Nebraska Law Review

Volume 51 | Issue 2 Article 3

1971

Corporate Stock Repurchases under the Securities Exchange Act of 1934

Mark R. Moskowitz
Rifkind and Sterling

CORPORATE STOCK REPURCHASES UNDER THE SECURITIES EXCHANGE ACT OF 1934

*Mark R. Moskowitz**

I. INTRODUCTION

Nearly a century ago the House of Lords decided that a corporation lacked the power to repurchase its own shares and that any repurchase was, therefore, ultra vires.[1] This question was subjected to considerable debate in the United States[2] and has been uniformly resolved in favor of vesting such power in the corporation. Since a stock repurchase is, in effect, a distribution of corporate assets, the states have limited this power so as to protect the interests of creditors and senior security holders.[3] State courts have subjected the power to further constraint where the purpose underlying the repurchase is suspect, so as to suggest the misuse of corporate assets and the violation of directors' fiduciary obligations.[4]

Corporate stock repurchases serve a number of useful purposes. A corporation may need shares to satisfy the requirements of employee option plans, purchase plans or pension plans, or to provide for employee stock bonuses. By using reacquired shares to meet these needs, rather than issuing new shares, the corporation can avoid expanding its equity base. Similarly, it can use reacquired shares to prevent the dilution of equity which would otherwise result from the exercise of outstanding warrants and the conversion of outstanding convertible securities. If the corpora-

---

* B.A., 1968, Brandeis University; J.D., 1971, Harvard University. Now associated with the firm of Rifkind and Sterling, Inc., Beverly Hills, California.

1 Trevor v. Whitworth, 12 App. Cas. 409 (1887).

2 *See, e.g.,* Nussbaum, *Acquisition by a Corporation of Its Own Stock,* 35 COLUM. L. REV. 971 (1935). For a more recent discussion of the issues see Kessler, *Share Repurchases Under Modern Corporation Laws,* 28 FORDHAM L. REV. 637 (1960).

3 These restrictions are comparable to those that are applied to the payment of dividends. In general, they require that the repurchase be made out of earned surplus or capital surplus and prohibit it where capital is or would be impaired. *See, e.g.,* N. Y. BUS. CORP. LAW § 513 (McKinney 1963).

4 Of particular interest are those cases involving purchases to preserve control, *see, e.g.,* Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964); Bennett v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (1962). This area has been opening up to the regulation of the federal securities laws, *see* pp. 212-214 *infra. See generally* Israels, *Corporate Purchase of Its Own Shares—Are There New Overtones?,* 50 CORNELL L. Q. 620 (1965).

tion is acquisition-minded, it may find that companies can be purchased more easily for stock than for cash[5]—once again, repurchase can provide the necessary shares without any subsequent increase in corporate equity.

The decision to engage in a repurchase program may be motivated by a desire to contract the equity base. There are several reasons for attempting this "reverse dilution."[6] First, even if it is desirable to maintain the present size of the enterprise, it may be advisable to reduce equity and exploit unused debt capacity. Such a recapitalization should increase the earnings per share and the value of the outstanding shares.[7] Second, there may be a leveling off of new investment possibilities or an industry-wide contraction, in which case operations would no longer require existing equity levels. Repurchase then serves as a good means of eliminating redundant liquid assets.[8] From a tax standpoint it provides an advantage over the alternative of distributing assets through increased dividends for the funds thereby distributed will be taxable at capital gains rates while dividends are taxable as ordinary income.[9] There is a further advantage over increased dividends if one subscribes to the belief that the market places a premium on a stable dividend rate and that dividends should not be increased substantially if it will be impossible to maintain them at that increased level.[10]

---

5 *See* Brigham, *The Profitability of a Firm's Purchase of its Own Common Stock,* 7(2) CALIF. MANAGEMENT REV. 69 (1964). And additional shares will be needed if merger is deemed to be preferable to a purchase of assets.

6 *See* Ellis, *Repurchase Stock to Revitalize Equity,* HARV. BUS. REV., July-Aug. 1965, at 119.

7 *See, e.g., id.* Putting aside the tax advantage of debt financing, specifically the deductibility of interest payments by the corporation, Modigliani and Miller argue that such a reordering of the corporation's capital structure will not increase its value as the arbitrage process will neutralize any benefits which would otherwise result from corporate leveraging. Modigliani & Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment,* 48(3) AM. ECON. REV. 261 (1958). For a criticism of their position see VAN HORN, FINANCIAL MANAGEMENT AND POLICY 157-62 (1968).

8 *See* Guthart, *More Companies Are Buying Back Their Stock,* HARV. BUS. REV., March-April 1965, at 40, 42.

9 *See* Guthart, *Why Companies Are Buying Back Their Own Stock,* FIN. ANALYSTS J., March-April 1967, at 105. The remaining stockholders may gain from this tax advantage, *see* Brigham, *supra* note 5, at 72.

10 *See* Lintner, *Distribution of Incomes of Corporations Among Dividends, Retained Earnings, and Taxes,* 46(2) AM. ECON. REV. 97, 99-100 (1956).

Absent any immediate need to reduce equity, stock repurchase may appear to be an attractive investment, particularly where the book value of the shares exceeds present market price. Since management is familiar with the prospects of the corporation, it may conclude that current market price understates actual value, and the greater the split between these figures, the more attractive is repurchase vis-a-vis alternative investments. Moreover, the risk that managment perceives in repurchasing its own shares is likely to be much less than it would be in purchasing the shares of any other company.[11] In terms of increased earnings per share, the effect of a repurchase is direct, as the earnings will be divided among fewer shares, whereas in the case of an outside investment, only the dividends on that investment would appear immediately in the reported earnings per share of the corporation.[12]

Finally, one may speculate as to a number of miscellaneous reasons for repurchasing shares. For example, the corporation may offer to buy small odd-lot holdings which are relatively costly to service,[13] or fractional shares which are a particular nuisance.[14] Or shares may be needed to satisfy outstanding claims or debts. Repurchase may also be useful for buying out dissident minority shareholders, or as a defensive tactic aimed at preventing a takeover of the corporation by a party who poses a threat not merely to the preservation of management's control but to the continued operation of the business in its present form.[15]

Corporate stock repurchases have become increasingly popular.[16] The Senate Committee on Banking and Currency reported that the cost of shares repurchased on the New York Stock Exchange in 1963 was more than $1.3 billion, as compared with the 1954 total of $274 million.[17] By 1965 this figure had increased to nearly $2 billion while money raised from common stock sales during that year was only $1.5 billion.[18] The Senate Committee concluded that regardless of the motive underlying a repurchase program, substantial repurchases will have an important impact on the market price of the security. Consequently, shareholders and potential investors who are interested in the market price of the corporation's stock

---

[11] *See* Guthart, *supra* note 9.
[12] *See id.*
[13] *See* Ellis, *supra* note 6, at 120.
[14] *See* Kessler, *supra* note 2, at 646.
[15] *See, e.g., id.* at 648; *see generally* Israels, *supra* note 4.
[16] *See, e.g.,* Guthart, *supra* note 8.
[17] S. Rep. No. 550, 90th Cong., 1st Sess. 5 (1967).
[18] Guthart, *supra* note 9.

ought to have "full information regarding [its] activities and intentions in repurchasing its own stock."[19] The Committee proposed an amendment to section 13 of the Securities Exchange Act of 1934[20] which would give the Securities Exchange Commission (SEC) the power to establish rules and regulations designed to prohibit fraudulent, deceptive and manipulative practices in connection with corporate stock repurchases. On July 29, 1968, subsection 13(e), along with the other provisions of the Williams Bill (S. 510), was enacted into law.[21]

In view of the expanding application of section 10(b)[22] of the 1934 Act and Rule 10b-5[23] promulgated thereunder, the need for section 13(e) appears questionable. Indeed, this was the reaction of many experts.[24] The new section does serve to focus our attention (and that of the SEC) on an increasingly important area of corporate activity which is ripe for abuse. Before considering this section in detail let us consider the problems in the area of corporate repurchases and the application of the federal securities laws (excluding 13(e)) to these problems.

II. RULE 10b-5 AND THE REQUIREMENT OF ADEQUATE DISCLOSURE—PROTECTION FOR THE SELLING SHAREHOLDERS

A. The Duty of Disclosure

The Securities Exchange Act of 1934, like the Securities Act of 1933, is premised on the notion that the purchase and sale of securities should be a rational process which permits an investor to make an informed decision based on an examination of material information.[25] When one party to a securities transaction possesses in-

---

19 S. Rep. No. 550, 90th Cong. 1st Sess. 5 (1967).

20 15 U.S.C. § 78m (1970).

21 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1970). The primary focus of the Williams Bill was the regulation of tender offers, *see* Part VI, pp. 239-45 *infra*.

22 15 U.S.C. § 78j(b) (1970).

23 17 C.F.R. § 240.10b-5 (1971).

24 *See, e.g., Hearings on S.510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess., at 106, 132 (1967) (statement of Ralph S. Saul, President, American Stock Exchange; statement of Stanley Kaplan, Professor of Law, Univ. of Chicago); Israels, *Limitation on the Corporate Purchase of its Own Shares,* 22 Sw. L. J. 755, 764 (1968).

25 *See, e.g.* Heller, *"Integration" of the Dissemination of Information Under the Securities Act of 1933 and the Securities Exchange Act of 1934,* 29 Law & Contemp. Prob. 749, 768 (1964).

formation of a material nature which is unavailable to the other party, the latter is unable to make an informed decision. Disclosure must be required in order to equalize the bargaining position of the two parties.[26]

Rule 10b-5 provides, in effect, that it is unlawful for any person in connection with the purchase or sale of any security to employ any device to defraud, to make any untrue statement of a material fact or to omit to state a material fact in order to make the statement made not misleading, or to engage in any act or practice or course of business which would operate as a fraud or deceit upon any person.[27] The Rule does not, by its terms, impose an affirmative duty of disclosure. The second clause of 10b-5 is directed to half-truths rather than complete omissions.[28] It does not require a party to a securities transaction "to state every fact about stock offered that a prospective purchaser [or seller] might like to know or that might, if known, tend to influence his decision . . . ."[29] Nevertheless, in *Cady, Roberts & Co.*[30] a unanimous Commission held that a corporate insider who has access to material information regarding the corporation which is not available to the general public may not trade in the corporation's securities until he has revealed that information. According to Chairman Cary, this duty of disclosure under Rule 10b-5 depends on two factors: (1) the existence of a

---

26 *See, e.g.*, Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951).

27 The precise text of Rule 10b-5 is as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

28 *See, e.g.*, Trussell v. United Underwriters, Ltd., 228 F. Supp. 757, 762, 767 (D. Colo. 1964).

29 Otis & Co. v. SEC, 106 F.2d 579, 582 (6th Cir. 1939). *But see* SEC v. Great American Industries, Inc., 407 F.2d 453, 462-63 (2d Cir. 1968) (Kaufman, J., concurring), *cert. denied*, 395 U.S. 920 (1969); *see generally* A. BROMBERG, SECURITIES LAW—FRAUD—SEC RULE 10b-5 (1968); *see also Current Policy Issues Involving Inside Information in the Securities Market*, 2 SECURITIES L. REV. 84, 104-110 (1970) (E. Folk, ed.) (Statement of John E. Tobin) [hereinafter cited as *Inside Information*].

