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CORPORATE ACQUISITION BY TENDER OFFER *

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The technique of acquiring control of a corporation by making a public offer to purchase a part of the corporation's stock at a fixed price—usually in cash and representing a premium above market—has been widely used in the United States in recent years. In 1965 there were twenty-nine cash tender offers to acquire control involving companies listed on the New York Stock Exchange and fifteen involving companies listed on the American Stock Exchange. In 1960 there were only eight such offers involving companies listed on both such exchanges.¹ The *Investment Dealer's Digest* reported thirty-two cash tender offers for the first six months of 1966.² The increasing use of tender offers coincides with a period in which combinations of American businesses have been prevalent. These combinations are accomplished through merger, consolidation or acquisition of assets for stock or cash.³ Tender offers are another technique for creating

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¹ Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock*, 22 BUS. LAW. 149 (1966).

² *Investment Dealers' Digest—Corporate Financing Directory*, pp. 78-79, Aug. 15, 1966.

³ Darrell, *The Use of Reorganization Techniques in Corporate Acquisitions*, 70 HARV. L. REV. 1183 (1957); Kaufman & Loeb, *Corporate Reorganizations—Selected Securities, Corporate and Tax Law Considerations in Choice of Form*, 16 U. SO. CAL. 1964 TAX INST. 199.

combinations. The corporation making the tender offer usually seeks to acquire working control through its purchases: it is not content with being an investor in the offeree company. In many cases, a merger proposal follows the successful completion of the tender offer.

Although contested tender offers capture the imagination of the public, tender offers are usually made only after the company making the offer feels confident that management of the offeree company will endorse the tender offer or at least will not actively oppose it. Stilling potential opposition to a tender offer is vital not only because it removes the major obstacle to the ultimate success of the tender offer, but also because it usually permits the tender offer to be effected at a lower price per share.⁴

In noncontested situations the tender offer may be a less expensive alternative to a conventional form of acquisition. In the latter situation the acquiring company must pay, either in cash or stock, for all the assets of the acquired company. The tender offer technique permits the acquiring company to gain control by purchasing a much smaller portion of the acquired company.⁵ A merger can still be effected later if it seems desirable. There are other reasons for preferring a tender offer as an acquisition technique. Management which may be neutral to a tender offer would not necessarily be willing to recommend a merger or sale of assets. In addition, shareholder approval of these transactions will ordinarily be required.⁶ The need for shareholder approval raises the necessity of providing the detailed information required by the Securities and Exchange Commission's

⁴ The defensive tactics of the management of First National Stores, Inc. forced Gamble-Skogmo, Inc., which sought the tender of 500,000 shares, to raise the tender price from \$35 to \$38. Even under these circumstances, the tender offer was not successful. N.Y. Post, July 8, 1966, p. 54, cols. 1-3.

⁵ A controlling shareholder who has agreed to sell his control block at a premium above the market price may insist that a tender offer be made to all the shareholders at the same price, in order to avoid the possible legal problems that may arise from the sale of control at a premium. See Jennings, *Trading in Corporate Control*, 44 CALIF. L. REV. 1, 31 (1956).

⁶ Typically an affirmative vote of two-thirds of the shares entitled to vote is required. ABA-ALI MODEL BUS. CORP. ACT § 67 (1960). Further, shareholders who dissent from the merger are entitled to demand that the corporation pay them the fair value of their shares. *Id.* § 74. The shareholders of both companies involved usually have this right. In New York, shareholders in the surviving corporation only have appraisal rights in limited circumstances. N.Y. BUS. CORP. LAW § 910(a) (1) (A) (ii).

A sale of assets may also require a two-thirds vote, but in some jurisdictions only a majority vote is necessary. ABA-ALI MODEL BUS. CORP. ACT § 72, ¶ 2.02(d) (1960). In many jurisdictions, appraisal rights are not available to the shareholders of the company selling its assets and are usually not available to the shareholders of the buying company. *Id.* § 73, ¶ 2.02(2) (b).

Under certain circumstances, a sale of assets may be regarded as a merger. For a discussion of some of the problems in this area, see HORNSTEIN, *CORPORATION LAW AND PRACTICE* § 362 (Supp. 1966); Folk, *De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc.*, 49 VA. L. REV. 1261 (1963).

proxy rules.⁷ Further, effectuation of the merger or sale of assets often requires extensive and expensive legal documentation.⁸ It also seems that the tender offer technique of acquiring shares is less vulnerable than acquisition by merger or purchase of assets to judicial questioning with respect to the fairness of the price paid. In a tender offer, each shareholder individually makes his own decision whether or not to sell his shares and thus, assuming adequate disclosure, no one has standing to complain about the terms of the offer.⁹ Certain of the advantages of using the tender offer technique of acquisition may be dissipated if a merger is subsequently effected.¹⁰

Use of the tender offer as an alternative to merger or acquisition of assets has its costs. The company making the tender offer often is not able to make the detailed investigation which can be made in connection with these transactions. In addition, it does not have the protection of the representations and warranties made in the agreement of merger or for sale of assets. The acquiring corporation also frequently pays more for each share of stock in the block it acquires than it would pay for each share if it were buying all the shares. In part, this increased price reflects the need to offer a premium above market to induce each shareholder to sell his stock.¹¹ In part, it reflects the taxable nature of the cash tender offer transaction. Moreover, if a merger is subsequently proposed, the price paid in the tender offer often sets the minimum value of the shares to be issued by the acquiring corporation in the merger. Finally, unlike the merger or asset acquisition situation, the offeror will own a company in which there are minority interests. An arm's-length relationship with the controlled company must accordingly be observed to avoid problems.¹²

⁷ SEC Reg. 14A, 17 C.F.R. § 240.14 (1964). See note 49 *infra* for a description of the companies subject to the proxy rules.

⁸ United Fruit Company abandoned a plan to buy the assets of Winchell Donut House, Inc., because of its concern that Winchell's many leases would have to be renegotiated. This problem was apparently solved by United Fruit's making a tender offer for Winchell shares. Wall Street Journal, Sept. 13, 1966, p. 15, col. 4. However, later the tender offer was called off. N.Y. Times, Nov. 11, 1966, p. 64, col. 8.

⁹ For a discussion of some remedies which may be available in the absence of full disclosure, see pts. IV & V *infra*.

¹⁰ If the offeror corporation acquires sufficient stock in the offeree company to effect a short-form merger, some of the complexities and disadvantages of a merger transaction can be avoided. A typical short-form merger provision is contained in ABA-ALI MODEL BUS. CORP. ACT § 68A (1960). For a discussion of the short-form merger, see Comment, *The Short Merger Statute*, 32 U. CHI. L. REV. 596 (1965).

¹¹ Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427, 1434-36 (1964).

¹² See *Mutual Shares Corp. v. Genesco, Inc.*, CCH FED. SEC. L. REP. ¶91,829 (S.D.N.Y. Oct. 13, 1966) (suit by minority shareholders of S. H. Kress & Company against Genesco, which had acquired 94.6% of Kress stock, alleging that Genesco ran Kress for its own benefit and in disregard of the rights of minority shareholders).

Tax disadvantages may also arise from the use of the tender offer as an acquisition technique. If the acquiring company secures less than 80% of the stock of the

If management opposes a conventional form of acquisition, a tender offer may be the only way to effect it.¹³ A merger or sale of the corporation's assets requires the affirmative approval of management. Proxy contests are the only other alternative to replacing management as a prelude to achieving the desired combination. They can be enormously expensive¹⁴ and are usually unsuccessful.

acquired company for cash, then later causes the acquired company to merge into it, a significant amount of "stepped-up basis" available for, say, depreciation or depletion deductions is lost. INT. REV. CODE OF 1954, § 334(b) (2). This would not be the case if the assets of the acquired company had been purchased for cash.

A subsequent combination of a company whose shares are acquired in a cash tender offer with the acquiring company presents other problems under the Internal Revenue Code. For example, a stock-for-stock exchange after a cash tender offer will only qualify as a tax-free reorganization if the cash purchases and the subsequent stock exchanges are not "integrated." If integrated and viewed as one transaction, the offer would not be "solely for voting stock," as required by § 368(a) (1) (B). Furthermore, after completion of the cash tender offer, the offeror cannot acquire the remaining assets of the offeree by an exchange for its stock. See Rev. Rul. 396, 1954-2 CUM. BULL. 127. The impact of Rev. Rul. 396 can usually be avoided by having a subsidiary of the acquiring company issue stock of its parent in exchange for the assets. Rev. Rul. 278, 1957-1 CUM. BULL. 124; BITTKER & EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 566-68 (2d ed. 1966). It is understood that the Service will not view this technique favorably if the cash tender offer and the asset acquisition are integrated. See De Kosmian, *Minimizing Number of Shares To Be Issued in Tax-Free Reorganization; Including Contingent Pay-outs, Use of "Boot," and Use of § 306 Stock 3-4*, in TAX ASPECTS OF ACQUISITIONS AND DISPOSITIONS OF BUSINESSES (P.L.I. ed. 1966).

A merger of the offeror and offeree corporations will constitute a tax-free reorganization—under § 368(a) (1) (A)—even if the cash tender offer and merger are viewed as one transaction, provided that the shareholders of the offeror are viewed as having a sufficient "continuity of interest" in the offeree. The Service has recently indicated that it will issue a favorable ruling if the value of the stock issued in the merger by the offeror is equal to 50% of the total consideration given by the offeror in the acquisition. See Rev. Rul. 66-224, 1966 INT. REV. BULL. No. 34, at 15. Early cases permitted as much as 60% of the consideration given to be paid in cash. See, e.g., *John A. Nelson Co. v. Helvering*, 296 U.S. 374 (1935). Thus, the offeror may acquire at least half of the outstanding stock for cash in a tender and still secure a favorable ruling on the issuance of stock to shareholders of the offeree company in a subsequent merger. See MacLean, *"Creeping Acquisitions"*, 21 TAX L. REV. 345 (1966).

Where a successful tender offer is followed by a merger, the transaction can be treated for accounting purposes as in part a "pooling of interest" and in part a "purchase." Cf. Proxy Statement, Gulf & Western Industries, Inc. and The New Jersey Zinc Company, Dec. 27, 1965 (relating to merger of New Jersey Zinc into Gulf & Western—acquisition accounted for as purchase to the extent of 57.5% and as a pooling of interest to the extent of 42.5%). Presumably, if the shares acquired by purchase are substantially in excess of those acquired by merger, the entire transaction may be viewed as a purchase. See generally AMERICAN INSTITUTE OF ACCOUNTANTS, BUSINESS COMBINATIONS (Accounting Research Bull. No. 48, 1957). See also WYATT, A CRITICAL STUDY OF ACCOUNTING FOR BUSINESS COMBINATIONS 98-102 (American Institute of Accountants, Accounting Research Study No. 5, 1963).

For an outline comparing the advantages of proceeding by tender offer with proceeding by other acquisition techniques, see Schmultz, *Forms of Transactions*, in BUYING, SELLING AND MERGING BUSINESSES 47 (P.L.I. ed. 1966). See also Stark, *Non-Income Tax Aspects of Corporate Reorganizations: A Check List of the Issues and Problems Involved*, N.Y.U. 24TH INST. ON FED. TAX 1085 (1966).

¹³ A tender offer may also be used as a way of competing with a merger being negotiated by management. Cf. N.Y. World Journal Tribune, Oct. 26, 1966, p. 25, col. 5 (tender offer for stock of The Belmont Iron Works while management was negotiating sale of the corporation's assets to Tower Industrial Corporation).

¹⁴ The battle for control of Fairchild Engine & Airplane Corporation cost the insurgents \$127,000. However, the insurgents in that case were successful and the shareholders voted to reimburse them for their expenses. *Rosenfeld v. Fairchild*

ful.¹⁵ By contrast the tender offer technique is simpler in its business and legal mechanics and cheaper. The major expense is the price of the shares bought. If the maker of the tender offer is correct in its belief that the shares which it seeks to acquire are depressed, it can view the purchase price as a reasonable investment. Indeed, if its bid for control fails, it may frequently be able to sell any shares acquired in the open market at a profit¹⁶ or management may be happy to cause this "disruptive influence in the corporation" to be bought out—sometimes with the corporate funds, sometimes with its own or its associates' funds.¹⁷

Experience with tender offers has educated managements in the techniques of defending against this threat to their control. Management is not simply a disgruntled shareholder attempting to upset a merger; it has the resources of the corporation at its disposal to defend what it will characterize as existing corporate policy.¹⁸ It can communicate its opposition to the shareholders by letter or advertisement. Since it possesses the shareholder list, it knows which shareholders hold large blocks of stock and should be wooed individually.¹⁹

Engine & Airplane Corp., 309 N.Y. 168, 128 N.E.2d 291 (1955). The insurgents in the contest for control of Montgomery Ward were not so lucky. They spent roughly \$500,000 in an unsuccessful attempt to unseat management. Their expenses were not reimbursed. However, their investment in the stock of Montgomery Ward appreciated by roughly \$1,000,000. See *Nation's Business*, July 1955, p. 32. See also *Phillips v. United Corp.*, Civ. No. 40-497, S.D.N.Y., May 26, 1948, *appeal dismissed*, 171 F.2d 180 (2d Cir. 1948) (unsuccessful insurgent's claim for reimbursement of \$13,000 expended in proxy contest denied).

¹⁵ A study of the fifty-six proxy contests for control occurring during the calendar years 1956-60 reported that only fourteen were successful. In ten other contests the insurgents obtained some representation on the board of directors through cumulative voting. See AUSTIN, PROXY CONTESTS AND CORPORATE REFORM 53-54 (1965).

¹⁶ If the tender offer is unsuccessful and the offeror decides to sell the shares it owns, it may have to defer selling until the impact of the tender offer on the market price has dissipated. See SEC Rules 10b-5, -6, 17 C.F.R. §§ 240.10b-5, -6 (1964). Moreover, if during the course of his program of acquiring shares of the offeree company the offeror becomes the holder of more than 10% of any class of the offeree's stock, he will be subject to the recapture provisions of § 16(b) of the Securities Exchange Act of 1934. 48 Stat. 896, 15 U.S.C. § 78p(b) (1964). For a discussion of liabilities under this section, see 2 LOSS, SECURITIES REGULATION 1058-82 (2d ed. 1961) [hereinafter cited as Loss].

¹⁷ See *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1964).

¹⁸ If management frames the problem in these terms it will usually be accorded access to the corporate treasury for the purpose of opposing the tender offer. A court will only bar management from using corporate assets if it believes that the sole issue at stake is retention by management of its position. See text accompanying notes 192-96 *infra*.

For a fascinating study of a battle for control of an English company, see Gower, *Corporate Control: The Battle for the Berkeley*, 68 HARV. L. REV. 1176 (1955).

¹⁹ If the offeror wishes to examine the stockholders' list, he must, in many jurisdictions, demonstrate, among other things, a proper purpose. See ABA-ALI MODEL BUS. CORP. ACT § 46 (1960). This burden is normally met where the purpose is to enable the requesting stockholder to make an offer to purchase stock of the company. See, e.g., *E. L. Bruce Co. v. State ex rel. Gilbert*, 51 Del. 252, 144 A.2d 533 (1958); *Crouse v. Rogers Park Apartments, Inc.*, 343 Ill. App. 319, 99 N.E.2d 404 (1951); *State ex rel. G. M. Gustafson Co. v. Crookston Trust Co.*, 222 Minn. 17, 22 N.W.2d 911 (1946). Compare *American Gen. Life Ins. Co. v. Miller*, CCH FED. SEC. L. REP. ¶ 91,448 (Baltimore City Super. Ct. 1964) (denial of inspection where Securities Act of 1933 registration statement relating to shares proposed to be exchanged in tender was allegedly false and misleading).

It may have strong allies—banks with which the corporation keeps deposits, insurance companies with which it places business, suppliers and customers. The banks might withhold financing needed by the offeror. The other allies might buy stock in the market and thus push up the price. Any of them might be helpful in keeping stock from being tendered.²⁰ The corporation itself might buy some stock²¹ or raise its dividend²²—both of which may have the effect of increasing the price of the stock. Other techniques used to defend against tender offers include attempts to arrange mergers with other companies,²³ or attempts to block the acquisition on the ground that it would violate the antitrust laws²⁴ or some other regulatory statute.²⁵

²⁰ The purchase of Louisiana Gas Service Company stock by interests friendly to it helped defeat a tender offer by Dorchester Gas Producing Company. Wall Street Journal, Feb. 11, 1966, p. 1, col. 1, p. 8, col. 4.

²¹ American Steel & Pump Corporation made a tender offer for 51% of the stock of Standard Products Company at \$13.50 per share. Standard immediately called a special stockholders' meeting to approve a repurchase of its own stock at a higher price. American in turn raised its tender price to \$15 per share. The Standard shareholders then authorized the company to repurchase its shares at \$17.25 and American abandoned its offer. Wall Street Journal, Feb. 11, 1966, p. 1, col. 1.

²² After a tender offer by Allied Products for 854,000 shares of Dayco Corporation at \$26 per share, the management of Dayco authorized a five-for-four stock split and increased the dividend from \$.125 on the old shares to \$.40 on the new shares. As a result, the market price for the Dayco stock rose above \$26, and Allied abandoned its offer. See N.Y. Times, Nov. 1, 1966, p. 53, col. 6, p. 55, col. 3.

Recently, the British Chancellor of the Exchequer indicated that one of the two cases in which a company would be exempted from the freeze on dividends was where an increased dividend might be necessary to resist a tender offer for control. The Financial Times, Oct. 5, 1966, p. 13, col. 3.

²³ When Sun Chemical made a tender offer for stock of Harshaw Chemical Company, Harshaw management stated that it had a proposal for a tax-free exchange with a "substantial industrial company." N.Y. Times, July 28, 1966, p. 42, col. 2.

²⁴ See, e.g., *Muskegon Piston Ring Co. v. Gulf & Western Indus., Inc.*, 328 F.2d 830 (6th Cir. 1964) (complaint alleging stock acquired in violation of Clayton Act).

²⁵ When Pennzoil Company made its successful tender offer for shares of United Gas Corporation, United sought to enjoin Pennzoil from acquiring more than 10% of the voting stock of United or, at least, from voting such stock. United claimed that, if the Pennzoil acquisition were effected, it would create a public utility holding company structure. United claimed that its corporate structure would have to be revised to comply with the provisions of the Public Utility Holding Company Act, and that it would also have to divest itself of certain subsidiaries—all to the detriment of its shareholders. The court denied the injunction. It stated:

An established corporate structure is not immune from change by legal means. If corporate stock is available for purchase it can be expected that there will be change of stock ownership and, indeed, change of control. The mere fact that the changed circumstances brought about by a change of stock ownership will subject a corporation to federal regulation does not restrict another corporation from exercising its legal rights to make a legitimate stock purchase.

United Gas Corp. v. Pennzoil Co., 248 F. Supp. 449, 457 (S.D.N.Y. 1965), *aff'd per curiam*, 354 F.2d 1002 (2d Cir. 1966).

The complaint in *Columbia Pictures Corp. v. Clairmont*, Civil No. 3581, S.D.N.Y., 1966, alleges that purchase of Columbia Pictures Corporation stock in a tender offer violated the Federal Communications Act.

The SEC has ordered a hearing to determine whether the proposed acquisition of shares of Michigan Gas and Electric Company by American Electric Power Company or Michigan Gas Utilities Company, its assignee, violates the Public Utility Holding Company Act. See *American Elec. Power Co., SEC Holding Co. Act Release No. 15,492* (June 2, 1966).

Although management opposition may not be successful, it may, as previously pointed out, force an increase in the tender offer price.²⁶ In addition, the contest period may produce uncertainty among the employees, suppliers and customers of the company to be acquired and thus damage its business. Furthermore, the tender offer, unlike most acquisition negotiations, is public. If the offer is not successful, it may be embarrassing to the offeror. Finally, other parties may be induced to compete for the corporation through a rival tender offer or merger proposal.²⁷

The rapidly increasing use of tender offers as an acquisition technique and the virulence of some of the battles surrounding them has created concern about this method of effecting transfers of corporate control. Substantially identical bills to regulate tender offers have been introduced in the United States Senate and the House of Representatives.²⁸ The Securities and Exchange Commission has submitted comments on this bill and proposed a substitute measure.²⁹ Concern has not been confined to the United States. Australia, the Canadian Province of Ontario and Great Britain have studied the problem and devised legislative solutions.³⁰

²⁶ See text accompanying notes 4, 21-22 *supra*; see also text accompanying notes 191, 205 *infra*.

