COMMENT

APPLICATION OF MARGIN REQUIREMENTS TO THE CASH TENDER OFFER *

I. INTRODUCTION

During the 1920's, the possibility of using the stock market to achieve an "instant profit" captured the imagination of a large number of ordinary investors. All one had to do was buy, wait for the market price of his security to rise and sell out for a painless and handsome profit. Brokers and dealers discovered a way to facilitate the transaction. Rather than have the customer tender the purchase price in cash, they would extend or arrange credit through a margin account. Because the broker held the purchased security as collateral, none of the scrutiny usually exercised by creditors was deemed necessary. Brokers generally financed these margin accounts by borrowing from or through banks, although other sources of credit were employed. These loans were secured by a pledge of stock owned either by the broker or his customer. Because loans to brokers commanded higher interest rates than other loans in the economy, a

* This Comment Bears a date of November 15, 1967.

1 "Margin" denotes the percentage of the purchase price which the purchaser must pay in cash. The balance is advanced by his creditor.

2 See note 125 infra and accompanying text.

3 At the high point in 1926, $3.3 billion was loaned to broker-members of the New York Stock Exchange, of which $2.6 billion was extended by New York banks for themselves or for others. By September 1929, these figures had grown to $8.5 billion and $6.5 billion respectively. J. FLYNN, SECURITY SPECULATION 247 (1934) [hereinafter cited as FLYNN].

4 See id. at 244-57; SENATE COMM. ON BANKING & CURRENCY, STOCK EXCHANGE PRACTICES, S. REP. No. 1455, 73d Cong., 2d Sess. 13-16 (1934) [hereinafter cited as SENATE REPORT 1455].

5 Loans to brokers were extremely liquid because most of them were "call" or "Street" loans: "loans secured by stocks and bonds, repayable at the option of either lender or borrower on demand." J. BOGEN & H. KROOSS, SECURITY CREDIT 2 (1960) [hereinafter cited as BOGEN & KROOSS]. These loans could be called by the creditor within 24 hours. As the figures for the end of 1929 demonstrate, see note 11 infra, most of the loans used to finance securities purchases could be withdrawn from the market extremely rapidly. See generally FLYNN 244-57; SENATE REPORT 1455, at 11-19. New York City banks became the center of the call loan market, principally because other commercial banks maintained balances with them which could be withdrawn on short notice; thus the New York banks needed a highly liquid outlet for these funds. BOGEN & KROOSS 2-4.
continuous supply of funds was insured. With margins as low as 10 percent, brokers reaped a bonanza; more people were able to buy, and to buy more. As a result, the amount of credit in the market rose sharply, accompanied by an equally sharp rise in the market value of traded securities.

Most loan agreements gave a broker the right to sell the collateral if the customer did not maintain a minimum margin in his account. As a result, the speculator who bought on low margin risked a market downturn. When the market fell, the collateral value of the stock held by the creditor also fell, causing the customer's margin to decline, and eventually the creditor made a margin call.

Interest rates on call loans reached a peak of 20 percent per annum in April 1929. Bogen & Krooss.

Although most loans to speculators were made by brokers, see note 1 infra, they were not the only lenders. In July 1929, 33 representative New York banks had loans outstanding to customers secured by stocks totalling about $2.2 billion. Flynn 248.

The Senate Committee on Banking & Currency found that in 1929 599,237 persons or 38.69 percent of the customers of member firms of the national exchanges purchased on margin. Senate Report 1455, at 9.

During the 1920's, there was a large increase in the number of shares traded on the New York Stock Exchange. In 1923, 237 million shares were traded; in 1929, over 1.12 billion. Securities Exchange Bill of 1934, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 4 (1934) [hereinafter cited as House Report 1383]; Senate Report 1455, at 8.

As the following chart so vividly illustrates, there was a dramatic rise in total loans to New York Stock Exchange member-brokers, which were, in turn, mostly loaned to their customers:

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>1922</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>1926</td>
<td>3.3 billion</td>
</tr>
<tr>
<td>April 29</td>
<td>6.8 billion</td>
</tr>
<tr>
<td>Sept. 29</td>
<td>8.3 billion</td>
</tr>
<tr>
<td>Nov. 29</td>
<td>4.0 billion</td>
</tr>
</tbody>
</table>

In the 10 days following Oct. 24, 1929, these loans declined $3 billion. Flynn 247-55; House Report 1383, at 4; Senate Report 1455, at 13.

The market value of all stocks listed on the New York Stock Exchange rose from $32.3 billion in 1926 to $69.8 billion in 1929. Flynn 251-52. The Standard Statistic Index climbed from $60 in 1922 to $212 in 1929. Senate Report 1455, at 13.

The willingness of the creditor to assign a high collateral value to securities, while demanding (and exercising) the right to sell the collateral securities if the required margin is not maintained in the account has been attributed to the "instant liquidity" which is characteristic of securities traded on the stock exchanges. Securities & Exchange Comm'n, Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 4, at 9 (1963) [hereinafter cited as SEC Special Study of Markets].

For a description of the mechanics of the minimum margin requirements or, as they are called, the maintenance requirements or maintenance margins, see id. at 10.

A margin call is a demand by the creditor for increased collateral. The loans which brokers procure to finance the customer’s purchase are generally also subject to the maintenance requirements. Thus the broker may be forced to make a margin call if only to cover his creditor’s margin call.
additional collateral was not forthcoming, the stock was sold.\textsuperscript{16} Most market speculators were unconcerned with this danger, however, until the autumn of 1929.\textsuperscript{17}

The losses suffered by investors during the early years of the Depression and the devastating decline of the national economy which followed the market crash focused governmental attention on the use of the stock markets for speculation, rather than for facilitation of the transfer of securities and the formation of capital. One result was the Securities Exchange Act of 1934.\textsuperscript{18} The use of credit for the purchase or carrying of securities, an integral aspect of market speculation,\textsuperscript{19} was regulated by section 7.\textsuperscript{20} In relevant part, section 7 provides:

\[(c) \text{ It shall be unlawful for any member of a national securities exchange or any broker or dealer . . . directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—}\]

\[(1) \text{ On any security (other than an exempted security) registered on a national securities exchange in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe . . . .}\]

\[(2) \text{ Without collateral or on any collateral other than exempted and/or securities registered upon a national securities exchange, except in accordance with such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe . . . to permit the extension or maintenance of credit in cases where the extension or maintenance . . . .}\]

\textsuperscript{16} When initial margins are extremely low (as they were during the boom period of the 1920's), a slight decline in the market will trigger the maintenance requirements, the resulting margin calls and forced sales.

\textsuperscript{17} For a detailed narrative of the rise and fall of the stock market during the 1920's, see J. GALBRAITH, THE GREAT CRASH, 1929, at 1-132 (1961).

\textsuperscript{18} 15 U.S.C. § 78a-hh (1964). Both congressional reports stressed the fact that the private sector was either unwilling or unable to control speculation. As evidence, they cited the speculative boom in the summer of 1933. House Report 1383, at 3; S. Rep. No. 792, 73d Cong., 2d Sess. 4-5 (1934) [hereinafter cited as SENATE REPORT 792].

\textsuperscript{19} In the debate on the bill, House Committee Chairman Rayburn said of credit controls: "I have from the beginning considered this problem paramount." 78 Cong. Rec. 7700 (1934).

\textsuperscript{20} 15 U.S.C. § 78g (1964). A complementary provision, Securities Exchange Act of 1934, § 8, 15 U.S.C. § 78h (1964), limits the sources and amounts which a broker, dealer or member of a national securities exchange may borrow. Section 8(a) requires that all borrowings be procured from member banks of the Federal Reserve System, from non-member banks who have agreed to abide by the Federal Reserve Board's requirements or from other broker-dealers who are subject to the Board's rules; section 8(b) limits borrowing to 2000 percent of the net capital employed in the business. The Federal Reserve Board has adopted regulations under this section. 12 C.F.R. § 220.5 (1967).
of credit is not for the purpose of purchasing or carrying securities . . . .

Under section 7(c), the Board of Governors of the Federal Reserve System (the Board or the FRB) has adopted Regulation T,\(^{21}\) which applies to brokers, dealers and members of national securities exchanges.\(^{22}\) An essential feature of section 7(c) and Regulation T is their focus: any amount of credit may be extended to the customer to purchase or carry securities; the statute and regulation are solely concerned with the collateral on which the broker extends or arranges this credit. First, section 7(c) (2) not only requires collateral to secure the loan to the customer, but declares that the only collateral acceptable is registered \(^{23}\) or exempted \(^{24}\) securities. Thus it is illegal for a broker to make an unsecured loan, a loan not secured by a security (for example, a mortgage) or a loan secured by unlisted securities.\(^{25}\)

Second, exercising authority granted under section 7,\(^{26}\) Regulation T limits the amount of credit which a broker may extend or arrange on a listed security pledged as collateral. The regulation prescribes a "maximum loan value" (or collateral value) for a listed security,\(^{27}\) which is currently\(^{28}\) 30 percent of its market value.\(^{29}\) Regulation T then provides that when the customer is extended credit,

\(^{21}\) 12 C.F.R. § 220 (1967).
\(^{22}\) Id. § 220.2(b).
\(^{23}\) It should be noted that the term "registered," as used in § 7 and this Comment, refers to securities registered (or listed) on a national securities exchange, and not to the registration requirements under § 12 of the Securities Exchange Act of 1934, 15 U.S.C. § 78l (1964) (registration of securities with the SEC), or under the Securities Act of 1933, 15 U.S.C. §§ 77a-aa (1964) (registration requirements for the public sale of securities).

