavorable and its stock price plummeted. ICC sought the opportunity to renew its tender offer and the shareholder reaction to the offer was overwhelming — "considerably . . . [greater] than ICC expected or wished."[73]

Shortly after the announcement of the tender offer, ELS filed suit in the Southern District of New York, under section 14(e) and rule 10b-5, in an effort to compel ICC to divest itself of ELS stock and to restrain the voting of the same, alleging that ICC, by its president, Robert Vesco, had misled shareholders by material misrepresentations[74] and omissions in the written tender offer,[75] and, by manipulative devices, had calculated to depress the price of ELS's shares.[76] Included

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[72] 409 F.2d 937 (2d Cir. 1969).

[73] *Id.* at 944.

[74] The misstatements in question appeared in the Wall Street Journal and on the Dow Jones Broad Tape; ELS alleged that ICC was responsible to correct this misleading material. The press release was apparently the result of an interview between Vesco and a columnist. In any event, Vesco denied making the published comment. *Id.* at 950 & n.11. The Dow Jones statement in issue came over the tape at the time the ICC negotiations had broken down and ELS had begun merger discussions with Carpenter. It related that no tender offer was contemplated presently. *Id.* at 950 & n.9.

[75] The tender offer was considered misleading by ELS because of its niggardly expression of ICC's subsequent plans for the "target"; the offer had merely recited that ICC would give consideration to a merger with ELS. On the basis of the concern over the adequacy of this portion of the offer, ICC amended its tender offer to include that the merger consideration would be on the basis of relative market prices during a representative period.

[76] It was alleged that in this manner ICC made its tender offer price more attractive. 409 F.2d at 943.

among the plaintiffs was the corporation itself; one Burgess, a large nontendering shareholder of ELS, purporting to represent all such shareholders; and one Fitzsimmons, a tendering shareholder, purporting to represent all such shareholders. At trial, the relief sought was denied in both instances, the denial of the preliminary injunction being conditioned upon trial at the October term.[77] Upon trial of the latter issue, the tendering shareholder's cause of action was summarily dismissed because ICC (following the "unexpected" success of its offer) had amended the offer to permit tendering shareholders the option of withdrawing their shares. As to the nontendering shareholders and the corporation, standing was recognized. The court refused to divest and restrain ICC from voting the acquired shares but believed that Vesco's statements had misled ELS and the public as to ICC's intention to make a tender offer, as to its intention to sell or not sell the ELS shares originally acquired and as to the number of shares it had acquired on the open market, all in violation of rule 10b-5 and section 14(e). Consequently, ICC was enjoined from further violating the 34 Act.[78]

On appeal, the Court of Appeals for the Second Circuit agreed with the district court's determination that both nontendering shareholders and the "target" corporation have standing to sue under section 14(e), a commodity not clearly available to 10b-5 suitors. The court did not, however, limit itself to the facts presented; rather it found "the issues raised about the standing of the target corporation and nontendering stockholders [to be of] such general importance in the enforcement of § 14(d) and (e) as to make an expression of our views desirable."[79] Having divested itself of the factual limitations, the court concluding that the interests of the "target" and nontenderers were "sufficiently independent to give standing to both under all the provisions added to § 14,"[80] affirmed the lower court's recognition of standing. However, considering the alleged misstatements, the court found that the statement following the announcement of the tender offer concerning a possible merger was sufficiently accurate and did not require elaboration. Indeed, as the court carefully noted, it is often just as serious to "overstate the definiteness of the plans as to understate them."[81] Since the Vesco announcement was skeletal, the court, by diluting the express requirement that the raider disclose "any plans

[77] 296 F. Supp. 462 (S.D.N.Y. 1968).
[78] 295 F. Supp. 1063 (S.D.N.Y. 1968).
[79] 409 F.2d at 945.
[80] *Id.* at 946.
[81] *Id.* at 948.

or proposals [he] may have,"[82] at least impliedly, approved broader statements as to a raider's subsequent plans. As to the final allegations, ICC was under no duty to correct unattributable misstatements, while the report over the broad tape was found to be accurate at the time it was released. Consequently, the complaint against ICC was dismissed.

The Effect of Section 14(e) and Electronic: A Burial Plot for Rule 10b-5

Prior to the passage of the Williams Act, most tender offer suits were prosecuted under the broad anti-fraud provisions of rule 10b-5; identified as a proper vehicle for the vindication of shareholders' rights,[83] but judicially limited to actions by "purchasers or sellers."[84] Insofar as both "targets" and nontenderers have generally been denied this status, 10b-5 has remained beyond their grasp.

While the passage of section 14(e) evinces a deep congressional concern over the plight of nontenderers and "target" companies, questions involving the viability of 10b-5 as a regulatory device are presently before the courts. In *Iroquois Industries, Inc. v. Syracuse China Corp.*,[85] the Second Circuit, reasoning that the 1968 Amendments evidenced that both the offeror and "target" corporations lacked standing to sue under rule 10b-5, refused to abandon the "purchaser/seller" doctrine enunciated in *Birnbaum v. Newport Steel Corp.*,[86] and upheld the dismissal of a 10b-5 claim brought by an offeror.

A more recent contribution to the portrait of 10b-5's role in the regulation of cash tender offers is *Crane Co. v. Westinghouse Air Brake Co.*[87] Seeking to frustrate Crane's take-over bid, Air Brake sought to effect a defensive merger with American Standard Company. Pursuant to a complex trading scheme, Air Brake in concert with American Standard, effectively manipulated the market price of the former's shares, thereby thwarting Crane's overtures. Significantly, upon the subsequent consummation of the proposed merger between Air Brake and American Standard, Crane being a direct competitor of Standard, was forced (because of a threatened antitrust action) to divest itself of the shares

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[82] Rule 14d-1, 17 C.F.R. § 240.14d-1 (1970); Schedule 13D, 17 C.F.R. § 240.13d-101 (1970).

[83] *See generally* Lockwood, *Corporate Acquisitions And Actions Under Sections 10(b) and 14 Of The Securities Exchange Act of 1934*, 23 Bus. Law 365 (1968).

[84] Under rule 10b-5, a plaintiff must be a purchaser or a seller in order to get relief. *See, e.g.*, Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). *Compare* Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); Entel v. Allen, 270 F. Supp. 60 (S.D.N.Y. 1967).

[85] CCH Fed. Sec. L. Rep. ¶ 92,526 (2d Cir. Nov. 3, 1969), *petition for cert. filed*, 38 U.S.L.W. 3454 (May 7, 1970).

[86] 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

[87] CCH Fed. Sec. L. Rep. ¶ 92,532 (2d Cir. Dec. 10, 1969).

it had picked up on the open market. Shortly thereafter, Crane commenced an action alleging, among other things, violation of rule 10b-5. Concluding that Crane was a "forced seller" under *Birnbaum*, the Second Circuit held Air Brake's failure to disclose the manipulative trading scheme a material omission, thus actionable under 10b-5.

While *Iroquois* and *Crane* reflect a clear judicial refusal to abandon the stringencies of *Birnbaum*,[88] conjecture as to the ultimate resolution of the issue, in view of the enactment of section 14(e), would seem merely academic. Clearly, the latter provision will provide the proper standard for redress.

Beyond providing an explicit formulation of the requisite capacity to sue under sections 14(d) and (e), *Electronic* affirms an earlier test of materiality: whether any shareholders who tendered their shares would probably not have done so had the alleged violation not occurred.[89] Clearly, such a test is more stringent than that presented by the court in *SEC v. Texas Gulf Sulphur Co.*[90] as determinative of materiality in a 10b-5 situation. That test defined information "which may affect the desire of investors to buy, sell, or hold the company's securities"[91] as material. However, in other respects section 14(e) is not as stringent as rule 10b-5. For instance, as *Electronic* establishes, a plaintiff need not be a purchaser or a seller[92] in order to seek redress under 14(e);[93] nor is it necessary that he be an "insider" for the duty of disclosure to attach.[94] Nevertheless, the plaintiff must establish that irreparable damage

88 *Cf.* Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967) (favoring what has been termed a "broad construction of 'purchase' and 'sale'," see Note, *supra* note 34, at 380 n.21).

89 *See* Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840, 843 (2d Cir. 1967). *See also* Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., CCH FED. SEC. L. REP. ¶ 92,470, at 98,224 (S.D.N.Y. Aug. 2, 1969).

90 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

91 *Id.* at 849.

92 *See* note 84 *supra*.

93 *See* 6 Loss 3620; Kennedy at 1113-14. A shareholder who accepts a tender offer naturally has standing under rule 10b-5. But a non-tenderer or the "target" company generally will not qualify as a purchaser or a seller. *But see* Neuman v. Electronic Specialty Co., CCH FED. SEC. L. REP. ¶ 92,591 (N.D. Ill. Dec. 31, 1969).

An important element in the reasoning on the standing issue in *Electronic* may be traced to the court's penchant to effectuate the legislative intention behind the Williams Act, *i.e.*, adequate disclosure for the public investor. The court saw its quest to be enforcement of that which "will best accomplish the purposes of the legislature." 409 F.2d at 946. To this end, standing was recognized for both non-tenderers and the "target." Similarly, in finding that ICC had not violated the securities law, the court looked to the congressional intendment and found the primary motivation to be the embellishment of "basic honesty and fair dealing [rather than the imposition of] an unrealistic requirement of laboratory conditions that might make the new statute a potent tool for incumbent management to protect its own interests against the desires and welfare of the stockholders." *Id.* at 948.

94 *See* Fleischer & Mundheim at 331-32; Swanson at 460. The greatest problem in

will result should the relief requested be denied,[95] and that he is reasonably certain of success in an action on the merits.[96]

Other Arenas of Fraud Collateral to the Cash Tender Offer: Short Tendering and Market Purchases During the Life of an Offer.

In order to further reduce the possibility of fraud in connection with tender offers, the Commission has adopted two rules under section 10(b). Rule 10b-4[97] is addressed to the practice known as short tendering and rule 10b-13[98] is designed to prohibit a tender offeror from purchasing on the open market while his offer is in effect.