²⁷ Recent events involving Kendall Refining Company vividly illustrate this point. On January 27, 1966, Kewanee Oil Company made a tender offer for any and all outstanding shares of Kendall Refining at \$52.50 per share. On January 31, 1966, Kendall and Witco Chemical Company agreed to a merger in which each Kendall share would be exchanged for Witco cumulative convertible preferred stock. On February 2, 1966, Kewanee offered \$55.50 per share for at least 180,000 shares of Kendall. Witco countered by improving the conversion and dividend rates and redemption terms on the convertible preferred it was offering in the merger. On February 22, 1966, Kewanee made a final offer of \$65 per share. Witco again increased the conversion and dividend rates on the convertible preferred. Witco's merger proposal was accepted by the Kendall shareholders.

²⁸ S. 2731, H.R. 14417, 89th Cong., 1st Sess. (1965). Neither bill was acted on by the Eighty-ninth Congress. Senator Williams, the sponsor of S. 2731, indicated that he will reintroduce the bill, with some changes, in the early days of the Ninetieth Congress. N.Y. Times, Nov. 19, 1966, p. 45, col. 7, p. 51, col. 3.

²⁹ SEC, Memorandum to the Senate Committee on Banking and Currency on S. 2731, 89th Cong. (1966) [hereinafter cited as SEC Memorandum on S. 2731].

³⁰ Australia: Companies Act, Act No. 71 of 1961, § 184, Tenth Schedule [hereinafter cited as Australia Companies Act]. The Australian legislation is directed at a bid for control of one corporation by or on behalf of another corporation. *Id.* § 184(1). For a discussion of the Australian legislation, see Shtein, *Some Legal Aspects of Company Takeovers in Australia*, 5 U. QUEENSLAND L.J. 47 (1965).

Ontario: The Securities Act, 1966, Bill 66, 27th Leg., 4th Sess. pt. IX [hereinafter cited as Ontario Securities Act]. Although passed by the appropriate legislative bodies, this act will not be effective until it is proclaimed by the appropriate executive official. The Ontario legislation is discussed in *Report of the Attorney General's Committee on Securities Regulation in Ontario* (1965) [hereinafter cited as the *Kimber Report*].

Great Britain: Prevention of Fraud (Investments) Act, 1958, 6 & 7 Eliz. 2, c. 45, § 14; Licensed Dealers (Conduct of Business) Rules, 1960, First Schedule, pt. II, Third Schedule [hereinafter cited as British Dealers Rules]. Recommendations for additional legislation in Great Britain are contained in Company Law Committee, *Report*, Cmd. No. 1749, ¶ 294 (1962) [hereinafter cited as the *Jenkins Report*]. The

Criticism of the tender offer technique has developed along two lines. One line directly attacks the desirability of permitting transfers of control to be accomplished by this route. Critics who follow this line usually characterize the makers of tender offers as corporate raiders who are set upon liquidating the companies over which they seek control. Senator Harrison Williams analyzed the problem in this way when he introduced S. 2731 in the Senate:

In recent years we have seen proud old companies reduced to corporate shells after white-collar pirates have seized control with funds from sources which are unknown in many cases, then sold or traded away the best assets, later to split up most of the loot among themselves

The ultimate responsibility for preventing this kind of industrial sabotage lies with the management and the shareholders of the corporation that is so threatened. But the leniency of our laws places management and shareholders at a distinct disadvantage in coming to grips with the enemy.³¹

British criticism focused on the "speculative element" involved in the tender offer procedure. This criticism blended with a feeling that such offers are "just not done by the best people."³²

This line of criticism has itself been severely attacked.³³ The report of the Attorney General's Committee on Securities Legislation

Licensed Dealers (Conduct of Business) Rules statutorily apply only to a limited number of transactions—those effected by a small group called licensed dealers. Tender offers effected by members of a recognized stock exchange are exempt from the Rules. However, the stock exchanges and other exempted dealers broadly comply with the provisions of the Rules in connection with the issuance of circulars containing tender offers. *Jenkins Report* ¶269. The British experience with respect to tender offers is most fully described in WEINBERG, TAKE-OVERS AND AMALGAMATIONS (1963).

Other countries have also adopted rules governing tender offers. See Cohen, *supra* note 1, at 152.

³¹ 111 Cong. Rec. 27348-49 (daily ed. Oct. 22, 1965). A management official of Julius Garfinckel & Company commented on a tender offer for its shares by Genesco, Inc. as follows:

This type of maneuver, which has been rampant in England, is, in my opinion, a wholly unfair and even an un-American approach. It involves no sacrifice for the purchaser because he can take or leave what is tendered. But, if he gets enough, working behind the backs of the management, he has succeeded without exercising any risk.

N.Y. Times, March 30, 1966, p. 57, col. 1. See N.Y. World Journal Tribune, Oct. 31, 1966, p. 16 (describing tender offer for Columbia Pictures Corporation as a "raid").

³² Penrose, *Some Aspects of the Take-Over Bid*, 9 JURID. REV. 146, 148 (1964) (quoting the Glasgow Herald, Feb. 11, 1954).

³³ Of course, there is nothing illegal per se about a purchase of control of a corporation. For example, in *Fenestra Inc. v. Gulf Am. Land Corp.*, 377 Mich. 565, 608, 141 N.W.2d 36, 55-56 (1966), the court observed:

It is one of the risks of publicly-held corporations that a total stranger may purchase a controlling interest in a particular corporation. If the purchase is not unlawful, the courts may not superimpose their suspicions, predilections, and judgments upon the actions of the entrepreneur.

See also *Studebaker Corp. v. Allied Prods. Corp.*, 256 F. Supp. 173 (W.D. Mich. 1966). In *Robotham v. Prudential Ins. Co.*, 64 N.J. Eq. 673, 678, 53 Atl. 842, 844 (Ch. 1903),

in Ontario concluded that take-over bids, in many cases, offer positive advantages to the companies involved, their shareholders and the economy in general.³⁴ These benefits include assuring competitive efficiency among corporate managers, increasing management accountability to its shareholders and affording the shareholders an opportunity to secure a premium for their shares. Logically, tender offers should be made for the shares of corporations whose rates of return on net worth or profit margins are low relative to their industry grouping.³⁵ These deficiencies will be reflected in the market price for a company's stock and accordingly present an opportunity for a significant profit to the offeror if the company can be revitalized and run more efficiently.³⁶ Moreover, as Professor Henry Manne has stated:

But the greater benefits of the take-over scheme probably inure to those least conscious of it. Apart from the stock market, we have no objective standard of managerial efficiency. Courts, as indicated by the so-called business-judgment rule, are loath to second-guess business decisions or remove directors from office. Only the take-over scheme provides some assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling stockholders.³⁷

the directors of Prudential sought to put the company "forever beyond the reach of reckless speculators, who . . . might acquire [stock] even at fancy prices, for the purpose of manipulating its assets" by having Fidelity Trust Company purchase a controlling interest in Prudential and then having Prudential purchase a controlling interest in Fidelity. The court enjoined this scheme to perpetuate the control of incumbent management. Compare the attitude of the Second Circuit in *Studebaker Corp. v. Gittlin*, 360 F.2d 692, 695 (2d Cir. 1966), in which the court noted that one of the purposes of the proxy rules was to provide protection from "irresponsible outsiders seeking to wrest control of a corporation away from honest and conscientious corporate officials."

³⁴ *Kimber Report* 20.

³⁵ A recent study reached similar conclusions concerning the companies which made the most inviting and successful target for proxy contests. Duval & Austin, *Predicting the Results of Proxy Contests*, 20 J. FINANCE 464 (1965). Other factors which invite attempts to take over control include accumulation of substantial amounts of cash and existence of undervalued assets. Further, the company may fit into the diversification plans of the company attempting the take-over. Poor stockholder relations may also indicate that a bid for control can be successful. See Barnhill, *The Corporate Raider; Contesting Proxy Solicitations and Take Over Offers*, 20 BUS. LAW. 763, 764-65 (1965).

A recent analysis of the proxy fights and take-over attempts in the movie industry indicates that the primary causes are the thin capitalization of most movie companies, the relatively small size of management holdings and the upsurge in prices television networks are paying for movies. Glenn, *Reaching for the Stars*, *Barron's*, Oct. 24, 1966, p. 5.

³⁶ See Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112-13 (1965). See also Manne, *Some Theoretical Aspects of Share Voting*, 64 COLUM. L. REV. 1427, 1434-37 (1964).

³⁷ Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 113 (1965). See also AUSTIN, *op. cit. supra* note 15, at 46-47.

Although none of the enacted or proposed legislation outlaws tender offers, some of it demonstrates a fundamental lack of sympathy for this device. The hallmark of such legislation is a provision which requires notice to be given to management well in advance of the making of the tender offer. The Williams Bill requires twenty days' notice.³⁸ The Australia Companies Act requires fourteen to twenty-eight days' notice.³⁹ The British Licensed Dealers (Conduct of Business) Rules require three business days' notice to the offeree company.⁴⁰ Such advance warning gives management time to marshal its resources against the tender offer. As indicated earlier, management has many inherent advantages over any outsider seeking to oust it from control and it is generally believed that secrecy until publication of the offer is a prerequisite to its success.⁴¹

The second level of attack on tender offers focuses on specific aspects of the technique used. The major complaint has been that the offeree shareholder does not receive sufficient information to enable him to make an informed decision about the desirability of selling his stock. All the enacted and proposed legislation seeks to provide for a minimal amount of disclosure. The Ontario Securities Act requires a summary of the volume of trading and price range of the offeree company's shares in the six-months period prior to the making of the offer, a description of any arrangements made with the management of the offeree company and any information known to the offeror which indicates a material change in the financial position or prospects of the offeree company since the date of the last published financial statements of the offeree company.⁴² The Australian and British legislation are similar.⁴³ In addition, the Australian legis-

³⁸ S. 2731, 89th Cong., 1st Sess. § 10(c) (1) (1965) [hereinafter cited as S. 2731]. The SEC's redraft of the Williams Bill eliminates this provision. The SEC proposal requires a statement containing specified information to be filed with it (for its information only) five days before the tender offer is made. SEC Memorandum on S. 2731, § 14(d) (1).

³⁹ Australia Companies Act § 184(2) (a).

⁴⁰ British Dealers Rules § 1(d) (ii). The Jenkins Report appeared to endorse this requirement. *Jenkins Report* ¶ 274. The Kimber Report rejected any notice requirement because notice "would hinder the success of a potential bid . . . and indeed, in some cases, would virtually ensure its failure." *Kimber Report* 24.

⁴¹ For a description of the elaborate security precautions taken by Pennzoil Company prior to its tender offer for United Gas Corporation, see *Wall Street Journal*, Feb. 11, 1966, p. 8, col. 4.

⁴² Ontario Securities Act §§ 90.7-9.

⁴³ Australia Companies Act, Tenth Schedule, pt. C, ¶¶ 2(d)-(g); British Dealers Rules, First Schedule, pts. I, II, ¶¶ 2(6)-(8).

Although the Williams Bill and the Commission proposal do not specifically call for any of these items of information, both of these legislative proposals contemplate the issuance of Commission rules to define areas of material information which the maker of a tender offer can reasonably be expected to provide. S. 2731, § 10(c) (1); SEC Memorandum on S. 2731, § 13(d) (1) (A). It is possible that the information called for by the Commonwealth legislation will serve as a model for such rules. See text accompanying notes 118-23 *infra*.

lation requires the offeree company to supply certain information, including any material changes in the financial condition of the company since the date of the balance sheet used in the annual report.⁴⁴ The Williams Bill and the SEC proposal require that a tender offer looking toward control or representation on the board of directors of the offeree corporation disclose any plans of the offeror with respect to the continuation of the business of the offeree company.⁴⁵

Legislation and legislative proposals have gone beyond disclosure to deal with certain aspects of tender offer techniques which are considered unfair to shareholders. In large part, regulation in this area is designed to relieve shareholders from the need to act before they have had a chance to weigh opposing arguments⁴⁶ with respect to the wisdom of selling their shares and to prevent them from being locked into an offer for too long a period of time.⁴⁷ The SEC's proposal and the Ontario legislation provide that where the terms of a tender offer are changed to provide increased consideration for shares purchased, the increased consideration shall be paid for all shares bought under the tender offer, including those tendered prior to the change in the terms of the tender offer.⁴⁸

⁴⁴ Australia Companies Act § 184(3), Tenth Schedule, pt. C, ¶ 2(h).

⁴⁵ S. 2731, § 10(c) (1) (iii); SEC Memorandum on S. 2731, § 13(d) (1) (A) (iii). The proposed American legislation and the Commonwealth legislation also call for information about the security holdings of the tender offeror, S. 2731, §§ 10(c) (1) (iv)-(vii); SEC Memorandum on S. 2731, §§ 13(d) (1) (A) (iv)-(v); Australia Companies Act, Tenth Schedule, pt. B, ¶ 1(c); British Dealers Rules, First Schedule, pt. II, ¶ 2(1); Ontario Securities Act § 90(1), the identity of the offeror (not required by the Ontario legislation), S. 2731, § 10(c) (1) (i); SEC Memorandum on S. 2731, § 13(d) (1) (A) (i); Australia Companies Act, Tenth Schedule, pt. B, ¶ 4(d); British Dealers Rules, First Schedule, pt. II, ¶¶ 2(1), (9), and information about arrangements made for ensuring payment by the offeror. S. 2731, § 10(c) (1) (ii); SEC Memorandum on S. 2731, § 13(d) (1) (A) (ii); Australia Companies Act, Tenth Schedule, pt. B, ¶ 3; British Dealers Rules, First Schedule, pt. II, ¶ 2(5); Ontario Securities Act § 90(6).

⁴⁶ Or competing bids for their shares.

⁴⁷ The SEC proposal requires that where a tender offer is made for less than all the shares and more securities are deposited than called for by the offer, the shares will be taken up on a pro rata basis rather than on a first-come, first-served basis. SEC Memorandum on S. 2731, § 14(d) (4). Similar provisions appear in the British and Ontario legislation. British Dealers Rules, First Schedule, pt. II, ¶ 1(4); Ontario Securities Act § 81(7). The Australian legislation does not specifically require that tender offers be made on a pro rata basis. However, it does require (1) that, unless withdrawn for all shares, any offer made must be kept open for at least one month, Australia Companies Act, Tenth Schedule, pt. A, ¶ 1, and (2) that if any offer is conditioned upon a minimum number of acceptances, the offer must specify the latest date on which the offeror can declare the offer "to have become free from that condition" and give an additional seven days for acceptance to be made. *Id.*, Tenth Schedule, pt. A, ¶ 4. The Commission's proposal also requires that a deposit may be withdrawn during the first seven days of the offer and at any time after sixty days from the date of the original offer. SEC Memorandum on S. 2731, § 14(d) (3). This provision appears to be modeled on the Ontario legislation. Ontario Securities Act §§ 81(2), (3), (5). For a more detailed discussion of these types of provisions, see pt. III *infra*.

⁴⁸ SEC Memorandum on S. 2731, § 14(d) (5); Ontario Securities Act § 83(1). Neither the Australian nor the British legislation contains such a provision. For further discussion of the problems involved in varying the terms of tender offers, see text accompanying notes 100-09 *infra*.

Although specific provisions of the proposed American legislation and the Commonwealth legislation will be discussed during the course of this article, our primary focus will be on the legal framework governing the making of tender offers as it exists and as it is developing under present law.

I

The prototype case which will serve as a basis of our discussion assumes that Corporation *A*, whose common stock is listed on the New York Stock Exchange, seeks to acquire 51% of the outstanding shares of common stock of Corporation *B*. The *B* shares, which are listed on the American Stock Exchange,⁴⁹ have been trading in the last two months at a price between \$18 and \$20 per share. *A* intends to purchase as much *B* stock as possible on the American Stock Exchange and to purchase one large block of *B* stock from a mutual fund which, *A* understands, wishes to dispose of its holdings in *B*. After accumulation of a block of *B* shares in this manner, *A* intends to make a public offer for tenders of *B* stock at \$25 per share. *A* presently owns no *B* shares and has no directors or officers in common with *B*.

If *A* pursues its plan for acquiring 51% of the shares of *B*, it is likely that those persons who sell their shares to *A* early in its acquisition program will receive less for their shares than those who sell their shares later—particularly those who sell their shares pursuant to *A*'s tender offer. Does present law try to benefit these early sellers by imposing on *A* an affirmative duty to disclose its plans, including its willingness to pay a price above market for a substantial block of *B* stock?⁵⁰ If such a duty exists it will probably be found in that part

⁴⁹ As is the case with any listed company, *B*'s shares would be registered under § 12(b) of the Securities Exchange Act of 1934. 48 Stat. 892, as amended, 15 U.S.C. § 78l(b) (1964). If *B* were an over-the-counter company with over \$1,000,000 in total assets and with a class of stock held by 500 or more stockholders of record, that stock would be registered under the Exchange Act. Section 12(g), 78 Stat. 566 (1964), 15 U.S.C. § 78l(g) (1964). When it registers its securities, a company must file an application for registration containing detailed financial and business information. Section 13 requires a registered company to file annual and periodic reports. 48 Stat. 894 (1934), as amended, 15 U.S.C. § 78m (1964). Registered companies are also subject to the proxy rules, issued under § 14, 48 Stat. 895 (1934), as amended, 15 U.S.C. § 78n (1964), and their officers, directors and any holders of more than 10% of the registered stock are subject to the insider trading provisions of § 16. 48 Stat. 896 (1934), as amended, 15 U.S.C. § 78p (1964).

⁵⁰ As indicated earlier, the Commission's suggested amendments to S. 2731 contain a provision that where the terms of a tender offer are changed to increase the consideration paid for shares tendered, shares which had been tendered prior to the announced increase must receive the higher consideration. SEC Memorandum on S. 2731, § 14(d) (5). According to the Commission this provision would "avoid the discriminatory effect of paying some holders more than others." *Id.* at 20. The Commission's recommendation does not extend to shares purchased in the market prior to the making of the tender offer.

of Rule 10b-5 issued by the Commission under the Securities Exchange Act of 1934 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."⁵¹ Although most of the cases arising under Rule 10b-5 involve an alleged misrepresentation or half-truth, recent cases accept the principle that liability may exist in situations involving total nondisclosure in the anonymity of a transaction on a stock exchange or in the organized over-the-counter market.⁵² The threshold problem then involves identification of those situations in which a purchase or sale by a person triggers a duty for that person to disclose material information not previously made public. At the outset it should be clear that there must be both a person having a status requiring him to disclose and a fact that must be disclosed. The type of fact which triggers responsibilities has been described in various legal formulae, but appears to involve an event the disclosure of which will have a significant impact on the market price of a company's securities.⁵³

The duty of disclosure appears to arise whenever persons who control the disclosure policies of a corporation effect a transaction in the corporation's securities. The federal securities laws try to create conditions under which investment decisions can be made after consideration of all relevant information. Thus, they have an interest in having all corporate news disclosed as soon as possible. However, the decision that an item of corporate news is ripe for publication—that is, it has been sufficiently checked for accuracy and a determination has been made that publication will not prejudice any legitimate interest of the corporation—is often a difficult one and normally should

⁵¹ 17 C.F.R. § 240.10b-5(c) (1964).

⁵² SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262 (S.D.N.Y. 1966); Cochran v. Channing Corp., 211 F. Supp. 239 (S.D.N.Y. 1962) (organized over-the-counter market). *Contra*, Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659 (1933). For a general discussion of Rule 10b-5, see 3 Loss 1445-74, 1682-1862.

For a provocative discussion of insider trading and a view that such trading should not be prohibited and is, indeed, beneficial, see MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966).

⁵³ It is not clear whether the information is material if it may have a significant impact on market price without having a significant impact on the intrinsic value of the stock. The *Texas Gulf Sulphur* opinion uses both tests. Compare 258 F. Supp. at 280 ("it is information which, if known, would clearly affect 'investment judgment' . . . or which directly bears on the intrinsic value of a company's stock"), with *id.* at 283 ("the results of K-55-1 were too 'remote' . . . to have had any significant impact on the market [price]"). The difference in result created by the use of the two tests is sharply posed in connection with information concerning a proposed stock dividend. See *Hafner v. Forest Labs., Inc.*, 345 F.2d 167 (2d Cir. 1965). See also Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 VA. L. REV. 1271, 1288-91 (1965).

be left to management.⁵⁴ If management's decision in determining the timing of the disclosure of corporate news is to be conclusive, management should have no personal interest in delaying disclosure.⁵⁵ Since *A* does not control the disclosure policies of *B*, its purchases of *B* stock will not trigger a duty to disclose under this theory.