\(^{24}\) Regulation T also provides that any stock having unlisted trading privileges under § 12(f) of the Securities Exchange Act of 1934, 15 U.S.C. § 78l(f) (1964), shall be deemed a registered security. 12 C.F.R. § 220.2(d) (1967). In this Comment the term "listed security" shall be used interchangeably with "registered security."

\(^{25}\) The term "exempted securities" is used with the same meaning as in Securities Exchange Act of 1934, § 3(a) (12), 15 U.S.C. § 78c(a) (12) (1964). 12 C.F.R. § 220.2(c) (1967). The most important of these are securities of the federal government, and state and local bonds.

\(^{26}\) Exercising authority granted under § 7(c) (2), Regulation T exempts transactions from § 7 where the customer does not intend to use the proceeds of the loan to purchase or carry stock. 12 C.F.R. § 220.4 (f) (8) (1967).

\(^{27}\) Section 7(a) requires the Board to promulgate rules with respect to the amount of credit which may be initially extended and subsequently maintained on any listed security. 15 U.S.C. § 78g (a) (1964).

\(^{28}\) 12 C.F.R. §§ 220.3, .8 (1967).

\(^{29}\) Maximum loan values have been set as high as 60 percent (1937-45), and as low as zero (1946-47). 2 Loss, SECURITIES REGULATION 1244-48 (2d ed. 1961) [hereinafter cited as Loss].

\(^{29}\) 12 C.F.R. § 220.8 (1967).
the amount of credit cannot exceed the maximum loan value (30 percent of the market value) of the listed securities pledged to secure the loan.\textsuperscript{30} Thus, in effect, the customer must meet a 70 percent initial margin requirement to purchase a listed security because, when the purchased securities are pledged, the broker may only extend or arrange credit equal to 30 percent of the purchase price--forcing the customer to put up the difference (70 percent of the purchase price) himself.\textsuperscript{32}

The FRB is authorized under section 7(d) to limit the extension of credit by anyone not subject to section 7(c), when the customer intends to use the proceeds of the loan to purchase a listed security.\textsuperscript{33} Nevertheless, the Board, by adopting only Regulation U,\textsuperscript{34} has limited

\textsuperscript{30} Id. \S 220.3(b). Furthermore, in order to determine the amount which he may lawfully lend, the broker may add to the maximum loan value of the listed securities the maximum loan value of any exempted securities which have been pledged. Id. \S\S 220.3(c) (2), .3(b). Regulation T provides that the maximum loan value of an exempted security shall be determined by the creditor "in good faith." Id. \S 220.3(c) (2).

Presently Regulation T requires, with certain exceptions not here relevant, all transactions between a broker and his customer in listed, unlisted and exempted securities to be recorded in a "general account." Id. \S 220.3. However, under amendments to Regulation T proposed by the FRB on October 25, 1967, the broker would be required to segregate dealings in exempted securities, non-convertible bonds and unlisted securities from the "general account" into special accounts. 32 Fed. Reg. 14855 (1967) (amending 12 C.F.R. \S 220.3 (1967)). See also note 37 infra.

In general, a customer has four business days to supply the needed collateral or the broker must sell the purchased securities. Id. \S\S 220.3(b) (1), .3(e). The proposed amendments to Regulation T would change this to five full business days. 32 Fed. Reg. 14856 (1967).

\textsuperscript{33} Because \S 7(c) (2) declares that no credit may be extended on an unlisted security, Regulation T provides that they have a zero maximum loan value, 12 C.F.R. \S 220.3(c) (2) (1967), and thus, when the customer purchases an unlisted security on credit, he must meet a 100 percent margin.

\textsuperscript{32} The following example may assist in understanding the operation of the margin requirements. An investor wishes to buy, on credit, $100 worth of stock of a listed company—for example, AT&T—which he will finance through his broker, using the purchased AT&T stock as collateral. Regulation T says that the AT&T stock has a maximum loan value of only 30 percent—or $30 in the illustration. The difference—$70—is the investor's margin, which he must meet in cash or additional listed securities. If additional securities are put up to fulfill the investor's $70 margin, those securities, like the AT&T stock, have a maximum loan value of only 30 percent. Thus the additional securities must have a market value of $233.33 (30% of $233.33 = $70).

\textsuperscript{34} Section 7(d) provides:

It shall be unlawful for any person not subject to subsection (c) of this section to extend or maintain credit . . . for the purpose of purchasing or carrying any security registered on a national securities exchange, in contravention of such rules and regulations as the Board of Governors of the Federal Reserve System shall prescribe . . . .

15 U.S.C. \S 78g(d) (1964).

\textsuperscript{34} 12 C.F.R. \S 221 (1967). On October 25, 1967, the Board proposed a new Regulation G to extend the coverage of \S 7 to factors or so-called "unregulated lenders" defined in Regulation G as "[e]very person who, in the ordinary course of his business . . . makes or arranges . . . any loan for the purpose of purchasing or carrying any registered security . . . ." 32 Fed. Reg. 14853 (1967). The types of loans covered by Regulation G would be substantially similar to those covered by Regulation U.
the operation of section 7(d) to banks. Regulation U is narrower in scope than section 7(c) and Regulation T, and provides:

No bank shall make any loan secured directly or indirectly by any stock for the purpose of purchasing or carrying any stock registered on a national securities exchange . . . [unless in conformity with the margin requirements set by the FRB] and as determined by the bank in good faith for any collateral other than stocks. Thus a bank is subject to Regulation U only when the borrower intends to use the proceeds of the loan to purchase a listed stock; furthermore, it need conform to the margin requirements only when the collateral offered is a stock (whether listed or unlisted). Although not required to do so, the Board has always set the same margins for both brokers and banks, and although both sections 7(c) and 7(d) authorize the Board to establish maintenance requirements, it has not done so.

35 The term “bank” is defined in §3(a)(6) of the Securities Exchange Act of 1934, 15 U.S.C. §78c(a)(6) (1964), as (1) a national bank, (2) a member of the Federal Reserve System, (3) any other banking institution a substantial portion of whose business consists of receiving deposits or exercising fiduciary powers similar to those exercised by national banks and which is examined by federal or state banking authorities, and (4) a receiver, conservator or liquidating agent of any institution which qualifies under (1)-(3) above. 36 12 C.F.R. §221.1 (1967). The FRB also has proposed amendments to Regulation U, 32 Fed. Reg. 14857 (1967), which are outlined in note 37 infra.

37 However the bank is held to a “good faith” standard when the purchase is of listed stock and the collateral accepted is not a stock. The proposed amendments to Regulation U would require a bank to segregate non-stock-secured loans from stock-secured loans. 32 Fed. Reg. 14857 (1967) (amending 12 C.F.R. §221.1(a) (1967) and adding id. §221.3(s)). See also note 30 infra.

It is now possible to state the most important distinctions between the purported reach of Regulation T and Regulation U: U applies only when the customer intends to purchase a listed stock; T to any purchase of a security; U only when the bank makes a loan; T for any extension or arrangement of credit, see note 59 infra; U imposes margin requirements only when the collateral offered is a stock; T when the collateral offered is a listed security; for all other collateral, T forbids the loan.

The proposed amendments to Regulations T and U would make the following changes: U would apply to the purchase of both listed stock and bonds convertible into listed stock (proposed 12 C.F.R. §221.3(b)(3) (1967)); U, like T, would apply to both the extension of credit (id. §221.1(a)) and its arrangement (id. §221.3(u)); U would also impose margins when convertibles were pledged (id. §221.3(t)); T would allow brokers to “effect and finance” transactions for customers in non-convertible listed bonds without regard to the margin requirements, provided this was done in a separate “special account” (id. §§220.3(a), 4(i)). 32 Fed. Reg. 14855, 14857 (1967).

38 HOUSE REPORT 1383, at 8.

39 Regulation U does not purport to cover the maintenance of credit, and although Regulation T leaves brokers free to establish their own maintenance requirements, it specifically imposes none. 12 C.F.R. §220.7(b) (1967). However, there are special requirements covering the withdrawal and substitution of collateral from undermargined accounts under both Regulations T (12 C.F.R. §§220.3(b)(2), 3(g) (1967)) and U (id. §§221.1(c), .111). The proposed amendments would tighten these rules by forbidding substitution of non-convertible bonds or exempted securities. Proposed 12 C.F.R. §§220.3(a), 4(k), 221.1(a), .3(s) (1967), 32 Fed. Reg. 14855, 14857 (1967).

Both the FRB and the Securities and Exchange Commission are assigned roles under section 7. The Board establishes margin requirements as part of its overall function of regulating the amount of credit outstanding in various sectors of the nation's economy. In addition to establishing the regulations under section 7, the Board occasionally renders advisory opinions, called Interpretations, applying the regulations to particular fact situations. After the Board has established and construed the law, the SEC is charged with its enforcement. As under the Exchange Act generally, SEC enforcement is directed primarily against securities firms.

II. THE PROBLEM

This Comment will consider the extent to which section 7 and the regulations enacted thereunder control activities of brokers in a situation removed from the original concern of the statute, which was the investor speculating in the market. The particular fact situation which will be examined is the public cash tender offer—the technique of acquiring control of a corporation (the offeree) by making a public offer to purchase all or part of the corporation's stock directly from its shareholders at a price fixed somewhere above current market value. Concurrently with this public offer, the acquiring corporation (the offeror or \(A\)) will generally employ an investment banking house to act as a "dealer-manager" to solicit shares from the banker's customers, other broker-dealers and large private shareholders.