A tender offer may not require that the stock certificates be deposited if a bank or member firm of an exchange guarantees their delivery on demand or at a specific time. This policy has led to a greater appreciation of short tendering. For example, if pursuant to a tender offer, shares were to be accepted pro rata and a clever broker estimated that only half of his shares would be accepted, he would tender twice as many shares as he owned. Without having to deposit them, he was assured of disposing all the shares he actually owned. In an effort designed to eliminate this practice, the Commission adopted rule 10b-4 which makes it a manipulative or deceptive device or contrivance for any person to tender for his own account any security he does not own, or to tender or guarantee the tender of another unless the security is in the tenderer's possession or the guarantor has reason to believe that the person owns the security and will deliver it.[99]

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getting corporate raiders involved in cash tender offers under 10b-5 is affixing a duty to disclose their impending plans. In most cases, when the plan is formulated, the raider has no connection whatsoever with the "target." Consequently, no "insider" responsibility to disclose its plans to the "target's" shareholders is present. *See, e.g.*, Mills v. Sarjem Corp., 133 F. Supp. 753 (D.N.J. 1955).

95 *See* Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc., CCH FED. SEC. L. REP. ¶ 92,557 (2d Cir. Jan. 8, 1970), *aff'g* ¶ 92,543 (S.D.N.Y. Dec. 24, 1969); Symington Wayne Corp. v. Dresser Indus., Inc., 383 F.2d 840 (2d Cir. 1967); Walston & Co. v. Haven Indus., Inc., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,364 (S.D.N.Y. Mar. 5, 1969); Armour & Co. v. General Host Corp., 296 F. Supp. 470 (S.D.N.Y. 1969).

96 The limits of federal regulation would further suggest that the plaintiff allege and prove either use of the mails or interstate facilities in the tender offer, or registration of the "target" company under the 33 or the 34 Act.

> § 14(e), alone of all the SEC fraud provisions that are not grounded on a registration requirement that is itself conditioned on some use of the mails or interstate commerce . . . is completely silent with respect to these assumed prerequisites to federal jurisdiction.

6 Loss 3661.

97 17 C.F.R. § 240.10b-4 (1970).

98 17 C.F.R. § 240.10b-13 (1970). This rule was recently adopted in SEC Securities Exchange Act Release No. 8712 (Oct. 8, 1969).

99 *See Hearing, supra* note 31, at 14 (statement of Mr. Cohen). *See also* 6 Loss 3662-63.

In most cases, a tender offeror is interested in obtaining control of the "target"; and this goal is usually accomplished by acquiring a majority of the outstanding shares. Frequently, a majority interest may be obtained from those few shareholders who own a controlling block of securities. When a tender offer is announced, controlling shareholders realize their superior bargaining position and may sell only at a higher consideration than that specified in the offer. This state of affairs often leads to private bartering between the offeror and the controllers, the results of which often deliver a profit to the large shareholder at the expense of the minority shareholder who does not command the leverage necessary to manipulate the offeror. Cognizant of such abuses, the Commission promulgated rule 10b-13 which prohibits the offeror from purchasing equity securities of the same class to which his offer pertains during the period of the tender offer in any manner other than pursuant to the terms of the tender offer. In this form, the rule protects the interests of shareholders who have already tendered their shares and prevents the large shareholders from exploiting the power incidental to their controlling positions. The rule covers the period from the time the offer is announced until the time the offeror must either accept or reject the tendered shares. The Commission feels that the pre-tender period is adequately covered by rule 10b-5 and is therefore not included within the coverage of 10b-13. The rule is applicable to cash and stock tender offers alike but does not apply to purchases by the issuer or employees pursuant to stock option or purchase plans.[100]

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[100] It should be noted that sly controllers who make an agreement with the offeror during the tender offer period to purchase their shares after the offer has elapsed are within the ambit of rule 10b-13. The original SEC proposal in this area required the offeror who purchased outside the realm of his offer to take up *all* tendered shares at the highest consideration given for any security of the class sought. *See* SEC Securities Exchange Act Release No. 8391 (Aug. 30, 1968). Apparently, a substantial amount of criticism concerning the original proposal was delivered to the SEC causing the rule to be amended to its present form. The main objection to the original proposal is that a "forced" sale goes far beyond the simple disclosure philosophy upon which our securities laws are based. *See* Schmults & Kelly, *supra* note 34, at 26-27.

For other reasons, the promulgation of 10b-13 has not ended the criticism launched upon it by some members of the securities bar. *See generally* Lowenfels, *Rule 10b-13, Rule 10b-6 And Purchases Of Target Company Securities During An Exchange Offer,* 69 COLUM. L. REV. 1392 (1969) wherein the author takes umbrage at the passage of the rule without observation of the traditional requirement that comment and criticism be accepted from the public prior to promulgation. Mr. Lowenfels' forcible argument takes issue with the SEC position that rule 10b-13 is but a "codification of existing interpretations under Rule 10b-6." *See* SEC Securities Exchange Act Release No. 8595 (May 5, 1969).

> Few members of the securities bar were ever aware of the staff's position and fewer members understood it. No in-depth rational analysis has ever been presented to justify this position.

Lowenfels, *supra,* at 1409.

The penalties ultimately levied upon a violator of the anti-fraud provisions in a cash tender offer are not punitive,[101] and where the violation is due to mistake[102] rather than chicanery, the penalty imposed may amount to an official chastisement and an order to desist from such conduct in the future.[103] Furthermore, a violator may effectively diminish prolonged litigation by merely consenting to the entry of an injunction without admitting the substantive violations. Of course, both the plaintiff (usually the SEC) and the court must also agree to such action, but when permitted this procedure amounts to a promise to avoid future possible violations of the anti-fraud provisions.[104]

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101 In fact, punitive damages are not recoverable under either the 33 or the 34 Act. *See, e.g.*, Globus v. Law Research Serv., Inc., CCH FED. SEC. L. REP. ¶ 92,474 (2d Cir. Sept. 9, 1969), *cert. denied*, 38 U.S.L.W. 3316 (Feb. 24, 1970); Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969).

102 However, one mistake which may prove very costly to an offeror occurs when he has become an investment company within the contemplation of the Investment Company Act of 1940, *i.e.*, if 40 percent of the company's assets is comprised of securities in another company, it has become an investment company. § 3(a)(3), 54 Stat. 797 (1940), *as amended*, 15 U.S.C. § 80a-3(a)(3) (Supp. IV, 1969).

The Act does provide exemptions in which an acquiring company must fall in order to avoid the stigma of being an investment company. The "target" must become a wholly owned subsidiary of the raider (but not engaging in the investment business) — an automatic exemption; or if the "target" is only controlled by means of a majority of the shares (and it is not an investment company) an exemption may be obtained from the SEC. § 3(b), 54 Stat. 797 (1940), *as amended*, 15 U.S.C. § 80a-3(b)(1),(2) (Supp. IV, 1969).

If the acquirer has to wait for an SEC exemption order, it may technically be operating as an unregistered investment company. The penalties for the unregistered operation of an investment company include the prohibition from selling any securities and from engaging in any business which involves interstate commerce. § 7(a), 54 Stat. 802 (1940), 15 U.S.C. § 80a-7(a) (1964). Furthermore, any contracts the company makes are totally void. § 46(b), 54 Stat. 845 (1940), 15 U.S.C. § 80a-46(b) (1964). *See generally* Kerr, *The Inadvertent Investment Company: Section 3(a)(3) of the Investment Company Act*, 12 STAN. L. REV. 29 (1959). *See also* SEC v. Fifth Ave. Coach Lines, Inc., 289 F. Supp. 3 (S.D.N.Y. 1968).

103 *Cf. In re* Susquehanna Corp., CCH FED. SEC. L. REP. ¶ 77,741 (SEC Aug. 5, 1969). This administrative proceeding was based on alleged misstatements in a schedule 13D filed by the acquiring company. The hearing officer found the statements materially misleading under section 13(d). The schedule had been filed in accordance with that section after the tender offer had been completed. The holding of the case was appropriately limited to section 13(d), thus eliminating any determination under section 14(d). (The misleading statements regarded the acquirer's intentions concerning the acquired company.) Susquehanna was ordered to file an appropriate amendment to its schedule 13D. Subsequent judicial consideration of the issue trods the path forged by *Electronic*. The Court of Appeals for the Fifth Circuit determined that the raider's future intentions were adequately disclosed in a statement which proclaimed no plan to liquidate or merge the "target" but reserving the right to review this position in the future. *See* Susquehanna Corp. v. Pan Am. Sulphur Co., CCH FED. SEC. L. REP. ¶ 92,610 (5th Cir. Mar. 13, 1970).

104 *See* SEC v. Parvin/Dohrmann Co., CCH FED. SEC. L. REP. ¶ 92,500 (S.D.N.Y. Oct. 30, 1969).

Transfer of Corporate Control: Section 14(f)

The cash tender offer facilitates the transfer of corporate control in the absence of management cooperation; other techniques, *e.g.*, merger and sale of assets, demand such affiliation.[105] Once the tender offer is completed, either "working control" through the existing board of directors or complete control through a new directorate is possible.[106] Generally, control is effectuated through share voting and whenever such voting is contemplated, the strict proxy regulations of the Commission must also be accorded substantial notice.[107] Assuming that the tender offeror's immediate goal is to acquire control and he is able to accomplish this objective by simply dealing with a controlling shareholder, undoubtedly he will do so. The typical situation consists of a controller selling his shares, at a profit, to the raider. The raider, in return, may request that the present board of directors resign. The federal proxy rules are ill-equipped to prevent such forced resignations and the subsequent installation of the raider's men on the board of directors.[108] Moreover, it is not entirely clear that a majority share-

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105 Where management opposes a more conventional form of acquisition, the tender offer may be the only way to effect it. As noted, other techniques, such as merger and asset acquisition, require its support. While the use of the tender offer as an alternative to merger or sale of assets is not without its costs, it would seem far superior to a proxy contest as a prelude to gaining control. *See generally* Fleischer & Mundheim at 318-22.

106 *See* Swanson at 437-38 & n.22:

> Several kinds of control are possible, including (1) complete ownership of the capital stock, (2) majority ownership, (3) majority ownership with a legal device, such as pyramiding through holding companies, voting trusts, and issues of non-voting stock, (4) minority control with shareholders widely and diversely scattered, (5) management control by self-perpetuation where the majority of shareholders are too dispersed and disinterested to exert a controlling influence, (6) proxy control through committees, and (7) interlocking corporate officers and directors.