A broader basis for restricting securities trading while in possession of material, undisclosed information stems from traditional notions of fiduciary responsibility as developed under both state and federal law. The duty of disclosure seeks to prevent a corporate insider from utilizing his position to take unfair advantage of the uninformed shareholder.⁵⁶ The Commission expressed this theory in its opinion in *Cady, Roberts*:

Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.⁵⁷

The class of persons on whom this fiduciary responsibility falls has been labeled "insiders." Although the concept of insider extends beyond management to controlling stockholders and employees, no case has held or suggested that it encompasses a person in *A*'s position.⁵⁸

⁵⁴ There are some limits on management's discretion in determining the timing of the disclosure of corporate news. For example, if a rumor concerning a corporate development circulates, management may have to disclose facts about that development even though it does not desire to do so. If management fails to make such disclosures, trading in the securities of the corporation may be suspended by the exchange on which the stock is listed or by the SEC. Securities Exchange Act of 1934, § 15(c)(5), 78 Stat. 574 (1964), 15 U.S.C. § 78o(c)(5) (1964); § 19(a)(4), 48 Stat. 898 (1934), 15 U.S.C. § 78s(a)(4) (1964).

⁵⁵ See Mundheim, *The Texas Gulf Sulphur Complaint: A Major Step in Restricting Insider Trading in Corporate Securities*, 1966 J. Bus. L. 284, 287-89; cf. Berle, *Publicity of Accounts and Directors' Purchases of Stock*, 25 MICH. L. REV. 827, 830-31 (1927).

⁵⁶ *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 829 (D. Del. 1951). Judge Leahy said that one of the primary purposes of the Securities Exchange Act was "to outlaw the use of inside information by corporate officers and principal stockholders for their own financial advantage to the detriment of uninformed public security holders." For state law cases expressing similar concepts, see, e.g., *Mansfield Hardwood Lumber Co. v. Johnson*, 263 F.2d 748, 754 (5th Cir.), cert. denied, 361 U.S. 885 (1959); *Taylor v. Wright*, 69 Cal. App. 2d 371, 379-81, 159 P.2d 980, 984-85 (1945). But see *Mairs v. Madden*, 307 Mass. 378, 30 N.E.2d 242 (1940). See also HENN, CORPORATIONS § 240 (1961), for differing state views on the fiduciary obligations of directors to shareholders with whom they effect securities transactions.

⁵⁷ *Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961).

⁵⁸ See Fleischer, *supra* note 53, at 1280-84; Comment, *Insider Liability Under Securities Exchange Act Rule 10b-5; The Cady, Roberts Doctrine*, 30 U. CHI. L. REV. 121, 131-47 (1962).

At any rate the undisclosed information possessed by *A* was not obtained as a result of a relationship giving access to information to be used solely for *B*'s purposes.

The *Cady, Roberts* opinion also talks about the "inherent unfairness" where one party deals with another, knowing that the other does not have certain material information. Although it can be argued that the underlying purpose of the securities laws is to promote to the extent possible an absolute parity of information⁵⁹ between persons who trade in the securities markets, no case has attempted to impose restrictions on securities trading on this basis.⁶⁰ Application of the fairness approach on a broad scale appears to be an administrative impossibility. Furthermore, this approach seems so contrary to the basis on which securities analysis and trading exists that a court should be reluctant to follow it without some clearer legislative signal. For example, would any person desiring to acquire a large block of stock by a series of small purchases have to notify all potential sellers of this fact? Reluctance to impose a duty of affirmative disclosure appears to flow naturally from the existing pattern of behavior in a competitive economy. Our economic system believes it desirable, on the whole, to reward the diligent who have acquired a superior market position.⁶¹

Except under a broad application of the fairness approach, none of the policies underlying Rule 10b-5 require *A* in connection with its purchases on the exchange to disclose its plans to acquire control of *B*. *A* does not have the relationship with *B* which results in the imposition of a fiduciary duty.⁶² *A*'s negotiation with the mutual

⁵⁹ We do not suggest that this argument can be extended to require a person to make his analysis of the information available to everyone with whom he deals. *Cady, Roberts* itself negatives such a suggestion by distinguishing between inside information and "perceptive analysis of generally known facts." 40 S.E.C. at 915. However, frequently it is difficult to distinguish between "facts" and "perceptive analysis of facts." See Comment, *The Prospects for Rule X-10B-5*, 59 YALE L.J. 1120, 1148 (1950).

⁶⁰ The information might relate to the company. Suppose *A*'s president learns from *D*, a potential customer of *B*, that it will place large, profitable orders with *B*. Only application of the fairness concept would seem to prevent *A* from buying *B* stock without disclosing this "outside" information. The information might relate, as it does in our prototype case, not to information about *B*, but to information about the trading market in *B* shares.

⁶¹ See Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 742 (1956).

⁶² See JENNINGS & MARSH, *SECURITIES REGULATION* 836-37 (1963). Compare *M. S. Wien & Co.*, 23 S.E.C. 735, 746-54 (1946) (violation of Rule 10b-5 by brokerage firm which purchased bonds from holders where, among other things, there was a failure to disclose an imminent tender offer by the issuer which was unexpected in light of the issuer's general financial position).

What if associates of the brokerage firm that is buying the *B* shares for *A* purchase *B* shares for their own account, knowing of *A*'s prospective offer? For the reasons set forth in the text, there would appear to be no duty of disclosure to their sellers. However, such an action would probably constitute a breach of their fiduciary duty to *A*. RESTATEMENT (SECOND), AGENCY §§ 393, 395 (1958); cf.

fund for the purchase of its block of stock should not call for a different result. Requiring disclosure of *A*'s intentions in the context of a face-to-face transaction would not, to be sure, present all the problems which would be raised if disclosure were required in connection with exchange transactions. On the other hand, there is no compelling reason for enhancing the bargaining position of the institutional investor in this case.⁶³ The information within *A*'s knowledge relates to its own intentions about its market activities. This is the type of intelligence that, in a free market context, should only have to be revealed for the most striking justification.⁶⁴

Under present law, *A* would be required to disclose its plans only if it can, in some manner, be brought within the insider class and then only under certain circumstances. For example, if prior to the commencement of its proposed market purchases (or during the course of such purchases) *A*'s management discusses the tender offer with *B*'s management and learns some material facts about *B* not yet disclosed to the public, *A* might be regarded with respect to those facts as a quasi-official of *B* for purposes of Rule 10b-5.⁶⁵ Similarly, if during the course of the purchasing program *A* and *B* agree to a merger in which the *B* shareholders would receive more than the present market price for their stock, *A* should cease its market purchases until the terms of the agreement are disclosed.⁶⁶

Suppose that during the course of its acquisition program, *A* accumulates over 10% of *B*'s common stock. Since a more than 10% stockholding is normally viewed as the benchmark of an insider for

Brophy v. Cities Serv. Co., 31 Del. Ch. 241, 70 A.2d 5 (1949). The New York Stock Exchange disciplined a member of a brokerage firm who, upon hearing from a president of a company that it planned to make a tender offer for its own stock at a price substantially above market, acquired stock for his wife before the news was made public. SEC, *Special Study of Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. I, p. 435 (1963).

⁶³ *A* will usually attempt to secure the block by having a broker or a Third Market maker get the stock for him. This technique gives the transaction the character of an ordinary market transaction. It is unlikely that any questions will be asked, particularly since there seems to be no duty to disclose *A*'s identity.

⁶⁴ In a face-to-face transaction, a seller may protect itself by asking appropriate questions during the negotiations. If the buyer misrepresents the facts in the course of the negotiations, the institutional seller would have a cause of action under Rule 10b-5(2). *E.g.*, *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965) (plaintiffs asked defendant, who was president, general manager and a director of the company, whether he "knew of any material change in the affairs of the company or in the past months which could cause us to have any different opinion about the company").

⁶⁵ See *Fleischer*, *supra* note 53, at 1284. Significantly, in the *Texas Gulf Sulphur* proceeding itself, the SEC did not seek any relief against those persons who had received the alleged inside information from the Texas Gulf Sulphur management or employees. The SEC tried to hold the management and employees responsible for the purchases made by the persons to whom they had given this information.

⁶⁶ See *Ward La France Truck Corp.*, 13 S.E.C. 373 (1943); Complaint, SEC v. *Golconda Mining Co.*, Civil No. 65-1512, S.D.N.Y., May 19, 1965.

federal securities law purposes,⁶⁷ must *A* now discontinue its program until it discloses its intentions to the other holders of *B* stock? The undisclosed information, *A*'s intention to purchase control and its willingness to pay more than the present market for such control, clearly did not come to *A* as a result of its newly acquired inside position. Thus, under the *Cady, Roberts* rationale, *A*'s ability to continue its purchases would not be inhibited.⁶⁸

Although knowledge of one's own intentions does not constitute inside information in the usual case, there are situations in which such intentions must be disclosed. The classic case involved the purchase by Transamerica Corporation of stock in Axton-Fisher Corporation, of which it was the controlling shareholder, without disclosing its intent to liquidate the corporation and sell Axton-Fisher's tobacco

⁶⁷ A more than 10% stockholder is subject to the insider reporting and profit recapture provisions of § 16 of the Securities Exchange Act. See also Securities Act of 1933, Schedule A(22), 48 Stat. 88, 15 U.S.C. § 77aa(22) (1964). In addition, various Commission forms require disclosure of the ownership of more than 10% of a company's outstanding stock. See, e.g., Form S-1, item 19(a), 17 C.F.R. § 239.11 (1964); Form S-8, item 24, 17 C.F.R. § 239.16b (1964); Form 10-K, items 5, 6(d), 17 C.F.R. § 249.310 (1964). In the case of a significant stockholder, the ability to acquire information because of his holdings may make him an "insider." However, in our prototype case, *A* will try to accumulate *B* stock in the market without disclosing its activities or its identity to *B* management. Thus, even if *A* has the ability to acquire information because of the size of its holdings, it will not try to use that ability. In any event, it is not clear that a person with access to corporate information solely by reason of his stockholdings is subject to restrictions with respect to information obtained from noncorporate sources.

⁶⁸ See *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 765 (D.N.J. 1955). In *U.S. Indus., Inc. v. Beryl*, Civil No. 6853, W.D. Wash., Aug. 23, 1966, the plaintiff alleged that defendants, directors of Sunshine Mining Company, violated § 10(b) by purchasing stock of U.S. Industries at a time when they knew that Sunshine was planning a tender offer at a higher price.

The open market purchases by *A* may also raise questions under § 16 of the Exchange Act as to whether *A* is directly or indirectly the beneficial owner of more than 10% of the *B* stock. *A* may acquire a "call" on a block of *B* securities which, if acquired, would make it a 10% or larger holder of *B* stock. If the option is nontransferable, a § 16 report need not be filed. Rule 16(a)(6), 17 C.F.R. § 240.16(a)(6) (1964). Although a transferable option acquired by a person already subject to § 16(a) must be reported, it has been suggested that no report must be filed by a party such as *A* which is not otherwise subject to § 16(a). See Feldman & Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 *Wes. Res. L. Rev.* 1054, 1092-95 (1966). A proposed amendment to Rule 16(a)(6) would eliminate any distinction in the reporting of transferable and non-transferable options. SEC Exchange Act Release No. 7794 (Jan. 20, 1966). Arrangements entered into by *A* with *B* shareholders prior to making its tender offer present difficult and unresolved issues as to whether *A* has an option or other beneficial interest required to be reported under § 16(a). For example, *A* may secure a commitment from holders of more than 10% of the *B* stock that they will tender their shares if *A* makes a tender offer. Does this create a partnership between *A* and the *B* stockholders? See Securities Exchange Act of 1934, § 3(a)(9), 48 Stat. 883, 15 U.S.C. § 78c(a)(9) (1964). Does it give *A* an "option"? If *A* is regarded as having beneficial ownership of more than 10% of the *B* stock, *B* has standing to secure an injunction to compel *A* to file the required report. *Chicago, So. S. & So. B.R.R. v. Monon R.R.*, CCH FED. SEC. L. REP. ¶ 91,525 (N.D. Ill. 1965).

inventory.⁶⁹ Although the court found that the price paid for the shares was fair if the corporation continued as a going concern, it also found that the price was too low if the corporation were to be liquidated. The court held that the plaintiffs were entitled to full damages for the losses they sustained by selling at the price offered by Transamerica. The opinion outlines the duty of a controlling shareholder in broad terms:

It is unlawful for an insider, such as a majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the majority stockholder by virtue of his inside position but not known to the selling minority stockholders, which information would have affected the judgment of the sellers. The duty of disclosure stems from the necessity of preventing a corporate insider from utilizing his position to take unfair advantage of the uninformed minority stockholders. It is an attempt to provide some degree of equalization of bargaining position in order that the minority may exercise an informed judgment in any such transaction.⁷⁰

The limits of the *Speed* case can be tested by supposing that *B* is a closed-end investment company whose shares are selling at a significant discount from net asset value. If *A* can persuade *B* to "open-end" (make its shares redeemable at net asset value) or to liquidate, it would immediately be able to realize a profit on all the shares it had previously purchased at the discount. We think that *A* can purchase *B* shares in this situation without disclosing its plans⁷¹—at least up to the point where *A* has obtained a consensus from the board of directors of *B* that its plan for liquidation will be proposed to the shareholders and there is at least a "reasonable probability" of its adoption.⁷² At that point *A* may be regarded as no

⁶⁹ *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951).

⁷⁰ *Id.* at 828-29.

⁷¹ An important distinction between the *Speed* case and the closed-end fund situation is that in the former only Transamerica knew—and that information was obtained in part from its designee on the board of directors—that if the company were liquidated, each share would be worth more than the present market value. This result is apparent to every investor in a closed-end fund with a significant discount from net asset value.

⁷² Mergers, and similar transactions, seem to be regarded as material facts when there is a "reasonable probability" of their occurrence. See *Quirke v. Norfolk & W. Ry.*, CCH FED. SEC. L. REP. ¶91,645 (S.D.N.Y. March 14, 1966). A thorough exploration of the question of materiality appears in *Rogen v. Ilikon Corp.*, CCH FED. SEC. L. REP. ¶91,699 (1st Cir. June 2, 1966). In its amicus brief in that case, the Commission said:

We disagree, however, with any suggestion in the opinion that when there are serious negotiations being carried on by the corporation which might significantly increase the market value of its stock, the corporation is free to purchase the stock without disclosure of such negotiations.

longer taking any significant risk with respect to the effectuation of its plan in purchasing more shares, and the additional profit it would obtain from doing so without informing the *B* shareholders is difficult to justify as serving any economic purpose.⁷³

If management decides to propose open-ending or liquidation to the shareholders of a closed-end fund, they may not purchase shares of the fund in the market prior to the announcement of the plan. Management's responsibilities are to all the shareholder interests in the corporation. Although management should be compensated for its ingenuity in devising the plan, it is fairer for this compensation to be paid by all the stockholders (in the form of bonus or additional salary) rather than by only those stockholders who sell their shares to the management at a price which does not reflect disclosure of the plan to open-end or liquidate.⁷⁴

II

When *A* has accumulated as much *B* stock as it can on the market and in private transactions, it will make a public solicitation of tenders. This solicitation will typically be made in the form of an advertisement in various financial and daily newspapers. In its barest form this advertisement will usually announce an offer to purchase a specified number of shares at a fixed price per share "subject to the terms and conditions set forth in an Offering Letter, dated _____." The advertisement will also state when the offer terminates and explain where the Offering Letter and Letter of Transmittal may be obtained.⁷⁵

Memorandum of SEC, *Amicus Curiae*, p. 2, *Rogen v. Ilikon Corp.*, CCH FED. SEC. L. REP. ¶91,699 (1st Cir. June 2, 1966). Compare the standard of materiality used in *James Blackstone Memorial Library Ass'n v. Gulf, M. & O.R.R.*, 264 F.2d 445 (7th Cir.), *cert. denied*, 361 U.S. 815 (1959), and *Lomman v. Lieb*, 37 Pa. D. & C.2d 305 (1965) (plaintiff must show that the sale was "assured"). See Symposium, *Insider Trading In Stocks*, 21 BUS. LAW. 1009, 1017 (1966) (statement of A. Fleischer, Jr.).

⁷³ For a discussion of a similar situation in connection with a tender offer, see note 92 *infra*.

⁷⁴ This analysis seems consistent with the findings of the court in *Speed v. Transamerica* that Transamerica by its domination of the Axton-Fisher board of directors, in effect, constituted its management. 99 F. Supp. at 833-34. In the case where *A* accumulates enough shares in the market to elect the directors of *B*, but has not disclosed its ability to do so, it is less likely that courts will impose the responsibilities of management upon *A*.

Compare *MANNE*, *op. cit. supra* note 52, at ch. X.

⁷⁵ If, as is usual, a broker will be paid a fee for procuring the tender of shares, the amount of the fee will normally appear in the advertisement.

The New York Stock Exchange has very recently repealed its requirement that member firms charge commissions when they tender securities for customers pursuant to a tender or exchange offer. The amount of the soliciting fee will be left to the discretion of the member firms. New York Stock Exchange, M.F. Educational Circular No. 216, Nov. 18, 1966.

The Offering Letter contains the name of the stock sought and the price offered. It also states the period during which the offer will remain open and the period through which it may be extended. In addition, it gives instructions for tendering shares and fixes the date of payment. The Offering Letter also describes the conditions under which the offeror will be obligated to purchase the shares. Typically, the offeror's obligation is conditioned on the receipt of a certain minimum number of shares with an option to take up as many shares tendered over the minimum as the offeror desires.⁷⁶ Although the customary offer requires the offeror to purchase a specified number of tendered shares if the minimum number are deposited, the offeror will not be bound, under the terms of some offers, if the offeree suffers a material adverse development.⁷⁷ The Offering Letter will state whether, if tenders exceed the minimum, the offeror will purchase the shares on a pro rata or first-come, first-served basis. The Offering Letter will also include a paragraph explaining the respective rights of the offeror and offeree with respect to dividend payments and other similar action taken by the corporation during the tender offer period. Many Offering Letters contain the market price of the shares over a period of time and a few indicate that sufficient funds have been deposited to insure payment for the number of shares requested.⁷⁸ The Offering Letter does not usually provide business or financial information about the offeree company. On occasion, however, it contains a summary of earnings and a dividend record and, in some cases, a

⁷⁶ Assuming *B* has 1,000,000 shares outstanding and *A* has already accumulated 120,000 shares, the minimum number in our prototype case might be 390,000 shares.

The offeror usually reserves the option to take all shares tendered if the minimum number of shares are not tendered.

⁷⁷ See *Offer To Purchase The First 65,000 Shares of Common Stock Tendered of Pacific Insurance Company of New York*, Sept. 16, 1966, p. 3, which stated:

Upon the occurrence, in the opinions of the Purchasers, of any of the following events prior to the purchase of any shares pursuant to this Purchase Offer, the Purchasers may by notice in writing delivered to the Depositary withdraw such offer:

- a) any significant increase in the aggregate number of outstanding shares of voting stock of the Company or any material change in its capitalization; or
- b) any material adverse change in the financial condition of the Company; or
- c) any other material adverse occurrence beyond the control of the Purchasers.

See also *Allied Products Corporation Offer to Purchase Shares of Common Stock of Dayco Corporation*, Oct. 24, 1966, p. 2 ("Allied may withdraw this offer . . . [if] there has been any other material adverse occurrence affecting Dayco, Allied or this offer").

⁷⁸ It is understood that many banks will not agree to be the depository of a tender offer unless the funds necessary to acquire the shares are deposited with the bank prior to the public announcement of the offer.

statement concerning the offeror's intentions—for example, its intention to seek representation on the board of directors.⁷⁹

The other document used in a public tender offer is the Letter of Transmittal. It is drafted for use by the shareholder when he sends his shares to the depositary (usually a bank) designated by the maker of the tender offer. The Letter of Transmittal contains the formal terms of the agreement between the offeror and the tendering shareholders.