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40 See SEC Special Study of Markets, pt. 4, at 2-3. The other basic credit tools of the Federal Reserve are:

1. discount operations—changing the interest rate at which member banks may borrow;
2. open-market operations—the buying and selling of Government securities to expand or contract the supply of money;
3. changes in reserve requirements—the percentage of deposits which member banks must keep in cash. Senate Report 1280, at 58-59.


43 Although this Comment will focus on the public cash tender offer, in some cases the offeree can be acquired through a private purchase of stock from a controlling or sole stockholder. The discussion in this Comment would be equally applicable to such an acquisition.

44 For a general discussion of cash tender offers, see Fleischer & Mundheim, Corporate Acquisition by Tender Offer, 115 U. Pa. L. Rev. 317 (1967) [hereinafter cited as Fleischer & Mundheim]. Although cash tender offers are usually associated with takeover bids, the same procedure could be used by a corporation which consolidates a subsidiary by buying out the minority stockholders.

45 The offeror pays his dealer-manager a fee for each share procured. The dealer-manager in turn pays a somewhat reduced fee to other brokerage houses for each share they have procured. Although the amount of this fee is discretionary, see Fleischer & Mundheim 335 n.75, it is generally double the normal stock exchange commission for the purchase of a security at that price.

Because a very large cash outlay is required to purchase the stock, it is assumed that A must obtain outside credit to finance a major portion of the purchase. A large number of corporations select an investment banking house for assistance in procuring major financing, relying on the investment banker’s expertise in the general field of corporate securities, his wide contacts within the financial community and his unique service of underwriting. Already requiring the services of an investment banker to act as a dealer-manager, it would be logical for A to seek his services in obtaining the needed funds. However, an investment banking house not only furnishes services in the form of counselling, placing securities and underwriting, but acts as a broker and dealer in securities. Furthermore, it will almost invariably be a member of one or more national securities exchanges. Thus the firm to which A has turned to bring its plans to fruition is squarely within the terms of section 7(c), which cover “brokers, dealers and members of national securities exchanges.”

Although section 7 and Regulation T have never been applied in any case, SEC administrative proceeding or Board Interpretation against an investment banker in a tender offer situation, the question has recently arisen, especially among counsel for such bankers, whether the reach of the statute extends to this type of transaction.

If the statute were held applicable, the participants in the tender offer financing would be subject to serious risks. The investment banker could face SEC disciplinary action. In addition to formal sanctions, any public investigation of a securities firm by the SEC can be an exceedingly damaging occurrence. In the past, registration statements have been filed under the Securities Act of 1933, where the issuer sold securities through an underwriter, the proceeds of which were to be used to purchase other securities. Although such a transaction would have been illegal if section 7(c) were deemed to cover business acquisitions, and if underwriting had

46 As a measure of the investment banker’s importance in this field, it is not uncommon to find an investment banker on the board of directors of a corporation. Cf. McLean Trucking Co. v. United States, 321 U.S. 67, 95 (1944) (dissenting opinion).

47 In the unlikely event that A turns to an investment banker who is not subject to § 7, no problems raised in this Comment are applicable.

48 The SEC can apply a wide range of sanctions. It may initiate administrative proceedings to revoke a broker-dealer’s registration, Securities Exchange Act of 1934 § 15(b), 15 U.S.C. § 78o(b) (1964), or to suspend or expel the investment banker from a national securities exchange or the National Association of Securities Dealers (the NASD). Id. §§ 15A(l)(2), 19(a)(3), 15 U.S.C. §§ 78o-3(l), s(a)(3).


been held to constitute either extending or arranging credit,\textsuperscript{51} no questions were raised as to the propriety of the transactions, and the registration statements became effective.\textsuperscript{52} Nevertheless, it is the stated position of the SEC that it will attempt to prevent undue market fluctuations induced by credit in the market.\textsuperscript{53} Therefore, if it is found that tender offer financings tend to cause market fluctuations, SEC action in this area is possible.\textsuperscript{54}

The offeror corporation also runs a serious risk that the tender offer will be enjoined by the offeree, its management or stockholders for a violation of section 7. There is precedent for enjoining violations of the Securities Exchange Act.\textsuperscript{55} Typically, where management

\textsuperscript{51} For discussion of whether underwriting is "arranging or extending credit", see note 77 infra.

\textsuperscript{52} For example, in 1955, an issue of 5% Convertible Subordinate Income Debentures was registered with the SEC by the National Can Corp. (Registration No. 2-11329). The proceeds were to be used to purchase outstanding shares of the Pacific Can Company, a listed company. The debentures were offered to the stockholders of National and the issue was underwritten by a group of investment bankers. The SEC permitted the registration statement to become effective.

The National Can registration statement presents the further question of whether the holder of a convertible debenture "extends credit" to the offeror within the meaning of §7. See note 59 infra.

\textsuperscript{53} SEC SPECIAL STUDY OF MARKETS, pt. 4, at 9.

\textsuperscript{54} A further risk to the investment banker is a suit by the offeror attempting to impose civil liability in either tort or contract—the offeror relying on cases which have allowed margin purchasers both contract rescission and money damages when their brokers extended credit in violation of §7 and Regulation T. Civil liability for violation of §7 is complex and unsettled, and is beyond the scope of this Comment. For two recent discussions of this topic, see Note, Federal Margin Requirements as a Basis For Civil Liability, 66 Col. L. Rev. 1462 (1966); Comment, Civil Remedies Based Upon Illegal Extensions of Credit in Violation of Regulation T, 61 Mich. L. Rev. 940 (1963).

\textsuperscript{55} In Studebaker Corp. v. Gittlin, 360 F.2d 692 (2d Cir. 1966), Gittlin intended a takeover of Studebaker through a proxy fight and got a state court order authorizing inspection of Studebaker's stockholder list. Studebaker was granted an injunction in federal court barring inspection, because Gittlin had not complied with the SEC proxy rules under §14 of the Securities Exchange Act of 1934, 15 U.S.C. §78n (1964). A major issue in Gittlin was whether private parties had standing to sue under §14, but private parties have long had standing to sue under §7. See note 54 supra. Furthermore, the Gittlin court held that in cases where an injunction requires only that the party comply with the statute, "irreparable injury" means only "unless an injunction is granted, the plaintiff will suffer harm which cannot be repaired." Id. at 698.

of the offeree corporation opposes the tender offer, timing is vital to
the offeror. If hostile management or stockholders could get an in-
junction delaying the tender offer, all the advantages of surprise and
speed might be lost and, as a result, the takeover attempt might fail.56
Furthermore, even if an injunction were denied, a successful tender
offer might be undone at a later trial if a violation of section 7 were
proved.57 Such a result would be as detrimental to the offeror as an
injunction.58

III. METHOD OF ANALYSIS: THE STATUTORY PURPOSES

It is clear that the literal words of section 7 and Regulation T
compel compliance with margin requirements when an investment
banker extends or arranges credit to finance a cash tender offer. An
investment banker becomes subject to the statute by merely extending
or arranging credit59 with which a customer (A) purchases

Fleischer & Mundheim 326, 348 n.119.

§91,978 (2d Cir. July 31, 1967) (alleged violations by offeror in a tender offer of
Rule 10b-5 and the Securities Act), the court denied an injunction saying that, if
the violations were proved at trial, the successful tender offer could be undone by
denying the offeror the right to vote the tendered shares. Cf. Vine v. Beneficial
Fin. Co., 374 F.2d 627 (2d Cir. 1967) (in a tender offer and subsequent short form
merger, a non-tendering private shareholder has standing to sue for money damages
under Rule 10b-5).

58 The probability that such suits would be brought will be increased if the
bill to regulate tender offers, now before Congress, is enacted. In the past, the
offeror’s financial arrangements have often been unknown to the offeree and the
public, but the present version of the bill requires public disclosure of these arrange-

59 The definition of the word “credit,” as used in §7, presents a question in
the tender offer situation. Whether the investment banker extends or arranges
“credit” depends upon what is received from the offeror in return for financing the
purchase of the offeree’s stock. The term has not been defined in the statute or
regulations, nor has it yet been directly construed. This situation is understandable
because the focus of the statute has always centered on the margin account when
the investment banker extends or arranges a loan for his customer, a situation which
no one doubts is within the statute.

In the tender offer area, however, the investment banker could receive any of
the fantastic variety of equity, debt or hybrid securities employed in corporate
finance. Determining whether a given instrument is “credit” would depend upon
whether a debtor-creditor relationship was created. Thus, the issuance of genuine
common or preferred stock, because it would not create this relationship, would be
exempt. On the other hand, notes, bonds and debentures all are comprehended
within the statute because they create the requisite debtor-creditor relationship.
Because Regulation U applied only to “loans” and not to the more comprehensive
securities.\footnote{Despite the clarity of the statutory language, it has been argued that the statute is not applicable because the offeror is not a “customer” as that word has traditionally been used in the securities business and, therefore, Congress could not possibly have intended §7 to apply in this situation. However, Regulation T provides:}

In the past, however, the FRB has not applied the statute to all transactions of individuals who admittedly come within the definitions provided by section 7. Rather the Board has recognized that when there is a conflict between the language of the statute and its purposes, the latter should prevail. In a 1962 Interpretation under section 7(c), a dealer, without complying with the margin requirements, sold stock on credit to the issuing corporation, which the latter retired. The Board held that this transaction was exempted from section 7, because

activity—“extend credit”—which appears in Regulation T, the Board has held that Regulation U does not apply when a bank purchases debentures, the proceeds of which will be used to purchase listed stock. 1937 Fed. Reserve Bull. 716-17. However, in keeping with the above analysis, the Board made it clear that it could subject a debenture to the statute. In the proposed amendments to Regulation U, “extend credit” has replaced “loan,” 32 Fed. Reg. 14857 (1967) (amending 12 C.F.R. §221.1(a) (1967)), thus presumably extending the margin requirements to the bank’s receipt of debentures.