107 § 14(a),(b),(c), 48 Stat. 895 (1934), *as amended*, 15 U.S.C. § 78n(a),(b),(c) (1964); Regulation 14A, 17 C.F.R. § 240.14a-1 *et seq.* (1970); Regulation 14C, 17 C.F.R. § 240.14c-1 *et seq.* (1970). The philosophy behind the proxy rules is the same as that behind the Williams Amendments, *i.e.*, to give shareholders the opportunity to intelligently exercise the rights concomitant to ownership of the corporation. In this instance, the right is the exercise of the corporate voting franchise. The proxy rules are both technical and vastly complex, but an important consideration in any corporate take-over when shareholder voting is required. *See generally* E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL (1968).

108 *See* Ratner, *Section 14(f): A New Approach To Transfers Of Corporate Control*, 54 CORNELL L. REV. 65 (1968).

> The reason that the proxy rules have been inapplicable in these situations is the provision in most state laws which permits the directors to fill vacancies on the board in the period between annual meetings. The provision has generally been interpreted as permitting the entire board to resign seriatim at the direction of the old "controlling" shareholder and to select designees of the new "controlling" shareholder to fill their places.

Id. at 66-67.

Compare DEL. CODE ANN. tit. 8, § 142(e) (1967) *with* N.Y. BUS. CORP. LAW § 705(b) (McKinney 1963).

holder violates a fiduciary duty to the corporation or the minority shareholders by selling his controlling interest.[109] However, in view of the 1964 amendments extending the scope of the 34 Act,[110] and the judicial approval of shareholder standing to bring action for proxy rule violation,[111] an anomalous situation had developed which permitted a corporation to be "sold out" without an informed vote of the company's "owners." The addition of section 14(f)[112] relieves the problems to a certain extent[113] by requiring the requisite proxy information to be sent to shareholders when resignations and installations on the board of directors attend the sale of a controlling interest in the corporation.[114]

BRIDGE TO EXCHANGE OFFERS

The Williams Amendments have been praised for filling in a serious gap in our securities regulation[115] and criticized as insufficient in their quest for investor protection.[116] As noted above, however, tender

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109 Clearly, the fiduciary duty exists to this extent: the controller cannot deliver the corporation into the hands of looters whose only intention is to mulct the company's treasury. It is not equally clear that the controller has a duty to ensure that all shareholders are afforded the same opportunity to sell their shares. *Compare* Essex Universal Corp. v. Yates, 305 F.2d 572 (2d Cir. 1962) *with* Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955). *See also* Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628 (1965).

110 The 1964 Amendments extended the Act's coverage to certain over-the-counter markets and further required information statements to be sent to all shareholders even when proxies are not solicited. *See generally* Phillips & Shipman, *An Analysis of the Securities Acts Amendments of 1964*, 1964 DUKE L.J. 706.

111 *See* J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

112 The section is not without precedent. *Cf.* § 16, Investment Company Act of 1940, 54 Stat. 813 (1940), *as amended*, 15 U.S.C. § 80a-16 (1964).

113 § 12(g), 48 Stat. 892 (1934), *as amended*, 15 U.S.C. § 78*l*(g) (1964). The coverage of the 34 Act reaches companies having more than 500 shareholders or more than one million dollars in assets.

114 The section does not cover "the situation where a transfer of effective control is achieved by a change of less than a majority of the board or by a sale of less than ten percent of the outstanding shares." Ratner, *supra* note 108, at 69. *See also* 6 Loss 3663.

115 *See* E. ARANOW & H. EINHORN, *supra* note 107, at 585-99; W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 317-47 (1968); Hornstein, *Corporations*, 1968 ANN. SURVEY OF AM. L. 59, 66-67. *See also Hearings Before the House Comm. on Ways and Means on the Subject of Tax Reform*, 91st Cong., 1st Sess., pt. 7, at 2363-76 (1969) (remarks of Mr. Budge).

116 [w]hether [or not] the Williams Bill goes far enough in protecting investors or the public interest . . . . [i]t is arguable that there are more basic public concerns than any to which the . . . Bill is directly addressed . . . including such things as undue extension or concentration of economic power; overextension of management; control of enterprise by sinister forces; and speculative excesses, including excessive short-term borrowing or excessive leverage, pyramiding or dilution, with resulting jeopardy not to [the target's] investors but to [the acquirer's].

Cohen, *supra* note 12, at 619.

Several states have followed the lead of Congress in the regulation of cash tender offers are merely another technique for the acquisition of corporate control, the more traditional modes of which have included, among others, stock exchange offers. The functional utility of the cash tender offer subsisted in what in fact has amounted to a complete lack of federal regulation. The stock exchange offer, on the other hand, is deemed an issuance of stock and accordingly is subject to the onus of registration and Commission approval prior to the actual exchange. Inasmuch as the 1968 amendments have seriously impeded the relative value of the cash tender offer as an acquisition device, a raider in assessing prospective "targets" must consider the individual merits of each alternative. While clearly a Hobson's choice, recent data would seem to indicate a preference for the rigors of the exchange offer.

Whether this conversion is a result of the prophylactic measures of the Williams Act or the difficulty of financing cash tender offers in an era of "tight" money, the stock-for-stock exchange has acquired a renewed respectability.[117] In an exchange offer, a raider offers to trade his securities for those of the "target's" shareholders. For all intents and purposes, the transaction is one which requires the cooperation of incumbent management.[118] The exchange of stock constitutes a sale for the purpose of the 33 Act and consequently must be registered with the Commission.[119] The 33 Act does provide, however, certain exemp-

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offers. *See, e.g.*, VA. CODE ANN. §§ 13.1-528-13.1-541 (Cum. Supp. 1968); OHIO REV. CODE ANN. § 1707.041 (Page 1969).

The Ohio provisions are far more prophylactic than the federal regulation. Unlike the Williams Act, the Ohio law, which became effective Oct. 9, 1969, is aimed at annihilating the cash tender offer. The state law requires a tender offeror to make public the terms of his bid at least 20 days before the offer is officially made.

[117] In an exchange offer, the offeror in effect prints his own financing. Unlike a cash tender offer, there is no need to hold outside financing together and there is no outsider, such as a bank, to act as a check on the soundness of the original or subsequent offers. In addition, as makers of exchange offers issue new types of securities to effect takeovers, the financial structures of their companies become more complex and, consequently, the merits of the exchange more difficult to evaluate.

Mundheim, *supra* note 60, at 956. *See also* Hamilton, *supra* note 34, at 270 & n.2.

[118] Absent such affiliation, an effective prospectus will be all but impossible to prepare. Equally important is the cooperation of the "target's" shareholders. Their action is voluntary, *i.e.*, each shareholder is free to accept or reject the offer on an individual basis. Conceptually, the prospectus must be provided so that the shareholder will be able to make an intelligent decision. *But see* Kennedy at 1103 wherein the author observes:

> In effect, the prospectus resembles a proxy statement prepared in connection with a merger; it is a formidable and lengthy document incomprehensible to most shareholders.

[119] § 2(3), 48 Stat. 74 (1933), *as amended*, 15 U.S.C. § 77b(3) (1964). "The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value." *See* United States v. Wernes, 157 F.2d 797 (7th Cir. 1946); United States v. Ridel, 126 F.2d 81 (7th Cir. 1942).

The form required to be filed for a stock-for-stock exchange is the lengthy S-1, tions from its registration provisions which may be invoked where a company falls neatly within the mandates of these sections.[120] The problem of premature disclosure, however, attends registered exchange offers and registered offerings generally. The difficulty ordinarily materializes during the pre-filing period when an agreement has been reached but no registration statement has been filed with the Commission. Consequently, any announcement may be interpreted as soliciting prospective purchasers for the stock of the combined company in violation of the 33 Act.

Jumping the Gun

Chris-Craft Industries, Inc. v. Bangor Punta Corp.,[121] demonstrates the problem of releasing information prior to the filing and effective date of the registration statement. Chris-Craft evidenced an interest in acquiring the Piper Aircraft Corporation in January of 1969. It quietly began picking up Piper shares on the open market. Subsequently, it made an exchange offer with Piper shareholders in which Chris-Craft mustered 34 percent of the outstanding shares. Following this episode, Chris-Craft proposed to make a follow-up exchange offer but met with opposition from the Piper family.

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17 C.F.R. § 239.11 (1970). *See* SEC Securities Act Release No. 4936 (Dec. 9, 1968). *See also* G. McCarthy, Acquisitions and Mergers 187 (1963) [hereinafter G. McCarthy].

The raider must submit certain information in the S-1 concerning the "target." Embarking on an exchange offer without the cooperation of incumbent management in the preparation of the S-1 is unwise. Section 11 of the 33 Act provides express relief for shareholders injured by misstatements or omissions in the registration statement. 48 Stat. 82 (1933), *as amended*, 15 U.S.C. § 77k (1964). Like other anti-fraud sections, a section 11 action is based upon untrue statements of material facts. However, "material" is defined as "those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." Rule 405(1), 17 C.F.R. § 230.405(1) (1970). In a very real sense, the registrant must make "full disclosure." Additionally, a suitor under section 11 need not be in privity with the defendant in his action. He may sue the corporation, its directors, the underwriters of the issue, experts named in the registration statement and any person who has signed the statement. Furthermore, a plaintiff in a section 11 action does not have to prove that the defendant knew of the false or omitted statements. Ordinarily, a plaintiff will not have to show that he relied on the false or omitted statements. Concerning the amount of care required in preparing a registration statement, see Escott v. Bar-Chris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968). *See generally* 3 Loss 1721-42.

The required information about the "target" includes a summary of its earnings, its organization, affiliates or parents if any, a description of its business and property, and any pending legal proceedings.

120 48 Stat. 75 (1933), *as amended*, 15 U.S.C. § 77c (1964) (exempted securities); 48 Stat. 77 (1933), *as amended*, 15 U.S.C. § 77d (1964) (exempted transactions). *See generally* 1 Loss 559-708. If any exemption is satisfied, the company will be able to avoid the expensive and time-consuming process of filing a prospectus. *Cf.* C. Schneider & J. Manko, Going Public Practice, Procedure and Consequences 21-25 (1969).