The problem to which this section of our article primarily addresses itself is the right of shareholders under present law to receive information from the maker of a tender offer who has no relationship to the company. Under federal law, any such right would have to spring from Rule 10b-5. The Rule is clear in prohibiting any outright misrepresentation or half-truth.⁸⁰ Thus, an offer by a party without financial resources to purchase the shares tendered would appear to constitute a violation unless the incapacity is disclosed.⁸¹ But misrepresentations and obvious omissions aside, the key legal issue revolves around whether there is anything in a bare public offer to purchase shares at a fixed price which gives the shareholder a greater right to information than he would have if he sold his shares on an exchange or in the organized over-the-counter market. The only distinction between the two situations is that in the tender offer the prospective buyer makes some concrete statements. Insofar as the investment decision-making process is concerned, these statements, in our hypothetical case, can be summarized as: "A is willing to pay \$25 per share for B stock if it can buy at least 390,000 shares." The making of the tender offer puts the shareholder on notice that someone is willing to pay a certain amount for a large quantity of stock. Presumably the person willing to do so thinks that the stock is (or is potentially) worth even more. Thus, an important element in the shareholder's decision whether or not to tender may be his judgment about the financial acuity of the person making the offer. On occasion, the shareholder cannot make even this judgment because he is not told whose money is at stake in the making of the purchases contemplated by the tender offer.

At the same time, the tender offer is not in form or in principle greatly removed from the classic market situation between two parties dealing at arm's length. Most securities transactions involve differing

⁷⁹ See note 95 *infra*.

⁸⁰ An outsider violates Rule 10b-5 if he makes a false statement to induce the sale of a security. See 3 Loss 1445; *cf.* *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964).

⁸¹ A tender offer by a party without financial resources may be viewed as an attempt to manipulate the market if the offeror attempts to take advantage of the increased market price.

judgments about the value of the company involved. The buyer purchases because he expects additional appreciation while the seller may sell because he believes he can secure a better return on his money elsewhere. Moreover, in the usual transaction on an organized market, the seller of securities neither knows who his buyer is nor the reasons for the buyer's purchases. The major difference between the ordinary market sale and the sale pursuant to tender offer is that the latter has been solicited—the buyer has expressed his willingness to buy shares and may have enlisted the aid of brokers to encourage holders of shares to sell.

Since our prototype case assumes that *A* is an "outsider" to the corporation, the only basis under present law for imposing upon it an affirmative duty of disclosure in its soliciting literature would rest on the theory that the bare statements made are either misleading or that certain statements necessary to make the statements made not misleading have been omitted. In other words, if the courts require additional information to be included in tender offers, they must conclude that the minimal statements made imply to those reading them the existence or nonexistence of certain additional facts which must be accounted for by the offeror.⁸² For example, if an offer to buy at a fixed price somehow conveys the notion that the offeror does not intend to seek a subsequent merger with the offeree company, the offer must negate that inference when a merger is contemplated. Only such a theory of disclosure by implication can provide a general theoretical basis for imposing extensive disclosure responsibilities upon the offeror.⁸³ We now turn to an examination of specific disclosure questions that may confront a party making a tender offer.

When *A* offers to buy *B* stock at \$25 per share, does *A* imply that it thinks *B* stock is worth around \$25, but not more? From time to time, there have been suggestions that an offer to buy securities at a particular price carries such an implication. In 1944 the Chief Counsel to the SEC's Division of Corporate Finance gave three ex-

⁸² In the absence of judicial decisions or legislative direction with respect to what can be implied from the simple statement, "I am willing to buy your shares at \$—," it would seem that the appropriate test is what people who read tender offers actually believe is meant by such a statement. We do not know of any empirical study which seeks to answer this question.

⁸³ An alternative theory, which could probably not be implied from existing rules (but might be implemented through new rules), argues that special disclosure protections are necessary whenever higher than normal compensation is paid to brokers to induce them to make rapid and aggressive efforts to consummate the desired transaction. See Heller, "Integration" of the Dissemination of Information Under the Securities Act of 1933 and the Securities Exchange Act of 1934, 29 LAW & CONTEMP. PROB., 749, 763-65 (1964). Special incentives for brokers are typically present in connection with the making of tender offers. New York Stock Exchange, M.F. Educational Circular No. 216, Nov. 18, 1966.

amples of situations involving omissions to state a material fact necessary to make a statement made not misleading.⁸⁴ One of these examples concerned a corporation which offered to repurchase some of its bonds at a fixed price which was below the prevailing market price of the bonds.⁸⁵ The Chief Counsel concluded that the offer to purchase at a particular price contained an implied representation that the offering price was at least equal to the prevailing market price. The examples did not appear to assume the existence of any other undisclosed material information—indeed, in each example, financial information was sent along with the offer.⁸⁶ The Chief Counsel's conclusions seem unwarranted in the absence of a special relationship between the offeror and the offeree requiring the offeror to come forward with material, generally unavailable information.⁸⁷ In all of the examples cited such a relationship seems to have existed.⁸⁸ Nevertheless, counsel may be inclined to advise even an outsider to disclose the prevailing market price in the unusual case where that price is greater than the tender offer price and is not readily available.⁸⁹

The possible implications of the Chief Counsel's conclusions should be tested against the case in which *A*, a stranger to *B*, knows that, if it can gain control of *B*, it can sell *B*'s inventory for twice the price *B* normally gets for it. Earlier we concluded that, under similar facts, *A* could purchase *B* shares in the market without disclosing its plans.⁹⁰ A similar conclusion was reached in the only case which considered this problem in the context of a public solicitation for

⁸⁴ Address by Edward H. Cashion Before National Association of State Securities Commissioners, Dec. 13, 1944, pp. 6-7, on file in Biddle Law Library, University of Pennsylvania. The examples cited did not involve litigated cases since in each case informal action by the Commission resulted in appropriate remedial responses.

⁸⁵ The other examples involved purchases by controlling shareholders under similar circumstances.

⁸⁶ The Chief Counsel seemed to think that the sending of this information put the offeror in a worse position than it would have been had it not sent the information. In a very confusing statement he categorized this information as "representations as to the value of the securities involved." *Id.* at 7. If the material sent really amounted to such a representation, his conclusion that the prevailing market price, the usual measure of value, should have been stated, seems correct.

⁸⁷ 3 Loss 1456-57; see *Speed v. Transamerica Corp.*, 99 F. Supp. 808, 843 (D. Del. 1951).

⁸⁸ It might be argued that bondholders are arm's-length creditors and no sort of fiduciary relationship extends from the corporation to them. *But see* 3 Loss 1454.

⁸⁹ It has been held that an insider need not disclose the market price where it is readily available. *Hafner v. Forest Labs., Inc.*, CCH FED. SEC. L. REP. ¶91,443 (S.D.N.Y. 1964), *aff'd*, 345 F.2d 167 (2d Cir. 1965).

Considerations similar to those discussed in the text are applicable when a rival makes a tender at a higher price.

⁹⁰ See text accompanying notes 71-73 *supra*. There seems to be little doubt that under present concepts *A* could purchase the inventory without disclosing that his purchase was motivated by an opportunity to sell it elsewhere at a higher price.

tenders.⁹¹ In that case, a syndicate made a tender offer for 80% of the shares of Tacony-Palmyra Bridge Company. The syndicate devised a plan under which it would be able, in effect, to resell the assets of the corporation at a substantial profit. These plans were not disclosed in the tender offer. The court rejected plaintiff's contention that the syndicate had a duty to disclose its plans:

Surely plaintiffs must have anticipated the likelihood that the defendants had a profit-making purpose in mind, especially when the price per share offered to them was substantially higher than the market value of the shares. . . . [I]n the absence of any fiduciary duty it was not incumbent upon the defendants to divulge their plans with respect to a subsequent resale of the property. The cases imposing a duty on the part of a purchaser of shares of stock to disclose his knowledge of future prospects and plans all involve situations where the purchaser holds a fiduciary position and where the knowledge has been obtained by virtue of an "inside" position.⁹²

⁹¹ *Mills v. Sarjem Corp.*, 133 F. Supp. 753 (D.N.J. 1955); cf. *Slavin v. Germantown Fire Ins. Co.*, 174 F.2d 799 (3d Cir. 1949); *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959), *aff'd per curiam*, 279 F.2d 685 (6th Cir. 1960).

⁹² 133 F. Supp. at 764-65. The force of the court's statement is somewhat diminished by its observation toward the end of the opinion that the scheme by which the syndicate planned to sell the assets of the corporation at a profit "was highly speculative and uncertain, both as to its ultimate materiality and its legality." *Id.* at 767.

Earlier, in connection with the purchase by *A* of shares in *B*, a closed-end fund, which *A* intended to open-end or liquidate, we suggested that *A* could not buy any shares in the market after there was a "reasonable probability" that its plan would be adopted. See text accompanying notes 71-73 *supra*. If *A* makes a tender offer for *B* shares and sets the minimum at the number of shares needed to approve an opening or liquidation, *A* takes no risk in effectuating its plans—although *A* still bears the normal market risk connected with the maintenance in value of the fund's portfolio. Nevertheless, strong arguments can be made for permitting *A* to make a tender offer without disclosing its plans under these circumstances. *A*'s plans were not conceived while an insider nor do they stem from the appropriation of confidential corporate information. Thus, the legal basis for compelling disclosure would rest on some aspect of the broad "fairness" theory previously discussed. Indeed, if disclosure were required, the tender offer probably could not be successful—it simply would not be attempted. This result seems undesirable if it is assumed that the disparity between the market price of these shares and their intrinsic value represents irrational market behavior and thus impairs its allocational efficiency. Compare *Complaint, Columbia Pictures Corp. v. Clairmont*, Civil No. 3581, S.D.N.Y., 1966 (failure to disclose alleged plan of liquidation when making a tender offer attacked as a material nondisclosure).

Both the Williams Bill and the SEC's proposal would require persons who make a tender offer seeking control or representation on the board of directors to disclose their plans "with respect to the conduct and continuation of the business" of the offeree company. S. 2731, § 10(c) (1) (iii); SEC Memorandum on S. 2731, § 13(d) (1) (A) (iii). Such a requirement raises a number of problems. Intentions with respect to the conduct of the business are often nebulous and can only be well defined when *A* assumes control of *B* and gets a better insight into its operations. At any rate, there seems to be little justification for requiring greater disclosure about the future plans of an outsider than is required about the future plans of management.

A "participant" in a proxy contest must disclose whether it has any arrangement or understanding with any person "with respect to any future transactions to which the issuer or any of its affiliates will or may be a party." SEC Schedule 14B, Item 4(b), 17 C.F.R. following § 240.14a-11 (1964).

The rationale of *Mills v. Sarjem* extends to the necessity of disclosing specific plans such as the plan to merge *A* and *B*. Indeed, the argument for requiring disclosure of such an intention in the tender offer must run the additional hurdle of showing that the intention to merge is a material fact.⁹³ However, as suggested earlier, if prior to the completion of the tender offer, the managements of *B* and *A* have agreed in principle on the terms of a merger, *A* should make appropriate disclosures.⁹⁴ Because the principles in this area are far from fully defined, cautious counsel may recommend a statement as to the offeror's plans about a possible merger.⁹⁵

A somewhat similar problem arises where the purchase price for *B*'s shares is acquired through short-term financing which is converted into long-term financing after *B* is merged into *A*. This device in effect permits the *B* shareholder to be bought out at least in part with his own assets.⁹⁶ Accordingly, it may be contended that *A* is an "insider" in respect of the purchases and burdened with the correlative duties. However, viewed as a problem of disclosure of *A*'s plans for the use of *B*'s assets, this case does not appear to be significantly different from the case where *A* knows that he can profitably dispose of *B*'s inventory.⁹⁷

⁹³ Normally a proposed merger will not be considered a material fact until the managements of the companies to be merged have agreed in principle on specific terms for concluding the merger. See cases cited at note 72 *supra*. Compare *Ross v. Paul Hardeman, Inc.*, CCH FED. SEC. L. REP. ¶91,483 (S.D.N.Y. 1965) (plaintiff entitled to have interrogation answered which related to an alleged omission in a prospectus concerning plans of defendant to merge with another corporation).

For a general discussion of the necessity to disclose plans for future action, see Comment, *The Regulation of Corporate Tender Offers Under Federal Securities Law: A New Challenge For Rule 10b-5*, 33 U. CHI. L. REV. 359, 367-68 (1966).

⁹⁴ See text accompanying note 66 *supra*.

⁹⁵ See *Offer To Purchase Common Stock of Wagner Electric Corporation*, May 31, 1966 ("If the Purchaser purchases Common Stock tendered pursuant to this offer it may in the future offer to acquire the entire business of Wagner Electric Corporation by purchase, merger or otherwise. The Purchaser has had discussions with the management of Wagner Electric Corporation regarding a possible merger with the latter but no agreement or understanding regarding such a transaction was reached."); *Invitation for Tenders of 413,000 Shares of Common Stock of Allied Mills, Inc.*, July 28, 1965 ("Continental has no present plans to change Allied Mills' capital structure or existence. It does plan, if the tendered shares are purchased, to vote the shares for its own nominees to the board of directors."). See also *Allied Products Corporation Offer To Purchase Shares of Common Stock of Dayco Corporation*, Oct. 24, 1966, p. 3; *Foremost Dairies, Inc. Offer to Purchase 550,000 Shares of Common Stock of McKesson & Robbins, Inc.*, Sept. 2, 1966, p. 2.

Expression of a firm intention to effect a subsequent merger may result in undesirable tax consequences for the offeror. See note 12 *supra*.

⁹⁶ Similar financing occurred in *Mills v. Sarjem Corp.*, 133 F. Supp. 753 (D.N.J. 1955). The bank loans in that case were paid off from what was, in effect, a sale of the offeree company's assets.

⁹⁷ The SEC proposal requires disclosure of the source and amount of consideration used in purchasing the stock tendered and also the names of any parties from whom funds have been borrowed for the purpose of making such purchases. SEC

A final problem relating to the disclosure of the offeror's intentions relates to his intent to acquire control of the offeree company. In the usual tender offer it is clear from the number of shares sought whether or not the offeror seeks to assert a degree of control. However, in some cases it is only when the shares sought by the tender offer are added to existing holdings of the offeror or his associates that it is clear that the offeror is seeking control. The Williams Bill and the SEC proposal require disclosure of the number of shares beneficially owned by the maker of the tender offer and his associates; the SEC proposal also requires disclosure of the number of shares which such persons have a right to acquire.⁹⁸ As a matter of practice offerors have disclosed their holdings when making a tender offer. However, for the reasons discussed above, it seems that normally there is no legal requirement to make such disclosures or to disclose the intent to exercise control.⁹⁹

One implication which may be drawn from the statement "*A* is willing to pay \$25 per share for *B* stock" is that \$25 per share is the best price that *A* is willing to pay during the period the tender offer is open.¹⁰⁰ The Commission has indicated in one proceeding that such

Memorandum on S. 2731, § 13(d)(1)(A)(ii). See also SEC Schedule 14B, Item 3(d), 17 C.F.R. following § 240.14a-11 (1964). Compare S. 2731, § 10(c)(1)(ii) (only the source of funds need be disclosed). The Commonwealth legislation only requires disclosure of the arrangements made to ensure that payment can be made for the stock tendered. See note 45 *supra*.

A's ability to finance the purchase of the *B* shares is restricted by regulations of the Federal Reserve Board. Thus, *A* could not borrow money from a bank and secure his obligation with the *B* shares, except in compliance with the margin rules, which presently permit loans of up to 30% on the value of the securities purchased. See Regulation U, 12 C.F.R. § 221 (1964) (applies to a stock-secured loan made for the purpose of purchasing a controlling interest in a corporation). However, a bank can loan money to *A* to purchase the *B* shares if the loan is not secured by a pledge of those shares. Moreover, if *B* is not a listed company, the margin restrictions of the Federal Reserve Board regulations would not apply.

If a member of a national securities exchange, or a firm which transacts business through such a member, helps arrange the financing for *A*'s purchase, questions may arise as to the applicability of the Federal Reserve Board's Regulation T. 12 C.F.R. § 220 (1964).

⁹⁸ S. 2731, § 10(c)(1)(iv); SEC Memorandum on S. 2731, § 13(d)(1)(A)(iv). The Commonwealth legislation contains provisions similar to those in the Williams Bill. See note 45 *supra*.

⁹⁹ The complaint in a recent case poses the problem of the maker of a tender offer who publicly announced that it was not seeking control, but who sought to exert control once the tender offer had been successfully completed. *Complaint, Columbia Pictures Corp. v. Clairmont*, Civil No. 3581, S.D.N.Y., 1966.

¹⁰⁰ During the tender period securities traders may enter into arbitrage transactions with respect to the securities sought to be acquired. A trader will buy the security on the trading market and tender it to the offeror. Any profit will result from a spread between the trading market price of the stock and the tender price. Although the market price normally shoots up to approximately the tender offer price on announcement of the tender, there may be a small spread reflecting the uncertainty of the market as to whether or not the tender will be accepted.

an inference should be drawn from that statement.¹⁰¹ In that proceeding Fruit of the Loom transmitted an offer by Bates Manufacturing Company to purchase shares of Fruit of the Loom at \$50 per share of preferred stock and \$20 per share of common stock and recommended that the shareholders accept the offer. Management informed its shareholders that it would tender its shares pursuant to the Bates offer. After the Bates offer was made public, Philadelphia & Reading offered to pay \$51.50 per share of Fruit of the Loom preferred stock and \$23 per share of Fruit of the Loom common stock. To combat this offer Bates contracted with a brokerage firm to make purchases on the open market at prices competitive with the Philadelphia & Reading offer. Two members of Fruit of the Loom management sold their shares to the brokerage firm at prices above those contained in the Bates tender offer. In addition, Fruit of the Loom management failed to inform its shareholders about the existence of Philadelphia & Reading's offer or the willingness of Bates to pay more than its published offer to meet the Philadelphia & Reading offer.

In support of its request for an injunction the Commission argued that Fruit of the Loom management breached a duty to its shareholders when, after it recommended acceptance of the Bates offer, it failed to inform its shareholders of the changes in circumstances which no longer made it advisable for Fruit of the Loom shareholders to accept the Bates offer. This argument accords with established principles of law.¹⁰² However, the Commission also argued that "Bates violated Rule 10b-5 by making a public offer to purchase stock of Fruit of the Loom at one price and then pursuing a secretive program . . . to pay higher and varying prices."¹⁰³ The Commission buttressed this argument by pointing to the use of Fruit of the Loom's management in furthering the offer and to Bates' knowing participation in the breach of fiduciary responsibility by Fruit of the Loom's management. It is not clear that the Commission could have obtained judicial approval for its position in the absence of the buttressing arguments. The SEC's proposed redraft of the Williams Bill contains a provision that where the terms of a tender offer are changed to increase the consideration to be paid for securities tendered, all shares, including those

¹⁰¹ Memorandum for Plaintiff in Support of Motion for Preliminary Injunction, *SEC v. Fruit of the Loom, Inc.*, Civil No. 61-640, S.D.N.Y., Feb. 24, 1961, reported in 27 SEC ANN. REP. 92-93 (1961). The defendants consented to a permanent injunction and made the rescission offers requested by the Commission.

¹⁰² See PROSSER, TORTS 711 (3d ed. 1964).

¹⁰³ Memorandum for Plaintiff in Support of Motion for a Preliminary Injunction, p. 11, *SEC v. Fruit of the Loom, Inc.*, Civil No. 61-640, S.D.N.Y., Feb. 24, 1961.

tendered prior to the change, shall be given the increased consideration.¹⁰⁴ Of particular significance is the Commission's explanation that the purpose of this provision is avoidance of the discriminatory effect of paying some holders more than others "since security holders tendering their shares pursuant to a tender offer normally assume that all tendering security holders will receive the same price."¹⁰⁵

If the Commission's judgment about the normal expectations of securities holders is right, a number of problems arise under present law with respect to *A*'s conduct after the tender offer has expired. Can *A* now buy additional *B* shares in the market at prices in excess of \$25 per share? Can *A* make a new tender offer at \$28 per share or negotiate with hold-outs for the purchase of their shares at \$28 per share? It is difficult to distinguish these post-tender offer transactions from the pre-tender offer transactions in which shareholders, unaware of *A*'s impending tender offer, sell their shares for \$22 per share.¹⁰⁶ As indicated earlier, we do not think that under present law these shareholders have a right to receive the difference between what they received and the tender offer price. Neither should any shareholder who tendered his shares for \$25 per share have any additional claim because a higher price was paid for shares purchased after the tender period expired. The more difficult case arises when *A* decides to close the original tender offer early because it is not producing sufficient tenders. Immediately thereafter, *A* publishes a new tender offer at \$28. The Commission's reasoning may suggest that, in order to terminate its tender offer on a date prior to that announced in the offer, *A* would have to give those shareholders who tendered under the original offer an opportunity to tender under the new offer.¹⁰⁷

¹⁰⁴ SEC Memorandum on S. 2731, § 14(d)(5). The Ontario Securities Act contains a similar provision. Ontario Securities Act § 83(1). In addition, the Jenkins Committee recommended adoption of such a provision in the British legislation. *Jenkins Report* ¶ 294(e). Australia does not have such a provision.