The most difficult case arises in the grey area where the investment banker receives a hybrid security—a convertible bond or debenture—in the transaction. Does the receipt of this bond create a debtor-creditor relationship? The FRB in a different context has recently held that a convertible bond is an equity. See proposed 12 C.F.R. §§221.3(b)(3), 3(l), 32 Fed. Reg. 14855 (1967); cf. Securities Exchange Act of 1934, §3(a)(11), 15 U.S.C. §78c(a)(11) (1964). However, although the holder of a convertible generally considers it an equity interest, the loan characteristics of this instrument before conversion would seem to compel its inclusion within the purview of the statutory requirement of “credit.”

Despite the clarity of the statutory language, it has been argued that the statute is not applicable because the offeror is not a “customer” as that word has traditionally been used in the securities business and, therefore, Congress could not possibly have intended §7 to apply in this situation. However, Regulation T provides:

For the purposes of this part, unless the context otherwise requires:

\begin{itemize}
  \item (c) The term “customer” includes any person \ldots (1) to or for whom a creditor is extending or maintaining any credit, or (2) who, in accordance with the ordinary usage of the trade, would be considered a customer of the creditor.
\end{itemize}

12 C.F.R. §220.2 (1967).

It is not clear why this two-part definition was used, but it is evident that the definition of “customer” in §220.2(c)(1) is nearly synonymous with “person,” and thus includes the offeror.

It might also be argued that a definition in Regulation T is relevant only when a transaction within its operative provision occurs, rather than in all situations which might arise under section 7(c). However, by its terms, Regulation T purports to cover every conceivable transaction between a creditor and a customer. 12 C.F.R. §220.3(a) (1967). The title of the Regulation buttresses the conclusion that no transactions would be excluded: “Credit by Brokers, Dealers and Members of National Securities Exchanges.”

The House Conference Report indicates that Congress intended the FRB’s definitions to have the force of law. H.R. REP. No. 1838, 73d Cong., 2d Sess. 30 (1934). Furthermore, Congress sought to vest the FRB with the broadest discretion to implement the statute, in view of the varied situations which would arise thereunder. House REPORT 1383, at 6-7.

Thus there can be little doubt that an attempt to hold the statute inapplicable through a construction of the term “customer” should fail. Such an attempt could only succeed through a frontal assault on the applicability of the statute itself.

\footnote{61 12 C.F.R. §220.119 (1967). See text accompanying note 116 infra.}
no statutory goal would be effectuated by prohibiting the transaction. ¹²

In view of this ruling, analysis of the applicability of the margin requirements in the tender offer area cannot cease with the literal words of the statute. For section 7 to be justifiably applied, it must be found that such application effectuates or advances a congressional purpose embodied in the statute.

Congress indicated three fundamental reasons for the inclusion of credit controls in the Exchange Act. ¹³ First, it intended to limit and control speculation which diverted credit resources into the stock market, precluding more desirable uses in commerce and industry. Congress sought to prevent funds, otherwise available at normal interest rates, from being drained off by the far higher rates on securities loans. ¹⁴

Second, there was an intention to protect the lamb—the margin purchaser—who can suffer serious financial loss if he buys on too thin a margin and his securities are subject to forced sale by his creditor in a market downturn. ¹⁵

The third, and perhaps most important, purpose was to prevent undue market fluctuations, which are often exaggerated or caused by the presence of an excessive amount of credit in the securities markets. ¹⁶

¹² In support of this proposition, the Board cited United States v. American Trucking Ass'n, 310 U.S. 534 (1940) and 2 J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION ch. 45 (3d ed. 1943).
¹³ Both the SEC and the leading treatise on securities regulation agree that Congress had these three primary purposes in enacting the section. See 2 Loss 1242-43; SEC SPECIAL STUDY OF MARKETS, pt. 4, at 2-3.
¹⁴ House Report 1383, at 8; Senate Report 1455, at 11. See also Senate Report 792, at 3. President Roosevelt cited no particulars when he condemned stock market speculation, but seemed to view it as an intrinsic evil in the American business system:

[O]utside the field of legitimate investment, naked speculation has been made far too alluring and far too easy for those who could and for those who could not afford to gamble. . . . [I]t should be our national policy to restrict, as far as possible, the use of these [securities and commodities] exchanges for purely speculative purposes.

¹⁵ Senate Report 1455, at 11; see Senate Report 792, at 6. In the House debate, Committee Chairman Rayburn stated: "A reasonably high margin requirement is essential so that a person cannot get in the market on a shoe string one day and be one of the sheared lambs when he wakes up the next morning." 78 Cong. Rec. 7700 (1934). See also Remar v. Clayton Sec. Corp., 81 F. Supp. 1014 (D. Mass. 1949). For an argument minimizing the importance of this purpose, see Note, Federal Margin Requirements as a Basis for Civil Liability, 66 Colum. L. Rev. 1462, 1467-71 (1966).
¹⁶ This congressional purpose was less well delineated than the other two, principally because the congressional reports tend at times to equate the adverse effects of excessive credit and speculation. However, as is demonstrated in the text, there are peculiar dangers attendant to market fluctuations—dangers which have been clearly recognized in more recent years. Both the SEC and Professor Loss have indicated that the most important function of § 7 is the control of market fluctuations. 2 Loss 1243; SEC SPECIAL STUDY OF MARKETS, pt. 4, at 9.
The most obvious danger occurs during a market "break" (or downturn), where excessive credit can lead to "snowballing." The forced sale of stocks by a creditor in a falling market to cover a decline in value of his collateral has the effect of continuing and amplifying the downward pressure on the market, leading to further margin calls and forced sales. Excessive credit, by increasing the amount financed in margin accounts, increases both the probability and the intensity of any snowballing effect. This phenomenon was an important cause of the severity of the market break in 1929.

In addition to intensifying market downturns, excessive credit also can be the source of the original downturn. In a rising market, investors are tempted to buy. A greater amount of available credit increases their purchasing power, thus amplifying the existing rise. This may lead to overpricing of stocks, producing a greater probability of a market break. Although it was the speculative boom which brought credit into the market, it was excessive credit which dramatically inflated stock prices during the 1920's—and set the stage for the tragic events of October, 1929.

As one moves away from the case of the individual speculating in the market, the first two congressional purposes become less important. In the tender offer area, these considerations are certainly irrelevant. The party receiving the credit is not an innocent investor requiring federal protection. He is either a corporation or an individual sufficiently resourceful to be in the business of buying corporations.

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68 The Senate Report indicated awareness of snowballing in the context of calls on loans which had been taken by brokers: "When the crash finally came, brokers' loans were called, causing greater depreciation in the value of securities . . . ." Senate Report 792, at 3. For clear statements on the dangers and mechanics of the snowballing effect, see Senate Report 1280, at 41, 52; Special Study, pt. 4, at 9-11.
69 SEC Special Study of Markets, pt. 4, at 11.
70 For a description of this process, see Senate Report 1280, at 52.
71 The Senate Report recognized the danger and the effect: During the boom period a vast and unhealthy volume of credit was sucked into the securities market . . . which made possible the inflation of prices of securities out of all proportion to their value . . . until the bubble burst in 1929. Senate Report 792, at 3. As the House Report stated: "If the rise in the market is occasioned by an excessive use of credit, a decline in the market loosens a process of deflation which feeds on itself and ruins not only security prices but all business as well." House Report 1383, at 4. See also Senate Report 1280, at 41. See generally J. Galbraith, The Great Crash, 1929, at 1-132 (1961).
72 The concept that persons who can fend for themselves do not need the protection of the federal securities laws has been employed in other contexts. See SEC v. Ralston Purina Co., 346 U.S. 119 (1953) (dictum) (Supreme Court considered the private placement exemption, Securities Act of 1933, §4(2), 15 U.S.C. §77d(2) (1964)); SEC Special Study of Markets, pt. 2, at 870-911, where, as a justification for not regulating the "third market" to the extent that the exchanges are regulated, the SEC repeatedly stresses that the third market deals only with professionals.
Similarly, the transaction does not involve market speculation as Congress envisioned it. Whatever the merits of A's plan, it is not a diversion of funds into the speculative market. A's tender offer is one form of business acquisition, as are mergers and purchases of assets. Profit is sought from the use or disposition of corporate assets, not from speculation in the corporation's securities. Thus the applicability of margin requirements to a tender offer must depend solely upon the third congressional purpose—whether the extension of credit may cause market fluctuations.

IV. EXTENSION AND ARRANGEMENT OF CREDIT

Prior to discussing the effect of various forms of tender offer financings on market fluctuations in parts V and VI, consideration must be given to whether the extension and the arrangement of credit should be distinguished as a general rule, apart from whether they create different effects on market fluctuations.