121 CCH Fed. Sec. L. Rep. ¶ 92,510 (2d Cir. Nov. 6, 1969), *aff'd en banc*, ¶ 92,648 (2d Cir. Apr. 28, 1970).

Seeking to prevent Chris-Craft from assuming control, the family advised the Piper shareholders that the offer was inadequate. In defense they sought to effect a merger with the Grumman Company, a venture which failed to materialize but which did effectively limit the success of the Chris-Craft offer. Throughout the proceedings, the Bangor Punta Corporation retained an interest in Piper, contingent upon acquiring the Piper family holdings. As a result of the family's militant opposition to Chris-Craft, negotiations were resumed with Bangor. An agreement was subsequently reached whereby Bangor was to receive the Piper family holdings in return for which it promised to use its best efforts to acquire control of Piper and thereby eliminate the Chris-Craft threat.[122] Eventually, mutual press releases[123] were issued by Bangor and Piper concerning the proposed merger and exchange offer. However, Bangor never filed a registration statement covering the proposed issuance and the Commission quickly moved to prevent further advertisement of the transaction. Through mutual consent, a permanent injunction was entered which prohibited Bangor and Piper from offering to sell or selling the proposed securities until a registration statement was filed.[124] Subsequently, Bangor complied by filing the requisite statement. However, by this time Bangor had received numerous tenders pursuant to its exchange offer and also acquired some 120,000 shares for cash on the open market while the exchange offer was in operation. Chris-Craft brought an action to restrain Bangor from accepting the shares tendered pursuant to the exchange offer, from voting

122 The exchange offer, which Bangor proposed to make to Piper shareholders in order to gain control, provided that each share of Piper common would be exchanged for Bangor securities and/or cash having a value of $80 or more. Furthermore, Bangor agreed that if it could obtain control, it would ensure that the Piper family received the same consideration that was ultimately given to the other shareholders.

123 The releases provided in pertinent part:

> Bangor Punta has agreed to file a registration statement with the SEC covering a proposed exchange offer for any and all of the remaining outstanding shares of Piper Aircraft for a package of Bangor Punta securities to be valued in the judgment of the First Boston Corporation at not less than $80 per Piper share.
>
> Sales of the combined companies would reach $450,000,000 in fiscal 1969, with approximately $180,000,000, or 40%, in the aircraft, recreational and leisure time fields.

Id. at 98,374.

124 SEC v. Bangor Punta Corp., CCH FED. SEC. L. REP. ¶ 92,428 (D.D.C. May 26, 1969). The defendants consented to the entrance of the injunction without admitting any of the substantive allegations of the complaint. The complaint was based on the mutual press releases which contained the $80 value placed on the Bangor package of securities, the projected sales earnings of the combined operation, the expression of the Piper family's desire to see the merger effectuated and the announced intention to file a registration statement. All of these things presumably constituted an offering to induce investors to purchase Bangor securities in violation of § 5(c), 48 Stat. 77 (1933), *as amended,* 15 U.S.C. § 77e(c) (1964), since no registration statement was in effect.

the shares purchased through the cash transactions and from cementing a merger with Piper.

The district court, in opinions by Judge Tenney, refused the requested relief, reasoning that the contested press release was neither an offer to sell nor a solicitaton of an offer to buy in the first instance.[125] Furthermore, as a separate trial to determine whether the cash purchases during the life of the exchange offer violated rule 10b-6[126] would not be in the interest of efficient judicial administration, it was denied.[127]

In a two-to-one determination, the Court of Appeals for the Second Circuit reversed.[128] It was clear, at least to Judges Waterman and Kaufman,[129] that the press release estimating the value of the exchanged

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125 Chris-Craft Indus., Inc. v. Piper Aircraft Corp., CCH FED. SEC. L. REP. ¶ 92,465 (S.D.N.Y. Aug. 19, 1969). As the exact terms of the exchange had not been determined, the parties could do no more in the interests of their shareholders, than they did by making the press releases in question.

The court also found that certain letters which Mr. Piper had sent to the shareholders urging acceptance of the Bangor offer, were not violative of section 14(e) because no reference was made to the possible increased consideration the Piper family would receive after Bangor achieved control. Judge Tenney held that this provision was designed to compensate the Piper family for having fixed the exchange for their personal holdings more than two months prior to the actual exchange offer and at a lower price than the deal offered to the public.

> [I]t merely provided protection for the Piper family should the market value of the securities they were to receive be less than the value of the securities offered to other Piper holders.

Id. at 98,204.

126 17 C.F.R. § 240.10b-6 (1970) which prohibits an underwriter, an issuer or a broker participating in such distribution from bidding for or purchasing the securities in which he has a beneficial interest or are the subject matter of the proposed distribution. It also prevents soliciting "buy" orders while the party engages in the distribution.

127 Chris-Craft Indus., Inc. v. Piper Aircraft Corp., CCH FED. SEC. L. REP. ¶ 92,467 (S.D.N.Y. Aug. 28, 1969).

> It must be remembered . . . that both Chris-Craft and Bangor Punta are seeking to gain control of Piper. Even assuming, *arguendo*, that a trial on this separate issue would indicate a violation by Bangor Punta of Section 10(b) or Rule 10b-6 and that divestiture should be ordered, and, further, that Chris-Craft were able to purchase every one of these 120,200 shares of Piper stock, plaintiff would still have failed to achieve the end which has provided the motivation for this suit, that is, control of Piper.

Id. at 98,213.

Chris-Craft alleged that when they had made their exchange offer, the Commission warned them that any purchasing done outside the offer would violate rule 10b-6. It seemed logical that the same proviso would be applicable to Bangor Punta.

128 By the time this appeal was argued Bangor had attained 52.7 percent of the outstanding shares while Chris-Craft had 46.2 percent. Accordingly, the Second Circuit refused to grant a preliminary injunction, concluding that since any possible harm to Chris-Craft had already been consummated, there would be no danger that Chris-Craft would suffer irreparable damage. CCH FED. SEC. L. REP. ¶ 92,510, at 98,375, *citing* Studebaker Corp. v. Gittlin, 360 F.2d 692, 698 (2d Cir. 1966). Furthermore, Bangor assured the court that no merger would be effected prior to the outcome of the litigation.

129 When it is announced that securities will be sold at some date in the future and, in addition, an attractive description of these securities and of the issuer is

securities at $80 was an offer to sell within the contemplation of section 5(c);[130] nor did this offer come within the exemptions of rule 135.[131] The liability-producing error was in fixing a price on the value of the exchange, because this estimate tended to encourage a formulation of the stock's value in the minds of prospective purchasers, without the benefit of a prospectus to aid them in their decision.

Although Bangor had contended that the information had to be disclosed under the present test of materiality,[132] the court held that the only material fact required to be revealed was its commitment to offer its securities for the Piper securities; there was no compulsion to disclose a market value.[133] Consequently, the press release violated section 5(c) and the court remanded this issue for a determination of the appropriate remedy.

Unlike Judge Tenney, the Second Circuit considered the 10b-6 allegation. Judge Waterman explained that a primary purpose of the rule is to prevent market manipulation by the issuer. Bangor contended that its purchases on the open market could only drive the stock's price up and thus make its exchange offer less attractive. The court disagreed reasoning that "this argument overlooks the decided benefits that purchases of target company stock can produce for the initiator of an exchange offer."[134] The true effect of this sort of manipulation is that it prods many investors into believing that the stock's rise is due solely to the "bullish" effect the exchange offer has upon the market. "Prevention of this kind of manipulation seems well within the spirit of Rule

> furnished, it seems clear that such an announcement provides much the same kind of information as that contained in a prospectus.

CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,376.

130 48 Stat. 77 (1933), *as amended,* 15 U.S.C. § 77e(c) (1964):

> It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security . . . .

131 17 C.F.R. § 230.135 (1970) allows certain notices to be sent by an issuer without incurring liability for offering a security for sale. These include: notice to shareholders that certain stock subscription rights are going to be issued to them; notice that securities are going to be offered in exchange for the shares which are presently held; notice to employees that a stock offering is going to be made to them.

132 *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969); New York Stock Exchange, Company Manual, at A-19 (1969).

133

> Had Bangor Punta revealed the titles of the securities it proposed to offer and revealed the basis or ratio on which the exchange was proposed to be made, as the Rule [135] permits, all the essential parts of the proposed transaction would have been placed before the public and the potentially misleading estimate of value would have been avoided.

CCH Fed. Sec. L. Rep. ¶ 92,510 at 98,377.

134 *Id.* at 98,378.

10b-6. It is within the letter of the Rule as well."[135] Since the rule prohibits not only purchasing shares while an offer is pending but also purchasing any right to purchase such security, the court saw the Piper shares as carrying a right to acquire Bangor securities and therefore technically within the ambit of the rule. Judge Waterman admitted that Bangor might be able to show that these purchases fell within the rule's exemption, *i.e.*, that they were unsolicited purchases effected neither on a securities exchange nor from or through a broker or dealer but this defense would have to be undertaken at trial.

Chief Judge Lumbard filed a dissenting opinion in which he agreed with Judge Tenney. Like the majority, he believed that *Texas Gulf Sulphur* required the press releases, since the agreement with the Piper family constituted material information. However, he also believed that the $80 figure was required to be revealed.[136] Because of the myriad of people that would be working on the exchange offer (*e.g.*, accountants, escrow agents, bankers, printers), the likelihood of the information leaking out to people anxious to capitalize on such news was great, but the likelihood of policing the activities of such a corpulent group was very small. In this situation, it was much better that the Piper shareholders learn of the exchange offer and its terms.

In consideration of rule 10b-6, the dissent noted that the majority was unnecessarily stretching the concept embodied in that rule. "Rule 10b-6 seeks to prevent the manipulation of the price of shares which are the subject of a current or impending public offering."[137] The rule is highly technical and of limited application, *i.e.*, to an offering company purchasing its own shares on the market during a public offering in order to buoy the market price up to that fixed for the distribution.[138]

The ulitmate impact of the Second Circuit's decision is to affirm the

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[135] *Id.*

[136] While the $80 figure may seem more difficult to justify, under the circumstances its announcement was the only course open to Bangor Punta. Responding to the problem of valuation, Rule 135(c)(4) provides for notification of "the basis upon which the exchange is proposed to be made . . . ."

> Although not free from doubt, in the light of *Texas Gulf* I would read this provision as requiring announcement of the $80 figure.

Id. at 98,379 (dissenting opinion).

[137] *Id.* at 98,381 (dissenting opinion).

[138] Similarly polarized to the majority's opinion concerning violation of rule 10b-6, but on different grounds is Mr. Lowenfels' argument:

> The court's rationale does not appear persuasive. If it is important that target company stockholders be informed with respect to cash purchases outside of an existing exchange offer, then the proper course is to require public disclosure of such purchases as soon as they are consummated. To prohibit such purchases entirely seems an unnecessary encroachment upon the functioning of a free market and will tend to prevent the very enhancement in market value which the target company stockholder desires.