A can almost always buy shares—and should be permitted to do so—in the open market at less than the tender price. An offer to buy at a specified price necessarily carries the implication that the offeror is willing to buy shares at less than the specified price.

¹⁰⁵ SEC Memorandum on S. 2731, at 20. It could be argued that in the usual case a shareholder will assume that, if the maker of a tender offer wants shares badly enough, he will pay more than he is presently offering. Each shareholder takes the risk of guessing whether or not more will eventually be offered. This risk is the essence of arm's-length bargaining. Courts will normally mitigate this risk only when a special relationship exists between the parties.

¹⁰⁶ *B* shareholders in the post-tender offer period may be better informed than *B* shareholders in the pre-tender offer period because they have been put on notice by the tender offer that there has been an active interest in acquiring *B* stock and that there may be an interest in acquiring additional shares.

¹⁰⁷ Some shareholders acting on "a bird in the hand" theory may be content to accept payment under the original tender offer.

Problems arising from the Commission's assumptions about shareholder expectations may perhaps be avoided by the use of a disclaimer provision. One version of such a provision might read:

This offer to purchase 390,000 *B* shares at \$25 should not be construed to mean that *A* may not during the tender period or thereafter buy *B* shares on or off the Exchange at prices below or in excess of \$25, or that *A* will not raise its tender offer price at a subsequent date.

The content of such a disclaimer will depend on the range of possibilities that occur to the lawyer preparing it.¹⁰⁸ The suggested disclaimer should be effective except perhaps where *A* has already committed itself to carry out any of the actions described in the disclaimer.¹⁰⁹

There has been a spasmodic use of "blind" tender offers in which the identity of the principal has been undisclosed.¹¹⁰ Normally it seems proper to make such a tender offer. However, its use may be questioned where acquisition by the undisclosed principal in effect imposes on the completion of the tender offer an undisclosed condition, such as approval by an administrative agency or the possibility of successful action under a statute, such as the antitrust laws.¹¹¹ Although no court has said that an insider cannot make a blind tender offer,¹¹² it is

¹⁰⁸ See Offer To Purchase 300,000 Shares of Common Stock of the Philip Carey Manufacturing Company, Feb. 8, 1966:

During the period of this offer, Purchaser may purchase shares of Philip Carey Common Stock in the market at not in excess of the tender price of \$38.00 per share offered hereunder, but such purchases, if any, will be in addition to any shares purchased hereunder and will not diminish its obligation to purchase shares under this offer.

¹⁰⁹ For a discussion of the limitations on the effectiveness of disclaimer clauses, see 3 Loss 1814-17; cf. Heft, Kahn & Infante, SEC Exchange Act Release No. 7020 (Feb. 11, 1963).

¹¹⁰ Offer To Buy 500,000 Shares of Common Stock of Studebaker Corporation, Feb. 8, 1966 ("Lehman Brothers and Lazard Frères & Co., as authorized agents of certain prospective purchasers"); Offer To Purchase the First 65,000 Shares of Common Stock Tendered of Pacific Insurance Company of New York, Sept. 16, 1966 ("For a limited period . . . certain purchasers . . . acting severally through Laidlaw & Company").

¹¹¹ Both the Williams Bill and the SEC proposal require disclosure of the identity and background of any person by whom or on whose behalf a tender offer is made. S. 2731, § 10(c) (1) (i); SEC Memorandum on S. 2731, § 13(d) (1) (A) (i). Both the Australian and British legislation forbid blind tender offers. Australia Companies Act, Tenth Schedule, pt. B, ¶¶ 1, 4; British Dealers Rules § 1(a). On the other hand, the Kimber Report recommended against requiring disclosure of the identity of the maker of the tender offer because of a fear that such a requirement might discourage some tender offers from being made. *Kimber Report* 25.

¹¹² A number of courts have upheld purchases by insiders who hid their identity. *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959), *aff'd per curiam*, 279 F.2d 685 (6th Cir. 1960); *Vulcanized Rubber & Plastics Co. v. Scheckter*, 400 Pa. 405, 162 A.2d 400 (1960). Compare *Beggy v. Deike*, 413 Pa. 74, 196 A.2d 179 (1963). Whether the failure to disclose his identity without more will subject an insider to liability was left open in *List v. Fashion Park, Inc.*, 340 F.2d 457, 464 n.4 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965), and *Cochran v. Channing Corp.*, 211 F. Supp. 239, 242 (S.D.N.Y. 1962). See Brief for National Association of Securities Dealers, Hughes & Treat, 22 S.E.C. 623 (1946) (brokerage firm should be under no duty to disclose whether its client is an officer or director of a company).

likely that such a situation will be scrutinized very carefully in order to be sure that there were no material undisclosed facts.¹¹³

Another area in which disclosure may have to be made relates to the minimum number of shares which must be tendered before the offeror's obligation matures. In the prototype case 390,000 shares are required. Suppose *A* knows that its associates hold 100,000 shares and plan to tender them. Information about the associates' holdings and the fact that they will be counted in determining whether or not the minimum has been reached may help *B* shareholders assess the likelihood of the tender offer's success. A correct assessment is important to *B* shareholders since the act of tendering their shares normally eliminates the alternative of selling their shares in a market in which the price of the stock is affected by the existence of the outstanding tender offer. In addition, if the tender offer is made on a first-come, first-served basis, such information may be important in persuading a shareholder not unnecessarily to delay his tender.¹¹⁴ If the tender offer is made on a pro rata basis, the information may perhaps help a shareholder gauge the likelihood of an extension of the offer and the consequent immobilization of his stock.¹¹⁵

When the Offering Letter contains information beyond the bare minimum assumed in the preceding discussion, additional but familiar problems of disclosure arise. For example, if a statement of the earnings of *B* through its last fiscal year is set forth in the Offering Letter, and earnings since the end of the fiscal year have risen sharply, such information probably must be disclosed unless it could not reasonably have been known to the person making the tender offer. In other words, the more information given in the Offering Letter, the greater the likelihood of problems relating to the failure to disclose. The problem is illustrated by a recent tender offer for the stock of Columbia Pictures Corporation in which the agent for the offeror, Banque de Paris, made the statement that the purpose of the offer was to acquire an "investment" position. When after the successful completion of the tender, the offeror, certain parties to whom it had sold part of the shares acquired and other large Columbia stockholders requested board representation, management brought suit to prevent the shares acquired from being voted for the reason, among others, that

¹¹³ See *Broffe v. Horton*, 172 F.2d 489 (2d Cir. 1949); *Taylor v. Wright*, 69 Cal. App. 2d 371, 159 P.2d 980 (1945); *Beggy v. Deike*, 413 Pa. 74, 196 A.2d 179 (1963); 3 Loss 1465.

¹¹⁴ Since the offeror wishes to encourage such an attitude he will probably include such information.

¹¹⁵ The attitude of the American and Commonwealth legislation toward the disclosure of the number of shares beneficially owned by the maker of the tender offer and his associates is described in note 45 *supra* and text accompanying note 98 *supra*.

the conduct of the offeror and its associates was inconsistent with the prior representations made on behalf of the offeror.¹¹⁶

The conclusion that the best protection against potential liability lies in minimizing disclosure runs counter to the Commission's regulatory approach which is oriented toward encouraging disclosure. Our prior discussion suggested that courts, operating in an adjudicatory context, probably will not—and probably should not—take steps to broaden disclosure requirements in the making of tender offers. If additional disclosure is desirable, the nature of such disclosure should be worked out in the legislative process—either by congressional enactment of statutory amendments to the Securities Exchange Act of 1934 or by the Commission through its rule-making powers.

If Congress decides not to enact legislation in this area, it is possible that the Commission will write rules under section 10(b) of the Securities Exchange Act of 1934 which embody many of the suggestions it has made in its comments on the Williams Bill. The authority of the Commission to draft rules defining "any manipulative or deceptive device or contrivance" is broader than the authority of a court in judging whether or not particular conduct comes within that definition.¹¹⁷

We cannot predict the provisions which any Commission rules might contain. Although the Williams Bill and the Commission's proposed redraft do not specifically call for information about the offeree company, it is possible that the rules would require such information. The disclosure requirements imposed in connection with exchange offers (stock tender offers) have been pointed to as providing a convenient analogy for defining the proper disclosure requirements for cash tender offers.¹¹⁸ In the exchange offer (in which the stock offered in exchange for the shares tendered must be registered under the Securities Act of 1933), the Commission requires disclosure of

¹¹⁶ Complaint, *Columbia Pictures Corp. v. Clairmont*, Civil No. 3581, S.D.N.Y., 1966. After the complaint was filed, Columbia and Banque de Paris apparently entered into an agreement under which the Banque will hold its stock as an investment, receive minority representation on the Columbia board of directors and will not act alone or jointly with other shareholders to exercise control over Columbia. *Wall Street Journal*, Nov. 15, 1966, p. 2, cols. 3-6.

¹¹⁷ See *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262, 289 (S.D.N.Y. 1966). In that case the Commission asked the court to fix a reasonable waiting period after announcement of Texas Gulf's mining discovery was made during which insiders should not have been allowed to trade. The waiting period was designed to give the public an opportunity to absorb the information announced. The court thought it inappropriate for it to fix such a period. It suggested that "if a waiting period is to be fixed, this could be most appropriately done by the Commission, which was established by Congress with broad rule-making powers." *Ibid.* See Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy*, 78 HARV. L. REV. 921, 946-47 (1965).

¹¹⁸ See Cohen, *A Note on Takeover Bids and Corporate Purchases of Stock*, 22 BUS. LAW. 149 (1966).

the terms of the offer and of pertinent business and financial data concerning both the offeror and offeree companies. These disclosure requirements may be justified on two theories. First, an exchange offer closely resembles a merger transaction and the shareholder should have sufficient information about the stock he is offered and the stock he is asked to give up before deciding on the course of action he should take.¹¹⁹ Second, if the exchange offer is successful, the tendering shareholder will own an interest in a company, a significant part of whose assets may be represented by stock in the offeree company.

In a cash tender offer there is no need to give the shareholders of the offeree company information about the business operations and

¹¹⁹ Exchange offers are unusual. First, as indicated in the text, they must be registered under the Securities Act of 1933 and will have to comply with state Blue Sky laws. Compliance with these requirements considerably increases the expenses of the offer and is time-consuming. Second, to make the requisite disclosures about the sought-after company may require the cooperation of management if there is no published information about the company. Third, exchange offers lack the element of surprise—so often necessary for a successful tender offer—since *B* will be informed of its pendency. The SEC staff may require the offeror to ask the offeree for the latest financial and business information about its operation. In any case, the filing of *A*'s registration statement will alert *B*. It appears that the Commission will not grant confidential treatment to the statement when filed. One possibility would be for the staff of the Commission to "pre-clear" the registration statement so that, when filed and made public, it will already reflect the comments of the staff and can be used immediately to solicit tenders. Finally, in an exchange offer involving registration under the Securities Act, *A* is severely restricted under § 5 of the act, 48 Stat. 77 (1933), as amended, 15 U.S.C. § 77e (1964), with respect to statements made, particularly during the period prior to the time that the registration statement becomes effective. The management of *B*, on the other hand, would not be under such restrictions in its opposition to the offer.

An exchange offer raises other problems. In order for the transaction to be nontaxable, the offer must consist of voting stock, common or preferred, and, upon completion of the offer, the acquiring company must own at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock of the acquired company. INT. REV. CODE OF 1954, § 368(a)(1)(B). See also note 12 *supra*. Moreover, unless stock has already been authorized, the offeror must secure a vote of its shareholders for an appropriate amendment to its charter. Furthermore, even if stock has already been authorized, issuance of the shares in connection with the exchange offer may need shareholder approval under certain state laws, if the stock to be issued equals one-sixth of the voting power of the corporation, *e.g.*, OHIO REV. CODE ANN. §§ 1701.01, 1701.84 (1964), or, under the rules of the major exchanges, if the common stock to be issued could result in an increase of outstanding common stock of roughly 20%. See, *e.g.*, NEW YORK STOCK EXCHANGE, COMPANY MANUAL A-284(3). Finally, if the shares to be issued by the offeror constitute a substantial part of its outstanding stock, it may be contended that the transaction constitutes a de facto merger giving appraisal and voting rights to the shareholders of the offering company. Compare *Appelstein v. United Board & Carton Corp.*, 60 N.J. Super. 333, 159 A.2d 146, *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960), with *Orzeck v. Englehart*, 41 Del. Ch. 361, 195 A.2d 375 (1963).

An unresolved Securities Act problem in exchange offers relates to the status of a controlling person of the company proposed to be acquired who negotiates with the offeror prior to the exchange offer and agrees to tender his shares if the offer is made. Apparently the staff of the Commission takes the view that, although the offeror's shares exchanged in the tender offer are registered, the controlling person acquires his shares as an "underwriter" and accordingly may not resell them without registration or unless an exemption is available. If the controlling person does not negotiate with the offeror or enter into any prior arrangements for the tender of his stock, he is apparently free to resell any shares acquired.

financial condition of the offeror. Even the need for information about the offeree company is not as clear as in the exchange offer. The tendering stockholder will not have a continuing interest in the offeree company through his ownership of stock in the offeror company. Moreover, there is nothing compelling about the attempt to analogize the tender offer to a merger. A cash tender offer can equally well be viewed as a form of a market purchase. In the context of a sale in the market the shareholder is only entitled to the information already made available by company management.¹²⁰

Even accepting the merger analogy, the crucial question is who should be burdened with the duty of supplying the information about the offeree company. Management generally is the proper party to furnish information about the company to the shareholders. It prepared the information which is already public and it has access to nonpublic material information which is relevant in evaluating the present value of the stock. An outsider such as the person making a tender offer can, in the usual case, only be expected to provide publicly available information about the offeree company. It is understood that the Commission has recognized this limitation by permitting the offeror in an exchange offer to obtain from public sources, including prior registration statements under the securities laws and reports filed with the state and federal authorities, the information about the offeree company it is required to put in the prospectus.¹²¹ The most helpful suggestion with respect to this problem—for both exchange offers and cash tender offers—is contained in the Australian Companies Act which requires the offeree company either to gather certain information¹²² and transmit it to its shareholders or to give it to the offeror which then must make the information available to the offeree shareholders.¹²³

¹²⁰ The present Chairman of the SEC has argued that, where a tender offer involves a potential change of control, a new, or at least vastly changed, company is created. Thus a shareholder's decision not to tender his shares amounts to a decision to purchase shares in the new company. This type of argument attempts to lay a basis for requiring a "reverse prospectus" when a cash tender offer is made. Cohen, *supra* note 117, at 152.

The analysis offered by Chairman Cohen would undoubtedly surprise the typical offeror. His intent is to induce the shareholders of the offeree company to sell their shares to him; he does not conceive his offer to be an invitation to invest in the enterprise which he seeks to take over. Indeed, if enough shareholders make what Chairman Cohen characterizes as a decision to invest in the new enterprise by not tendering their shares, the tender offer will fail and the new enterprise will not materialize.

¹²¹ Compare SEC Rule 409, 17 C.F.R. § 230.409 (1964) (information need not be furnished where it is unknown and not reasonably available to the registrant).

¹²² This information includes any material undisclosed facts about the financial condition of the company which are not reflected in the last published reports of the company.

¹²³ Australia Companies Act § 184(3). In his study of the British experience with tender offers, Weinberg argues that directors of the offeree company should send shareholders information with respect to the latest financial position of the com-

III

Our discussion has focused primarily on problems relating to the disclosure of information in the tender offer. There are also substantive problems arising out of the way in which a tender offer may be conducted. *A*'s interests are best served if *B* shareholders can be induced to tender their shares early, thus freezing their interests without, however, obligating *A* until it is sure that its objectives can be achieved. The technique which accomplishes this objective is the first-come, first-served tender offer. In our prototype case *A* would usually not be able to use such a form of tender offer. The New York Stock Exchange has stated that the use of such an offer by a company subject to its regulation is "normally objectionable."¹²⁴ It requires that acceptance of shares be on a pro rata basis for a minimum period of ten days. This requirement implements the Exchange policy of providing all stockholders of a company "an opportunity to participate on equal terms in any offer made which may affect the rights and benefits of such stockholders."¹²⁵ The ten-day breathing period, according to the Exchange, puts shareholders living at a distance from the place of tender on an equal footing with those who live nearby. It also prevents insiders of the offeree corporation (and their friends) from being first in line with their shares.

The Commission's redraft of the Williams Bill goes further. It requires all tender offers to be on a pro rata basis.¹²⁶ The Commission argued that such a provision discourages hasty and ill-considered action and generally is fairer to all security holders. This provision encourages the delay of any tender until the last day on which the

pany and with respect to the interests of the directors. He suggests that transactions by the directors in the stock of the offeree and offeror companies within the past year and details of the directors' service agreements be disclosed in the materials sent to the shareholders. WEINBERG, TAKE-OVERS AND AMALGAMATION'S 151 (1963); see text accompanying notes 161-64 *infra*.

¹²⁴ NEW YORK STOCK EXCHANGE, COMPANY MANUAL A-179. The Company Manual appears to require pro rata offers whenever a tender offer is made by a listed company, whether or not the offeree company is listed. If a nonlisted company makes an offer for a listed company, the Exchange's policy is probably inapplicable, because the Exchange does not have any jurisdiction over the nonlisted company. However, if a member firm participates in the offer the Exchange may request the firm to ask the offeror to abide by the Exchange's policy.

It is understood that the American Stock Exchange has an informal policy which closely resembles that of the New York Stock Exchange.

¹²⁵ *Ibid.* The reach of this policy is not clear. Does it prevent a New York Stock Exchange listed corporation from making an offer to buy all the shares of one shareholder at a price above market without making the offer available to all the other shareholders of that corporation?

¹²⁶ SEC Memorandum on S. 2731, § 14(d)(4). For a discussion of the Commonwealth legislation, see note 47 *supra*.

offer is open.¹²⁷ In this respect it gives management many of the advantages in combatting the offer that would derive from a requirement that management be notified in advance of the publication of a tender offer.¹²⁸

The mechanics of the typical tender offer include the making of an offer to buy by the person seeking to acquire the shares and the acceptance of that offer by the shareholders when they return the Transmittal Letter and deposit their stock with the depositary named in the Transmittal Letter. The usual Transmittal Letter states that the tendering shareholder accepts the offer made and deposits his stock irrevocably for a specified period, all in accordance with the terms and conditions set forth in the Offering Letter and the Letter of Transmittal. Suppose that in our prototype case the market drops sharply after 30,000 shares have been tendered. Can *A* withdraw the offer at a date prior to the termination date set forth in the offer? Normally an offer may be withdrawn before it is accepted.¹²⁹ The tender of shares constitutes an acceptance of *A*'s offer by the tendering shareholders. The contract created is, however, subject to a condition subsequent—the tender of 390,000 shares. *A*'s withdrawal of the offer makes it impossible for the condition to occur. Since *A* prevented the condition from occurring, the condition will probably be excused and *A*'s obligation to purchase the 30,000 shares tendered becomes absolute.¹³⁰ The shareholders who did not tender their shares might argue that they did not do so because the pro rata nature of the offer implied that there was no need to tender shares until the end of the period stated in the offer. Their theory would be that they relied to their

¹²⁷ For the protection of those who do not wait to tender their shares, the Commission also proposes that a tender offer permit any shareholder to withdraw his shares at any time until the expiration of seven days after the offer has been published. SEC Memorandum on S. 2731, § 14(d) (3).

¹²⁸ See text accompanying notes 38-41 *supra*.