Investment bankers may both extend credit directly or arrange for its extension, and section 7(c) speaks to both alternatives. Although investment banking houses are large lenders, the typical tender offer requires millions of dollars, and thus it is more probable that the investment banker will participate by arranging the financing for A from other sources.

There are numerous ways in which an investment banker could arrange credit. For example, he might contact a lending institution, such as a bank or an insurance company, and negotiate the loan, or, he might place long or short term notes (either secured or unsecured) directly with other creditors. The investment banker would be effective in these situations because of his superior contacts within the financial community. Alternatively, A might employ the investment banker to underwrite a public offering of debt securities, the proceeds of which A would use to purchase the offeree's stock.

73 Securities speculation has been defined as "an operation in which one buys or sells securities with the design to make a profit out of changes in the market price of such securities." FLYNN 4.

74 Fleischer & Mundheim 317-18: Tender offers are another technique for creating 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.

76 Huge amounts are loaned through margin accounts to investors and speculators. It was estimated that on June 30, 1959 brokers had loans outstanding to customers totalling $4.04 billion. Bogen & Krooss 21-23.

78 Several factors indicate that the investment banker will not employ his own capital to finance A's tender offer. Investment bankers, in large part, have financed the loans to their margin customers by borrowing themselves. See notes 3-11 supra and accompanying text. 1959 statistics are given in Bogen & Krooss 21-25. Furthermore, §8(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78h(a) (1964), limits this borrowing by securities firms to 2000% of the net capital employed in the business. See note 20 supra.
In any of these cases, the investment banker would not violate the extension of credit provisions of section 7; there could only be a violation for arranging credit. The question involved then is whether there is a reason to distinguish between an extension and an arrangement of credit in defining the reach of section 7.

To justify such a distinction, it might be argued that the statute was not intended to cover the arrangement of credit for a tender offer because the arranging provisions were intended to prevent the illegal extension of credit; thus any violation for arranging credit should be determined by reference to the legality of the extension of credit by the party the investment banker contacts.

This is not, however, what the statute commands or what Congress intended. Section 7 placed strict limitations on the lending powers of brokers—far stricter than on other lenders. As a result, Congress was concerned with broker efforts to circumvent these requirements. This explains the prohibitions of section 7(c)(2). For example, Congress forbade brokers from using unregistered or over-

77 Although a detailed discussion of the extent to which an investment banker could participate in a tender offer financing before his actions constitute "arranging" credit is beyond the scope of this Comment, it is clear that the examples given in the text constitute arranging.

The leading case on this subject is an SEC proceeding, Sutro Bros. & Co., [1961-64 Transfer Binder] CCH Fed. Sec. L. Rep. ¶76,913 (1963), which considered whether brokers who assisted customers in procuring loans on margins as low as 20 per cent from factors (unregulated lenders) "arranged" credit. The SEC's Division of Trading and Exchanges took the position that a broker "arranges" credit if "knowing or with reasonable grounds to know that the customer has himself secured credit in excess of that permitted by Regulation T, [he] performs any act or deed for the purpose of assisting the customer in . . . implementing it . . . ." Id. at 81,385. Wisely, it seems, the Commission rejected this standard, which would have held the broker if he but executed the sale and delivered the securities to the lender on the customer's instructions. The Commission concluded that there could not be "arranging," unless the broker becomes an intermediary between the customer and the lender to the extent that credit would not have been given but for the broker's role therein.

There can be little doubt that underwriting would be classified under §7(c) as either "extending or arranging credit." Most underwriting is "firm-commitment underwriting," where the investment banker technically purchases the securities and then resells them (although perhaps holding some himself) to other dealers or to the ultimate buyer. 1 Loss 159-72. It might be argued that the investment banker's purchase and resale should not be characterized for the purpose of §7 as an extension of credit, because the form of the transaction is merely a risk shifting device, and in reality, the ultimate purchaser is the party extending credit to the issuer. This would mean that both firm-commitment underwriting and "best-efforts underwriting," where the investment banker acts only as an agent for the issuer, would be treated the same under §7. Even if this argument is accepted, it seems clear that underwriting would then be classified as arranging credit, because the transaction satisfies the SEC's "but for" test in Sutro Bros. The underwriter is an essential link between the purchaser's extension of credit and the issuer, and without his services, the issuer would receive no funds.

78 It may be assumed arguendo that a direct extension of credit would be covered by §7 in a tender offer financing.

79 Section 7 provides no exceptions for the arrangement of credit; rather, by its terms, the requirements of §§7(c)(1) and 7(c)(2) apply with equal force to both extending and arranging credit.

80 For a discussion of the reasons which led Congress to single out brokers for more stringent treatment, see notes 124-25 infra and accompanying text.
the-counter stocks as collateral, because they were thought to have an indefinite market price and thus an indeterminable collateral value (maximum loan value). Had Congress not prohibited the use of this type of collateral, the margin requirements easily could have been skirted by brokers. On the same rationale, the statute is designed to prevent a broker from circumventing the margin requirements by arranging that which he may not extend. This conclusion concerning the proper statutory construction of the arranging provisions is supported by the FRB's construction and implementation of these provisions in Regulation T, which provides, as a general rule, that a broker may only arrange credit if he could also extend it. Thus it may be

81 House Report 1383, at 8.
82 12 C.F.R. § 220.7(a) (1967). When registered securities are offered as collateral, §§ 7(b) and 7(c)(1) empower the Board to distinguish between transactions in applying the margin requirements. See 15 U.S.C. § 78g(b), (c)(1) (1964). Section 7(b) is quoted at note 106 infra. Exercising this discretion, the Board adopted § 220.7(a) of Regulation T which implements the general statutory policy relating to the arrangement of credit by a broker, but also provides an exception thereto:

A creditor [an investment banker] may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon which the creditor, under the provisions of this part, may himself extend or maintain such credit to such customer, but only on such terms and conditions, except that this limitation shall not apply with respect to the arranging by a creditor for a bank subject to Part 221 [Regulation U] to extend or maintain credit on registered securities or exempted securities.

12 C.F.R. § 220.7(a) (1967).

Although, as a practical matter a large portion of the credit arranged by an investment banker will be provided by banks subject to Regulation U, Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. (April 4, 1967) (statement of SEC Chairman Manuel Cohen) the advantage of this exception will rarely be available. First, and most important, the exception only applies when the offeror pledges listed or exempted securities to the bank as collateral. Thus, under § 7(c)(2) and Regulation T, an investment banker is still prohibited from arranging credit on unlisted securities, when the collateral offered is not a security or on no collateral at all. Second, when a bank extends credit to purchase a listed stock, secured by a listed stock, the bank must comply with the margin requirements under Regulation U, see text accompanying note 36 supra, and an investment banker may only arrange this transaction if the lending bank so complies. Remar v. Clayton Sec. Corp., 81 F. Supp. 1014 (D. Mass. 1949) (broker who arranged for a bank loan, when the bank violated Regulation U, violated §7(c)). The FRB also concluded that such actions are unlawful, saying: “[A]ny person who aids or abets a violation of law by another is himself guilty of a violation.” 12 C.F.R. § 220.111(b) (1967).

Thus, the most important transaction which §220.7(a) exempts from compliance with the margin requirements involves the purchase of an unlisted stock secured by a listed security. In order for this transaction to be used, however, the offeror would not be able to put up any of the stock purchased in the tender offer as collateral.

The exception authorized in §220.7(a) also applies to two other transactions. Because neither of them is likely to occur in the tender offer situation, they are offered more under a heading of “Guides to the Practitioner.”

If the bank loan to purchase a registered stock is secured by a registered security other than a stock, the bank may allow any margin which it in “good faith” determines. Thus a bank loan to purchase listed stock, secured by a pledge of listed bonds or debentures, need not be within the 70 per cent margin requirements; an investment banker may arrange this extension of credit under §7(a) of Regulation T. Similarly, where the purpose of the loan is to purchase a regis-
assumed in the subsequent discussion that whether given transactions should come within section 7 is in no way governed by whether they involve extensions or arrangements of credit.\textsuperscript{3}

V. THE STOCK-SECURED LOAN

In this section the discussion of the effect which the extension or arrangement of credit for a tender offer has on market fluctuations will focus on a common form of corporate loan agreement. When the investment banker extends or arranges credit, the loan agreement requires $A$ to secure the extension of credit with a pledge of securities.\textsuperscript{4} Under the terms of the agreement, the pledgee has the right to sell the pledged securities if $A$'s collateral does not maintain a predetermined minimum value.\textsuperscript{5} This stock-secured loan \textsuperscript{8} arrangement would be similar to the arrangements which investment banking houses use in most of their individual margin accounts.

Although there is no precedent for the applicability of section 7(c) to the stock-secured loan, an analogous ruling by the FRB is relevant. In 1959, the Board was asked if Regulation U applied when a bank made a stock-secured loan which the customer intended to use to purchase a controlling interest in a corporation, or if such a loan was exempt, because it was not for speculative or investment purposes. The Board answered that the loan would be covered "regardless of the reason for which the purchase is made." \textsuperscript{87}

This ruling is justified in view of the congressional goal of preventing market fluctuations. In a falling market, a stock-secured loan is in jeopardy because, if additional collateral cannot be raised, the stock may be sold and snowballing may result, thus intensifying a market break.\textsuperscript{88} In this context the purpose of the stock-secured loan is altered security which is not a stock, Regulation U does not apply and the bank may make the loan on no margin at all. Provided this loan will be secured by a registered security, an investment banker may arrange the transaction.