Lowenfels, *supra* note 100, at 1406.

Commission's position.[139] However, it does not alleviate the confusion which has attended the pre-filing and waiting periods for registration statements. It has been noted that the score in the Bangor-Chris-Craft litigation is tied—two-to-two on the issue of "gun jumping" (*i.e.*, Judges Waterman and Kaufman for, and Judges Lumbard and Tenney against).[140] This characterization certainly attests to some residual uncertainty; but stealing the Second Circuit's thunder in its "solution" is a recent study[141] and its recommendations, designed to ease the confusion pervading the "gun jumping" doctrine.

THE WHEAT REPORT

Recognizing the sound policy in restricting materials which may solicit buyer interest in a proposed offering, the Wheat Study Group set out to clarify the restrictions and harmonize them with recently expanded timely disclosure policies. As to determining whether a proposed release during the waiting or pre-filing period is forbidden, many cases are so unequivocal that a decision can be reached without lengthy deliberation. In those cases which are not so readily resolved, the Study recommends consultation with the Commission's staff to obviate any confusion: "The Study knows of no substitute for this procedure and issuers are encouraged to employ it."[142]

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139 *See* SEC Securities Act Release No. 3844 (Oct. 8, 1957). *Accord*, SEC v. Arvida Corp., 169 F. Supp. 211 (S.D.N.Y. 1958); *In re* Carl M. Loeb, Rhoades & Co. & Dominick & Dominick, 38 S.E.C. 843 (1959). The SEC position is that section 5 prohibits issuers, underwriters or dealers from beginning their public sales campaign prior to the effectiveness of a registration statement. A sales campaign may be initiated in newspaper or magazine interviews, in speeches or on radio or television or in reports to stockholders. The prime purpose of the 33 Act is to slow down the distribution process so that investors can make an intelligent decision concerning a proposed offering. This purpose is frustrated when particles of information are revealed out of context in order to tempt the investors' buying instinct. *See* 38 S.E.C. at 849-50. *See also* 1 Loss 212-23; Gadsby, *Current Problems Under Section 5 of the Securities Act of 1933 and Release No. 3844*, 13 Bus. Law. 358 (1958).

140 *See* Address by John E. Tobin, Practising Law Institute, First Annual Securities Regulation Institute, New York City, Nov. 7, 1969. Subsequent determination by the Second Circuit tips the delicate balance toward the Waterman opinion. *See* CCH Fed. Sec. L. Rep. ¶ 92,648 (2d Cir. Apr. 28, 1970).

141 Securities and Exchange Commission, Disclosure to Investors, A Reappraisal of Federal Administrative Policies under the '33 and '34 Acts (CCH ed. 1969) [hereinafter The Wheat Report]. (The Report also contains a series of separately paginated Appendices, containing recommendations in rule form. Appropriately, each shall be referred to as *Appendix*.) *See also* Schulman, Book Review, 15 Wayne L. Rev. 1374 (1969).

142 The Wheat Report at 132. The Study was satisfied that the Commission's policies and procedures on this aspect of the problem were adequate. It was more concerned with the timely disclosure problem although it stated that any conflict which would arise between an obligation to disclose and "gun jumping" would be a rare case.

> [S]uch a question will not arise very often in view of the fact that events creating a duty to make prompt disclosure . . . are relatively infrequent and consequently will not often occur during the period when the "gun jumping" doctrine inhibits corporate publicity.

Id. at 133.

As to timely disclosure, the Study would simplify the situation by exempting instances where the issuer in good faith determines that disclosure is required and the release "is purely factual and does not include predictions, conclusions or opinions."[143]

Acting upon the Report's recommendations in this instance, the Commission concurred with their findings, but believed the conflict to be "more apparent than real."[144] It should be evident that this situation, if it does arise, would occur during the pre-filing period. During the waiting period, *i.e.*, between the filing of the registration statement and its effectiveness, communications with prospective investors should be restricted to "red herrings,"[145] "tombstone" ads[146] and the announcements permitted by rule 135.[147] The Commission has also accepted the

[143] *Id.* at 133.

[144] SEC Securities Act Release No. 5009 (Oct. 7, 1969).

> Disclosure of a material event would ordinarily not be subject to restrictions under Section 5 . . . if it is purely factual and does not include predictions or opinions . . . . [When close questions arise we encourage] issuers and their counsel to seek informal consultation with the Commission's staff which is accustomed to dealing with such questions and is usually able to give rapid and definite responses.

[145] "Red herrings" are preliminary prospectuses which are identical to the final prospectus except that price and other unavailable information is omitted. It also contains a legend announcing that a registration statement has been filed but has not become effective; that the information therein contained is subject to change; and that the "herring" is not to be considered an offer to sell securities. The Commission permits these prospectuses through rules promulgated under § 10(b), 48 Stat. 81 (1933), *as amended*, 15 U.S.C. § 77j(b) (1964). *See also* Rule 433, 17 C.F.R. § 230.433 (1970) (the preliminary prospectus); Rule 434, 17 C.F.R. § 230.434 (1970) (summary prospectus prepared by independent organizations summarily containing the information required in the preliminary prospectus); Rule 434a, 17 C.F.R. § 230.434a (1970) (summary prospectus filed as part of the registration statement).

It should be noted that oral efforts to sell during the waiting period are permissible. However, acceptances of the solicited "buy" orders are not allowed until after the registration statement has become effective. *See* C. SCHNEIDER & J. MANKO, *supra* note 120, at 17-18.

[146] The "tombstone" ad or identifying statement is not considered a prospectus during the waiting and post effective periods for purposes of section 2(10), 48 Stat. 74 (1933), *as amended*, 15 U.S.C. § 77b(10) (1964) (definition of prospectus). *See also* Rule 134, 17 C.F.R. § 230.134 (1970) which contains the permissible contents of the advertisement.

The reason these ads are allowed is that conceptually they are not intended to be selling documents but rather instruments to give the issuer some idea of the number of people that would be interested in receiving a prospectus. *See* SEC Securities Act Release No. 3224 (June 6, 1947). *See generally* 1 Loss 223-45.

[147] The Wheat Study realized that many issuers contemplating a public offering make limited announcements concerning their decision in spite of the fact that the SEC might consider this practice to be "gun jumping" if no registration statement has been filed. Consequently, the Study recommends that these limited announcements in the pre-filing period be allowed. *See* THE WHEAT REPORT at 134; *Appendix* VII-2 at 1 (proposed amendment to rule 135).

In SEC Securities Act Release No. 5010 (Oct. 7, 1969), the Commission adopted this recommendation by proposing to allow limited announcements identifying the security, stating the amount of securities expected to be registered and the approximate dollar amount and time of the offering (proposed rule 135(a)(1)).

recommendations[148] which would allow an issuer in a statutory merger, consolidation or asset acquisition involving an offer of securities, to make limited announcements containing the name of the issuer, the title of securities involved, the basis of the exchange and the expected date of the transaction.[149]

"Gun jumping" also presents some very real problems to the broker/dealer which arise when he participates in an underwriting. The independence of his judgment in making recommendations is in question and gives rise to "the old conflict of interest between his functions as a 'broker' and as a 'dealer' " because of the additional consideration he may be receiving. Evidently, such questions do not arise in the absence of an underwriting. As "[i]t is apparent that a considerable uncertainty pervades the application of [the] 33 Act restrictions to the publication activities of brokers and investment advisers,"[150] the central question then is when may a broker/dealer publicize his judgments and recommendations concerning various securities.[151]

Upon the Report's recommendations[152] the Commission has proposed certain rules to salve the broker/dealer's dilemma.[153] Proposed rule 137 permits a person having no arrangements with the participants to an underwriting to publish information concerning an issuer whose securities are in registration. The recommendations made can only be in regard to issuers subject to the filing requirements of the 34 Act,[154] and the non-participant must receive no consideration for his act.[155]

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148 *Appendix* VII-2 at 1.

149 SEC Securities Act Release No. 5010 (Oct. 7, 1969) (proposed rule 135(a)(4)). The release states that this amendment is necessary in light of proposed changes in rule 133 requiring registration of securities issued in certain business combinations. *See* notes 185-91 *infra* and accompanying text.

150 THE WHEAT REPORT at 138.

151 The Study gives the following example:

> [O]ne leading brokerage firm stated that it had been unable to include in its regular quarterly survey of stocks on its recommended list any recommendation concerning American Telephone and Telegraph for a period of two years, for the reason that AT&T was always "in registration" during this period. This was so, even though the brokerage firm was not a member of any underwriting syndicate or selling group for the security . . . .
>
> Another leading brokerage firm . . . refrains from publishing a recommendation concerning a security in registration *only* when it will be included in the underwriting group.

Id. at 137.

152 *Appendix* V-1, V-2, V-3.

153 SEC Securities Act Release No. 5010 (Oct. 7, 1969) (proposed rules 137, 138, 139).

154 § 13, 48 Stat. (1934), *as amended*, 15 U.S.C. § 78m (Supp. IV 1969); § 15(d), 48 Stat. 895 (1934), *as amended*, 15 U.S.C. § 78o(d) (1964).

155 A broker/dealer who is participating in an offering will also be free to make recommendations by virtue of proposed rules 138 and 139. Proposed rule 138 will permit him to publish recommendations about an issuer's common stock when he participates in that issuer's offering of non-convertible, debt or preferred stock which

The proposed additions to the Commission's rules on "gun jumping" clarify many gray areas that could lead and may have led to many unwillful violations of the securities law. Parenthetically, however, these additions would not assuage Bangor Punta's violation, for even under these proposals a violation was embodied in the predicted earnings of the combined enterprise. The recent addition of rule 10b-13 would also prohibit the cash purchases which Bangor made on the market during its offer.