30 40 S.E.C. 907 (1961).

relationship to the corporation which gives the party access to information intended for a corporate purpose or for use in the conduct of corporate business and not for making a profit out of it in the stock market; and (2) the unfairness involved in permitting a party to take advantage of the information knowing that it is not available to those with whom he is dealing.[31]

One usually thinks of an insider as an officer, director or controlling shareholder.[32] However, for purposes of 10b-5 the term has not been so limited,[33] and, indeed, it can not be so limited if the aforementioned goal of the securities laws is to be attainable. Whatever the present boundaries of the term "insider," it seems self-evident that the corporation itself should be considered to fall therein so as to subject the corporation to an affirmative duty of disclosure. When a shareholder contemplates selling his shares to a corporate officer, he may be injured when that officer possesses superior knowledge about the value of those shares, knowledge which is unavailable to the shareholder. That, after all, is the assumption underlying the disclosure requirement. It would seem anomalous to require the officer to make certain disclosures when purchasing the shares for his own account, but not when he purchases them for the corporation. The injury to the shareholder would be the same in either case. One may posit an argument for treating the two cases differently, based on the notion that inside information is a corporate asset,[34] and, hence, the corporation should

---

[31] *Id.* at 912; *see* Financial Analysts Federation, Corporate Disclosure and Insider Information, Interview with Philip A. Loomis, Jr., General Counsel, SEC, Oct. 7, 1968 [hereinafter cited as Loomis Interview]. Mr. Loomis has recently been appointed to the Securities Exchange Commission by President Nixon.

[32] *See* Securities Act of 1934, § 16, 15 U.S.C. § 78p (1970).

[33] *See* Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961). According to Judge Bonsal in the *Texas Gulf Sulphur* case, for purposes of Rule 10b-5 the term "insider" extends to any employees "who are in possession of material undisclosed information obtained in the course of their employment." S.E.C. v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 279 (S.D.N.Y. 1966), *aff'd in part and rev'd in part,* 401 F. 2d 833 (2d. Cir. 1968), *cert. denied,* 394 U.S. 976 (1969). Liability has now been extended beyond "insiders" to "tippees" who have been defined as "persons given information by insiders in breach of trust," Ross v. Licht, 263 F. Supp. 395, 410 (S.D.N.Y. 1967); *see* Investors Management Co., Inc., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶77,832 (SEC Administrative Proceeding File No. 3-1680, June 26, 1970).

[34] *See* Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969), *discussed in* 83 HARV. L. REV. 1421 (1970).

be free to utilize it.[35] But this misconceives the injury involved in an insider trading on inside information. The real harm is not to the corporation but to the other party to the transaction and to the market. The detrimental effect on the market is twofold—first, current market prices may come to reflect the impact of a transaction which otherwise would not have occurred, and second, the price mechanism is also distorted, to the extent material information is not disclosed, because supply and demand are held to a false equalibrium point. The corporation should not be rewarded for distorting the market by being able to reap the benefits of its nondisclosure.

In one of the first cases decided under Rule 10b-5 the SEC did subject a corporation to the same duty of disclosure that would have been required of other insiders. The case, *Ward La France Truck Corp.*,[36] involving a corporate stock repurchase, was an easy one to decide in view of the magnitude of the nondisclosures and the real identification of the two leading officers with the corporate entity. La France, the president, and Grossman, the treasurer, together owned seventy-four percent of the outstanding shares. The Commission recognized that a corporate repurchase would affect their ownership percentage, and hence, the value of their holdings, almost to the same extent as if they purchased the shares for themselves. In repurchasing its shares at prices as low as $325 the corporation not only failed to disclose its presence in the market, but also failed to reveal that earnings had greatly improved due to war orders and that management had been negotiating a sale of their control shares at forty-five dollars and eighty-six cents to a corporation which would then vote to liquidate Ward La France by effecting a transfer to it of all the assets for which the minority shareholders were to receive twenty-five dollars per share. The SEC held that the corporation's failure to disclose these facts when it entered the market constituted a violation of Rule 10b-5. Now the courts, too, have recognized that the principles underlying the disclosure requirements apply not only to officers, directors, and majority shareholders, but to corporations themselves.[37]

B. Material Information

Surely a corporation engaged in a stock repurchase is not required to search out and disclose all manner of information about

[35] *See* Kennedy, *Transactions By a Corporation in its Own Shares*, 19 Bus. Law. 319, 324 (1964).
[36] 13 S.E.C. 373 (1943).
[37] *See* Kohler v. Kohler Co., 319 F.2d 634, 638 (7th Cir. 1963).

itself upon threat of a violation of Rule 10b-5.[38] There is, obviously, information which is of no import to a prospective seller. Moreover, as one authority has observed, "Congress said 'You file a registration statement when you sell securities,' and they did not say 'You file a registration statement when you buy securities.' "[39] The type of information which must be disclosed is material inside information, the term "inside" referring to the fact that it is not widely known in the investment community.[40] As to "material," the only definition in the Commission's rules and regulations is that which appears in Rule 405 of the 1933 Act:

> The term "material" when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered.[41]

In decisions by the Second Circuit a different test of materiality has been applied—that of the "reasonable man" rather than the "prudent investor."[42] The question to consider is whether the reasonable man would attach such importance to the information that it might affect his decision to buy, sell or retain his holdings in the corporation. According to Judge Waterman in the *Texas Gulf Sulphur* case, "[t]his . . . encompasses any fact . . . which in reasonable objective comtemplation *might* affect the value of the corporation's stock or securities."[43]

Materiality seems to involve a playoff of several factors: (1) the reliability of the information or probability that the anticipated event will come to pass; (2) the immediacy of the impact of the information on the market price of the securities; and (3) the total foreseeable impact on the activities of the corporation and the market price of the stock.[44] Thus it becomes impossible for man-

---

[38] *See id.* at 642.

[39] DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS § 3.33, at 109 (J. Flom, B. Garfinkle, & J. Freund ed. 1967) (statement of David Ferber, Solicitor, SEC) [hereinafter cited as DISCLOSURE REQUIREMENTS].

[40] *See* Loomis Interview, *supra* note 31.

[41] C.F.R. § 230.405 (Z) (1971).

[42] *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969); List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965).

[43] 401 F.2d at 849; *accord,* Kohler v. Kohler Co., 319 F.2d 634, 642 (7th Cir. 1963).

[44] The interplay of probability and impact was suggested by the Second Circuit in *Texas Gulf Sulphur,* 401 F.2d at 849. According to Thomas A. Halleran, the impact should be discounted by its immediacy. *Inside Information, supra* note 29, at 89.

agement to avoid disclosure by refusing to finalize an important decision until after a repurchase transaction has been completed. In *Texas Gulf*, for example, the Second Circuit concluded that the single drill core pointed to a mineral discovery of such vast potential that the information was material despite the low level of reliability. In *List v. Fashion Park, Inc.*,[45] on the other hand, the court viewed the intention to sell the company as being "too remote to influence the conduct of a reasonable investor."[46] Similarly, one can posit a short-run earnings projection which, though highly reliable, is immaterial because it is so consistent with past patterns that its disclosure would have little impact.[47]

The type of information that we are concerned with generally relates to matters such as significant changes in earnings or sales,[48] significant mergers or acquisitions, stock splits, rights offerings, sales of assets, complete or partial liquidation of the business,[49] expansion of existing facilities, substantial change in investment policy, dividend action or inaction,[50] tender offers (particularly where the price offered exceeds the current market price of the stock),[51] major changes in corporate management, development of significant new product lines or techniques of production, or discoveries of substantial mineral deposits.[52] The very fact of the repurchase itself creates a new category of information which may be classed as "material."[53] Before discussing this in detail, let us first consider two problems which relate to the above-mentioned information.

1. Unreliable Information

Rule 10b-5 may operate as a double-edged sword. If a corporation releases information which proves to be unreliable, it may be held liable under Rule 10b-5 as having made an "untrue statement

---

45 340 F.2d 457 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965).

46 *Id.* at 464.

47 *See Inside Information, supra* note 29, at 89-90, (statement of Thomas A. Halleran).

48 *See, e.g.,* Ward La France Truck Corp., 13 S.E.C. 373 (1943).

49 *See, e.g., id.*

50 *See, e.g.,* Cady, Roberts & Co., 40 S.E.C. 907 (1961); *cf.* Cochran v. Channing Corp., 211 F. Supp. 239 (S.D.N.Y. 1962).

51 17 C.F.R. § 240. 13e-1 (1971).

52 *See, e.g.,* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969).

53 For an attempt to categorize the other areas of material information, *see Inside Information, supra* note 29, at 91-93 (statement of Thomas A. Halleran).

of a material fact."[54] Yet we have discovered that information, even where unreliable, may have such impact that it falls under our definition of "material" so as to impose an affirmative duty of disclosure on the corporation. The corporation does have one way out of this dilemma—it may forego the repurchase transaction.[55]

2. Imputed Knowledge

The other problem is one which does not exist where non-corporate insiders are involved. An insider will not be held liable under Rule 10b-5 for failure to disclose information which he does not himself have. Since a corporation acts through its agents, it is important to consider when knowledge possessed by a director, officer or employee will be attributed to the corporation so that failure to disclose the information at the time the corporation re-purchases its stock will violate 10b-5. Admittedly, most of the areas cited as material involve the board of directors as a group or the higher echelons of management, and so there would be little trouble in imputing knowledge of the event to the corporation. Yet consider the case of the geologist employed by the corporation who finds a drill core to be promising, but he wants to conduct some more experiments before disclosing his findings—or the research chemist who has come up with a formula for some new product, but wants to run more tests in order to refine his work. Arguably, in both of these cases the information is too remote to be material. But assuming that it is material, will the corporation be charged with such knowledge?

One view is that since the board of directors is unaware of the discovery, it is not taking advantage of the inside information when it fails to make the disclosure upon repurchasing its stock.[56] The trouble with this position is that it encourages a breakdown in the chain of intracorporate communication. Moreover, it fails to clarify when knowledge of inside information is attributable to the corporation. Suppose that the information reaches the Vice President for Research and Development—does it matter that he is not on the board of directors; or if on the board, that he is not on the executive committee that handles most of the corporate business; or if on the committee, that he was not present at the meeting which voted on the repurchase; or if present, that he did not vote;

[54] The SEC has classed some information as inherently unreliable. This includes "[p]redictions as to specific future market values, earnings, or dividends," Rule 14a-9 n. (a) of the Securities Exchange Act of 1934, 17 C.F.R. § 240, 14a-9 n. (a) (1971).

[55] *See* Cady, Robert & Co., 40 S.E.C. 907, 911 (1961).

[56] *See* Kennedy, *The Corporation's Obligations When It is Trading in Its Own Stock,* 50 CHI. B. RECORD 384, 390 (1969).

or if he voted, that his vote was not crucial to the outcome? If we succeed in choosing a cut-off point along the vertical line of authority, what is the effect of a horizontal spread of the information at levels below this point? For example, if we decide that the knowledge of a non-director officer is not attributable to the corporation, should we reach the same result if the information has spread to all non-director officers? Admittedly, there is no easy answer.

The doctrine of "imputed knowledge" is a product of the law of agency. According to the Second Restatement, "[a] person has notice of a fact if his agent has knowledge of the fact, reason to know it, or should know it . . . ."[57] But this is qualified by the statement that it applies to "circumstances coming within the rules applying to the liability of a principal because of notice to his agent."[58] And these circumstances are not in point for they involve situations in which the activity of the agent whose knowledge is to be imputed results in the liability.[59] Nevertheless, it is instructive to note that the Restatement limits the application of the doctrine to cases in which the agent has a duty to disclose the information to his principal—where "in failing to impart the knowledge, [he] has failed to act properly within the scope of his authority."[60]

The case law adds to the confusion. In *Cady, Roberts & Co.*[61] a partner of the brokerage firm who had received information about a cut-back in Curtiss-Wright's dividend rate sold Curtiss-Wright stock for his discretionary accounts without revealing the information knowing that as yet it had not been made public. The SEC imposed sanctions on the partner, but not on Cady, Roberts, ruling that the firm "had no opportunity to prevent [the partner's] spontaneous transactions and no contention has been made that its procedures for handling accounts did not meet proper standards."[62]

In a recent proceeding, *Investors Management Co., Inc.,*[63] the SEC again sidestepped the doctrine of imputed knowledge. Inside

---

57 RESTATEMENT (SECOND) OF AGENCY § 9(3) (1957).

58 *Id.*

59 *Id.* ch. 8.