This unequal treatment of brokers and bankers in the extent to which each may extend credit for dealings in listed bonds or debentures is considerably narrowed in the proposed amendments to Regulations T and U. First, a bank would be subjected to the margin requirements when the customer purchased bonds convertible into listed stock. Proposed 12 C.F.R. § 221.3(b)(3) (1967). Second, a broker could give "good faith" loan value to non-convertible listed bonds held in a special account. Id. §§ 220.3(a), 4(1), 32 Fed. Reg. 14855, 14858 (1967).

\textsuperscript{83} Additional arguments for distinguishing the arrangement and extension of credit, because the former does not result in market fluctuations are dismissed at notes 88, 113 infra.

\textsuperscript{84} In practice, the pledged securities generally would be those purchased in the tender offer or securities of a subsidiary of $A$, because industrial and commercial corporations normally do not hold a portfolio of other securities.

\textsuperscript{85} On the importance of a maintenance requirement in defining a stock-secured loan, see note 110 infra.

\textsuperscript{86} For convenience, this Comment will use the term stock-secured loan as a short-hand term to mean a loan collateralized by any security. In the overwhelming percentage of cases the collateral in fact would be stock.

\textsuperscript{87} 12 C.F.R. § 221.110 (1967).

\textsuperscript{88} Despite the conclusions in part IV, finding no justifiable distinction between extension and arrangement of credit, such a distinction would still be valid if it were
together irrelevant. Thus, where the loan for a tender offer is collateralized by securities, a bank cannot lend without compliance with Regulation U and, in the absence of circumstances which limit the possibilities of a sale of collateral by the pledgee, there arguably is justification for requiring an investment banker to comply with Regulation T.\textsuperscript{89}

Several other factors remain to be analyzed. The danger of downward fluctuation exists only when the collateral is sold during a period of a market break; thus the sale normally must be made shortly after the initial downturn begins.\textsuperscript{90} In most tender offer financings, the nature of the financial arrangements presents practical or legal reasons why such a rapid sale of collateral could not be made. The typical loan used to finance a tender offer is so enormous that to obtain it, large amounts of collateral are required. The securities pledged as collateral frequently represent a majority of the company's stock. In these circumstances, it is unlikely that a pledgee would attempt to unload his collateral in a falling market. The tender offer is not similar to the usual situation where the pledgee can insure the collectibility of his loan by selling an amount of stock small enough for the market to absorb it. With huge holdings as collateral, the pledgee usually will find either that there is no market for his stock or that the securities held only can be sold at disastrously low prices. Because the aim of the pledgee is to maximize recovery of his investment, the only feasible course of action in most cases is to hold his collateral.

Even if the pledgee decided to sell his collateral, he might have to overcome other obstacles. In certain cases the default which would allow the pledgee to sell the collateral would constitute an act of bankruptcy by A.\textsuperscript{91} It is doubtful that the other creditors of A would be willing (even if A was) to permit most of A's assets to be sold by the pledgee without an attempt at reorganization or orderly liquidation under the bankruptcy act.\textsuperscript{92}

\textsuperscript{89} There is further justification, because all loans in a tender offer financing tend to cause upward market fluctuation. \textit{See} note 114 infra and accompanying text.

\textsuperscript{90} Modern market breaks are usually short in duration. In its exhaustive study of the May 1962 break, the SEC states that it only lasted for three trading sessions; only the first of which saw a sharp decline in the market averages. During the following two days, the hectic market recovered. \textit{SEC Special Study of Markets}, pt. 4, ch. 13.


The Securities Act of 1933 creates a further problem for the pledgee if he quickly attempts to sell his collateral when that collateral consists of securities in companies which A controls. In the typical case of a stock-secured loan, either the shares of the offeree corporation or of a subsidiary of the offeror are pledged. A, of course, controls its subsidiary, and after a successful tender offer—the only time credit is extended—A normally controls the offeree. In these circumstances, A is a "control person" and thus the pledgee will be designated an underwriter, thereby subjecting this secondary distribution to the registration requirements of the Securities Act. Although this would not prevent the pledgee from selling the securities, it would cause long delays. The preparation of a registration statement is a lengthy process, and after filing, there is at least a four week delay before it becomes effective. This process eliminates the panic selling which is characteristic of market breaks, and generally means that the securities cannot be brought to the market before the break ends.

These factors—the magnitude of collateral holdings and the consequent improbability that they would be sold; the fact that default and sale might represent an act of bankruptcy; the possibility that a registration statement might be required—undercut the danger of causing market fluctuations inherent in most stock-secured loans. However, these factors alone are not determinative. The pledgee

93 See note 84 supra.
94 Although the statute does not use the phrase "control person," the term is used to designate the person defined in the statute as "directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." Securities Act of 1933, §2(11), 15 U.S.C. §77b(11) (1964). As applied to the hypothetical tender offer under consideration, the company whose securities were pledged as collateral would be the issuer, and the offeror, controlling the issuer, the "control person." See SEC Rule 405, 17 C.F.R. § 230.405 (1967).
95 The pledgee might seek an exemption under §4(1) of the Securities Act, 15 U.S.C. §77d(1) (1964), which exempts from the registration requirements "transactions by any person other than an issuer, underwriter, or dealer." Because the pledgee cannot be deemed an issuer or a dealer in the sale of collateral, Securities Act of 1933, §§2(4), 2(12), 4(3), 15 U.S.C. §§77b(4), 8(12), d(3) (1964), the question arises whether he is an underwriter. Section 2(11), 15 U.S.C. §78b(11) (1964), defines an underwriter as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security . . . ." Section 2(11) defines a "control person" for the purposes of that section, as an issuer.
In SEC v. Guild Films Co., 279 F.2d 485 (2d Cir.), cert. denied, 364 U.S. 819 (1960), the court considered the attempted sale of collateral which had been pledged to the selling banks to cover a personal note by an investor who took the shares for investment purposes only. The court held that the pledgee-banks were underwriters because they "purchased from an issuer with a view to . . . distribution." 279 F.2d at 489. In the alternative, the court held that a "good faith" pledge was no defense. In so holding, the court affirmed an injunction barring the sale. For a criticism of this decision on its facts, see 74 HARV. L. REV. 1241 (1961).
96 See Wheat & Blackstone, Guideposts for a First Public Offering, 15 BUS. LAW. 539 (1960).
97 Wheat & Blackstone estimated the delay at between four to eight weeks after the initial filing. Id. at 547-48, 553.
98 See note 90 supra.
might decide to unload his collateral on an already depressed market, despite the losses this would entail. Such action could turn an orderly market retreat (in that issue at least) into a rout. Likewise, in cases where default and sale would constitute an act of bankruptcy, someone (A or a creditor other than the pledgee) must voluntarily take private actions to prevent the securities from coming to the market. Not only must it be in that person’s economic interest to act, but he must recognize this and act accordingly.

Thus in both of these situations, a combination of interest, perception and action by a private party is needed to accomplish the deterrent purposes of section 7. There is no guarantee that these will be forthcoming in a particular case and, therefore, it would be inappropriate to fashion an exception to section 7 based solely on these considerations.

The fact that a registration statement might be required before the collateral could be sold carries somewhat greater weight. In contrast to the two factors discussed above, its utilization does not depend upon the judgment of a private person. Thus it arguably would be reasonable to exempt from the margin requirements stock-secured tender offer financings, where the collateral only could be sold with a registration statement.

However, there are considerations which even cast doubt on the wisdom of such a limited rule. First, there is no guarantee that the sale of the collateral, after the effective date of the registration statement, would not continue or amplify a market downturn. Second, and more importantly, the pledgee could take advantage of the “brokers’ exemption” of the Securities Act. Under Rule 154, the SEC permits the sale by control persons of a limited amount of securities which have not been registered under the Securities Act. Although a pledgee is not a control person, the SEC has ruled that he will be so considered under this exemption. Because the formula under the

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100 The ‘brokers exemption’ is § 4(4) of the Securities Act, 15 U.S.C. § 77d(4) (1964), which exempts “brokers’ transactions, executed upon customers’ orders . . . but not the solicitation of such orders” from the registration and prospectus requirements of the statute.


There are limited circumstances where the pledgee could not utilize the Rule 154 exemption. If any of the stock held by the offeror had been received from a control person in a private placement, neither he nor his pledgee could sell that stock (or any other stock of the same company) under Rule 154 because it would be “investment stock.” See Kennedy, The Case of the Scarlet Letter, 23 BUS. LAW. 23 (1967). However, such stock remains “investment stock” for only a limited duration—generally no more than one year, thus minimizing the occasions when the situation would occur. Id. at 28, 1 Loss 671. In any event the pledgee could dispose of the stock in a private placement. Kennedy, supra at 31-32. For the effect of a private placement on market fluctuations, see note 104 infra.
rule is complex and dependent upon many variables, the exact amount of collateral which may be sold cannot be determined in advance; however, utilization of this exemption could lead to the sale—immediately and without a registration statement—of a significant bloc of collateral in a market downturn. Finally, the pledgee always could dispose of the collateral through a private placement.

The foregoing discussion indicates that the risk that all the collateral will be sold in a falling market is slight, although the risk is greater that only part will be sold. Nevertheless, the overall probability remains slight—certainly less than the probability that an individual margin account might be subject to forced sale. However, because of the magnitude of the holdings in the tender offer situation, a sale in a falling market would cause far greater market disruption than the forced sale of collateral from a margin account.