A "DECORATIVE CURLICUE":[156] THE SALE IS NOT A SALE

As has been previously noted, there are certain take-over situations wherein registration under the 33 Act is not required. Consequently, many raiders avail themselves of these exemptions in effecting a corporate take-over. Perhaps the most noble and notable is provided by SEC rule 133,[157] the notorious "no-sale" rule. The rule is applicable to mergers, consolidations or reclassifications of securities, and stock-for-assets acquisitions, accomplished through a stockholder vote of the acquired corporation when such vote is required by state law or by the corporation's certificate. The requisite vote must bind all of the corporation's shareholders, although dissenters' appraisal rights remain intact.[158] However, the rule is not intended to be a license to flood the country with unregistered securities, and therefore contains restrictions covering subsequent offerings of the exempted securities. The express restrictions in the rule itself provide sufficient problems to a claimant of the registration exemption. Additionally, the rule is jaundiced with an administrative gloss which has developed over the years.[159]

is registered on form S-7 or S-9. Proposed rule 139 permits him to publish recommendations in a market letter or industry survey when he participates in an offering of an issuer subject to section 15(d) of the 34 Act or who has securities registered under section 12 of that Act. The permissible publication must be one that has been distributed with some regularity for at least two years. The recommendation of his issuer's security must not be given "special prominence" or more favorable treatment than it has been given in the past.

156 I have a particular fondness for the many decorative curlicues and imaginative interpretations with which [the Securities Act of 1933] has been embellished over the years.

Speech by former SEC Chairman Manuel F. Cohen, ALI-ABA Conference on Current Problems of Broker-Dealer Regulations, Washington, D.C., June 7, 1968, *quoted in*, Schneider, *Acquisitions Under The Federal Securities Acts—A Program For Reform*, 116 U. PA. L. REV. 1323, 1358 n.95 (1968) [hereinafter Schneider].

157 17 C.F.R. § 230.133 (1970).

158 Rule 133(a) also allows a subsidiary to do the acquiring when the stock offered in a stock for assets acquisition is that of the parent corporation if the parent owns at least 80 percent of the subsidiary's total voting power and 80 percent of all other outstanding shares of the "puppet." 17 C.F.R. § 230.133(a) (1970).

159 *See* Kennedy, *The Case of the Scarlet Letter*, 23 BUS. LAW. 23 (1967).

The origins of the rule are based upon a "no-sale" theory in which the shareholders of a corporation are deemed an autonomous group embodying corporate action in approving the merger or acquisition; presumably there is no individual action.[160] The theory was an unmitigated one, naturally leading to abuse and subsequent SEC limitation for section 5 purposes only.[161] Furthermore, the Commission in the *Great Sweet Grass Oils*[162] litigation held that the 133 exemption does not create "free" stock perpetually liberated from registration; subsequent distributions of the stock must be registered. Nor will a preconceived plan to evade registration under the rule, *i.e.*, where the shareholders are used "merely as a conduit for distributing a substantial amount of securities to the public,"[163] or where the exchange is only a "step in the major activity of selling the stock,"[164] be condoned. Most significantly, the rule was held inapplicable where the negotiators have such control of the voting power as to render the vote a mere formality.[165]

In 1959, the rule was amended to its present form, containing certain express proscriptions from its utilization.[166] The rule triggers the registration requirements of section 5 when securities acquired in a 133 transaction are subsequently offered for sale by those considered underwriters in the 2(11)[167] sense, and therefore subject to registration. They include any person who purchases securities previously issued in

[160] *See* National Supply Co. v. Leland Stanford Junior University, 134 F.2d 689, 694 (9th Cir.), *cert. denied*, 320 U.S. 773 (1943).

[161] *See* SEC Securities Act Release No. 3965 (Sept. 15, 1958). For the history of rule 133, see generally 1 Loss 518-42; Cohen, *Rule 133 of the Securities and Exchange Commission*, 14 RECORD OF N.Y.C.B.A. 162 (1959); Sargent, *A Review of the "No-Sale" Theory of Rule 133*, 13 BUS. LAW. 78 (1957).

[162] *In re* Great Sweet Grass Oils, Ltd. & Kroy Oils, Ltd., 37 S.E.C. 683 (1957), *aff'd per curiam sub nom.* Great Sweet Grass Oils, Ltd. v. SEC, 256 F.2d 893 (D.C. Cir. 1958), *petition for review withdrawn sub nom.* Kroy Oils, Ltd. v. SEC, No. 13,920 (D.C. Cir. Dec. 10, 1958).

[163] 37 S.E.C. at 691.

[164] *Id.* The Commission was impressed with and consequently adopted the reasoning utilized in SEC v. Micro-Moisture Controls, Inc., 148 F. Supp. 558 (S.D.N.Y. 1957) (preliminary injunction), 167 F. Supp. 716 (S.D.N.Y. 1958) (final injunction), *aff'd sub nom.* SEC v. Culpepper, 270 F.2d 241 (2d Cir. 1959).

[165] The ratiocination in this situation being: "the transaction is not corporate action in a real sense, but rather is action reflecting the consent of the persons in control, and consequently results in a 'sale' as to them." 37 S.E.C. at 691.

[166] *See* SEC Securities Act Release No. 4115 (July 16, 1959); SEC Securities Act Release No. 4077 (May 4, 1959). *See also* Comment, *Recent Developments In The No-Sale Theory Under The Securities Act of 1933: Proposed Revision of Rule 133*, 47 CALIF. L. REV. 112 (1959).

[167] 48 Stat. 74 (1933), *as amended*, 15 U.S.C. § 77b(11) (1964) (definition of underwriter).

a 133 transaction from shareholders of a constituent corporation[168] with a view toward distributing the shares. Also included are those who offer or sell these securities with a view toward distribution pursuant to a contract or arrangement made with the issuer, an affiliate of the issuer, or a person who, in connection with the transaction, is acting as an underwriter of the securities.[169] Additionally, a controlling shareholder of the acquired corporation is considered an underwriter in the 133 transaction and must register his shares before any sale can be perfected.[170] However, this controlling shareholder may, in limited circumstances, be permitted to sell a small amount of the shares when accomplished via brokers transactions.[171] When invoking the leakage provisions, "buy" orders for the securities may not be solicited. The only person who may be compensated in the transaction is the broker. And finally, only certain amounts of the securities can be sold within a six month period.[172]

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168 Rule 133(f) defines a constituent corporation as any corporation, other than the issuer, which is a party to the 133 transaction described in section (a) of the rule, *e.g.*, the acquired corporation.

Section (f) also defines an affiliate as "a person controlling, controlled by or under common control with a specified person." 17 C.F.R. § 230.133(f) (1970).

169 Rule 133(b). This section also provides that its proscription is inapplicable to arrangements made in connection with a 133 transaction which allow shareholders to sell or purchase fractional interests in order to make their holdings whole interests. 17 C.F.R. § 230.133(b) (1970).

170 Rule 133(c). When the constituent corporation transfers shares of the issuer to its own shareholders upon its complete or partial liquidation, there is no distribution involved. 17 C.F.R. § 230.133(c) (1970).

171 § 4(4), 48 Stat. 77 (1933), *as amended*, 15 U.S.C. § 77d(4) (1964) exempts from the provisions of section 5 "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market, but not the solicitation of such orders."

Rule 133(e) implements the above definition as follows:

> "brokers" transactions [include] . . . transactions by a broker acting as agent for the account of the seller where (a) the broker performs no more than the usual and customary brokers' functions, (b) the broker does no more than execute an order or orders to sell as a broker and receives no more than the usual or customary brokers' commissions, (c) the broker does not solicit or arrange for the solicitation of orders to buy in anticipation of or in connection with such transactions and (d) the broker is not aware of any circumstances indicating that his principal is failing to comply with [133(d)].

The term "solicitation of such orders" includes solicitations of "buy" orders but not solicitations of "sell" orders.

If within the 60 days prior to the broker's transactions, he has received from a dealer a written bid for a security or a written solicitation of an offer to sell, a subsequent inquiry regarding the state of that dealer's bid or solicitation is not considered an unexempted brokers' solicitation. 17 C.F.R. § 230.133(e) (1970).

172 Rule 133(d). Specifically, the amounts permitted are "approximately one percent of the shares or units of such security outstanding at the time of receipt by the broker of the order to execute such transactions" if the security is not traded on an exchange. If the security is traded on an exchange, the permissible amount is either this "one percent" provision or "the largest aggregate reported volume of trading on securities exchanges during any one week within four calendar weeks preceding the receipt of such order," whichever is smaller. 17 C.F.R. § 230.133(d) (1970).

An isolated examination of the rule breeds this conclusion — securities acquired in a 133 transaction may be resold without registration if the seller is neither an underwriter nor an affiliate of a constituent corporation. This class of seller will normally include a noncontrolling shareholder of the acquired corporation. The acquired corporation and its controlling shareholders may only sell their shares within the leakage provisions of 133(d); other sales must be registered on the simplified form S-14.[173] If this form is not available and no other exemption can be found, a formal registration statement must be filed.

Ostensibly, rule 133 may seem complicated enough, however, the administrative gloss previously referred to, must also be considered. Several of these policies seem to be well-settled and understood. For instance, it is recognized that rule 133 exempts the subject securities from registration but not from the anti-fraud provisions of the Act.[174] Additionally, the rule applies to mergers and stock-for-assets acquisitions, but not stock-for-stock adventures.[175] Other policies are less transparent. For example, the negotiated transaction rule born in the *Great Sweet Grass Oils* case, but not incorporated into the 1959 revision of the rule, is still enforced.[176] Determination of a controlling person is not as easy as it may first appear, since the Commission may regard family, business or personal associates as a single entity for 133 purposes. (Particularly in determining the amount of securities which may be sold under the leakage provisions.)[177]

These examples are just a few of the varied interpretations which confronted securities specialists and have generated inconsistent opinions as to the present state of the law. Once again, the Wheat Study

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[173] 17 C.F.R. § 239.23 (1970). The form is available only "if the registrant was subject to, and solicited proxies from its stockholders with respect to such transaction in accordance with the provisions of Regulation 14A" of the 34 Act. This simplified registration statement may consist of the registrant's proxy statement plus information concerning the proposed distribution, the results of the original 133 transaction, material developments in the issuer's business and recent financial information. Moreover, the registrant must keep the S-14 current for two years pursuant to an undertaking agreement. *See generally* 1 Loss 537; Sommer, *Mergers, Consolidations, Sales of Assets—Rule 133*, 16 W. Res. L. Rev. 11 (1964); Throop, *Recent Developments With Respect To Rule 133*, 15 Bus. Law. 119, 125-130 (1959).

[174] *See* SEC v. National Sec., Inc., 393 U.S. 453 (1969). *See also* G. McCarthy at 175; Schneider at 1348 & n.71.