60 *Id.* § 275 and Comment *a.*

61 40 S.E.C 907 (1961).

62 *Id.* at 917.

63 [1969-70 Transfer Binder] CCH FED SEC. L. REP. ¶77,832 (SEC Administrative Proceeding File No. 3-1680, June 26, 1970). Although none of the parties filed a petition for review of the hearing examiner's decision, the Commission has decided that it should express its own views regarding the obligations of "tippees." SEC Securities Exchange Act Release No. 8947, [1969-70 Transfer Binder] CCH FED SEC. L. REP. ¶77,844 (July 30, 1969).

information regarding a reduction of earnings for Douglas Aircraft was passed by Merrill, Lynch to a number of its large accounts which subsequently sold their holdings of Douglas common stock. After findings that twelve of the respondents had violated section 10 (b) the hearing examiner turned to the case of Dreyfus Corporation. Despite evidence that a securities analyst employed by Dreyfus did receive the information and recommended the sale of the Douglas stock to the president of Dreyfus, the examiner found that the particular inside information was not conveyed to the president and did not influence his decision to sell. The examiner concluded that no use was made of the information so that Dreyfus, as a tippee, had no duty of disclosure.[64] This decision is questionable for several reasons: first, it encourages a party to hold on to information despite a general duty to the corporation to pass it on, despite knowledge that his corporation is acting consistently with such information, if not on the basis of it, and despite the market's need for such information;[65] second, it seems to impose on the Commission the difficult burden of proving that inside information which was received by an agent of the corporation was passed on and did in fact influence the ultimate decision; third, it is arguable that Dreyfus did use the information, albeit unconsciously, to the extent that the president was influenced by the opinion of his analyst. Of course, this case did involve a tippee who may be held to a lesser duty of disclosure than the corporation itself when repurchasing its stock. And the agent who acquired the inside information was a general employee rather than a director or high-ranking executive. But the decision does show that the SEC will not act lightly in imputing an agent's knowledge to the corporation for purposes of the 10b-5 disclosure requirement.

The California Court of Appeals seems to have reached a contrary result in *Black v. Shearson, Hammill & Co.*[66] Dunbar, a Shearson partner, was also on the board of United States Automatic Merchandising Company (USAMCO), and he decided that Shearson should "make the market" in USAMCO stock. While Shearson was touting the stock, Dunbar learned that the position of the company was drastic. His duty to the corporation forbade him from revealing this information to Shearson's personnel.[67] Nevertheless, he participated in the sale of USAMCO convertible debentures to

---

64 [1969-70 Transfer Binder] CCH FED. SEC. L. REP. ¶77,832, at 83,961.
65 *See* pp. 199, 203-03 *supra*.
66 266 Cal. App. 2d 362, 72 Cal. Rptr. 157 (1968).
67 The New York Stock Exchange has made explicit the director's common law duty in its Educational Circular No. 162 (June 22, 1962):

the plaintiffs, and responded to an inquiry by one of Shearson's salesmen, who was also involved in the sale, that "[n]othing has changed the picture." The court held both Dunbar and Shearson liable for compensatory and punitive damages. In order to hold Shearson liable the court had to attribute Dunbar's knowledge to the firm. Yet this is not surprising as the case approaches the typical agency situations contemplated by the Second Restatement,[68] where the agent has actively contributed to the liability. The court may have concluded, sub silentio, that whatever the duty of disclosure owed to outside investors, plaintiffs were Shearson's own customers to whom it owed a greater duty. (This reasoning would apply to a corporation purchasing shares from its own stockholders.) Finally, the court may have been influenced by Shearson's circulars, which seemed to go beyond the realm of legitimate "puffing" and included statements found to be false, and its assurances to its customers that they would benefit from Shearson's access to inside information (through Dunbar).

An adequate solution to our problem is suggested by Article 1 of the Uniform Commercial Code which provides, in another context, that:

> Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.[69]

"Every director has a fiduciary obligation not to reveal any privileged information to anyone not authorized to receive it. Not until there is full public disclosure of such data, particularly when the information might have a bearing on the market price of the securities, is a director released from the necessity of keeping information of this character to himself. Any director of a corporation who is a partner, officer, or employee of a member organization should recognize that his first responsibility in this area is to the corporation on whose Board he serves. Thus, a member firm director must meticulously avoid any disclosure of inside information to his partners, employees of the firm, his customers or his research or trading departments."

68 *See* p. 203 *supra*.

69 UNIFORM COMMERCIAL CODE § 1-201 (27). According to the comments to this section:

Under this standard an agent's knowledge of material information will be attributed to the corporation when the agent, in light of his position in the corporation, would be expected to pass the information up through the channels of intracorporate communication or when he is apprised of the repurchase transaction which is "materially affected" by such information through the intervention of the federal securities laws.

3. Identity of the Purchaser

As noted earlier, there is certain information directly related to the repurchase which may have to be revealed. A real question arises as to the necessity for the corporation (or any insider) to disclose its identity as a purchaser. At least one observer has noted the importance of such a disclosure.[70] The Second Circuit recognized the question on two occasions, but sidestepped it both times.[71] According to agency law, an agent may conceal the identity of his principal if he has no reason to believe that the other party would not have dealt with the principal, even if he believes that such concealment will result in more favorable terms.[72] But this rule may be inapposite for the repurchase situation where the third party is not a stranger but is rather a shareholder with respect to whom the corporation is in a fiduciary position.

In *Ward La France Truck Corp.*,[73] a repurchase case, the Commission cited as one element of the 10b-5 violation the failure of the purchaser to identify itself. However, the Commission seemed to view such disclosure as important not for the direct information which it would impart to the selling shareholder, but because it might lead to "inquiries or surmises concerning the better condition

---

"This makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction."

70 Note, *Corporate Stock Repurchases Under the Federal Securities Law*, 66 COLUM. L. REV. 1292, 1306 (1966); *cf. Personal Investing*, FORTUNE, Dec. 1967. *But see, e.g.*, Fleck, *Corporate Share Repurchasing: An Informal Discussion*, HARV. BUS. SCHOOL BULL., Jan.-Feb. 1965, at 12 (statement of John Lintner); Kennedy, *supra* note 35, at 329.

71 List v. Fashion Park, Inc., 340 F.2d 457, 464 n.4 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965); Cochran v. Channing Corp., 211 F. Supp. 239, 242 (S.D.N.Y. 1962). In Ross v. Licht, 263 F. Supp. 395, 409 (S.D.N.Y. 1967), the district court stated that the identity of the purchasers, who included some insiders, was not material—but the court stressed that the plaintiff had solicited the purchases for some time.

72 RESTATEMENT (SECOND) AGENCY § 304, Comment c. 1957).

73 13 S.E.C. 373 (1943).

of the company, if not the actual plan afoot."[74] At the very least, we can conclude that when other incidents of deception or non-disclosure are present the purchaser's failure to disclose its identity may serve as a "badge of fraud and a method to forestall further inquiry into the scheme of the purchasers."[75] And an observation made ten years ago by Professor Loss still seems appropriate today:

> [A]ll that can be safely said in the present state of the law is that an insider cannot be certain that failure to disclose his identity will *not* be considered a violation of Rule 10b-5, or at the very least will not be more likely to lead the courts to find a violation when the non-disclosure of identity is considered in connection with all the other circumstances.[76]

The identity of the purchaser may have to be revealed in connection with other information which is more clearly material. If the corporation's purchases are to be substantial, not simply in absolute terms but relative to the general trading in the security, then it is likely to have an impact on the market price. The effect may be most unsettling where the corporation's entry into the market occurs sporadically.[77] And it may be increased where the corporation makes its purchases through more than one broker or makes its bids or purchases at the opening and closing of trading, if the securities are listed on an exchange.[78] In such cases the corporation should reveal the extent of the intended repurchase and the methods to be used in enacting the repurchase. This will permit the selling shareholder to evaluate the market effect of the repurchase in order to determine whether it is in his interest to postpone sale of his stock so as to enable him to take advantage of ensuing price increases.

4. Purpose of the Repurchase

A final consideration for the corporation is the materiality of the purpose underlying the repurchase.[79] If the corporation needs the shares to finance a merger or acquisition, the materiality of

---

[74] *Id.* at 380.

[75] Kennedy, *supra* note 56, at 390.

[76] 3 L. Loss, Securities Regulation 1465 (2d ed. 1961) [hereinafter cited as Loss].

[77] *See* Loomis, *Recent Activity at the Securities and Exchange Commission,* 61 Nw. U.L. Rev. 677, 684 (1966).

[78] *Cf.* SEC v. Georgia-Pacific Corp., [1964-66 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,692 (S.D.N.Y. May 24, 1966) (consent decree).

[79] Carlos Israels suggests still another area of information related to the repurchase that is "prima facie material"—the intentions of "insiders" as to the retention or sale of their own shares. Israels, *supra* note 24, at 762.

the merger or acquisition will determine whether the corporation must disclose itself and its intentions. If management has determined that the market value is not reflective of the true value of the corporation[80] or that a repurchase is necessary to eliminate a problem of over-capitalization and will result in a substantial increase in earnings per share, this information seems to meet our test of materiality. On the other hand, if the repurchase is aimed at furnishing shares for an employee pension plan, it is questionable whether the foreseeable impact of the disclosure of such a purpose would be great enough to warrant labeling this as material information.[81] But if the repurchase is of a sufficient scale to require its disclosure, a further disclosure of purpose is advisable, both for the tactical reason of setting aside any thoughts that the repurchase is really motivated by some hidden value in the stock, a belief which, albeit mistaken, could cost the corporation some money, and for avoiding a claim that the disclosure made is only a "half truth," though such claim is of doubtful validity.

C. Private Right of Action

The discussion, up to now, has focused on the disclosures required of the corporation. But what of the selling shareholder who is victimized by the corporation's failure to disclose material information? Nowhere in Section 10(b) or Rule 10b-5 is there any explicit recognition of a private right of action by one deceived in a securities transaction. Nevertheless, in 1951 the Second Circuit held that there was such a right,[82] and today ten of the eleven Courts of Appeals have acknowledged the existence of a private cause of action either by way of direct holding, dictum or sub si-

---

[80] Management must be careful here not to make an affirmative misstatement. A selling shareholder would have little right to complain that he relied to his detriment on an overly optimistic estimation of of value, List v. Fashion Park Inc., 340 F.2d 457 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965), but a shareholder who retained his stock might claim injury. Under the present state of the law such an "aborted seller" would not have an immediate cause of action, Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 954 (1952), but he may have an action if he later sells at a lower price, Stockwell v. Reynolds & Co., 252 F. Supp. 215, 219 (S.D.N.Y. 1965) ("The words 'in connection with the purchase or sale of any security' contained in Section 10(b) and Rule 10b-5 do not require that the purchase or sale immediately follow the alleged fraud.").

[81] *See* Kennedy, *supra* note 35, at 324.

[82] Fischman v. Raytheon Mfg. Co., 188 F.2d 783 (2d Cir. 1951). The real trailblazing decision was Kardon v. National Gypsum Corp., 69 F. Supp. 512 (E.D. Pa. 1946) (motions to dismiss denied), 73 F. Supp. 798 (E.D. Pa.) (decision on merits), *modified,* 83 F. Supp. 613 (E.D. Pa. 1947).

lentio.[83] The Supreme Court has never clearly ruled on the matter. In *Surowitz v. Hilton Hotels Corp.*,[84] an action in which the complaint alleged violations of Rule 10b-5, Justice Black made an oblique statement which may be interpreted as an affirmative response.[85] Perhaps the best authority for implying a private right of action under 10b-5 is the Court's decision in *J. I. Case Co. v. Borak*,[86] wherein the Court upheld a private right of action for violation of Section 14(a) of the 1934 Act and the rules promulgated thereunder.[87] The language of the decision is broad and indicates a readiness to imply private rights of action where necessary to effectuate the objectives of the federal securities laws.[88]

In addition to the requirement of proximate causation,[89] an element common to all tort cases, an important limitation on the private right of action is the requirement of reliance.[90] According to Judge Waterman, this requirement is not inconsistent with Rule 10b-5 since its aim, as he sees it, "is to qualify, as between insiders and outsiders, the doctrine of *caveat emptor*—not to establish a

---

83 *See* 6 Loss, *supra* note 76, at 3871-72 (Supp. 1969).