¹²⁹ CORBIN, CONTRACTS §§ 38-40 (1963 ed.). New York has a statute making a written offer which states that it will be irrevocable for a stated period binding on the offeror. N.Y. GEN. OBLIG. LAW § 5-1109. Tender offers typically do not expressly state that they are irrevocable. Under certain circumstances courts may imply that the offer is irrevocable for a specific period. See *Jarka Corp. v. Hellenic Lines, Ltd.*, 182 F.2d 916 (2d Cir. 1950). It is not clear to what extent a tender offer published in the *New York Times* or the *Wall Street Journal* by *A*, a Delaware corporation, for the stock of *B*, an Ohio corporation with shareholders scattered throughout the country, calling for deposit of shares with a New York bank, will be governed by the New York General Obligation Law.

UNIFORM COMMERCIAL CODE § 2-205 contains a provision similar to that in the New York General Obligation Law. However, by its terms this section is applicable only to the purchase or sale of "goods." The definition of "goods" specifically excludes investment securities. *Id.* § 2-105.

¹³⁰ SIMPSON, CONTRACTS 302-03 (2d ed. 1965).

detriment on *A*'s implied promise to keep the offer open.¹³¹ Recovery on such a theory has, however, been granted sparingly in commercial transactions. Courts seem to require a showing that the person seeking recovery expended time and expense in order to take advantage of the offer¹³² or has abandoned an existing right.¹³³ It is doubtful that recovery would be granted to the nontendering shareholder if his only action was to delay a sale of his shares.¹³⁴

Once a shareholder has tendered his shares under our prototype case he probably cannot withdraw them until the tender offer period has expired.¹³⁵ Suppose, however, *A*'s offer stated that *A* had no obligation to purchase any shares if, in its judgment, such purchases would be contrary to its best interests. If *A*'s discretion in rejecting the shares cannot be reviewed against objective standards, its offer may be regarded as an invitation to deal and shares deposited under such a tender offer may be withdrawn before they are purchased.¹³⁶ Similarly, if *A*'s offer were a first-come, first-served offer, any shares deposited after the first 390,000 shares have been deposited could be withdrawn. In the pro rata tender offer shareholders may have similar rights with respect to the part of their deposit which *A* is not obligated to accept.¹³⁷ These conclusions suggest that perhaps *A* may have an obligation to announce when the minimum number of shares have been deposited under a first-come, first-served offer, and, in the

¹³¹ RESTATEMENT, CONTRACTS § 90 (1932):

A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

See also 1 WILLISTON, CONTRACTS 191 (3d ed. 1957).

¹³² *Goodman v. Dicker*, 169 F.2d 684 (D.C. Cir. 1948); *Security Stove & Mfg. Co. v. American Ry. Express Co.*, 227 Mo. App. 175, 51 S.W.2d 572 (1932).

¹³³ *Trexler's Estate*, 27 Pa. D. & C. 4 (1936); see RESTATEMENT, CONTRACTS § 90, illustrations 1-4 (1932).

¹³⁴ *Rennie & Laughlin, Inc. v. Chrysler Corp.*, 242 F.2d 208 (9th Cir. 1957); *Gill v. U.S. Rubber Co.*, 195 F. Supp. 837 (N.D. Ind. 1961); CORBIN, CONTRACTS § 200 (1963 ed.).

¹³⁵ One problem for the maker of the tender offer is the point at which he must file § 16(a) reports with respect to the shares tendered. Until the minimum number of shares are tendered, he normally has only an option to purchase the shares tendered. The rules for reporting options are discussed at note 68 *supra*. If any of the shares tendered can be withdrawn, it is doubtful that a § 16(a) report must be filed with respect to them. Once the minimum number of shares are tendered, the offeror is normally obligated to purchase the number of shares specified in the offer and is regarded at that time as having acquired a beneficial interest in such number of shares for the purposes of § 16(a).

¹³⁶ *Nebraska Seed Co. v. Harsh*, 98 Neb. 89, 152 N.W. 310 (1915); *Moulton v. Kershaw*, 59 Wis. 316, 18 N.W. 172 (1884).

¹³⁷ It may, however, be argued that *A*'s obligation to take a part of the shares tendered in a pro rata offer provides sufficient consideration to make irrevocable the option granted to *A* with respect to those shares which it is not obligated to purchase.

case of a pro rata offer, to announce from time to time how many shares over the minimum have been deposited.

IV

In this section of our article, we turn to the duty of *B*'s management to advise its shareholders about the desirability of accepting *A*'s tender offer. If management opposes the tender offer, it will so advise shareholders and deluge them with reasons supporting its position.¹³⁸ However, management frequently makes no comment on a tender offer and leaves the decision whether or not to tender solely to the shareholder. Although such management abstention is not possible in connection with other acquisition forms such as the effectuation of a merger or the sale of the assets of the corporation, a tender offer appears to be viewed as a transaction between a shareholder and a potential purchaser. It is not thought to involve a corporate interest and therefore management has neither an interest nor a responsibility with respect to the transaction.¹³⁹

This attitude was expressed in a case in the United States Court of Appeals for the Second Circuit¹⁴⁰ in which, prior to selling his shares to a stranger to the corporation, the plaintiff asked the president of the corporation to tell him what he thought the shares were worth. The president refused and told the shareholder to make up his own mind. The plaintiff sold his shares at \$43.57 a share; shortly thereafter all the shares in the corporation were sold at \$321 per share. The court held that the president had not acted improperly by refusing to give advice to the plaintiff. It reasoned that the president did not stand in any fiduciary relationship to the plaintiff merely because he knew of the impending sale.¹⁴¹ The court's conclusion that the president did not owe the shareholder a duty to advise him about the price he should ask for his shares appears to be proper where the shares sold do not constitute a controlling block of shares. A contrary result might imply that management would have to inform any stockholder who asked for advice whether or not the market price for his shares at the

¹³⁸ Management opposition to tender offers is discussed in pt. V *infra*.

¹³⁹ See *Mairs v. Madden*, 307 Mass. 378, 30 N.E.2d 242 (1940); cf. *Abelow v. Midstates Oil Corp.*, 41 Del. Ch. 145, 151, 189 A.2d 675, 678 (Sup. Ct. 1963). Of course, management may recommend acceptance of a tender offer. See Prospectus, *The Ruberoid Company*, Sept. 12, 1966 (exchange offer of shares of *The Ruberoid Company* for stock of *American Felt Company*).

¹⁴⁰ *Brofie v. Horton*, 172 F.2d 489 (2d Cir. 1949).

¹⁴¹ The court made it clear, however, that if plaintiff could show that the president or his wife secretly purchased his stock by using the ostensible purchaser to shield their identity, it would hold the president liable for failing to make affirmative disclosures about the financial condition of the company. *Id.* at 494.

time of any sale was fair. Such a burden should not be imposed in the ordinary course of business.

It is not clear that this analysis should apply where a tender offer for control is made. Such a transaction is unusual in the life of the corporation and involves a significant percentage of its stockholders. Moreover, the tender offer resembles the sale of the assets of the corporation with some of the financing of that sale coming from shares which are not purchased.¹⁴² Thus, it might be argued that some duty of director comment should be imposed—at the least each director might be required to disclose whether or not he plans to tender his shares. On the other hand, the tender offer for control differs in important respects from the acquisition of assets or merger situation. Acceptance of the offer is entirely voluntary with the individual shareholder who can make his own judgment about the investment merits of the offer. In a merger or sale of assets transaction the board of directors negotiates the deal for the shareholders and the individual shareholder is bound by the vote of his fellow shareholders.

Significantly, neither the Commonwealth legislation nor the proposed American legislation requires directors to comment on the terms of a tender offer. The Ontario Securities Act proceeds from the premise that directors do not have a duty to make comments, but that if they decide to recommend for or against acceptance of the tender offer the directors must supply certain information.¹⁴³

Even if management is not required to give shareholders the benefit of its judgment concerning the adequacy or fairness of a tender offer, must it disclose any favorable material facts—such as a significant

¹⁴² See Andrews, *The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505, 531-33 (1965); Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 752 (1956).

¹⁴³ Ontario Securities Act § 95. The Ontario Act requires the circular containing the director's recommendation to include the following information:

1. The number of shares of the offeree company beneficially owned by each director and executive officer;
2. The decision of each director and executive officer and 10% shareholder with respect to tendering his shares;
3. The number of shares of the offeror company beneficially owned by each director, executive officer and 10% shareholder;
4. Details of any arrangement made or proposed to be made between the offeror company and the director or executive officer as to compensation for loss of office or as to their remaining in or retiring from office;
5. Details of any material contract with the offeror company to which any director, executive officer or 10% shareholder is a party; and
6. Details of any material change in the financial position or prospects of the offeree company since the date of the last published financial statements of the company.

Ibid. The Australian Companies Act requires the directors either to recommend for or against the merger or to state that they do "not desire to make a recommendation or consider [themselves] not justified in making a recommendation." Australia Companies Act § 184(3), Tenth Schedule, pt. C, ¶ 1. See note 123 *supra*.

firming of prices and increase in the backlog of orders for the corporation's products¹⁴⁴—which might affect shareholder judgment with respect to the desirability of accepting the tender offer? We have already noted the holding of the Second Circuit that management need not disclose favorable developments to an inquiring shareholder expressing a desire to sell.¹⁴⁵ Although good practice among American corporations dictates prompt disclosure of material information concerning the corporation's business unless there are legitimate business reasons for withholding the information, that practice is codified only in the rules of the major exchanges and the National Association of Securities Dealers.¹⁴⁶ Failure to abide by such rules has not yet been held to give rise to civil liability.¹⁴⁷ Courts may not be willing broadly to impose a duty of prompt disclosure because it might involve them in frequent review of management discretion over the timing of the publication of corporate news and would raise extraordinarily complex questions regarding the class of persons entitled to receive damages for a breach of this duty.¹⁴⁸ On the other hand, courts have undertaken these

¹⁴⁴ See *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965).

¹⁴⁵ See text accompanying note 140 *supra*.

¹⁴⁶ NEW YORK STOCK EXCHANGE, COMPANY MANUAL A-20 to A-22; NATIONAL ASS'N OF SECURITIES DEALERS, MANUAL G-54, § 7 ("minimum standards" for inclusion in an over-the-counter quotations list); American Stock Exchange, Listing Form L, at 1, 5. The Commission requires the filing of reports which call for disclosure of the details of certain corporate transactions, such as mergers or acquisitions, after they occur. It may be contended that a failure to disclose material events as required by these reports subjects a company to civil liability. See Fleischer, "Federal Corporation Law": An Assessment, 78 HARV. L. REV. 1146, 1157-1158 (1965).

Sometimes prompt disclosure can be a defensive tactic. When AMK Corporation made a tender offer for the shares of John Morrell & Company, Morrell management accelerated the preparation of the earnings report for fiscal 1966 "in order that all shareholders [could] have current information on the company's operating results." Statement of W. W. McCallum, President of John Morrell & Company, N.Y. Times, Nov. 26, 1966, p. 49, col. 7. The report showed earnings of \$695,000 which compared favorably with the net loss of \$344,667 shown in the prior fiscal year. McCallum also reported that no officer or director of Morrell intended to tender his stock.

¹⁴⁷ *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178 (2d Cir.), *cert. denied*, 35 U.S.L. WEEK 3125 (U.S. Oct. 10, 1966). See also *O'Neill v. Maytag*, 339 F.2d 764 (2d Cir. 1964) (no violation under federal law); *Gaynor v. Buckley*, 318 F.2d 432 (9th Cir. 1963).

In his excellent article on implied rights of action, Professor Shipman points out that in *Colonial Realty* the court carefully left open the possibility of implied rights of action flowing from violations of those self-regulatory requirements which play an integral part in SEC regulation. He concludes that "in its dictum—that there is a possibility of implied rights without a showing of a violation of the act or Commission rules—the opinion is a sophisticated groundbreaker." Shipman, *Two Current Questions Concerning Implied Private Rights of Action Under the Exchange Act: Authority of the Administrative Agency to Negate; Existence for Violation of Self-Regulatory Requirements*, 17 WES. RES. L. REV. 925, 963 (1966).

¹⁴⁸ Some of these problems are discussed in Painter, *Inside Information: Growing Pains for the Development of Federal Corporation Law Under Rule 10b-5*, 65 COLUM. L. REV. 1361 (1965).

tasks when the corporation or management engage in securities transactions¹⁴⁹ or induce others to do so by affirmative representations.¹⁵⁰ Courts might also be willing to intervene in cases involving a significant market transaction such as a tender offer.¹⁵¹ However, court intervention here would extend its review to a situation where an outsider controls the timing of the event which triggers management liability for failure to disclose. Some protection against failure to disclose exists in the Securities and Exchange Commission's power to suspend the tender offer and trading in the security if it had reason to believe material facts had not been disclosed.¹⁵² At any rate, it would

¹⁴⁹ Under federal law management's failure to disclose in these circumstances is actionable because it occurs "in connection with the purchase or sale of any security." See, e.g., *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262 (S.D.N.Y. 1966).

¹⁵⁰ See *Miller v. Bargain City, U.S.A., Inc.*, 229 F. Supp. 33 (E.D. Pa. 1964); *Freed v. Szabo Food Serv. Inc.*, CCH FED. SEC. L. REP. ¶91,317 (N. D. Ill. 1964). *Contra*, *Heit v. Weitzen*, CCH FED. SEC. L. REP. ¶91,701 (S.D.N.Y. June 9, 1966) (allegedly false statements were designed to conceal overcharges to the government). The court in *Texas Gulf Sulphur* stated that Rule 10b-5 may be violated if the purpose of issuing a false and misleading press release is to affect the market price of the company's stock to the advantage of the company or its insiders. 258 F. Supp. at 283-84.

See also SEC Exchange Act Release No. 7968 (Sept. 30, 1966) (injunction sought by SEC against further distribution of an annual report of a company which allegedly contained false and misleading statements). Early cases under Rule 10b-5 intimated that a defrauded person had a remedy only against the person from whom he bought, or to whom he sold, securities. See Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*, 51 VA. L. REV. 1271, 1293 n.111 (1965). However, a long series of cases has held a cause of action lies under the Rule if there is a false statement and the corporation or its management was executing securities transactions, even though the plaintiff did not buy or sell securities from any of the alleged defrauders. See, e.g., *Fischman v. Raytheon Mfg. Co.*, 188 F.2d 783 (2d Cir. 1951); *Gann v. Bernzomatic Corp.*, CCH FED. SEC. L. REP. ¶91,713 (S.D.N.Y. July 15, 1966); *Barlas v. Bear, Sterns & Co.*, CCH FED. SEC. L. REP. ¶91,674 (N. D. Ill. March 31, 1966); *Rosen v. Bergman*, CCH FED. SEC. L. REP. ¶91,659 (S.D.N.Y. March 21, 1966); *Fischer v. Kletz*, 249 F. Supp. 539 (S.D.N.Y. 1966). State law may impose liability when a company releases a report which it knows is misleading for dissemination to the general public and reliance on the statement by investors is intended. See Prosser, *Misrepresentations and Third Persons*, 19 VAND. L. REV. 231, 243-45 (1966).

¹⁵¹ Commentators have increasingly argued that courts may be willing to find liability for nondisclosure in certain situations even though there has been no securities trading by the corporation or management and there have been no false or misleading statements. See Symposium, *Insider Trading in Stocks*, 21 BUS. LAW. 1009, 1025 (1966) (statement of T. A. Halleran).

The former head of the SEC's Special Study of Securities Markets has stated:

[I]t would require no great extension of existing trends to read the rule [10b-5] as providing a general sanction for an issuer's failure to disclose where previous disclosures have become materially misleading—creating a general obligation to make whatever material disclosures are necessary (but not otherwise affirmatively required) to maintain the current accuracy of a registrant's continuous disclosure file.

Cohen, "Truth in Securities" Revisited, 79 HARV. L. REV. 1340, 1366 (1966).

¹⁵² Securities Exchange Act §15(c)(5), 78 Stat. 574 (1964), 15 U.S.C. §78o(c)(5) (1964); §19(a)(4), 48 Stat. 898 (1934), 15 U.S.C. §78s(a)(4) (1963).

be appropriate for a court to inquire whether disclosure of all material facts has been made in those cases where management has received some reward for its acquiescence in the tender offer.¹⁵³

If the material facts which management fails to disclose indicate an unfavorable turn in the financial condition of the corporation, the shareholders who tender their shares will benefit at the expense of the maker of the tender offer. To the extent that the duty to disclose arises from a concept of the fiduciary relationship of management to its shareholders, it may be argued that even the limited rights available to *B* shareholders against *B* management for its failure to disclose are not available to *A*. However, federal law does not seem to distinguish between sellers and buyers of securities—between those who are shareholders and those who are becoming shareholders.¹⁵⁴ In any event, management's tender of its own shares will probably trigger its duty of disclosure.¹⁵⁵

Although failure to disclose under these circumstances would permit *A* to rescind its purchase of management stock, its purchases of stock from other *B* shareholders could not normally be rescinded. Suppose, however, that in our prototype case 390,000 shares had been tendered, of which 30,000 were management shares. *A* would argue that it is not obligated to buy any of the shares tendered because only 360,000 of the 390,000 shares required by the offer have been tendered. Since the 30,000 shares of management stock have been deposited in violation of Rule 10b-5, the deposit should, according to this argument, be regarded as void under section 29 of the Securities Exchange Act.¹⁵⁶ It would urge that *B* shareholders are the proper persons to bear the risk of loss resulting from unfavorable occurrences to the enterprise of which they are the owners.¹⁵⁷ On the other hand, *B* shareholders

¹⁵³ If this situation is analyzed as involving a breach of management's fiduciary obligation, suit could be brought under state law and a showing that the failure to disclose occurred "in connection with the purchase or sale of any security" would be unnecessary.

¹⁵⁴ *Cady, Roberts & Co.*, 40 S.E.C. 907, 913-14 (1961); see Symposium, *Duties and Liabilities of Corporate Directors*, 22 BUS. LAW. 29, 133 (1966).

¹⁵⁵ *SEC v. Texas Gulf Sulphur Co.*, 258 F. Supp. 262 (S.D.N.Y. 1966).

It may be argued that, where *A* makes an unsolicited offer to buy, it should be forced to take *B* "as is." See *Hafner v. Forest Labs., Inc.*, 345 F.2d 167 (2d Cir. 1965); *Connelly v. Balkwill*, 174 F. Supp. 49 (N.D. Ohio 1959). The assumption in these cases appears to be that the purchaser in this situation relies on his own expertise and consequently is not entitled to the same protection as the unsophisticated investor who buys in the market. However, it seems that both the purchaser in the market and the maker of a tender offer rely on management's having fulfilled its duty of disclosure.

¹⁵⁶ 48 Stat. 903 (1934), as amended, 15 U.S.C. 78cc (1964). Cf. *Polakoff v. Delaware Steeplechase & Race Ass'n.*, 254 F. Supp. 574 (D. Del. 1966) (stock acquired in violation of Rule 10b-5 not regarded as legally owned for determining requisite stock ownership for a "short-form" merger).

¹⁵⁷ In other words if the proper disclosure had been made there would have been a fall in the market price of the stock and the tender offer would have been made at a lower price.

would argue that 390,000 shares have been tendered, but that management's breach of duty merely excused *A* from having to buy more than 360,000 shares.¹⁵⁸ Acceptance of this argument would not make the determination of who, between *A* and the *B* shareholders, should bear the risk of loss, turn on the decision of management to tender its shares.¹⁵⁹ It would make *A* look to *B* management for damages to compensate it for the loss suffered in the purchase of the shares. However, case law has not yet developed to the point where it can be confidently asserted that *B* management's failure to disclose in connection with its sale of 30,000 shares will make it liable for damages incurred in connection with the purchase of more than ten times the number of shares they sold. This issue was left open for later decision in the *Texas Gulf Sulphur* opinion.¹⁶⁰

In its efforts to enlist the cooperation of *B* management, *A* might make various promises to the management—long-term employment contracts, raises in salary—whose fulfillment is conditioned on the success of the tender offer. If such arrangements are negotiated as a *sine qua non* for management's acquiescence in the tender offer, they are probably improper.¹⁶¹ The more difficult question concerns the need to disclose the existence and details of arrangements made for the future employment of management where these arrangements do not constitute a condition of management's acquiescence in the tender offer. Although such arrangements might be proper, the suspicion

¹⁵⁸ *A*'s purpose in making the tender offer presumably can only be accomplished if it can buy the minimum number of shares tendered. As a consequence *A* may have to buy *B* management's shares at the inflated price.