[175] *See* A. Choka at 20; Schneider at 1324. *But see* Okla. Stat. Ann. tit. 18, § 1.170a (Supp. 1967); N.Y. Banking Law. § 143(a) (McKinney Supp. 1969) requiring a shareholder vote in certain stock-for-stock transactions. Possibly rule 133 would be applicable under these conditions although this is not clear. *See* Schneider at 1335 n.40.

[176] *See* Schneider at 1325 & n.5.

[177] *See* Strathmore Securities, Inc., SEC Securities Exchange Act Release No. 8207 (Dec. 13, 1967) (19 shareholders adduced a control group). The case is criticized in Schneider at 1327 & nn.9-10.

Group grappled with the confusion in the hope of clarifying the demands of the federal securities law, thus lending the law greater operational efficiency.[178]

The Study's concern with the state of the "negotiated transaction" exemption was bolstered by the SEC's refusal to grant "no action" letters where the acquired company has only a few shareholders. The Commission has also refused to grant "no action" letters where the acquiring company has only a few shareholders,[179] or where "if the transaction were structured otherwise than as a merger or sale of assets, the issue of the new shares would clearly amount to a private placement."[180]

Another problem is the product of the disparity between the reporting requirements of the 33 and the 34 Acts.[181] Essentially, when a company is acquired in a 133 transaction and that company is not subject to the reporting requirements of section 12 of the 34 Act, the voting shareholders may receive no information concerning the proposed merger or acquisition. When the company is subject to the reporting requirements, the shareholders are at least assured of receiving a proxy statement concerning the transaction. Aside from all other considerations, our securities laws strive to protect the investor against a vote cast in ignorance.

The Study also criticized rule 133's reclassification of a controlling shareholder as a triumph of form over substance.

> A shareholder of the acquired corporation ought not to be deemed an underwriter following a statutory merger or sale of assets if he is not so regarded following a voluntary exchange of securities, and vice-versa. If the acquired corporation is publicly held, if there has

[178] THE WHEAT REPORT at 251-96.

[179] Refusing "no action" letters in this situation is designed to frustrate the phenomenon known as a reverse merger, wherein a larger company merges into the smaller. In the conventional situation, exemplified by a smaller company merging into the larger, the controlling shareholders of the smaller company will be underwriters for 133 purposes and unable to sell except within the leakage provisions. When the larger company merges into the smaller, the controllers of the smaller company become noncontrolling shareholders of the composite company and no registration would be required for subsequent sales. *See* Schneider at 1342 n.58.

[180] THE WHEAT REPORT at 266.

[181] The central purpose of the Study and its recommendations was to utilize the Commission's rule making power:

> (a) to enhance the degree of coordination between the disclosures required by the '33 and '34 Acts;
> (b) to respond to the call for greater certainty and predictability; and
> (c) to develop a consistent interpretative pattern which would help to assure that appropriate disclosures are made prior to the creation of interstate public markets in the securities of any issuer.

Id. at 8. *See also* Knauss, *Disclosure Requirements — Changing Concepts of Liability*, 24 BUS. LAW. 43, 45-48 (1968).

> been full disclosure to its shareholders in connection with the transaction, and if the issuing corporation . . . is required to keep such disclosures reasonably current through periodic reports under the '34 Act, provisions such as Rule 133(c), (d) and (e) are no longer appropriate.[182]

Moreover, under the system as it adumbrates investor protection and intelligent exercise of the franchise, rule 133 creates too many problems which frustrate the purposes of the disclosure scheme.[183]

Consequently, the Study recommended that rule 133 be replaced with a 33 Act registration procedure for mergers and sales of assets. Necessary concomitants to such a repeal are the creation of a registration procedure to cover the 133 transactions which does not mitigate the disclosures which may already be required; definite rules covering the resale of securities by persons presently considered underwriters in 133 transactions; and guidelines to determine when an acquisition does not constitute a public offering.[184]

Rule 133 is Defunct

In conjunction with its rapid implementation of the Wheat Report's recommendations, the Commission accepted that report's conclusion[185] concerning rule 133 and has made certain proposals along the lines recommended by the Study Group.[186] Initially, rule 133 would be revised to require that proposals for mergers, consolidations, reclassifications of securities[187] or transfers of assets, as presently defined, which are submitted for a shareholder vote, be registered.[188] The revision provides that a bare notice of a shareholder meeting for voting on these proposals is not an offer or sale of a security if the shareholders

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182 THE WHEAT REPORT at 271-72 (footnote omitted).

183 The Study felt that one of the important considerations which helped an acquiring corporation in making a decision as to which form of acquisition to use was the amount of disclosure required in each method. *Id.* at 270.

184 *See* THE WHEAT REPORT at 280-96; *Appendix* VI-1 at 14-22, 25-28; VII-1 - VII-4.

185
> [W]hen a shareholder is asked to vote on the question whether or not his company should be acquired by another and, accordingly, whether or not he wishes to exchange his shares for the securities of the acquired company, an offer of a security within the meaning of the '33 Act is made to him.

Id. at 272.

186 *See* SEC Securities Act Release No. 5012 (Oct. 9, 1969).

187 The proposed revision notes that a reclassification of securities may very well be exempt from registration by virtue of section 3(a)(9) or 3(a)(10) of the 33 Act. 48 Stat. 75 (1933), *as amended,* 15 U.S.C. § 77c(a)(9) (voluntary exchange of shares between the issuer and its shareholders); § 77c(a)(10) (1964) (court or agency approved reorganization).

188
> The reason for the proposed change is that when such matters are submitted to the vote of shareholders, each such shareholder is being asked to determine whether or not he wishes to surrender the security he then holds for a new security. In practical effect, therefore, the new security is being offered to him.

SEC Securities Act Release No. 5012 (Oct. 9, 1969).

entitled to vote are given a prospectus at least 20 days before the meeting.[189]

While the Wheat Group had recommended the creation of a new form S-16 to bear the burden of the new registration requirements,[190] the Commission felt that a revised edition of the existing form S-14 would suffice. The revision provides, as does the present form, that the prospectus consists of a proxy or information statement satisfactory to the Commission's proxy rules. When a company is already subject to the proxy rules, an S-14 filing will fulfill the requirement of filing a proxy or information statement and also serve as the required prospectus to be furnished the shareholders.[191]

For purposes of section 5, it is necessary that the term "preceded by a prospectus," as used in that section, include the transactions covered by rule 133. Consequently, proposed rule 153A includes within that term, 133 transactions. The term for 133 purposes means sending a prospectus to all eligible voters prior to the designated voting date.[192]

Proposed rule 181 clarifies the meaning of "transaction not involving any public offering" as used in the private offering section 4(2). When an issuer makes an offer and sale of securities in connection with the acquisition of a business, there is no public offering of securities if the offer and sale is made to not more than 25 offerees[193] who hold an

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189 Communications which are permitted under the proxy rules prior to a proxy statement are also allowed under revised rule 133. Rule 14a-12, 17 C.F.R. § 240.14a-12 (1970).

190 THE WHEAT REPORT at 280-82; *Appendix* VII-1.

191 Rule 14a-2(d), 17 C.F.R. § 240.14a-2(d) (1970) presently exempts from the coverage of the proxy rules any solicitation involved in the offer or sale of securities which are registered under the 33 Act. The Commission proposes to amend this rule so that the exemption is not applicable to solicitations involved in the offer or sale of securities registered but issued in a 133 transaction. Both the proxy rules and registration requirements will be applicable but duplicate filings will be unnecessary.

192 This latter provision eliminates a problem which was recognized by the Study Group. When a company is acquired in a 133 transaction it becomes necessary to determine the shareholders of record. Following the transaction but prior to issuance of new certificates, shareholders may change through transfers. Consequently, the issuer might be forced to check for such changes and send the transferees a proxy statement with the new shares (§ 5(b)(2)). The Study believed this procedure to be unnecessary for full and fair disclosure. THE WHEAT REPORT at 284-85. *See also* SEC Securities Act Release No. 5010 (Oct. 8, 1969).

Concerning the delivery of prospectuses requirements, dealers are required to deliver a prospectus in connection with the sale of a security subject to a registration statement. The time limit can be either 90 days for a first offering or 40 days for a subsequent offering. A proposed amendment to rule 174 would eliminate the 40 day requirement if the issuer is subject to the reporting requirements of section 13 or 15(d) of the 34 Act. Notice should also be taken of proposed rule 15c2-8 which requires that reasonable steps be taken by broker/dealers to see that prospectuses are delivered.

193 The proposed rule defines "offeree" as including an individual, his spouse and minor children, any trusts or estates they may have a beneficial interest in, any partnership

interest in the acquired company and the form of the transaction is a voluntary exchange of stock or one of the 133 methods of acquisition. However, a subsequent reoffering by one of the offerees will convert the entire transaction into a public offering and therefore subject the shares to registration.[194]

Proposed rule 181 clarifies a giant problem area in connection with business combinations. Prior to the Wheat Report, the favorite exemptions utilized by acquiring companies were rule 133 and the private placement exemption provided by section 4(2).[195] The proposed rule eliminates the uncertainty in this area to a greater degree than the Wheat proposals for private placements in general.[196] The proposed rules for private placements endeavor to transform subjective tests into objective ones. The key to these proposals comes from the Supreme Court's decision in *United States v. Ralston Purina Co.*[197] to the effect that the 4(2) exemption hinges upon "the need of the offerees for the protections afforded by registration."[198] It is sufficient to note that the private placement proposals[199] mark the demise of numerous "decorative curlicues" in the federal securities law.[200]

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of which substantially all the partnership interests are held by any of the above mentioned people, and any corporation or organization of which substantially all of the shares are held beneficially by any of these people.

The rule admits that it is not exclusive and circumstances may cause the "25 offeree" criterion to be increased. It also warns that issuers have the burden of proving the existence of the exemption and that persons receiving securities in a private offering may be deemed underwriters upon resale of the securities.

194 *See Appendix* VI-1 at 25-26.

The Wheat Report recommended a proposed rule 169 which would exclude from the 2(11) definition of underwriter the following in connection with a 133 transaction which is submitted to a shareholder vote: the corporation, its officers and directors, persons retained or employed by the corporation to solicit proxies, and any person who transmits such proxy soliciting material. Neither would a corporation or its officers or directors be so considered by recommending acceptance of the offer to exchange their securities.