84 383 U.S. 363 (1966).

85 *Id.* at 373-74; *see also* Tcherepnin v. Knight, 389 U.S. 332 (1967).

86 377 U.S. 426 (1970).

87 15 U.S.C. § 78n(a) (1970), 17 C.F.R. §§ 240. 14a-1 -12 (1971).

88 *See* Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702, 708 (N.D. Ind. 1968) ("[T]he courts should maintain the same alertness to provide remedies for violations of Section 10(b) which the Supreme Court found . . . to be necessary to carry out the Congressional purpose in enacting Section 14(a) of the same Act."). Professor Loss is in general agreement with this broad reading of the *Borak* decision though he indicates that there are several reasons why the Supreme Court's implication of a private right of action under the proxy rules may not foreclose the matter with respect to Rule 10b-5. 6 Loss, *supra* note 76, at 3870.

89 *See, e.g.*, Smith v. Bear, 237 F.2d 79, 87-88 (2d Cir. 1956). In recent years the courts have diluted the causation requirement. *See, e.g.*, Weber v. Bartle, 272 F. Supp. 201, 204 (S.D.N.Y. 1967); *see generally* Comment, *Schoenbaum v. Firstbrook: The New Fraud Expands Federal Corporation Law*, 55 U. VA. L. REV. 1103, 1107 n.29 (1969).
I sidestep the question of whether scienter is required under clause (b) of Rule 10b-5. Loss argues that scienter, even in a watered down form, must be required or else clause (b) would be ultra vires as going beyond the boundaries established by Congress in Section 10(b), 6 Loss, *supra* note 76, at 3884-85. *But see* Ellis v. Carter, 291 F.2d 270, 274 (9th Cir. 1961), and this view is gaining a following, *see* 6 Loss 3886.

90 For a list of cases that either hold or assume that reliance is required, *see* 6 Loss, *supra* note 76, at 3777-78. In an administrative proceeding for violation of Rule 10b-5, where the aim is not to compensate an injured party, a showing of reliance would not be required.

scheme of investors' insurance."[91] Reliance is closely akin to materiality. They differ in that reliance "substitute[s] the individual plaintiff for the reasonable man."[92] Hence the plaintiff's knowledge and business acumen become relevant to his cause of action.[93] He need not actively rely on the defendant's silence—such a stringent requirement would all but eliminate the chance for a successful action where the purchase was made on an exchange or in an over-the-counter transaction.[94] And this is consistent with the test of reliance set out in the *List* case: "whether the plaintiff would have been influenced to act differently than he did if the defendant had disclosed to him the undisclosed fact."[95]

If the corporation does violate Rule 10b-5 by failing to make the requisite disclosures, the group of potential plaintiffs will exceed the number of shareholders from whom the corporation repurchased its stock. At one time it was believed that "a semblance of privity" was necessary to the maintenance of a successful action.[96] And there are still those who would like to uphold a privity requirement, recognizing the extensive liability which could result from its elimination.[97] Yet it is now generally accepted that the absence

---

[91] List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965).

[92] *Id.* As to situations in which materiality and reliance may diverge, *see* Note, *supra* note 70, at 1309 n.123.

[93] *See* Kohler v. Kohler Co., 319 F.2d 634, 641-42 (7th Cir. 1963), though here the distinctions between reliance and materiality seem to merge, and the court appears to be talking about the latter. This may be attributed to the fact that the transaction involved was a private sale of stock to the corporation and not an open-market purchase or a tender offer. In such a case the "reasonable man" test may have no place. *See* Note, *supra* note 70, at 1309.

[94] Admittedly, it is troublesome to talk about reliance in the case of anonymous market trading where there have been no affirmative misstatements. *See* 83 HARV. L. REV. 1423-24 n.14 (1970). Yet a selling shareholder may be thought justified in relying on the belief that the corporation will observe the fiduciary duties owed to him, particularly if he knows that the corporation is in the market. Cf. Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del. 1965).

[95] List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir.), *cert. denied,* 382 U.S. 811 (1965). One commentator suggests that a finding of materiality should shift to the defendant the burden of proving that the selling shareholder would not have acted differently had the proper disclosure been made. Note, *supra* note 70, at 1310.

[96] *See* Joseph v. Farnsworth Radio & Television Corp., 99 F. Supp. 701, 706 (S.D.N.Y. 1951), *aff'd per curiam,* 198 F.2d 883 (2d Cir. 1952).

[97] *See, e.g.,* Kennedy, *supra* note 56, at 391. According to Professor Ruder, privity should be required where liability is based on negligence though it may be eliminated as a requirement where the complaint is predicated on some form of intentional misconduct. Ruder, *Texas-*

of privity is not fatal but merely "one factor that will have to be taken into account."[98] This change in attitude has probably been prompted by a desire to maintain the efficacy of 10b-5 protection for open market transactions. Thus the corporation repurchasing its stock can not avoid the duty of disclosure by electing a method of repurchase which eliminates direct contact with the selling shareholders, and the liability to which it will subject itself by breach of that duty may far exceed the scope of the intended repurchase.

III. RULE 10b-5 AND THE PREVENTION OF FRAUDULENT MANAGEMENT—PROTECTION FOR THE CORPORATION AND CONTINUING SHAREHOLDERS

A. The Problem

A corporate stock repurchase is not only a means of putting shares in the corporation's treasury; it is also a means of putting corporate assets, particularly cash, in the hands of those shareholders that decide to relinquish all or part of their holdings in the corporation. Unlike the payment of dividends, an alternative method for distributing corporate assets, the corporation engaged in a repurchase need not transfer these assets to shareholders on an equal basis. And this is not due simply to the volitional element involved in a repurchase—that a shareholder may decline to sell his stock. The corporation is not bound to take up shares pro-rata. This leaves room for abuse by corporate management as it is possible to discriminate unfairly among shareholders by paying too much to selected sellers. The potential for abuse is accentuated by the built-in conflict of interest, for the repurchase may be necessary to preserve the control of those who forced the corporation to undertake the transaction. To the extent that there is no collateral benefit to the corporation, it represents a blatant waste of corporate

---

Gulf Sulphur—The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases, 63 Nw. U.L. Rev. 423, 441-42 (1968); *see* Comment, *Civil Liability Under Section 10B and Rule 10B-5: A Suggestion for Replacing the Doctrine of Privity*, 74 Yale L.J. 658, 667 (1965). This distinction may be inapposite in the case of a corporate stock repurchase. It is based on the notion that if the gravamen of the complaint is negligence, the plaintiff must show that defendant owed him a duty of care, and this is supplied by the requirement of privity. But the corporation already owes its shareholders a duty of care. Hence, privity would seem to be unnecessary.

98 Cochren v. Channing Corp., 211 F. Supp. 239, 245 (S.D.N.Y. 1962). Professor Blomberg has gone so far as to characterize privity as "a relic of personal transactions in a less developed economy." Bromberg, *supra* note 29, at 205 n.28.

assets. If the officers and directors are themselves shareholders, then they may be the beneficiaries of the corporation's questionable munificence to the detriment of the remaining shareholders.

Traditionally, the states have been the repositories of remedies for protecting minority shareholders from abuses by corporate insiders acting for their own benefit, rather than the benefit of the corporation. If a director induced the board to reacquire some of the shares at a price in excess of their assumed value, the corporation would have a cause of action for breach of the director's duty of loyalty.[99] The usual procedure for holding an insider liable in such a case is the shareholder's derivative suit. Out of a fear of the "strike suit," a spurious action begun for the purpose of extorting management into an out-of-court settlement, many states imposed procedural obstacles which seriously inhibit legitimate derivative actions. For example, a complaining shareholder may be required to seek the action or approval of the board of directors[100] or to put up a sizeable security bond to cover the defendant's costs.[101] Since these requirements are classifiable as "substantive" for *Erie* purposes,[102] they follow the plaintiff into the federal courts in suits grounded on diversity of citizenship. The only escape is to base the action on the federal securities laws.[103] For this purpose, Rule 10b-5 seems well suited.

B. Relief Under Federal Securities Laws

We have already seen how 10b-5 operates to require the corporation to disclose material information to those from whom it repurchases its stock. Where the selling shareholder is a director, who is himself a receptacle for inside information, it seems reasonable to expect 10b-5 to operate reciprocally so as to protect the corporation, at least to the extent that the director's knowledge is not chargeable to the corporation. If the corporation does have a good cause of action under state law, then the suppression of any information related to this cause of action raises the possibility of a

---

99 *But see, e.g.*, N.Y. Bus. Corp. Law § 713(a) (McKinney Supp. 1971) (Despite unfairness, the vote of a disinterested majority of the board seems to be sufficient to uphold the transaction).

100 *See e.g.*, Cal. Corp. Code § 834(a)(2) (West Supp. 1971).

101 *See, e.g.*, N.J. Stat. Ann. § 14A:3-6(3) (West 1969).

102 Erie R.R. v. Tompkins, 304 U.S. 64 (1938); *see* Cohen v. Beneficial Indus. Loan Corp., 337 U.S. 541 (1949) (security for expenses statute).

103 *E.g.*, McClure v. Borne Chem. Co., 292 F.2d 824 (3d Cir.), *cert. denied*, 368 U.S. 939 (1961). Basing the action on federal law brings other advantages, including nationwide service of process and liberal venue provisions. *See* Securities Exchange Act of 1934, § 27, 15 U.S.C. § 78 aa (1970).

corporate action under 10b-5. Moreover, clause (c) of Rule 10b-5 prohibits "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," and a corporation is defined as a "person" in the 1934 Act.[104] Relief would seem to be in order where the corporation is a defrauded purchaser, and the stockholder derivative suit is the likely vehicle for such an action.[105] As to the present scope of the relief available to minority shareholders suing on behalf of the corporation and the solution of the conceptual difficulties involved in granting such relief, an examination of the case law is necessary.

1. The Development of Federal Case Law

In *Birnbaum v. Newport Steel Corp.*[106] the Second Circuit denied recovery in a shareholder's derivative suit involving the sale of control at a premium. The decision was correct on its facts in that neither the plaintiff-shareholder nor the corporation was a defrauded purchaser or seller.[107] Of particular interest is the court's statement that the Rule was not directed "at fraudulent mismanagement of corporate affairs."[108] This statement need not be taken literally. Its context suggests that the court did not intend to preclude relief for all sorts of mismanagement but meant only that form of mismanagement that was not "associated with the sale or purchase of securities."[109]

Eight years later in *Hooper v. Mountain States Securities Corp.*[110] the Fifth Circuit upheld an action brought by a trustee in bankruptcy on behalf of a corporation to recover from ousted corporate officials who fraudulently induced the corporation to issue shares in return for certain worthless assets. The court reasoned that such protection was warranted under the "public interest" clause of Section 10(b). *Hooper* thus offered the corporation protection from fraud by outsiders. It would seem plausible to extend the protection

---

104 Securities Exchange Act of 1934, § 3(a)(9), 15 U.S.C. § 78c(a)(9) (1970).

105 A derivative right of action under Rule 10b-5 was first recognized in Hooper v. Mountain States Securities Corp., 282 F.2d 195 (5th Cir. 1960), *cert. denied,* 365 U.S. 814 (1961), though it was suggested eleven years earlier in Slavin v. Germantown Fire Ins. Co., 174 F.2d 799, 805-06 (3d Cir. 1949) (dictum).