¹⁵⁹ If *A* purchases the 390,000 shares tendered and later discovers the material, undisclosed fact, the policy of not disturbing completed commercial transactions would be another reason for a court not to permit rescission of the purchases from *B* shareholders other than management.

¹⁶⁰ If the function of civil liability under Rule 10b-5 is compensatory, it is difficult to find a rational basis for limiting management's liability to the damages suffered on the 30,000 shares it sold. See Painter, *supra* note 148. It has been argued that the primary purpose of imposing civil liability under Rule 10b-5 in cases involving the failure to disclose inside information is one of deterrence. Such an argument would limit management's liability to the forfeiture of any profits it made as a consequence of its failure to disclose. See Mundheim, *The Texas Gulf Sulphur Complaint*, 1966 J. BUS. L. 284, 290-91. This appears to have been the Commission's theory in the *Texas Gulf Sulphur* case, in which it limited its request for relief to an order requesting defendants to offer rescission with respect to the shares they purchased or whose purchase they stimulated.

On the other hand, if *A* purchased the *B* shares in reliance on false or misleading reports filed by *B* with the Commission or distributed to its shareholders, *A* may have an action in damages against *B* with respect to all of the shares acquired. See Securities Exchange Act of 1934, § 18, 48 Stat. 897, 15 U.S.C. § 78r (1964); cases cited note 150 *supra*.

¹⁶¹ See LATTIN, CORPORATIONS 261 (1959); Nielson, *Directors' Duties Under Anglo-American Corporation Law*, 43 U. DET. L.J. 605, 649-55 (1966).

lingers that they may have influenced management's judgment about the tender offer. If management affirmatively recommends acceptance of the tender offer, any arrangements made with management should probably be disclosed.¹⁶² It would also seem prudent to disclose any arrangements¹⁶³ made when management remains neutral. Such disclosure could be made in A's Offering Letter.¹⁶⁴

Management's general fiduciary responsibilities prohibit it from taking advantage of a tender offer at the expense of its shareholders. For example, management cannot buy shares in the market in anticipation of reselling them under a planned tender offer of which it has been informed.¹⁶⁵ Nor can management persuade the maker of a tender offer to buy its shares secretly at a price higher than that offered shareholders in the tender offer.¹⁶⁶ Finally, as noted previously, management may not recommend acceptance of one tender offer without disclosing a pending higher offer of which it has knowledge.¹⁶⁷

¹⁶² See Complaint, SEC v. Skagit Valley Tel. Co., Civil No. 286, W.D. Wash., Dec. 9, 1965. The Commission charged a violation of Rule 10b-5 where directors who recommended acceptance of an offer of \$300 per share failed to disclose the grant to them of stock options and continuing employment at an increased salary by the maker of the tender offer. *But see* Seagrave Corp. v. Mount, 212 F.2d 389, 395-96 (6th Cir. 1954).

The Commonwealth legislation imposes a similar duty of disclosure. Australia Companies Act, Tenth Schedule, pt. C, ¶ 2(d); British Dealers Rules, First Schedule, pt. II, ¶ 1(6); Ontario Securities Act § 95(4).

¹⁶³ In many cases there are only vague understandings with respect to the future position of incumbent management.

¹⁶⁴ Compare note 143 *supra*.

¹⁶⁵ See Hughes & Treat, 22 S.E.C. 623, 626 (1946) (dictum). See also SEC v. Gentile, SEC Litigation Release No. 323 (S.D.N.Y. 1946) (defendant purchased minority stockholders' shares without informing them of a right to sell their shares at higher prices); Reed v. Riddle Airline, 266 F.2d 314 (5th Cir. 1959) (dictum) (improper for insider to purchase stock without disclosing that outsider, a well-known financier, had evidenced interest in purchasing large blocks of stock); cf. R. D. Bayly & Co., 19 S.E.C. 773, 784 (1945); BAKER & CARY, CASES ON CORPORATIONS 590-94 (1959) (discussion of state law cases).

Query whether a brokerage firm which has a representative on the board of directors of the offeree corporation can properly act as the broker for the offeror in its purchases in the market place prior to making the tender offer.

Serious questions arise if the management of the offeror, having been advised in advance of a first-come, first-served tender offer, deposits its shares before all the shareholders have an adequate opportunity to do so.

¹⁶⁶ Leech, *Transactions in Corporate Control*, 104 U. PA. L. REV. 725, 750-58, 769-73 (1956).

¹⁶⁷ SEC v. Fruit of the Loom, Inc., Civ. No. 61-640, S.D.N.Y., 1961, reported in 27 SEC ANN. REP. 92-93 (1961); Complaint, SEC v. Skagit Valley Tel. Co., Civ. No. 286, W.D. Wash., Dec. 9, 1965.

A tender of stock by controlling persons or of stock subject to investment restrictions may be in violation of the Securities Act of 1933 unless the offeror acquires the stock for investment. As long as the offeror is attempting to secure a controlling block it may be assumed it has an investment intention. In any event, a resale of such stock could subject the offeror to liability as an "underwriter."

V

In an earlier section of this article we described various steps which management might take if it opposed acceptance of a tender offer.¹⁶⁸ In this section, we shall analyze the legal problems which arise in connection with specific defensive tactics.

Management's minimum response to a tender offer it opposes will be an advertisement or letter voicing its opposition and spelling out reasons for not tendering. When Banque de Paris et des Pays Bas offered to purchase 350,000 shares of common stock of Columbia Pictures Corporation, management published an advertisement designed to bring "certain facts" to the attention of Columbia stockholders.¹⁶⁹ The advertisement pointed out that no Columbia director was tendering his shares; that if the Banque de Paris et des Pays Bas was willing to offer \$33 per share, it must think the stock is worth much more; that the market value of one Columbia subsidiary alone was the equivalent of \$31.75 per share of Columbia stock outstanding; that Columbia's film library and real estate holdings had materially increased in value; that the transaction was taxable; and that the advice of brokers and dealers to tender should be viewed in the light of the fifty cent commission payable to them for each share whose tender they could procure.¹⁷⁰ Many of these themes appear periodically in management literature opposing tender offers.¹⁷¹

Assume that *B* management issued a statement suggesting that the price per share offered in *A*'s tender offer was inadequate and that some of the facts presented to demonstrate the inadequacy of the price were false or misleading. If the false or misleading facts are material, the Commission could probably secure an injunction against dissemination of the statement and obtain an order requiring publication of correcting literature. The Commission's action would be premised on the theory that the statement is reasonably calculated to affect the decision of buyers or sellers of *B* shares and thus is made in connection with the purchase or sale of a security.¹⁷² As a practical matter, however, it is unlikely that the Commission would seek an injunction except

¹⁶⁸ See text accompanying notes 18-25 *supra*.

¹⁶⁹ N.Y. Times, Oct. 7, 1966, p. 67, col. 2.

¹⁷⁰ The advertisement also urged shareholders not to tender before the last day of the offering period. It argued that tender prior to that date gives a "free option" to the Banque de Paris et des Pays Bas for the balance of the offering period and possibly beyond that date.

¹⁷¹ See, e.g., Letter From President of Julius Garfinckel & Company, March 11, 1966 (comments on tender offer by Genesco, Inc.); Wall Street Journal, Feb. 14, 1966, p. 28, col. 1 (comments by management of Northwestern National Insurance on tender offer of Seaboard Western Investing Corporation).

¹⁷² SEC Exchange Act Release No. 7968 (Sept. 30, 1966).

in a flagrant case. The Commission does not have the manpower to go to court to remedy every misstatement made. It is probably most reluctant to intervene in a contested situation in which there is opportunity for each side to correct the material issued by the other side.¹⁷³

If the Commission does not intervene, *A* may have difficulty securing relief under federal law against the statements issued by *B* management. We have found no case granting a person in *A*'s position a remedy. Courts have almost uniformly construed the language in Rule 10b-5 that forbids any act, practice or course of business which operates as a fraud upon any person, "in connection with the purchase or sale of any security," to require that the plaintiff in a Rule 10b-5 case must have purchased or sold a security.¹⁷⁴ Because of this requirement, a recent case held that a corporation which was the object of a bid for control could not secure an injunction under Rule 10b-5 against allegedly false statements of the persons making the bid.¹⁷⁵ In only one case has a court recognized that the plaintiff has a cause of action when he is dissuaded from selling by the defendant's false representations—these representations interfered with the plaintiff's investment decision-making process.¹⁷⁶ Even in that case, however, the plaintiff eventually sold his stock—at a lower price than he would have received had he sold the stock when he first tried

¹⁷³ For a statement of the Commission position during a proxy contest, see von Mehren & McCarroll, *The Proxy Rules: A Case Study in the Administrative Process*, 29 LAW & CONTEMP. PROB. 728, 732-35 (1964).

¹⁷⁴ *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952); *Hoover v. Allen*, 241 F. Supp. 213, 222-23 (S.D.N.Y. 1965).

¹⁷⁵ *Studebaker Corp. v. Allied Prods. Corp.*, 256 F. Supp. 173 (W.D. Mich. 1966); cf. *Polakoff v. Delaware Steeplechase & Race Ass'n*, 254 F. Supp. 574 (D. Del. 1966); *Defiance Indus., Inc. v. Galdi*, 256 F. Supp. 170 (S.D.N.Y. 1964).

¹⁷⁶ *Stockwell v. Reynolds & Co.*, 252 F. Supp. 215 (S.D.N.Y. 1965). *Contra*, *Keers & Co. v. American Steel & Pump Corp.*, 234 F. Supp. 201 (S.D.N.Y. 1964). In *Fudge & Semenza*, 30 S.E.C. 334 (1949), a group of brokers persuaded other persons not to bid at a delinquent assessment sale, thus permitting purchase of the stock at a fraction of its value. The Commission found that the brokers' conduct violated Rule 10b-5. In *McManus v. Jessup & Moore Paper Co.*, 5 S.E.C. Judicial Decisions 810 (E.D. Pa. 1948), the court denied a motion to dismiss the complaint of an "aborted seller." However, it did so without opinion. For other cases in which Rule 10b-5 has been held to be violated even though there were no executed securities transactions, see *M. L. Lee & Co. v. American Cardboard & Packaging Corp.*, 36 F.R.D. 27 (E.D. Pa. 1964) (alleged fraudulent course of conduct by prospective underwriter preventing underwriting); *Investment Service Co.*, SEC Exchange Act Release No. 6884 (Aug. 15, 1962), *aff'd sub nom. Barnett v. United States*, 319 F.2d 340 (8th Cir. 1963) (failure of a brokerage firm to execute a brokerage order under circumstances involving a breach of fiduciary obligation). The implications of these cases may be that the *B* shareholders who are dissuaded from selling by the misrepresentations of *B* have an action against it, at least where their shares are subsequently sold at a loss.

State law cases have permitted recovery to persons who were induced not to act by another's fraudulent misrepresentations. See, e.g., *Continental Ins. Co. v. Mercadante*, 222 App. Div. 181, 225 N.Y. Supp. 488 (1927) (defendant induced plaintiff to retain his bond holdings by false representations relating to the financial condition of the corporation).

to do so. *A*'s case is more difficult than the abortive seller case because the misleading statements do not interfere with its investment decision-making process. *A*, in effect, seeks to vindicate the rights of *B* shareholders, who, it claims, were dissuaded by the false representations from tendering their shares.¹⁷⁷

At the same time there are inferences which can be drawn from recent cases supporting *A*'s efforts to secure injunctive relief. In *J. I. Case Co. v. Borak*,¹⁷⁸ the Supreme Court showed little patience with procedural limitations which interfered with a vindication of substantive rights under the securities law and ordered the federal courts to fashion an appropriate federal remedy for a violation of the proxy rules.¹⁷⁹ The easiest cases for a court to grant relief occur where *A* merely requests an injunction and does not claim damages or seek to unravel a completed transaction.¹⁸⁰ Recently the Second Circuit in *Studebaker Corp. v. Gittlin*¹⁸¹ held that a corporation had standing to seek an injunction against the use by the defendant of written authorizations, allegedly obtained in violation of the proxy rules, to inspect the corporation's list of stockholders.¹⁸² The court found that

¹⁷⁷ In general, federal courts have not been sympathetic to such an argument. See *Vine v. Beneficial Fin. Co.*, 252 F. Supp. 212 (S.D.N.Y. 1966); *Kremer v. Selheimer*, 215 F. Supp. 549 (E.D. Pa. 1963).

The kind of argument *A* must make may find some precedent in *Voege v. American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965). In that case defendant made a tender offer for shares of the corporation in which plaintiff was a shareholder. After the completion of the tender offer, defendant held more than 90% of the shares of the corporation. It then caused the corporation to merge with it under the Delaware short-form merger provision. Under the terms of the merger, plaintiff and other minority shareholders were paid \$17 per share for their holdings—the same price as that paid under the tender offer. The plaintiff sought relief under Rule 10b-5 on the allegation that statements in the tender offer were false and misleading. The court denied the defendant's motion to dismiss. The plaintiff's best argument was that these false and misleading statements deceived other shareholders into tendering their shares and thus made possible the short-form merger which forced the sale of her shares. In other words, the success of the deception on the other shareholders resulted in damage to the plaintiff. The plaintiff's case in *Voege* was easier than *A*'s case because plaintiff "sold" her shares—in the sense that the merger resulted in the disposition by the plaintiff of her shares. *Voege* is also distinguishable because even though plaintiff was not directly deceived into selling her shares at \$17 per share, the court purported to find deception, "for when she acquired her stock she did so upon the justifiable assumption that any merger would deal with her fairly, only later to find, according to the complaint, that the terms of the merger were designed to defraud her." *Id.* at 374.

¹⁷⁸ 377 U.S. 426 (1964).

¹⁷⁹ *Cf. Surowitz v. Hilton Hotels Corp.*, 383 U.S. 363 (1966). In *Pettit v. American Stock Exch.*, 217 F. Supp. 21 (S.D.N.Y. 1963), the court permitted the corporation to sue on behalf of its "extremely large and scattered" stockholders. It thought that the corporation provided a convenient vehicle for circumventing the serious practical difficulties inherent in making each defrauded shareholder pursue his own remedy.

¹⁸⁰ *Cf. SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

¹⁸¹ 360 F.2d 692 (2d Cir. 1966).

¹⁸² The authorizations came from shareholders holding more than 5% of the corporation's stock. Section 1315 of the New York Business Corporation Law permits a shareholder who has authorization in writing from holders of more than 5% of any class of the outstanding shares to demand inspection of the corporation's shareholders list.

the corporation had an interest in seeing that the contest for control of which it was the object was fought within the principles laid down under the proxy rules. In the case under discussion *A* has an interest in seeing that the *B* management's statements do not contravene the prohibitions of Rule 10b-5 because such statements are reasonably calculated to affect the sale of shares to it.¹⁸³

In the last part of its opinion, the *Gittlin* court held that a private person may bring an action solely to vindicate the policies of the Securities Exchange Act.¹⁸⁴ The plaintiff corporation charged that the material used to solicit the stockholder authorizations did not contain all the information required to be contained in a proxy statement and had not been filed with the Commission in accordance with the provisions of Rule 14a-6.¹⁸⁵ There was no charge that the statements contained in the soliciting material were false or misleading or that any of the persons who gave their authorization were misled into doing so. The court granted the injunction on the theory that in this case the plaintiff corporation stood in the shoes of the Commission. It made the judgment that "the public interest in enforcing the Proxy Rules outweighed any inconvenience to [the defendant] in having to start again."¹⁸⁶

Since *A*'s problem in getting a remedy under Rule 10b-5 against *B* management's misstatements relates primarily to its inability to show that it has been deceived in connection with the purchase or sale of a security, it may be more successful seeking relief under state tort concepts. Tort law recognizes that economic relations are entitled to protection against unreasonable interference.¹⁸⁷ For example, malicious circulation of the false statement that *X* has gone out of business—thus depriving him of customers—is actionable.¹⁸⁸ However, the cases in

¹⁸³ *A* might also sue derivatively on behalf of *B* to enjoin the directors from interfering unfairly with its attempt to gain control of *B*. Such action was taken in *Michigan Gas Utils. Co. v. Michigan Gas & Elec. Co.*, Nos. 198-66 & 199-66, St. Joseph (Mich.) County Cir. Ct., 1966. Although the *Gittlin* court stated that a corporation did not have to remain aloof during a proxy contest for control, it suggested that when the corporation departed from its normal position of neutrality it should do so only at the behest of management and not be forced to do so in a derivative action. The court saw a special role for management in protecting the corporation from attempts by "irresponsible outsiders" to take control.

Under the SEC's proposed amendments to the Williams Bill, it would be unlawful for any person to make misleading statements or misleading omissions in connection with a tender offer. SEC Memorandum on S. 2731, § 14(d)(6). Presumably this provision would give rise to private rights of action for damages or an injunction to anyone, such as *A*, who can demonstrate that he was damaged by a violation.

¹⁸⁴ 360 F.2d at 698.

¹⁸⁵ 17 C.F.R. § 240.14a-6 (1964).

¹⁸⁶ 360 F.2d at 698.

¹⁸⁷ PROSSER, TORTS 938 (3d ed. 1964); Halpern, *Intentional Torts and the Restatement*, 7 BUFFALO L. REV. 7 (1957); see *Defiance Indus., Inc. v. Galdi*, 256 F. Supp. 170 (S.D.N.Y. 1964).

¹⁸⁸ *Ratcliffe v. Evans*, [1892] Q.B. 524; PROSSER, *op. cit. supra* note 187, at 939.

which relief has been granted normally involve some direct disparagement of the plaintiff's property, business or person. This would perhaps be the case if the *B* management characterized *A* as a "raider" which planned to loot the corporation. *B*'s management, however, will generally discourage acceptance of *A*'s offer by "puffing" the value of *B* stock.¹⁸⁹ In addition, it will probably be necessary for *A* to prove that *B* management deliberately lied in making the false statements.¹⁹⁰

Another device which *B* management might use to combat *A*'s tender offer is to have *B* purchase *B* stock in the market. Such purchases will dry up the supply of *B* stock which might be tendered. In addition, the buying demand will tend to drive the price of shares up and thus make the tender offer look less attractive.¹⁹¹

Although there seems to be no question that corporations in the United States can purchase their own stock, questions do arise under state law concerning the propriety of corporate purchase of its own stock during a contest for control. A series of Delaware cases¹⁹² has justified such corporate purchases on the theory that "a threat to control by an 'outsider' poses a question of 'corporate policy' in terms of conflicting views as between management and a large 'outsider' interest as to how the business should be conducted."¹⁹³ In one Delaware case which did not sanction corporate purchases of its own stock, management acted so hastily in causing the corporate purchases to be made that it did not have time to find out whether or not purchase by the outside interest involved "any real threat to corporate policy."¹⁹⁴ The case was thus presented as a use of corporate funds to preserve the control of the incumbents—a practice condemned in a number of judicial opinions.¹⁹⁵ The difficulty is that most contests for control

¹⁸⁹ Courts have been reluctant to find liability in common law cases where a seller of goods makes consciously exaggerated claims for his own products. *Id.* at 949-50.

¹⁹⁰ *Id.* at 944-45.

¹⁹¹ If management does not control a large position in the *B* stock, purchases of *B* stock by *B* will help *A* by reducing the number of shares it must purchase to gain control. In that case *B* management's purposes will be served if it can persuade interests friendly to it to purchase *B* stock.

¹⁹² *Cheff v. Mathes*, 41 Del. Ch. 494, 199 A.2d 548 (1964); *Kors v. Carey*, 39 Del. Ch. 47, 158 A.2d 136 (1960); *Martin v. American Potash & Chem. Corp.*, 33 Del. Ch. 234, 92 A.2d 295 (1952). *Accord*, *Hendricks v. Mill Eng'r & Supply Co.*, — Wash. —, 413 P.2d 811 (1966).

¹⁹³ *Israels, Corporate Purchase of Its Own Shares—Are There New Overtones?*, 50 CORNELL L.Q. 620, 623 (1965). The issue of the propriety of management's using corporate funds to defend its position also arises in proxy contests. *Compare Rosenfeld v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291 (1955), with *Lawyer's Advertising Co. v. Consolidated Ry. Lighting & Refrigerating Co.*, 187 N.Y. 395, 80 N.E. 199 (1907). See Note, *Buying Out Insurgent Shareholders With Corporate Funds*, 70 YALE L.J. 308 (1960).