It seems fair to conclude that in the case of a stock-secured loan, it is impossible to fashion a general rule of exemption which eliminates the dangers Congress sought to control when it enacted section 7. Although a stock-secured loan to finance a tender offer may have been far from what Congress had in mind in 1934, application of section 7 to that situation is both rational and legitimate.

An inflexible result, however, is not necessarily compelled. The FRB’s paramount authority over the interpretation and construction

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103 The formula which the SEC adopted in Rule 154 is as follows: Sales of the same class of security by or on behalf of the control person within the preceding six months may not exceed

\[ \begin{align*}
(1) & \text{if the security is not traded on a national exchange, 1 per cent of the shares outstanding;} \\
(2) & \text{if the security is traded on an exchange, the lesser of (a) 1 per cent of the shares outstanding, or (b) the largest volume traded in any one week of the last four weeks.}
\end{align*} \]

SEC Securities Act Release 4818, supra note 102, requires the broker to include the sales by both the pledgor and the pledgee within the preceding 6 months in determining the amount which may be sold lawfully.

Because §7 was designed to limit the forced sale of collateral in margin accounts which often involved only a few thousand dollars, the forced sale of collateral by the pledgee in the tender offer—through the brokers’ exemption—would probably be, in relative terms at least, a very substantial sale indeed. The stock of most subsidiaries is not traded and thus the pledgee could sell up to 1 per cent of the entire issue. Similarly, the usual flurry of trading in the offeree corporation’s stock, at the time of the tender offer, would generally mean that large amounts of that stock would also qualify to be sold. Although this discussion is speculative, very real risks seem to be present.


Although the pledgee has the option to privately place his collateral, it is unlikely that he will do so. The purchaser would have to take the shares for “investment” purposes only and could not resell the securities in the absence of unusual circumstances; thus the purchaser would demand a 10 to 15 per cent discount to compensate for the collateral’s immediate unsalability. Kennedy, supra note 102, at 31-32. Even if the pledgee were to utilize a private placement, the effect of the transaction on market fluctuations would be limited to removing demand for shares of that particular company. Cf. text following note 117 infra. This effect would be, at best, indirect and not comparable to selling on an exchange.
of section 7 permits it to exempt the transaction—certainly when the collateral is listed stock and probably when it is unlisted—although this result is unlikely in light of the Board's determination holding a bank subject to the statute. In view of the minimal risk of market fluctuations and the modern need for flexibility in corporate financing, exemption in certain situations—such as these—well might be desirable.

VI. THE NON-STOCK-SECURED LOAN

In contrast to the stock-secured loan, the investment banker could extend or arrange credit, under terms whereby the creditor would not hold a pledged security as collateral. For example, A could obtain an unsecured loan, or a loan not collateralized by securities (for example, a mortgage on its plant or equipment). The investment banker

105 The House Report on the Securities Exchange Bill stresses not only the flexibility which Congress sought to give the Board, but also indicates that the Board was expected to exercise this flexibility.

In a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers in the administrative agency have been found practically essential...


106 When the collateral is a listed security, the FRB has the authority under §§7(c)(1) and 7(b) to prescribe lower margins (and thus no margins at all) for specified transactions or classes of transactions. Section 7(b) provides:

(b) [The FRB] . . . may, from time to time, with respect to all or specified securities or transactions, or classes of securities, or classes of transactions, by such rules and regulations . . . prescribe such lower margin requirements for the initial extension or maintenance of credit as it deems necessary or appropriate for the accommodation of commerce and industry, having due regard to the general situation of the country . . . .

15 U.S.C. §78g(b) (1964). The Board has exercised this authority by providing a 25 per cent margin to enable a customer to purchase warrants in a special subscription. 12 C.F.R. §220.4(h) (1967).

107 The authority granted the FRB by the statute to exempt transactions does not extend to cases where the collateral is an unlisted security. 15 U.S.C. §78g(c)(2) (1964). The Board has never exempted such a transaction. In these circumstances the Board would have to find the transaction entirely outside the statutory purpose. See 12 C.F.R. §220.119 (1967). Although it would probably be unwilling to make such a ruling for all cases, a given case might pose so few risks that it would be entitled to, and would receive, an exemption.

108 12 C.F.R. §221.110 (1967), discussed at note 87 supra.

109 One situation where exception may be desirable is exemplified in a widely used tender offer financing technique—the offeror obtains a short-term stock-secured loan and, after successful completion of the acquisition, converts this loan to long-term financing secured by assets of the acquired corporation. Although the risks presented by the stock-secured loan are still present while the loan is outstanding, the shorter the term of the stock-secured loan, the less the probability that these risks might be realized. In the delicate process of balancing inherent in each particular case, it may be found that the risks presented by the stock-secured portion of the financing do not warrant the imposition of §7 controls. However, it still must be shown that the statute is inapplicable to the non-stock-secured loan. See Part VI infra.

110 There is a third type of loan arrangement which has characteristics of both the stock-secured and the non-stock-secured loan and presents difficult problems of characterization. This is a loan which, although collateralized by securities, is obtained under such terms that there can be no sale of collateral to cover a
could place unsecured notes with other creditors or underwrite an issue of debentures.

In these cases, a basic element in the stock-secured situation is absent: the existence of a pledged security which the pledgee may sell in a falling market to protect his loan. If there is no pledge, no stock may be sold for lack of sufficient collateral in a market break, thereby contributing to a downward spiral of the market. Therefore, the justification for subjecting the tender offer to the margin requirements where the credit is secured by stocks is absent.\textsuperscript{111}

The question then becomes whether this is the type of snowballing Congress sought to prevent with §7. First, the causal connection between a market decline and the forced sale of collateral which maintenance margins produce is absent. In this case, both the market decline and the sale are attributable to a third factor—the financial difficulties of the company. Second, any sale of collateral would be independent of general stock market performance; it need not occur during a market break. Thus, it would only be by chance that the sale of collateral would accentuate a market downturn (the time of the sale would have to coincide with the market downturn). Third, the decline in the market value of the collateral would result from the affairs of a single company. Thus the decline should not spread to other stocks in the market. In sum, any snowballing would be limited to one stock—the collateral—and would be unrelated to a market break.

When Congress enacted §7, it was not concerned with the general upward and downward movement of market values, but rather with market breaks and transactions which caused or intensified breaks and, therefore, the transactions which should be subjected to §7 ought to be those which affect market breaks. Since the probability that the loan under consideration would lead to snowballing during a market break is slight, subjecting the loan to §7 restrictions on that basis alone seems indefensible.

\textsuperscript{111}A question arises whether snowballing can be attributed, nevertheless, to the non-stock-secured loan, merely because the debtor holds a security purchased on credit. When the market value of the security falls, the holder might decide to sell to protect his investment, thereby further depressing the market. Furthermore, certain types of tender offer financing, notably short-term financing where required long-term credit has not been procured, increase the probability that the takeover attempt will collapse and that the offeror's stock holdings in the offeree will be liquidated. Similarly, in some tender offer situations, the offeror will take a position in the offeree, then be unable or unwilling to acquire outright control, and thus be left holding securities he does not want. The difficulty with holding that ownership of securities purchased on credit should be subjected to §7 because snowballing might result is that the argument fails to recognize the relationship which Congress sought to regulate between credit and the sale of securities in a falling market. The essence of stock ownership is that the holder places his capital at the risk of the market. If the owner expects a market decline, this will always create an incentive to sell. However, the fact that the owner purchased on credit does not enter this equation; it should not affect his decision. Theoretically, he has other assets with which to repay his loan, because the creditor extended credit without looking to the purchased securities for repayment.

The role of the pledgee can be sharply distinguished from that of the owner who purchases on credit. While the owner assumes the risk of the market, the traditional stock-secured loan in a margin account was designed to insulate the
Yet, because section 7 requires an investment banker to secure any extension or arrangement of credit with the pledge of a listed security, on the face of the statute it would be illegal for him to extend or arrange credit for any non-stock-secured loan. To analyze this apparent anomaly, one must once again determine whether the goal of section 7—preventing market fluctuations—would be advanced by forbidding an investment banker from extending or arranging a loan not secured by a listed security to finance A’s tender offer.

Even accepting the fact that the credit extended to A cannot have a depressing effect upon the market, the effect of a tender offer is to introduce borrowed money into the purchase of stock. The net effect will be an appreciation in the price of the offeree’s stock, even if A makes only a public bid for the shares it wishes to buy. To insure that it will acquire sufficient shares to gain control, the tender price offered by A will be higher than the market price. With an offer outstanding which is above current market value, the market price of the offeree’s stock will, of course, tend to rise to or just below the tender price. In addition, if management opposes the tender offer, the offeror may be required to raise the tender price repeatedly, thus exaggerating the price rise initially induced by the tender offer.112 This indicates that all loans to finance a tender offer can cause market fluctuation by tending to create inflationary rises in market prices, thus providing some justification for subjecting an investment banker’s extension or arrangement113 of a non-stock-secured loan to the operation of section

pledgee from the risks of the market. See J. GALBRAITH supra note 71, at 26. Generally the pledgee looked only to the purchased securities for satisfaction of his debt and the personal credit of the borrower was unimportant. See discussion in note 125 infra and accompanying text. Thus, to minimize his risks, the pledgee required the value of the collateral to exceed the amount of the loan. In a market decline, however, this margin narrowed—often very rapidly—thus threatening the pledgee’s loan. Before the margin disappeared, the pledgee would attempt to recoup his loan by selling the collateral.