106 193 F.2d 461 (2d Cir.), *cert. denied,* 343 U.S. 956 (1952).

107 *But see* Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5,* 54 U. VA. L. REV. 268 (1968).

108 193 F.2d at 464.

109 *Id.; see* Pettit v. American Stock Exch., 217 F. Supp. 21, 25 (S.D.N.Y. 1963).

110 282 F.2d 195 (5th Cir. 1960), *cert. denied,* 365 U.S. 814 (1961).

to activity by insiders who owe the corporation a duty cognizable under state law.[111] And the courts did move in this direction. In *Pettit v. American Stock Exchange*,[112] a factual situation similar to *Hooper* except for the involvement of an insider, a similar result was reached. Faced with the *Birnbaum* dictum, the district court distinguished it, as suggested above, by considering that here the mismanagement issue was directly connected with a purchase or sale (just as it would be in our repurchase case).

Pettit was approved by the Second Circuit in *Ruckle v. Roto American Corp.*[113] In *Ruckle* the alleged fraud resulted from withholding the latest financials from a minority of the board and the concomitant issuance of 75,000 shares of stock to Roto American's president at an arbitrarily determined price. The case presented some difficulty which was not present in *Hooper* or *Pettit*. The fraud in these earlier cases involved the deception of the board by withholding information as to the value (or valuelessness) of the assets acquired by the corporation. Here the valuation question was directed to the corporation's stock, and as the majority of the board had seen the financials and controlled the vote, the board was not deceived. Since a corporation acts through its board of directors, and since the directors' knowledge is generally attributed to the corporation,[114] it was arguable that the corporation was not deceived by the transaction. But the court found that the failure to disclose material facts to the minority board members was sufficient to satisfy the requirements of Rule 10b-5.[115] By way of *obiter* the court went even further so as to suggest that full disclosure to the board need not preclude liability under 10b-5.[116]

The Second Circuit's approach in *Ruckle* is undoubtedly correct. In terms of the repurchasing corporation's duty of disclosure we have already seen how the knowledge of an officer or director may be attributed to the corporation.[117] It is not inconsistent to protect

---

111 *See, e.g.*, McClure v. Borne Chem. Co., 292 F. 2d 824, 834 (3d Cir. 1961) (dictum) (Rule 10b-5 "imposes broad fiduciary duties on management vis-a-vis the corporation and its individual stockholders.").

112 217 F. Supp. 21 (S.D.N.Y. 1963).

113 339 F.2d 24 (2d Cir. 1964).

114 *See* Bergeson v. Life Ins. Corp. of America, 265 F. 2d 227, 232 (10th Cir.), *cert. denied*, 360 U.S. 932 (1959) ("A corporation necessarily acts vicariously. It is elementary that a corporation can acquire knowledge only through its officers and agents. Their knowledge is the knowledge of the corporation.").

115 339 F.2d at 27.

116 *Id.* at 29.

117 *See* pp. 202-06 *supra*.

a corporation by refusing to impute to it the knowledge of an insider who is acting against its interests.[118] One can reach this conclusion by ignoring the corporate entity and considering the action as a direct fraud on the innocent shareholders to whom the insider's knowledge is not attributable.[119] But one need go no further than traditional agency law that recognizes an exception to the doctrine of imputed knowledge where the agent secretly acts for his own interest and adversely to the principal.[120]

Within several weeks, however, the Second Circuit seemed to reverse itself with its decision in *O'Neill v. Maytag.*[121] National and Pan American Airlines each owned a substantial block of the other's stock. Pursuant to an order of the CAB, the two companies were required to dispose of these holdings and to arrange for an exchange of shares. As a result of a change in the respective market value of the shares, the exchange ratio proved unfavorable to National. A National shareholder instituted an action alleging that the excessive price was paid by the defendant board of directors in order to perpetuate their control of the corporation. The Court dismissed the complaint indicating that while there may have been a good claim under state law, Rule 10b-5 was not applicable to a breach of general fiduciary duties absent deception.[122]

O'Neill involved a repurchase transaction rather than a sale. But surely this is not enough to distinguish it from *Ruckle. O'Neill* could be interpreted as a simple failure in pleading for the court did distinguish *Ruckle* by indicating that it involved a "clear allegation of deception."[123] This interpretation is doubtful since the complaint was stated with considerable particularity, and federal pleading rules are quite liberal.[124] Another suggestion is that the court was trying to limit 10b-5 to cases involving a misrepresentation or failure to make a necessary disclosure as opposed to those involving mere unfair transactions to which an insider is a party.[125] But, arguably, *O'Neill* did involve a failure to disclose the real purpose underlying the transaction, the attempt to preserve control. Nor can one say, as with *Birnbaum,* that management's breach of

118 *See* Weitzen v. Kearns, 271 F. Supp. 616, 621 (S.D.N.Y. 1967); Heilbrunn v. Hanover Equities Corp., 259 F. Supp. 936, 938 (S.D.N.Y. 1966).
119 *See* Pappas v. Moss, 393 F.2d 865, 869 (3d Cir. 1968).
120 RESTATEMENT (SECOND) OF AGENCY § 282(1) (1957).
121 339 F.2d 764 (2d Cir. 1964).
122 *Id.* at 767-68.
123 *Id.* at 768.
124 *See* Note, *supra* note 70, at 1312-13.
125 *See* Bloomenthal, *From Birnbaum to Schoenbaum: The Exchange Act and Self-Aggrandizement,* 15 N.Y.L. FORUM 332, 341 (1969).

duty was not directly connected with the purchase. Rather, one must conclude that the court exhumed the imputation theory, thereby reverting to the old cliche that "the directors constitute the corporation and a corporation like any other person, cannot defraud itself."[126] This is consistent with Professor Loss' interpretation of the decision—that the Second Circuit found it necessary to call a halt to the rapid development of the law under 10b-5 so as to re-evaluate its direction.[127]

The retreat begun in *O'Neill* was continued by the district courts.[128] The courts of the Southern District of New York focused on the requirement of causation for determining when there was sufficient intra-corporate deception to satisfy 10b-5. Thus in *Barnett v. Anaconda Co.*[129] the court denied relief in a derivative action brought in connection with a misleading proxy statement since the defendant possessed enough shares to control the vote. The court held that any corporate injury was caused by a breach of fiduciary duty cognizable under state law, not by deception. Of particular interest is *Hoover v. Allen*[130] which like *O'Neill* involved a stock repurchase. The complaint alleged that defendant directors used false and misleading statements inducing shareholders (other than plaintiffs) to sell their stock to the corporation in order to gain control, whereupon defendants committed certain acts of waste. The court reasoned that as the misstatements depressed the price of the stock, they caused injury to the selling shareholders and not the corporation.[131] But it suggested that if a premium had been paid for the shares, then recovery under 10b-5 would be in order.[132] This is consistent with *Ruckle* but runs contrary to the implication of *O'Neill* that a corporation cannot be deceived by its board of directors. In order to maintain consistency with *O'Neill* it was treated as a case of faulty pleading, but the court did infer from the Second Circuit's failure to mention the scheme to maintain control that the fraudulent acquisition of control would not be

126 Ruckle v. Roto American Corp., 339 F.2d 24, 29 (2d Cir. 1964).
127 6 Loss, *supra* note 76, at 3637-38.
128 *See e.g.*, Carliner v. Fair Lanes, Inc., 244 F. Supp. 25 (D. Md. 1965). The complaint alleged that the insiders failed to reveal that the purpose of the repurchase was to perpetuate defendants' control and "bail out" the majority shareholder. In dismissing the complaint the court held that the requirement of deception as set out in *O'Neill* was not satisfied since the transaction was "fully explained to the entire Board of Directors," *id.* at 29.
129 238 F. Supp. 766 (S.D.N.Y. 1965).
130 241 F. Supp. 213 (S.D.N.Y. 1965).
131 *Id.* at 227.
132 *Id.* at 227-28.

actionable in itself under federal law.[133] Implicit in this proposition is the notion that the acquisition in no way caused the corporation to be deceived. Moreover, even if it was actionable under 10b-5, it was not the proximate cause of the corporate waste.[134] Hence the corporation could not seek federal redress for the real injury.

The conceptual framework underlying this line of cases was well laid out in *Globus, Inc. v. Jaroff*.[135] According to *Globus*, in order to determine the sufficiency of the alleged deceit one must look to the decision-making body for the transaction in question. Fraud is only actionable under 10b-5 if the corporate body which makes the ultimate decision to buy or sell the securities is deceived. If the directors possessed the sole power to decide on a repurchase, any deception of the shareholders resulting from the transaction would not inure to their detriment—that is, the deception would not "cause" the injury.[136] The "logic" of the decision suggests that no relief will be granted even where the decision rests with the shareholders if those perpetrating the deception control a majority of the stock so as to render the minority's vote ineffective.[137] However, *Globus* may be questioned on its own terms. If the deception masks a cause of action available under state law, then it would cause injury to the minority shareholders.[138] The import of *Globus* is to deny relief to those who are most in need of protection. From a policy standpoint, this decision is deplorable. Fortunately, the courts now have declined to impose such a rigid requirement of causation.[139]

---

133 *Id.* at 228. The court did recognize an injury to the remaining shareholders whose power was diluted through the repurchase (though, of course, their respective ownership percentages would be increased). But this injury was irremediable under the *Birnbaum* doctrine, *id.* at 228-29. *But see* Stockwell v. Reynolds & Co., 252 F. Supp. 215, (S.D.N.Y. 1952).

134 241 F. Supp. at 229. In this regard, the court explicity rejected a "but for" standard of causation.

135 266 F. Supp. 524 (S.D.N.Y. 1967).

136 The dictum in *Hoover* suggesting that there would be a good cause of action if a premium had been paid for the reacquired stock is inconsistent with this position.

137 *See* Barnett v. Anaconda Co., 238 F. Supp. 766 (S.D.N.Y. 1965).

138 *See* Note, *Shareholders' Derivative Suit to Enforce a Corporate Right of Action Against Directors Under SEC Rule 10b-5*, 114 U. PA. L. REV. 578, 585-87 (1966). *But see* Comment, *supra* note 89, at 1108-09 n.33.

139 *See* Swanson v. American Consumer Indus., Inc., 415 F.2d 1326, 1331-32 (7th Cir. 1969); Weber v. Bartle, 272 F. Supp. 201, 204 (S.D.N.Y. 1967); Laurenzano v. Einbender, 264 F. Supp. 356, 362 (E.D.N.Y. 1966); *see generally* Kaplan, *Shareholder Attacks on Mergers and Acquisitions Under Federal Securities Laws*, 50 CHI. B. RECORD 441, 443-44, 452 (1969).

In 1967 the Second Circuit again reversed itself, moving back in the direction of the *Ruckle* decision. In *Vine v. Beneficial Finance Co.*[140] the court refused to dismiss an action charging that defendants made false representations in a successful tender offer which permitted them to acquire the ninety percent ownership necessary for a short form merger, intending to force out the remaining shareholders at an unfair price. By so ruling, the court had to loosen the *Birnbaum* doctrine so as to recognize a shareholder forced out in such a merger as a "seller" of securities. Moreover, the court had to strain to find deception by holding that the deception practiced on those who sold pursuant to the tender offer was so connected with the later forced sale by the remaining shareholders as to sustain an action by the latter.[141] This is consistent with the dictum in *Hoover* which indicated that, in the context of a fraudulent repurchase, the remaining shareholders had sustained an injury in the dilution of their power which would have been remediable but for *Birnbaum*. The decision could have been easier, but the Second Circuit was not ready to find an actionable fraud absent deception.[142]

In *A. T. Brod & Co. v. Perlow*[143] the court demonstrated its willingness to expand protection under 10b-5 by applying it to new situations. Defendants were engaged in the practice of "free riding," which is common in "hot issue" markets. Securities of new issues are purchased at the public offering price with the expectation that excess demand will result in immediate trading at a higher price. Where this holds true, the party buying on credit can resell at a profit and, in effect, need never pay for the security. If the security trades at less than the public offering price, then there is an immediate loss. Defendants suffered such a loss and refused to pay. Brod, the brokerage firm, brought a 10b-5 action claiming that it had been defrauded since defendants planned to pay only if they made a profit. The Second Circuit reversed a dismissal of the complaint without even citing *O'Neill*, the decision that had been relied on by the lower court.