¹⁹⁴ *Bennett v. Propp*, 41 Del. Ch. 14, 187 A.2d 405 (1962).

¹⁹⁵ *Anderson v. Albert & J. M. Anderson Mfg. Co.*, 325 Mass. 343, 90 N.E.2d 541 (1950); see Note, *Buying Out Insurgent Shareholders With Corporate Funds*, 70 YALE L.J. 308, 316 (1960); cf. *Lawyer's Advertising Co. v. Consolidated Ry.*

can be dressed up as involving a conflict of policy. In addition, shareholders are, in effect, deprived of a choice between the conflicting policies and personalities when corporate funds can be used to purchase enough shares to make it impossible for the outsider to gain the control he seeks. For both reasons, the legal literature has been very critical of the Delaware line of authority.¹⁹⁶

The development under federal law of doctrines different from those evolving in the states does not find support in decided cases. In a number of cases a plaintiff, suing derivatively in a Rule 10b-5 action, has alleged that management caused the corporation to purchase shares solely in order to preserve its control. Courts have consistently ruled that such allegations do not state a cause of action under Rule 10b-5.¹⁹⁷ These rulings are based, in part, on the courts' failure to find any deception with respect to the value of the shares bought.¹⁹⁸ On the other hand, if management caused the corporation to purchase shares at too high a price by withholding information from the board of directors (or possibly the shareholders) which indicates that the stock is overvalued, a cause of action under Rule 10b-5 on behalf of the corporation would seem to lie.¹⁹⁹

Instead of buying up shares in the market, management might cause the corporation to issue stock at market to persons who will be

Lighting & Refrigerating Co., 187 N.Y. 395, 80 N.E. 199 (1907). *But see* Lawrence v. Decca Records, Inc., 20 Misc. 2d 424, 195 N.Y.S.2d 431 (Sup. Ct. 1959) (complaint alleging use of corporate funds to buy stock at market to cement control of incumbents not actionable in the absence of an allegation of damage to the corporation).

¹⁹⁶ Marsh, *Are Directors Trustees?*, 22 BUS. LAW. 35, 61-62 (1966); Note, *Buying Out Insurgent Shareholders With Corporate Funds*, 70 YALE L.J. 308 (1960); Note, 1965 DUKE L.J. 412, 415-16.

¹⁹⁷ O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964) (purchases at price above the market); Hoover v. Allen, 241 F. Supp. 213, 227-29 (S.D.N.Y. 1965) (purchases by the corporation at prices alleged to be fraudulently depressed); cf. Carliner v. Fair Lanes, Inc., 244 F. Supp. 25 (D. Md. 1965).

In O'Neill v. Maytag, *supra*, the court rejected the SEC's position that a claim under Rule 10b-5 is stated by allegations that a corporation's "controlling directors caused it to acquire a large block of its own stock at an excessive price for the purpose of removing the threat to the directors' control represented by the stock." 339 F.2d at 768.

¹⁹⁸ See Fleischer, "Federal Corporation Law": An Assessment, 78 HARV. L. REV. 1146, 1165-66 (1965). It is not clear what action a court would take if the failure to disclose resulted in both management and shareholders not being aware of the rights the corporation might have under state law with respect to the transaction. See the discussion of *Barnett v. Anaconda*, *Ruckle v. Roto Am. Corp.* and *O'Neill v. Maytag* in Comment, *Shareholders' Derivative Suit To Enforce a Corporate Right of Action Against Directors Under SEC Rule 10b-5*, 114 U. PA. L. REV. 578 (1966).

¹⁹⁹ Cf. *Ruckle v. Roto Am. Corp.*, 339 F.2d 24 (2d Cir. 1964).

If B acquires shares in the market at a time when it has not disclosed material information, its purchases may be viewed as violating Rule 10b-5. See Kennedy, *Transactions by a Corporation in Its Own Shares*, 19 BUS. LAW. 319 (1964). If the only undisclosed information is B management's purpose to maintain control through the open-market purchases, it is not clear that a cause of action lies under the Rule since arguably the existence of such a purpose may not be viewed as the kind of information which affects the value of the stock purchased. See Fleischer, "Federal Corporation Law": An Assessment, 78 HARV. L. REV. 1146, 1166 (1965).

friendly to management. Although such a device is the exact converse of the buy-up it seems to present greater difficulties. Several cases have dealt with this technique of preserving control and condemned it.²⁰⁰ Although the reasoning of the Delaware cases discussed previously suggests that these cases need not be followed if management can show that the issuance was necessary to prevent control being achieved by an outsider who wished to implement policies inimical to the welfare of the corporation, courts which are troubled by the critiques of these cases may find it easier to abide by the precedents in the issuance of stock cases. There are additional reasons for not following the rationale of Delaware buy-up cases in the stock issuance cases. In the buy-up situation posited above,²⁰¹ each shareholder has an equal opportunity to sell his shares to the corporation through the market;²⁰² but in the stock issuance case certain specially chosen people are favored with the opportunity to buy the stock. This distinction is particularly important because the issue of stock may be made at a time when it is difficult to place much confidence in the market value of the shares. Suppose in our prototype case, *B* stock was selling at \$23 per share on the American Stock Exchange fourteen days prior to the end of the tender offer period. A court might be troubled if *B* issued 100,000 shares of stock to close associates of management at \$23 per share.

Federal law provides remedies for the issuance of stock to preserve management control if *B* management causes the stock to be issued at below market price or at too low a price considering financial information withheld from the market.²⁰³ As indicated earlier, no federal cause of action appears to arise where the stock is issued at fair value.²⁰⁴

²⁰⁰ Schwab v. Schwab-Wilson Mach. Corp., 13 Cal. App. 2d 1, 55 P.2d 1268 (1936); Macht v. Merchants Mortgage & Credit Co., 22 Del. Ch. 74, 194 Atl. 19 (1937); Ross Transport, Inc. v. Crothers, 185 Md. 573, 45 A.2d 267 (1946); Elliott v. Baker, 194 Mass. 518, 80 N.E. 450 (1907); Luther v. C. J. Luther Co., 118 Wis. 112, 94 N.W. 69 (1903); BAKER & CARY, CASES ON CORPORATIONS 912-13 (1959).

²⁰¹ See text accompanying note 191 *supra*.

²⁰² All three of the Delaware cases cited in note 192 *supra* involve the purchase of a large block of shares from the dissident group.

²⁰³ See Ruckle v. Roto Am. Corp., 339 F.2d 24 (2d Cir. 1964). There is some question about the availability of a federal cause of action when the entire board of directors participates in the transaction. Compare O'Neill v. Maytag, 339 F.2d 764, 767-69 (2d Cir. 1964), and Elfenbein v. Yaeger, CCH FED. SEC. L. REP. ¶91,368 (S.D.N.Y. 1964), with Heilbrunn v. Hanover Equities Corp., CCH FED. SEC. L. REP. ¶91,706 (S.D.N.Y. July 21, 1966) (a corporation, in issuing its stock, may be defrauded by all of its directors and is not barred from relief by notions of imputed knowledge). If management acquired shares in exchange for assets with an inflated value, the corporation presumably would have a cause of action under Rule 10b-5. See Hooper v. Mountain States Sec. Corp., 282 F.2d 195 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961); Simon v. The New Haven Board & Carton Co., 250 F. Supp. 297 (D. Conn. 1966).

²⁰⁴ See text accompanying note 197 *supra*.

One of the consequences of a program for corporate purchases of its own stock is raising the price of the stock.²⁰⁵ This result which, as indicated earlier, may be an important element in defeating the tender offer, can be accomplished in other ways. Management itself, or interests friendly to it, may purchase stock in the market. The price of the stock may also be boosted if management announces an increased dividend. If these techniques are successful in defeating the tender offer, the withdrawal of the tender offer and the withdrawal of the buying pressure created by management may result in a drop in the price of *B* shares. Similarly, failure to continue to maintain the new dividend level may result in a price drop. The problem presented by these situations concerns the remedies, if any, available to persons who purchased *B* stock at the "inflated" prices, or to persons who were dissuaded by these "inflated" prices from tendering their shares,²⁰⁶ or to *A*, the success of whose offer may be adversely affected.

If, for example, a purchaser of *B* stock at an "inflated" price can prove that the dividend was raised solely to create a rise in the price of *B* shares, he probably would be able to recover damages from *B* management.²⁰⁷ On the other hand, if the directors can justify the dividend action as serving some corporate purpose (*i.e.*, that the financial condition of the corporation warranted the establishment and maintenance of a higher dividend pay-out), the fact that the increased dividend had an impact on the price of the stock will probably be irrelevant. Questions of fact, then, present the primary issue in these cases, with the problem of who has the burden of proof a key factor in determining their outcome.

The recent consent judgment against Georgia Pacific Corporation²⁰⁸ and the undertaking given to the SEC by Genesco, Inc. suggest

²⁰⁵ With certain limited exceptions, *B* could not bid for or purchase any of its shares if it were engaged in a "distribution" subject to Rule 10b-6 of the Securities Exchange Act. This Rule embraces not only the conventional underwriting of shares for cash, but, in the opinion of the staff of the Commission, may be operative in other situations where a corporation is issuing, or proposing to issue, securities, such as where it has a convertible security outstanding or has reached an agreement in principle to acquire another company for its stock.

²⁰⁶ We have already discussed some of the difficulties of recovering under federal and state law faced by persons who do not purchase or sell their securities. See text accompanying notes 174-77 *supra*. The most appealing case in this category may be presented by those persons who tendered their shares, but whose shares were not taken up by *A* because the minimum number of shares was not tendered.

²⁰⁷ See *Cochran v. Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962). In that case the court refused to dismiss a complaint which alleged that defendants caused a corporation whose shares they planned to purchase to reduce its quarterly dividend for the purpose of depressing the price of its shares and thereby facilitating defendant's purchase program. See *Collins v. United States*, 157 F.2d 409, 410 (9th Cir. 1946); *Gob Shops of America, Inc.*, 39 S.E.C. 92, 103 (1959); *Coronado Dev. Corp. v. Millikin*, 175 Misc. 1, 22 N.Y.S.2d 670 (Sup. Ct. 1940).

²⁰⁸ *SEC v. Georgia Pac. Corp.*, CCH FED. SEC. L. REP. ¶ 91,692 (S.D.N.Y., May 24, 1966).

that the manner in which management-inspired purchases of *B* stock are effected may be very relevant in determining whether or not these purchases violated the anti-manipulative provisions of the Securities Exchange Act.²⁰⁹ Although the purchases may have the effect of driving up the price of the *B* stock, the existence of a manipulative purpose may be difficult to establish if the purchases are made in a manner consistent with buying the stock at the lowest possible price. The Genesco undertakings suggest a procedure for purchasing stock in such a manner. This procedure includes placing limitations on bids placed prior to the opening of the market, not purchasing at prices in excess of the last sales price or highest independent bid price, limiting the volume of purchases on a daily and weekly basis and effecting all purchases on any one day through one broker.²¹⁰

B management may also oppose *A*'s tender offer by arranging a merger between *B* and a third corporation. Effectuation of such a merger normally requires solicitation of proxies to secure the necessary shareholder approval. The material which *A* distributes to induce the tender of shares is reasonably calculated to result in the withholding of proxies from *B* management.²¹¹ Nevertheless, this fact alone will not subject *A*'s soliciting material to the Commission's proxy rules. Even if *A* seeks proxies in connection with the tender of shares, it seems that his soliciting material should not necessarily be subject to the proxy rules—that is, if the proxies are solicited with respect to shares of which *A* can be considered the beneficial owner.²¹² Difficult

²⁰⁹ Section 9(a)(2) of the Securities Exchange Act prohibits a series of transactions creating actual or apparent active trading in a security, or raising or depressing the price of the security, for the purpose of inducing its purchase or sale by others. The knowledge of a person that his purchase will affect the market price of the stock does not make his actions unlawful. "However, when purchasing is done under such circumstances that it must be expected to, and does, raise the price, and where the purpose of such purchasing is to induce others to purchase—presumably at the higher levels thus created—the statutory elements are present, and a violation of the Act is involved." SEC Exchange Act Release No. 34-3056 (Oct. 27, 1941). The management-inspired purchases of *B* stock would not be for the purpose of inducing others to purchase; their purpose is to induce *B* shareholders not to tender by maintaining the price of *B* stock above the tender price. It is not clear whether this latter purpose is covered by § 9. Rule 10b-5 under the Securities Exchange Act, which is captioned "Employment of Manipulative and Deceptive Devices," makes it unlawful "to employ any device, scheme or artifice to defraud" or "to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." It is not clear whether standards of manipulative conduct different from those contained in § 9 are applicable under Rule 10b-5. These provisions are often cited together. See, e.g., SEC Exchange Act Release No. 34-3056 (Oct. 27, 1941). For a discussion of the anti-manipulative provision generally, see 3 Loss ch. 10A.

²¹⁰ Prospectus, Genesco, Inc., May 10, 1966, pp. 21-23.

²¹¹ A proxy solicitation is defined to include the furnishing of a communication to security holders under "circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." SEC Rule 14a-1(f)(iii), 17 C.F.R. § 240.14a-1(f)(iii) (1964).

²¹² Rule 14a-2(c) exempts from the solicitations to which the proxy rules apply, "any solicitation by a person in respect of securities of which he is the beneficial owner." 17 C.F.R. § 240.14a-2(c) (1964). See *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 768 (D.N.J. 1955); text accompanying note 220 *infra*.

questions concerning the need to comply with the proxy rules occur when *A*'s soliciting material seeks not only to induce the tender of shares but also directly attacks the proposed merger. At some point—and it is difficult to define that point abstractly—material soliciting tenders of shares which also attacks the proposed merger may be construed by the SEC staff as a proxy solicitation.²¹³

An additional set of problems arise if the vote on the merger occurs before the tender offer expires. Can *A* vote the shares tendered against the merger? If the shares are tendered without proxies being attached, it is doubtful that *A* can vote them unless he is firmly obligated to purchase the shares.²¹⁴ Even if the *B* shares are tendered with proxies, these proxies can normally be revoked if they are not specifically stated to be irrevocable. However, if the proxies state that they are irrevocable, *B* shareholders cannot revoke them under state law if they are coupled with a sufficient interest to support the promise of irrevocability.²¹⁵ A sufficient interest exists where *A* is firmly obligated to purchase the shares—for example, where 390,000 shares have been tendered in a first-come, first-served offer.²¹⁶ It probably exists where *A* is obligated to purchase the shares subject to a condition subsequent over whose occurrence he has no control—for example, where 250,000 shares have been tendered. The proxy given in this case seems similar to the irrevocable proxy given the creditor with whom stock is pledged. This creditor may vote the stock even though the debt is not in default—and may never be in default.²¹⁷ In

²¹³ Compare *Union Pac. R.R. v. Chicago & No. W. Ry.*, 226 F. Supp. 400 (N.D. Ill. 1964), with *Brown v. Chicago R.I. & Pac. R.R.*, 328 F.2d 122 (7th Cir. 1964). The proxy rules have recently been amended to permit management of a company which has proposed a merger to its shareholders to reply to an intervening tender offer before distributing the written proxy statement required by Rule 14a-3 of the Securities Exchange Act. This amendment was apparently designed to give management the right immediately to reply to a tender offer which, if successful, could defeat the proposed merger. Rule 14a-12, SEC Exchange Act Release No. 7775 (Dec. 12, 1965).

²¹⁴ If *A* is firmly obligated to purchase the shares, its position seems similar to that of an after-record-date shareholder. It should be able to demand that the person tendering the shares vote them as it directs or compel the execution of a proxy. See Maidman, *Voting Rights of After-Record-Date Shareholders: A Skeleton in a Wall Street Closet*, 71 YALE L.J. 1205 (1962).

²¹⁵ See FREY, MORRIS & CHOPER, *CASES ON CORPORATIONS* 383 (1966).

²¹⁶ See *N.Y. BUS. CORP. LAW* § 609(f) (2); cf. *Smith v. San Francisco & N.P. Ry.*, 115 Cal. 584, 47 Pac. 582 (1897); *Groub v. Blish*, 88 Ind. App. 309, 152 N.E. 609 (1926).

²¹⁷ See *Mobile & O.R.R. v. Nicholas*, 98 Ala. 92, 12 So. 723 (1893); *N.Y. BUS. CORP. LAW* § 609(f) (3); cf. *Abercrombie v. Davies*, 35 Del. Ch. 599, 123 A.2d 893 (Ch. 1956), *rev'd on other grounds*, 36 Del. Ch. 371, 130 A.2d 338 (Sup. Ct. 1957) (irrevocable proxy given in connection with advance of funds to corporation enforced); *Ecclestone v. Indialantic, Inc.*, 319 Mich. 248, 29 N.W.2d 679 (1947) (irrevocable proxy to creditor and officer of corporation); *Deibler v. Chas. H. Elliott Co.*, 368 Pa. 267, 81 A.2d 557 (1951) (irrevocable proxy to vendor to insure payment of salary to him for life). Compare DEL. CODE ANN. tit. 8, § 217 (1953) (circumscribing pledgee's right to vote). *Contra*, ARIZ. REV. STAT. ANN. § 10-272 (1956) ("a vote cast by a person holding stock as security is void").

both cases, a person who is not the legal owner of stock has a sufficient economic interest in the enterprise to justify letting him vote to protect that interest. *A* is interested in purchasing *B* as it is and not as part of a new enterprise. Since *A* will be obligated to buy the *B* shares tendered if the conditions of the tender offer are met, it seems unfair to permit the shares tendered to be voted against what *A* conceives to be its interests.²¹⁸ The most difficult case for finding a sufficient interest to support the promise of irrevocability involves proxies given in connection with those shares with respect to which *A* merely has an option—but no obligation—to purchase. There is some authority—albeit much less compelling reason—suggesting that *A* may be able to vote these shares.²¹⁹

Even if *A* has sufficient interest in the *B* shares tendered to be able to vote them under state law, the Commission staff seems to take the position that proxies transmitted with tendered shares cannot be voted until *A* is firmly obligated to purchase the shares. The Commission's argument rests on the theory that, until *A* is firmly obligated to purchase the shares, *A* is not "the beneficial owner" of the shares—as that term is used in Rule 14a-2(c)—and that the request for proxies is, therefore, not exempt from the proxy rules. This argument suggests that the form of irrevocable proxy requested should provide that the proxy become effective only on the date *A* becomes firmly obligated to buy the stock to which the proxy relates.²²⁰ Even this technique does not make the solicitation fit literally within the exemption provided in Rule 14a-2(c) because the solicitation is made with respect to shares of which *A* will become (rather than is) the beneficial owner. However, the Commission staff does not appear to be pressing this literal construction. Because of these restrictions on the exercise of proxies, *A* probably would find it expedient to provide in the tender offer that its obligation to purchase is discharged if a material change—such as a merger—occurs in *B*'s business condition.

²¹⁸ If *A*'s obligation to purchase the shares tendered is discharged by a material change in *B*'s business condition—for example, as a consequence of a merger—the justification for giving the vote to *A* largely disappears. See text accompanying note 220 *infra*.

²¹⁹ *Boyer v. Nesbitt*, 227 Pa. 398, 76 Atl. 103 (1910); see *Ringling v. Ringling Bros.-Barnum & Bailey Combined Shows, Inc.*, 29 Del. Ch. 318, 49 A.2d 603 (Ch. 1946), *modified*, 29 Del. Ch. 610, 53 A.2d 441 (Sup. Ct. 1947) (by implication), noted in Comment, 15 U. CHI. L. REV. 738, 742 (1948). *Contra*, *Stoelting Bros. Co. v. Stoelting*, 246 Wis. 109, 16 N.W.2d 367 (1944); *Bryne v. Morley*, 78 Idaho 172, 299 P.2d 758 (1956) (dictum).

²²⁰ For an example of the use of this technique, see Letter of Transmittal, Form of Tender for Shares of Common Stock of Allied Mills, Inc. (tender expiring Aug. 16, 1965) ("If and to the extent that the accompanying tender of shares of common stock of Allied Mills, Inc. shall be accepted . . . the undersigned hereby irrevocably constitutes and appoints . . . his/their attorneys and proxies").