Therefore, unlike the owner situation, the existence of credit fundamentally influenced the pledgee. It was this relationship between credit and the panic sale of securities which Congress sought to correct with §7. While margin requirements have no application in the case of the owner’s decision to sell, they are directly applicable to the pledgee situation, because they establish a margin between the value of the collateral and the amount of credit, thereby minimizing the risk of a forced sale.

Because §7 was designed to regulate situations where credit is a factor in a decision to sell securities in a falling market, there is no justification for the argument which attributes a tendency to create snowballing to the mere ownership of securities purchased on credit.

112 For example, when Kewanee Oil Company made a tender offer for the stock of Kendall Refining Company at $52.50, Kendall management’s maneuverings required Kewanee to raise the offering price twice within one month, first to $55.50 and then to $55. Fleischer & Mundheim 323 n.27. Despite these efforts, the tender offer failed.

113 In terms of the congressional purpose of preventing market fluctuations, an arrangement of a non-stock-secured loan can be treated no differently than the extension thereof because it is not the method of financing or the participants, but the cash tender offer itself—an offer to pay a price above current market value—which tends to raise market prices, thereby causing market fluctuations.
However, the extent of the market fluctuation which results from the tender offer is not uniform and depends upon a number of factors. If the offeror precedes his public tender offer with secret purchasing activities in the market, such a degree of market fluctuation may result as to justify the imposition of margin requirements. Although the extent of the market rise will be limited by the offeror's intention to purchase only at or below a pre-determined price, subsequent rises may be caused by the effect which the offeror's earlier market purchases have had on investor psychology. Successful investing in large measure requires educated guesses concerning market performance. Trends which develop in the movement of prices may be amplified as investors gauge their decisions to follow such trends. Sharp movement upwards or downwards in one issue can spread easily to others. Although it perhaps is unreasonable to assume that price movements in one security will pace the market, if such movements become widespread, important repercussions may result.\textsuperscript{115}

It is apparent, however, that in cases where the public cash tender offer is not preceded by purchases in the market, the degree to which margin requirements advance the statutory goal of restraining market fluctuations is slight indeed. While steady advances in the market price over a period of time may give the illusion of a market trend and affect investor psychology, the public offer for shares at a stated price should not affect securities other than those directly involved in the tender offer. Moreover, unless the tender offer is contested by the offeree's management or stockholders, the rise in the price of the offeree stock which the offer causes is normally stabilized at or near the offering price, thus minimizing market movement.

Furthermore, the FRB has exempted a transaction from section 7 which is closely analogous to the non-stock-secured loan, holding that the extension of credit by a dealer to finance a corporate redemption of stock was not prohibited by the statute, even when the margin requirements were not met.\textsuperscript{116} As in the non-stock-secured loan situation, a legitimate and non-speculative business purpose motivated the transaction.\textsuperscript{117} Most importantly, both situations resulted in the purchase of stock under circumstances that only modestly affected the market price of the issue. The sale by the dealer would have raised

\textsuperscript{114} For reasons of clarity, discussion of upward market fluctuation has been limited to the part of the Comment dealing with the non-stock-secured loan. However, as the text states, all loans for a tender offer financing, including stock-secured loans, cause upward market fluctuations. Therefore, even if the stock-secured loan is deemed not to violate § 7 despite the possible adverse affect which the sale of collateral might have on a declining market, it still must be found inapplicable on the basis of upward market fluctuation as well.

\textsuperscript{115} See SEC Special Study of Markets, pt. 4, at 11.


\textsuperscript{117} In the debt retirement case the purpose of the purchase of stock would be a recapitalization by a reduction of the capital stock account.
the price of the stock (at least in theory) because of the reduction in
the supply of the issuer's securities. This result would have occurred
whether or not the stock was subsequently retired. Although the Board
specifically stated that it was not considering the acquisition by one
corporation of the securities of another corporation, this ruling is
authority for the proposition that a modest rise in the price of a
security in the market does not automatically bring section 7 into play.

Therefore, it would seem impossible to determine whether the
margin requirements ought to apply to the non-stock-secured loan
solely by reference to section 7 and its purposes. Rather, the more
profitable analysis would begin with the tender offer device itself and
the investment banker's role therein.

Fundamentally, the cash tender offer is a method of corporate
acquisition and reorganization. In cases where the management of the
offeree corporation is hostile to the acquiring corporation, a tender
offer—either for cash or shares—is frequently the only feasible means
for accomplishing the acquisition. The alternative would be a costly
and usually unsuccessful proxy fight.

The merits of the tender offer device have been debated—but this
debate has centered on issues of corporate raiding, full disclosure and
protection of the stockholders of the offeree corporation. In fact,
countries which regulate tender offers have made no provision for the
control of credit. Similarly, legislation designed to regulate tender
offers which is now before the United States Congress requires only
that the sources of credit be divulged. Because the margin require-
ments would not apply to any person other than an investment banker
who finances a tender offer through a non-stock-secured loan, it is
essential to examine the possible justification for such diverse treat-
ment.

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118 For a discussion of the beneficial role which tender offers play in the economy,
see Statement of Professor Robert H. Mundheim on March 22, 1967 in Hearings
on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking &

119 Id. at 324-25.

120 Id. at 324-27.

121 Legislation in Great Britain, Australia and Ontario, Canada requires only
disclosure of the financial arrangements made for ensuring payment by the offeror.
Id. at 341 n.97, 327 n.45.

that the purpose of these provisions was to ensure the financial responsibility of the
offeror and his ability to repay, to prevent the improper use of the offeree's assets
after acquisition and to reveal any special deals which have been made with the
offeree's management at the expense of minority stockholders. Hearings on S. 510
Before the Subcomm. on Securities of the Senate Comm. on Banking & Currency,

123 In a non-stock-secured loan situation, a bank would be subject to Regula-
tion U only if a listed stock were purchased. Even in these cases, if some coll-
lateral were taken, the bank would only be held to a "good faith" standard; if there
were no collateral, Regulation U would not apply. For the transactions covered
by the regulation, see text accompanying note 36 supra.
In 1934, when Congress considered section 7 in the context of traditional margin accounts, there was justification for treating brokers more harshly than other lenders. Congress was concerned with the large volume of market trading and the large number of thinly margined accounts. All lenders had an economic incentive to create thinly margined accounts, because such accounts increased the amount of outstanding loans which carried favorable interest charges. However, brokers clearly had the major incentive. First, brokers lacked the additional outlets for their loans which were traditionally available to banks and other lenders. Furthermore, brokers not only were paid interest on their loans, but received a commission on every purchase or sale of stock by their customers. Finally, Congress undoubtedly felt that bankers were more responsible and gave greater scrutiny to their borrowers. Brokers rarely rejected new margin accounts, but this was not the practice (in theory at least) of the bankers.

Although these judgments may still be valid in the context of the individual margin account, they should be given little weight in the tender offer situation. The investment banker participating in a tender offer financing has no overwhelming economic incentive to act in a way which creates dangerous market conditions. His position is indistinguishable from that of other counsellors or creditors. Successful investment banking is built on reputation. Although a broker may feel he can take risks with individual margin accounts, this option realistically is not available to an investment banker when such huge amounts of money are involved. A sour or irresponsible deal could seriously damage his reputation and business prospects. In view of these considerations, it makes little sense to tell the investment banker, who is generally in the tender offer from the beginning as a dealer-manager, that he must leave the room when financing is discussed.

Under the proposed amendments to Regulation U, the regulation would apply when either a listed stock or a bond convertible into a listed stock is purchased. 32 Fed. Reg. 14857 (1967). This change would not subject any new non-stock-secured loans to the regulation. Likewise, the proposed Regulation G would not alter the result outlined above, due to the similar coverage of Regulations U and G. Id. at 14853.

124 The Senate Report stated that the committee “feels that the time has arrived to remove the control of credit in margin transactions from the hands of those who, by reason of their self-interest, are least qualified to administer such control—the stock exchanges and their members.” Senate Report 792, at 7.

125 The ease and celerity with which such a transaction [a loan to a margin purchaser] is arranged, and the absence of any scrutiny by the broker of the personal credit of the borrower, encourage the purchase of securities by persons with insufficient resources. Senate Report 792, at 6-7. For a discussion of the congressional fear that brokers would attempt to circumvent the requirements of the statute, see note 81 supra and accompanying text.

126 See note 49 supra and accompanying text.

127 See note 45 supra and accompanying text.
The results are more serious if the investment banker is barred by the arranging provisions from underwriting a financing, the proceeds of which will be used to buy stock. In other cases, the offeror can turn to different financial experts to accomplish his purposes. But in the field of underwriting, investment bankers are unique. If an investment banker were barred from participation, alternative methods of financing would have to be sought.

Imposition of margin controls on non-stock-secured loans advances the congressional purposes behind section 7 in only the slightest degree; no one who has considered the problem has found a need to regulate credit for tender offers; and solely prohibiting an investment banker from extending or arranging credit is irrational and harmful. Thus imposition of margin controls on non-stock-secured loans (excepting those cases where there are open market purchases) is unwarranted, unnecessary and undesirable.

In conclusion there seems to be a serious problem that an investment banker who extends or arranges financing for a cash tender offer will run afoul of section 7 of the Securities Exchange Act. However such an application of the margin requirements would be exceedingly arbitrary under many circumstances. It is apparent that the time has come for the FRB to provide standards to guide the investment banker who participates in a tender offer.