---

140 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

141 A similar result was reached in Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del. 1965). In *Voege* there was no tender offer, and the court had to strain even more to find deception. The court reasoned that when plaintiff purchased her shares she received an implied promise that she would be dealt wth fairly, and it was as to this proimse that she had been deceived, *id.* at 375.

142 *See* Bloomenthal, *supra* note 125, at 375.

143 375 F.2d 393 (2d Cir. 1967).

Four things about *Brod* are significant for our problem. First, it indicated that the language of section 10(b) did not limit protection to "investors," but protection was warranted where it was "in the public interest,"[144] a point which had been raised by the Fifth Circuit in *Hooper*. Although a corporation repurchasing its shares may do so for investment reasons, it is arguable that the corporation is not an "investor" in the strict sense of the term since treasury shares are not treated as an asset on the corporation's books.[145] Second, the court emphasized that the artificial demand created by such action can have a manipulative effect on the market[146]—a similar statement could be made about a sizeable repurchase, particularly where the price paid exceeds the current market price. Third, although the court implicitly adhered to the requirement of deceit for an actionable fraud, it indicated a willingness to recognize deceit in unique situations.[147] Fourth, the court moved from the language of clause (b) of Rule 10b-5, with its emphasis on disclosure, and focused on that prohibiting a "device, scheme, or artifice to defraud,"[148] which opens up the possibility of eliminating the deception requirement.

Vine and *Brod* are especially significant in the way that they have been interpreted. Shareholders of Atlas Corporation brought a derivative action based on the sale of stock owned by Atlas to Hughes Tool Company for an unfair price. The plaintiffs alleged that the defendants failed to disclose that both Atlas and Hughes were controlled by the same individual. Such a disclosure, indicating a conflict of interest, could have resulted in a challenge to the transaction under state law. Judge Bonsal discussed the complaint in *Entel v. Allen*[149] for failing to state a cause of action since plaintiffs did not allege that Atlas had been deceived in approving the transaction. However, in rehearing the complaint in light of *Vine* and *Brod*, Judge Bonsal reversed himself.[150] He saw those decisions as under-cutting the deception requirement and holding 10b-5 applicable to *"all* fraudulent schemes."[151] He concluded that "[i]f an undisclosed scheme to breach State contract law is encompassed by Section 10(b) and Rule 10b-5, then an undisclosed scheme to

---

144 *Id.* at 396.
145 *But see* Bloomenthal, *supra* note 125, at 354 n.89.
146 375 F.2d at 397.
147 *Id.*
148 *Id.* at 398.
149 270 F. Supp. 60 (S.D.N.Y. 1967).
150 *Id.* at 67-71.
151 *Id.* at 70.

breach State corporate fiduciary law must also be covered."[152] At least one commentor views *Entel* as marking the elimination of the deception requirement and a shift in emphasis to breach of a fiduciary duty.[153] But the import of the case is less clear. The use of the term "undisclosed" in the above quotation raises some doubt as to whether Judge Bonsal would have upheld the action if appropriate disclosures had been made to the shareholders. The *"all* fraudulent schemes" language is pulled out of context from the *Brod* opinion where it was tied to the term "deception."[154] Moreover, since state remedies for breach of fiduciary duty vary from state to state, *Entel* may be read as limiting 10b-5 protection to the remedy, if any, which would be available under the law of the state of incorporation rather than affording uniform protection for such breaches of duty as defined by some federal standard.

2. Potential Expansion of Protection

The foregoing panorama of cases provides the necessary background for discussing the most significant case to date, *Schoenbaum v. Firstbrook*,[155] which represents a significant expansion of Rule 10b-5 in this area of corporate mismanagement. Aquitaine Company of Canada Ltd. acquired control of Banff Oil Ltd. through a tender offer and placed three men on the Banff board of directors. The companies entered into an agreement whereby Aquitaine agreed to help finance an exploration program by splitting costs and ownership rights. Banff's board then unanimously[156] approved the issuance of 500,000 shares of Banff stock to Aquitaine at the current market price of one dollar and thirty-five cents per share to cover Banff's share of the expenses, though it seemed that Banff needed only $77,500 for this purpose. Exploration proved successful and a producing well was completed. Banff announced the discovery but withheld details, as it was permitted to do under Alberta law. Thereafter, the Banff board approved the issuance of 270,000 shares of its stock to Paribas Corporation at the market price which was now seven dollars and thirty cents, allegedly to finance construction of a pipeline. Four months later, when details of the discovery were announced to the public, the price of Banff stock shot up to eighteen dollars. Plaintiff-shareholder brought a derivative action against Aquitaine, Paribas and the Banff board of directors alleging that defendants violated Rule 10b-5 by forcing Banff to sell its shares at

---

152 *Id.*
153 *See* Comment, *supra* note 89, at 1109-10.
154 375 F.2d at 397.
155 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied,* 395 U.S. 906 (1969).
156 Aquitaine's three representatives on the Banff board did not vote.

market price in view of the oil discovery. The district court denied relief on the ground that the decision-making body of the corporation had not been deceived.[157] A three-judge panel affirmed the lower court's ruling[158] relying on the vote of a disinterested majority of the board, the members of which were fully informed, and indicated that absent deception there could be no action under 10b-5 even if there were a breach of fiduciary duty. Judge Hays dissented, raising an argument that held sway with the Third Circuit in *Pappas v. Moss*.[159] The essence of the argument is that the court should look past the corporate fiction, the maintenance of which resulted in the imputation of knowledge to the corporation, and view the transaction as a fraud on the minority shareholders who were uninformed as to the true value of their holdings.[160]

The case was reheard, en banc, and the full Second Circuit reversed as to all defendants but Paribas. The court relied, in part, on Judge Hays' dissent from the panel opinion, finding as "fraud" the failure to disclose to the shareholders material facts related to a securities transaction which was adverse to their interests. But the court went much further, applying for the first time the language of clause (c) of Rule 10b-5 by recognizing the issuance of stock for inadequate consideration as an "act, practice, or course of business which operates or would operate as a fraud or deceit . . . ."[161] Thus an action could be maintained under 10b-5 without any showing that there was a misstatement or failure to disclose material information—without alleging or proving deception.

Since the action was dismissed as to defendant Paribas, it is obvious that there are some limitations on this "new fraud."[162] The court noted that the negotiations with Paribas were at arm's length, a conclusion which appears to be based on the finding that Paribas was not in a position, through stock ownership or otherwise, to exert any undue pressure on the Banff board to sell its stock at a price below value.[163] The situation with Aquitaine was quite the opposite since it owned a large amount of Banff stock and had three members on the board. While the other five board members may not have been "interested," in the strict conflict of

157 Schoenbaum v. Firstbrook, 268 F. Supp. 385, 395 (S.D.N.Y. 1967).
158 405 F.2d 200 (2d Cir. 1968).
159 393 F.2d 865, 869 (3d Cir. 1968).
160 405 F.2d at 215.
161 405 F.2d at 219-20.
162 *See generally* Comment, *supra* note 89.
163 405 F.2d at 219.

interest sense, it is doubtful that they were "independent,"[164] as Aquitaine was in a position to exercise a controlling influence over their decisions.[165] Recognizing that this position of power could enable a party to act to the detriment of minority shareholders and that such an insider power play is as much a "fraud" as "deception," the court in *Schoenbaum* provided the minority with a protective tool unlimited by available state remedies. Of course, every transaction in which there is a conflict of interest involving a party capable of exercising a controlling interest will not be an actionable fraud. Ultimately, the test must be one of fairness.[166] Positive benefit to the corporation need not be conclusive for an alternative transaction might have been even more beneficial. The search for fairness should lead us to the hypothetically reasonable and disinterested board of directors—the inquiry being whether such board would have entered into the transaction in the light of available alternatives.[167]

It is not clear yet to what extent the court will continue to expand this actionable "new fraud." Precedent under the Holding Company Act[168] can help the courts to identify the existence of a "controlling influence." But since the concept is an elusive one, not defined by any objective quantum of ownership or representation, a rule of thumb may be in order. Looking to Section 16 of the 1934 Act[169] for guidance, controlling influence could be presumed where the party in question is an officer, director or ten percent shareholder, with that party having the burden of overturning the presumption. Where unsuccessful in meeting this burden he would then have to prove the fairness of the transaction. In every other case the plaintiff would have to prove the existence of a controlling influence before he could challenge the purchase or sale on fairness

---

164 *See* Brief for SEC as Amicus Curiae at 44, Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc).

165 In a case under the Holding Company Act, where the term "controlling influence" is of particular relevance, it has been described as follows: "[s]uch control as might result from the command of one mind over another, or from station or prestige, or from habituation to the policies of another." American Gas & Elec. Co. v. SEC, 134 F.2d 633, 648-49 (D.C. Cir.) (dissenting opinion), *cert. denied,* 319 U.S. 763 (1943).

166 See Comment, *supra* note 89, at 1122-23, 1126.

167 *See id.* at 1123, 1124 n.111. A similar test was suggested by the SEC for determining when to require disclosure to the shareholders. *See* Brief for SEC as Amicus Curiae at 40, Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc).

168 15 U.S.C. §§ 79-79z-6 (1970).

169 15 U.S.C. § 78p (1970).

grounds. A viable alternative is to abandon "controlling influence" and look to the existence of an objectively defined conflict of interest to determine when the test of fairness will be called into play. Cases since *Schoenbaum* apparently have interpreted the decision so as to focus on the conflict of interest.[170] Transactions between the corporation and one or more of its officers, directors, ten percent shareholders, or any other corporation, firm, association or entity in which one or more of its officers, directors or ten percent shareholders are officers or directors are financially interested,[171] may be automatically suspect and subject to challenge under Rule 10b-5. Greater flexibility could be attained by eliminating "ten percent shareholder" from the "conflict of interest" definition and substituting "affiliate," a term that has been applied in the federal securities laws in other contexts.[172] Such a test, when coupled with the disclosure requirements, should go far toward limiting insider abuses and restoring the integrity of the securities market.

The shift from a "controlling influence" test to the "conflict of interest" test suggested above is a significant one which takes us well beyond *Schoenbaum*.[173] The difference can be illustrated by the following example: John Jones is president of X corporation and a member of the board of directors. He owns 50,000 shares of X common stock or five percent of the total shares outstanding which are currently selling on the market at five dollars per share. In need of $200,000 Jones offers to sell half his shares to the corporation at eight dollars. The sale is approved by the other five members of the board. Under the *Schoenbaum* test the inquiry would focus on whether Jones was in a position to exercise a "controlling influence" over the board's decision. Such a determination is a difficult one to make. If there are other shareholders owning a much larger percentage of the outstanding stock, then it is arguable that he did

---

170 *See* Swanson v. American Consumer Indus., Inc., 415 F.2d 1326, 1333-34 (7th Cir. 1969); Penn Mart Realty Co. v. Becker, 300 F. Supp. 731, 736 (S.D.N.Y. 1969). ("Just as the board cannot protect shareholder interests where it has been deceived by the outside purchaser, so it will not protect shareholders where . . . a majority of its members have other interests in the transaction.").

171 *See, e.g.,* MODEL BUS. CORP. ACT § 41 (1969) conflict of interest statute limited to directors).