The Commission has yet to adopt this rule in its proposals but has asked for comments concerning it.

195 48 Stat. 77 (1933), *as amended,* 15 U.S.C. § 77d(2) (1964) (section 5 inapplicable to transactions by an issuer not involving any public offering). *See* G. McCarthy at 175-79; A. Choka at 18-19.

196 The Wheat Report at 152-247; *Appendix* VI-1.

> In one particular area . . . a more definite standard . . . was thought to be practicable. An issuance of securities for the purpose of acquiring a closely-held going business can reasonably be considered as distinct from issues made for other purposes . . . . [The proposed rule is] restricted to bona fide business combinations and intended to provide assurance that registration is not required where the offerees are limited to a designated number . . . .

Id. at 157-58.

197 346 U.S. 119 (1952).

198 *Id.* at 127.

199 *See* SEC Securities Act Release No. 4997 (Sept. 9, 1969).

200 *See, e.g.,* SEC v. Guild Films Co., 279 F.2d 485 (2d Cir.), *cert. denied,* 364 U.S. 819 (1960); Gilligan, Will & Co. v. SEC, 267 F.2d 461 (2d Cir.), *cert. denied,* 361 U.S. 896 (1959); *In re* Crowell-Collier Pub. Co., SEC Securities Act Release No. 3825 (Aug. 12, 1957).

REPAIRS IN 34 ACT REPORTING

The Wheat Report acknowledges the fact that its proposals are interdependent. In order for any of the 33 Act revisions to operate efficiently, comparable repairs in 34 Act reporting requirements are necessary. But even considering the viability of such corrections, their effectiveness is questionable if the investor is unable to have the information at his disposal. In short, "it sticks in one's craw to go to the trouble of providing more meaningful information in reports filed with the Commission unless those who need such information can get it quickly and inexpensively."[201] The answer for more meaningful dissemination lies in the Commission's microfiche[202] reproduction system. A microfiche for its small size contains many pages of printed material.[203] Its contents are projected to a screen by means of a desk top reader, a machine which is fairly inexpensive.[204] Equally inexpensive is the cost of microfiche to subscribers[205] and storage problems are greatly reduced. Since the availability of SEC reporting documents will be greatly increased, the onus will fall upon broker/dealers to see that greater accessibility is afforded to investors.[206]

Under the 34 Act, an issuer files a series of reports starting with the general registration form 10[207] which is supplemented by annual reports on form 10-K.[208] Significant current events may be filed on

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201 Wheat, *The Disclosure Policy Study Of The SEC*, 24 BUS. LAW. 33, 40 (1968).

202 A microfiche is a small rectangular sheet of film on which many pages of typed or printed matter can be reproduced in a grid pattern.

THE WHEAT REPORT at 314.

203 I have in my hand a microfiche of the entire old and new testament — 1445 pages in all — on a card no larger than about one and one half inches square. The problem with this one is that reading technology has not yet caught up with it. You have to use a microscope to read it. The best the current readers can do . . . is about half of Shakespeare on a four by six inch fiche!

Wheat, *supra* note 201, at 41.

204 It is reported that the standard reading machine costs a little over $100. There is a more expensive model which not only screens the microfiche's contents but is also capable of printing desired pages. *Id.*

205 The following comparison is made to the Commission's standard hard copy reproduction service:

This service enables anyone to obtain a copy of any public document filed with the Commission at a cost of 9¢ per standard page. The cost of a copy of a 60-page document is $5.40. By contrast, a microfiche of the same document, individually ordered, would cost 75¢. On a subscription basis . . . the cost per microfiche varies between 50¢ and 23¢.

THE WHEAT REPORT at 315.

206 *See* Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340, 1377-78 (1966). *See generally* THE WHEAT REPORT at 319-23.

207 17 C.F.R. § 249.210 (1970) (general form for registration of securities pursuant to section 12(b) or (g) of the 34 Act).

208 17 C.F.R. § 249.310 (1970) (annual reports pursuant to section 13 or 15(d) of the 34 Act).

form 8-K or 9-K[209] but the use of these documents has not been heavily subscribed to in the past.[210] The Wheat Group made significant recommendations for the present forms 10 and 10-K in order to make them more timely, more informative and less repetitive.[211] In conjunction with these latter notions, the Study also advised that a new quarterly report (10-Q) be instituted, replacing forms 8-K and 9-K. In addition to its regular duties, this form would be required to be filed within 10 days after a significant acquisition or disposition of assets.[212]

Of great importance to companies dealing with corporate takeovers are the Study's recommendations concerning the merger proxy statement.[213] This statement has been held in high regard by the sophisticated but sharply criticized by the average shareholder because of its length and complexity.[214] The solution to this problem lies in a summarization of the vital data which could be attached to the formidable statement. This summary, no longer than six or seven pages, would contain in clear and concise language general information as to the purpose of the solicitation. Also included would be the date and place of the meeting, the title of securities entitled to vote, the date of record, notice of appraisal rights and a brief description of the securities offered. Additionally, the proposal to be voted upon would be briefly outlined. Along with a summary of the tax consequences of the transaction, the business of both parties to the merger should be identified. A description of the combination's new management is desirable as well as a comparison of the companies' stock prices for an appropriate period along with the net income, dividends and book values per share. This summary should be correlated to an appendix which will be attached to the document containing further details concerning each item. The Wheat Group also recommends a similar procedure in connection with a voluntary exchange of securities.[215]

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209 17 C.F.R. §§ 249.308 (current reports); 249.309 (semiannual reports) (1970).

210 It is reported that the 8-K filings are quite irregular and that many investment advisers and securities firms make no general use of these reports. *See* The Wheat Report at 333-34.

211 *Id.* at 331-35. The recommendations are outlined in detail at 337-64.

212 These recommendations were accepted by the Commission with minor changes. *See* SEC Securities Exchange Act Release Nos. 8680, 8681, 8682, 8683 (Sept. 9, 1969).

213 The term is used in a broad sense to include proxy statements sent in connection with a vote on a statutory merger, consolidation or sale of assets.

214 The Study reviewed a number of merger proxy statements which ranged from approximately 60 to over 200 pages in length. The complaints of shareholders concerning these massive documents are understandable.

The Wheat Report at 377.

215 *Id.* at 376-81. At this time the Commission has not implemented these recommendations.

CONCLUSION

The origins of federal securities regulation are traceable to an era of severe economic dislocation encouraged in part by the widespread manipulative practices of financial entrepreneurs. Comprehending the plight of the average investor, Congress sought to assure the availability of pertinent corporate data, in the hope that the intelligent evaluation of new offerings would insure against history repeating itself to such an awesome degree.

Although many yesterdays have vanished since the "great crash," the dynamics of the securities market itself mandates continuous protection against newer and more subtle forms of investor exploitation. The increasing popularity of the cash tender offer and the concomitant proliferation of defensive takeover tactics are indeed recent expressions of such innovations, the tactical and legal dimensions of which have been the subject of this note. Manifestly, while providing some of the more dramatic illustrations of intercorporate exploits, both have presented a virginal area, ripe for federal regulation.

Typically, congressional involvement was characterized by the long-hallowed assurance that increased disclosure facilitates the intelligent disposition of securities. To this end, Congress, appreciating both the disruptive and salutary effects of take-over bids, "sought" to strike a balance between adverse interests and "adopted" a policy of "strict neutrality" which relegates the formulation of specific disclosure items to the administrative expertise of the SEC. Echoing the harangue, the SEC also assures that recent regulations are equally neutral in their impact and simply place a premium upon the interest of the average investor.[216] Despite such euphuisms, the prophylactic nature of the Williams Amendments emerges.

The reduction in the number of cash tender offers, compounded by the resurging popularity of the stock exchange offer, would seem to attest not only to the effectiveness of the new measures but also, and perhaps more importantly, to the motivational factors, underlying their enactment: the frustration of merger hyperactivity. Clearly, recent Congressional[217] and administrative[218] efforts evidence a general concern that the merger wave is having a specious effect upon the economy;

[216] 34 SEC ANN. REP. 10 (1968).

[217] *See, e.g.*, The Tax Reform Act of 1969, Pub. L. No. 91-172, 91st Cong., 1st Sess. § 411 *et seq.* (Dec. 30, 1969).

[218] *See, e.g.*, 1969 WHITE HOUSE TASK FORCE REPORT ON PRODUCTIVITY AND COMPETITION, 115 CONG. REC. 6350 (daily ed. June 16, 1969); 1968 WHITE HOUSE TASK FORCE REPORT ON ANTITRUST, 115 CONG. REC. 5642 (daily ed. May 27, 1969).

the policy-makers have sought, in several instances, to neutralize those factors which give particular impetus to corporate combinations.

In the realm of corporate securities, this secreted ratiocination would appear to have had the anomalous effect of compelling the raider to resort to more traditional acquisition techniques. Whether this "sterilization," *i.e.*, replacing the tender offer with the stock exchange offer as a prelude to achieving control, will in fact impede corporate combinations, of course, remains to be seen. However, one conclusion would seem evident, and that is a legislative imprimatur has seemingly been affixed to the issuance of complex packages of corporate securities in acquisition schemes.[219] Hopefully, preexisting regulatory devices will protect the investor from certain obvious abuses.

Militating against the stringencies of such ambivalence is the corpus of decisional law likely to attend the eventual implementation of the amendments. Taking Congress at its word, the Second Circuit, cognizant of the substantial economic benefits which may result from the infusion of dynamic management into a waning corporate structure, has afforded the raider some freedom in placing required information before the public. While some may deprecate the action as an unwarranted intrusion into the legislative sphere,[220] it should be noted that despite the comprehensiveness of the legislation, congressional circumspection has mandated such an approach. Indeed, if the impact of its own words is to thwart the policy sought to be effected, one may only suggest that Congress itself be more judicious in articulating its justifications and asserting its goals.

Nevertheless, it is suggested that such rhetoric be viewed in its proper perspective. As investor protection is ideally the final consideration, the expedition of the avowed purposes of both the Williams Amendments and securities law generally requires greater emphasis upon accessibility and comprehension in disclosure documents. While the Wheat Report recommendations take significant strides in this direction, the delay attending their final implementation seriously impedes their effectiveness.

[219] *See* Hamilton, *supra* note 34, at 295 & n.102. *See generally Hearings, supra* note 115, at 2367.

[220] *See* Note, *supra* note 34, at 402-03.