172 For a definition of "affiliate," *see* 17 C.F.R. § 230.405(a) (1971).

173 It also goes beyond the position taken by the Commission in its amicus brief. *See* Bloomenthal, *supra* note 125, at 356.

not have enough power to control the board, and its decision was an independent one. On the other hand, the prestige resulting from Jones' position in the corporate hierarchy and his personal persuasiveness may in fact bear on the board's decision. Moreover, the vote may exemplify corporate logrolling, as each of the other five directors recognizes that one day he may need the key to the corporate treasury. The "conflict of interest" test avoids the difficult inquiry into the independence of the board decision and focuses directly on the ultimate issue, the fairness of the transaction. It recognizes that when the disinterested members of the board are asked to deal with one of their own, they can not always be relied upon to protect the interests of the shareholders.

In one respect the proposed test may not go far enough. Suppose that the shares to be repurchased are not those of Jones but rather belong to an outsider. If the transaction is motivated by a desire to pay off minority shareholders who threaten to sue management for some independent breach of fiduciary duty[174] or to perpetuate the directors' control of the corporation, then there is a conflict of interest. The latter situation is like that in *O'Neill*, to which we are forced to return. The liberalized notions of deception which have emasculated the causation requirement may afford adequate protection. Thus a failure to disclose to the shareholders the colorable motive behind the transaction may be enough to sustain a cause of action. But *Schoenbaum* takes us beyond deception.[175] *Schoenbaum's* treatment of Paribas is not apposite for there the board had no apparent interest in consenting to that sale. No other decisions take us any further, though Judge Bonsal's second opinion in *Entel v. Allen*,[176] and the concurring opinion in *Dasho v. Susquehanna*,[177] if read liberally, do point to liability in a case like *O'Neill* even absent any element of deception. If the disclosure requirements prove ineffective in preventing these abuses, then our test may have to be expanded beyond the traditional conflict of interest situations into the realm of motivation.[178]

---

174 *See* Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir.), *cert. denied*, 389 U.S. 977 (1967).

175 For another decision recognizing "fraud" in the absence of deception, *see* Condon v. Richardson, 411 F.2d 489, 492 (7th Cir. 1969).

176 270 F. Supp. 60, 67-71 (S.D.N.Y. 1967).

177 380 F.2d 262, 267-70 (7th Cir.) (Fairchild, J., joined by Cummings, J.), *cert. denied*, 389 U.S. 977 (1967).

178 For a view that Rule 10b-5 should not operate in the area of motive, *see* Fleischer, *"Federal Corporation Law": An Assessment*, 78 HARV. L. REV. 1146, 1165-66 (1965).

IV. SECTIONS 9 & 10 OF THE 1934 ACT AND THE PREVENTION OF MARKET MANIPULATION—PROTECTION FOR OUTSIDE INVESTORS

A. The Economic Effect of Repurchase

If the market is functioning properly, the market price for any security represents an equilibrium point marking the intersection of the true supply and demand curves for that security. Buying and selling do, of course, affect price in that they are indicia of demand. A substantial increase in buying, reflecting increased demand, absent any corresponding increase in supply, should lead to an increase in market price. This proposition holds true whether the purchaser is an independent investor or the corporation whose stock is being acquired. Thus a large corporate stock repurchase can have a significant impact on the market.[179]

As already indicated, the very act of repurchase or details related to the transaction may themselves be material so as to call into play the disclosure requirements of Rule 10b-5. With the apparent elimination of the privity requirement this duty extends not only to the shareholders who sell their stock to the corporation, but in effect, to all other shareholders as well. For some, this knowledge may convince them to hold on to their stock, either out of a desire to postpone sale and reap the full benefit of any increase in price resulting from the repurchases, or from a calculation that the repurchases reflect some theretofore unperceived value in the stock or will so benefit the corporation as to justify retaining their equity interest. For others, the knowledge may convince them to sell out of a belief that the corporation's entry into the market has created an unstable demand curve and that prices will drop as soon as the corporation has satisfied its need for the stock. Outside investors, those who do not presently own any stock in the corporation, also have an interest in acquiring this information since it relates to the price that they will have to pay to acquire the stock.[180] The affirmative disclosure requirements do not protect them unless they purchase their stock directly from the corporation.[181] But the securties laws do afford them some protection by way of preventing management from manipulating the price of the stock.

---

179 *See, e.g.,* S. Rep. No. 550, 90th Cong., 1st Sess. 5 (1967). A repurchase acts to increase price not only through added demand but also through a reduction in the available supply.

180 *See* Halsey, Stuart & Co, Inc., 30 S.E.C. 106, 112 (1949) ("It is of utmost materiality to a buyer . . . to know that he may not assume that the prices he pays were reached in a free market . . . .").

181 Of course, to the extent that the information is released to shareholders it may well reach the ears of outsiders.

The legitimate goal of corporate management is to maximize the present value of the enterprise by maximizing present and future earnings streams. A concern with the market price of the corporation's stock should be secondary—if the market is operating efficiently, then the price will reflect the successful attainment of that goal. Nevertheless, management is directly attuned to the market's treatment of the stock, and management's objectives may be skewed by the incentives involved in raising the market price. First, increased prices solidify management's position vis-a-vis the shareholders whose primary concern is the value that their holdings will bring on the market. Second, increased prices make it more costly, and hence more difficult, for an outsider to take control of the corporation by way of a tender offer. Third, they help mask any instances of corporate mismanagement. Fourth, if the corporation is to engage in a merger or acquisition, which requires payment by the corporation of its own shares, the number of shares that will have to be paid will be reduced in accordance with any increase in the market price of the shares up to the time of the consummation of the agreement. Fifth, since officers and directors are likely to own stock in the corporation, they can benefit directly from any increase in price to the extent that the law permits them to sell that stock. Finally, increased prices can produce a snowball effect—by making the corporation look more attractive to new investors, they increase demand which raises the market price even higher.

Since corporate repurchases have a direct effect on market price, management may be tempted to have the corporation repurchase some of its stock for the sole purpose of artificially inducing a favorable increase in the price of the stock.[182] By assumption such conduct is "manipulative," a term applying to practices which are intended to disturb an orderly functioning of the market, particularly through the deliberate raising, lowering or pegging of security prices. As contemplated, the transaction is prohibited by Section 9(a)(2) of the 1934 Act.[183] Other provisions of the Exchange Act regulate the time and details of a stock repurchase that is legitimately motivated so as to limit its impact on the market, thereby reducing the opportunity for market manipulation.

B. SECTION 9(a)(2)

Section 9(a)(2) prohibits a person from making any purchases the effect of which is to create actual or apparent active trading in a security or to raise its price if done for the purpose of inducing

[182] *See* Davis v. Pennzoil Co., 438 Pa. 194, 264 A.2d 597 (1970).
[183] 15 U.S.C. § 78i(a)(2) (1970).

others to purchase that security.[184] A corporation is considered to be a "person" for purposes of the 1934 Act,[185] and a substantial stock repurchase program may well have the effect of creating actual or apparent active trading. By its terms 9(a) (2) is only applicable to a security traded on a national securities exchange. However, the Commission has traditionally taken the view that transactions which would violate 9(a) (2) if effected in a registered security would result in a violation of Section 17(a) of the 1933 Act[186] and Section 15 of the 1934 Act[187] if effected in a security that is not so registered.[188]

The key to illegality under 9(a) (2) is the requirement of purpose. In the committee hearings the term "purpose" was said to be synonymous with "intent."[189] The criminal law generally charges one with intent where he has or, under the circumstances, should have knowledge that certain consequences will follow naturally as the result of his acts. But for purposes of 9(a) (2) the term "purpose" cannot be applied so broadly. The large investor making heavy purchases in a particular security can be fairly certain that others will enter the market and so can be said to intend that they do so. But the Exchange Act was not designed to inhibit such conduct. Even if new traders enter the market and raise the price of his holdings, that is not determinative, for this may really be incidental to his primary aim of making a profitable investment. The purpose requirement of 9(a) (2) should not be satisfied unless the prohibited end, inducing others to trade, is the primary objec-

---

184 The full text of § 9(a)(2) is as follows:

"(a) It shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange —

....

"(2) To effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security, for the purpose of inducing the purchase or sale of such security by others."

185 Securities Exchange Act of 1934, § 3(a)(9), 15 U.S.C. § 78c(a)(9) (1970).

186 15 U.S.C. § 77q(a) (1970). Considering the similarity between this section and Rule 10b-5, it seems clear that the transaction would also violate 10b-5.

187 15 U.S.C. § 78o (1970).

188 SEC Securities Act Release No. 2955, Securities Exchange Act Release No. 3505, at 2 (Nov. 16, 1943).

189 *Hearings on S. Res. 84, 56, & 97 Before the Senate Comm. on Banking and Currency,* 73d Cong., 1st & 2d. Sess., pt. 15, at 6510 (1934).

tive to which the activity is directed. Of course, if the party's only aim is to increase the price of the stock through his purchases, the success of which depends in part on others purchasing at that price, then he is likely to be held to have had the proscribed purpose.

Since a corporate repurchase is usually motivated by some legitimate end, such as to the need for stock to fund a stock option plan or a pension fund or to finance a merger or acquisition, Section 9(a) (2) will not pose much of a problem. But if these purchases have been continuous and significant, they may account for a good portion of the trading volume. A problem then arises if the particular corporate need has been satisfied. A termination of the purchase program could result in a considerable diminution of the market price. Management may find it desirable to continue trading in its own stock so as to prevent, postpone or ease the market decline. However, such a course of action is inadvisable. Absent the legitimate purpose to justify the transactions management is likely to be charged with attempting to induce investors to purchase at the supported price.[190] An a fortiori case for finding a violation of 9(a) (2) is where management believes the stock is undervalued, and the repurchase program is directed solely at moving up the market price.[191]

C. Rule 10b-6

Rule 10b-6[192] prohibits those participating in a distribution and those on whose behalf a distribution is being made (including the issuer) from bidding for or purchasing, or attempting to induce others to purchase, the security that is being distributed or the right to purchase that security, as well as any security of the same class and series. Subsection (b) extends the prohibition to those securities into which such security is immediately convertible or exchangeable—a recognition that any enhancement of the market

---

190 *See* Ruder, *Dangers in a Corporation's Purchases of its Own Shares,* 13 Prac. Law., May 1967, at 75, 78; *see also* Russell Maguire & Co., Inc., 10 S.E.C. 332, 347 n.20 (1941).

191 *See* Davis v. Pennzoil Co., 438 Pa. 194, 264 A.2d 597 (1970); *see also* S. Rep. No. 550, 90th Cong., 1st Sess. 5 (1967). Section 10(b) is aimed at preventing manipulative devices, and since this conduct qualifies as "manipulative" under our definition of the term, it appears that this repurchase would violate § 10(b) and Rule 10b-5, quite apart from any violation of § 9(a) (2). *See* Ruder, *supra* note 189, at 80; *see also* Russell Maguire & Co., Inc., 10 S.E.C. 332, 348-49 (1941) (failure by defendants to disclose that they manipulated price of the stock by their purchases held to be a violation of § 17(a) of the 1933 Act).

192 17 C.F.R. § 240.10b-6 (1971). Due to the considerable length of the rule, I shall refrain from including the complete text.

position of the underlying security makes the senior more attractive since it increases the value of the conversion privilege. The rationale of this rule is that the party selling securities in a distribution should not be in a position to facilitate the success of the distribution by making purchases, the effect of which is to maintain or raise the market price to a level which does not adequately reflect existing supply and demand.[193] To this broad prohibition the Commission has grafted a number of exceptions or limitations, necessary for the proper functioning of the market and the distribution process, which are themselves of minimal manipulative potential.

1. Terminology of Rule 10b-6

a. Distribution

The application of Rule 10b-6 turns on the existence of a "distribution," and it is at the commencement of that event that the issuer must call a halt to any stock repurchase program. Unfortunately, the rule lacks any clear-cut definition of the term "distribution," which makes it rather difficult to apply. The far-reaching and undefined scope of the rule was recognized and criticized by the *Special Study of the Securities Market,* which requested a "clarification by the Commission of the intended impact of the rule . . . ."[194] The SEC responded by agreeing to take steps necessary to clarify the situations in which a party falling within the purview of 10b-6 can purchase a given security without violating the rule.[195] But such action has not been forthcoming.

In the context of the Securities Act of 1933 "distribution" is generally taken to be synonymous with "public offering." However, 1933 Act interpretations are not conclusive for the purpose of defining "distribution" under Rule 10b-6.[196] If an offering is exempted from registration under the 1933 Act, it does not follow that there

---

193 *See* Bruns, Nordeman & Co., 40 S.E.C. 652, 60 n.11 (1961), citing Federal Corp., 25 S.E.C. 227, 230 (1947) (pre-10b-6 case finding violation of § 9(a)(2)). In a companion rule, 10b-7, 17 C.F.R. § 240. 10b-7 (1971), the Commission has set out the permissible limits of stabilizing the market during an offering, to offset normal downside pressures. Subsection (a)(viii) of Rule 10b-6 specifically excepts stabilizing transactions not in violation of 10b-7 from the prohibitions of that rule.

194 SEC, REPORT OF THE SPECIAL STUDY OF THE SECURITIES MARKETS, H. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, at 547 (1963) [hereinafter cited as SPECIAL STUDY]; *see id.* at 545-47, 568-69.

195 SEC Special Study Release No. 25 (April 30, 1963).

196 *See* Whitney, *Rule 10b-6: The Special Study's Rediscovered Rule,* 62 MICH. L. REV. 567, 573 (1964).

is an exemption from Rule 10b-6.[197] But the converse is true—that is, offerings registered under the Securities Act are clearly "distributions" with respect to 10b-6. In this type of situation at least one commentator suggests that the commencement of the distribution, and hence the prohibition on purchasing, may be the time of filing the registration statement, which according to Section 5 of the 1933 Act[198] is the time when offers may be legally made.[199] Since that Act permits negotiations between the issuer and the underwriter before that period, it is arguable that the prohibition begins to run as soon as the issuer starts preliminary negotiations with a prospective underwriter with a view to distribution, if that occurs before the filing of the registration statement.[200] This is consistent with the position taken by the SEC staff that the rule is as applicable to one about to distribute as it is to one actually in the process of distributing.[201] Note, however, that in the case of purchases otherwise than on an exchange, underwriters and dealers are given a ten day cushion so that they are not brought within the purview of the rule until ten days prior to the commencement of a distribution, which is defined for these cases as no sooner than the effective date of the registration statement.[202] If this is adequate to protect the market, then perhaps the same rule should be applied to issuers.[203] But this view overlooks the reason for the exception. The ten day rule is not premised on the conclusion that such protection is sufficient, but rather, it recognizes that the dealer making a distribution of an over-the-counter security may well be one who makes the market in that security, and that to prevent trading for any longer period might seriously undercut the market for the security.

Suppose that the offering in question is not one that requires registration under the 1933 Act. Now we are back to the problem

---

197 *See, e.g.*, Bruns, Nordeman & Co., 40 S.E.C. 652, 660 (1961).

198 15 U.S.C. § 77e (1970).

199 Foshay, *Market Activities of Participants in Securities Distributions*, 45 U. VA. LAW REV. 907-920 (1959).

200 *See* Duff & McDonald, *Trading and Stabilizing in Distributions, Particularly Rule* 10b-6, in S.E.C. PROBLEMS OF CONTROLLING STOCKHOLDERS AND IN UNDERWRITERS 245 (C. Israels ed. 1962).

201 *See* Letter from Philip A. Loomis, Jr., Director of the Division of Trading and Exchanges of the SEC, to Edward H. Ladd, III, of The First Boston Corporation, March 27, 1958, cited in Foshay, *supra* note 199, at 920-21 & n.52. President Nixon has recently appointed Mr. Loomis to the Securities Exchange Commission.

202 17 C.F.R. § 240.10b-6(a)(3)(xi) (1971).

203 *See* Comment, *The SEC's Rule 10b-6: Preserving a Competitive Market During Distributions*, 1967 DUKE L.J. 809, 847-48.

of determining what constitutes a distribution for purposes of 10b-6. Several SEC decisions indicate that 10b-6 will be called into play if securities are sold pursuant to a "major selling effort."[204] Once again, we lack a precise definition, though the Commission has indicated that a "major selling effort" depends on the size of the offering and the sales methods utilized;[205] however, this does not mean that "any special retail selling effort" is essential.[206] As to the former, both the absolute number of shares to be marketed and the relationship of that number to the total shares outstanding should be considered. The number of intended offerees may also be relevant. Sales methods that might characterize "a major selling effort" include use of high pressure sales tactics, payment of special commissions, engagement of broker-dealers for the specific purpose of placing bids in the sheets,[207] and sales over-the-counter for a listed security.[208] The presence of a formalized selling group may be indicative of a "major selling effort," but this is not necessary,[209] and 10b-6 has been applied where only one broker-dealer was involved in the distribution.[210]

Although the preceding discussion is particularly applicable to an offering of securities for cash, the term "distribution" is not so limited. Thus, if a corporation offers its shares to stockholders of another corporation pursuant to a merger or acquisition agreement 10b-6 may be called into play.[211] This interpretation appears quite reasonable. Absent such control the acquiring corporation could repurchase its shares so as to jack up the market price in order to make its proposal more attractive or reduce the number of shares which it must offer in exchange for the assets or shares of the acquired corporation.

A corporation may resume repurchasing its stock when the distribution comes to an end. It is generally held that a distribution

---

204 *See, e.g.*, Gob Shops of America, Inc., 39 S.E.C. 92, 103 n.25 (1959).

205 *See* Bruns, Nordeman & Co., 40 S.E.C. 652, 660 (1961).

206 Pennaluna & Co., SEC Securities Exchange Act Release No. 8063 (April 27, 1967).

207 *See, e.g.*, Tager v. SEC, 344 F.2d 5 (2d Cir. 1965).

208 *See* Disclosure Requirements, *supra* note 39, § 3.701, at 131 (statement of Llewellyn P. Young); 3 Loss, *supra* note 76, at 1597; *see also* Theodore A. Landau, 40 S.E.C. 1119, 1125 (1962).

209 *See, e.g.*, Sidney Tager, SEC Securities Exchange Act Release No. 7368 (July 14, 1964), *aff'd* 344 F.2d 5 (2d Cir. 1965).

210 *See* Batten & Co., Inc. v. SEC, 345 F.2d 82 (D.C. Cir. 1964).

211 *See, e.g.*, Miller v. Steinbach, 268 F. Supp. 255, 280 (S.D.N.Y. 1967); SEC v. Georgia-Pacific Corp., [1964-66 Transfer Binder] CCH Fed. Sec. L. Rep. ¶91,692 (S.D.N.Y. 1966).

does not end until the block of securities being offered finally "comes to rest in the hands of the investing public."[212] This requirement is not satisfied where shares are left with "insiders" of trading firms or others with a view to the ultimate resale of the shares by or through such firms.[213] Nor is it sufficient for a corporate issuer to leave shares with officers, directors or affiliates, or with their friends or relatives, with an understanding that they will immediately dispose of the shares or that the corporation will repurchase the shares from them.[214] Thus in *Mayo & Co., Inc.*[215] the Commission attacked an agreement made by sellers to repurchase within one month shares distributed in a Regulation A offering on the ground that the repurchase agreement was a bid in violation of 10b-6 and that the securities never did come to rest. Similarly, in *R. A. Holman & Co., Inc. v. SEC*[216] the Second Circuit held that where a firm sold a large portion of the distribution to its controlling stockholder and his relatives, and repurchases of those shares were begun almost immediately, that the short time span between the initial sale and repurchase were indicative of "a preconceived plan with manipulative effects."

A special problem arises in the case of warrants and convertible securities. Once the warrants or conversion privilege become exercisable, there is an "offer" of the obtainable security, as the term is defined in Section 2(3) of the 1933 Act,[217] even if registration of that security was not required upon the offering of the warrants or senior securities. Thus it appears, and current SEC policy would hold,[218] that there is a distribution of the underlying security until all warrants and conversion privileges have been exercised or have expired. This is particularly troublesome in that such rights or privileges could last for several years which would seem to place a prohibitive restriction on a corporation's power to repurchase its

---

212 R. A. Holan & Co., Inc. v. SEC, 366 F.2d 446, 449 (2d Cir. 1966), *amended on rehearing,* 377 F.2d 665 (2d Cir.), *cert. denied,* 389 U.S. 991 (1967).

213 *See* SEC Securities Act Release No. 4150, Securities Exchange Act Release No. 6097, at 3 (Oct. 23, 1959).

213 *See* SEC Securities Act Release No. 4150, Securities Exchange Act Release No. 6097, at 3 (Oct. 23, 1959).

214 *See, e.g.,* Batten & Co., Inc. v. SEC, 345 F.2d 82, 84 (D.C. Cir. 1964).

215 41 S.E.C. 944, 947 (1964).

216 366 F.2d 446, 450 (2d Cir. 1966), *amended on rehearing,* 377 F.2d 665, *cert. denied,* 389 U.S. 991 (1967).

217 15 U.S.C. § 77b(3) (1971).

218 *See* Loomis, *Purchases By a Corporation of Its Own Securities,* 22 RECORD OF N.Y.C.B.A. 275, 278 (1967); *cf.* Rule 155, 17 C.F.R. § 230.155 (1971).

own shares. At least one critic of this policy suggests that it is inequitable because the corporation lacks control over when the rights and privileges will be exercised by their holders.[219] This overlooks the fact that a corporation could use a repurchase plan to manipulate the price of the underlying security so as to induce those parties to exercise their rights and privileges. But such action by the corporation would constitute a clear violation of Section 9(a)(2), and the cumulative protection resulting from the application of Rule 10b-6 to such cases would seem unnecessary if not undesirable. Moreover, where the repurchases are of a limited scope and pursuant to a continuing repurchase program aimed at supplying shares for an employee option or pension plan, particularly where conducted by an independent trustee, the manipulative potential is minimal. It seems especially unfair to deprive the employees of their benefits for any protracted period of time, and to subject them to the adverse effects of higher prices resulting from stepped-up purchases upon removal of the 10b-6 prohibition.[220] Hence, there is a real need for explicit guidelines in this area to limit the scope of 10b-6.[221] In the absence of such guidelines one possible limitation of the restriction is to hold that there is no distribution despite the de jure exercisability of the warrants or conversion privilege if they are not exercisable de facto—that is, if the current market price of the stock makes their exercise unreasonable. When Philip A. Loomis, Jr. was General Counsel of the SEC he expressed his belief that the Commission would be unlikely to raise any objection to purchases made by an issuer under such circumstances.[222]

b. Issuer

Another problem regarding 10b-6 involves the administrative construction of the term "issuer" which appears in subsection (a)(2). Clearly it applies to the corporation whose shares are being distributed. The SEC staff has interpreted the term so as to apply it to officers, directors and controlling shareholders, thereby forbidding trading by these classes when the corporation is so prohibited. This position was stated in an SEC release[223] wherein the SEC proposed

---

219 Comment, *supra* note 203, at 852-53.
220 *See* Foshay, *supra* note 199, at 933-34.
221 For a proposed amendment to Rule 10b-6, discussed at p. 257 *infra*, see SEC Securities Exchange Act Release No. 8920 (July 13, 1970); *see also* SEC v. Georgia-Pacific Corp., [1964-66 Transfer Binder] CCH FED. SEC. L. REP. ¶91,692 (S.D.N.Y. May 24, 1966) (consent decree); Genesco, Inc., [1964-66 Transfer Binder] CCH FED. SEC. L. REP. ¶77,354 (May 10, 1966) (prospectus).
222 Loomis, *supra* note 218, at 278.
223 SEC Securities Exchange Act Release No. 5415 (Dec. 5, 1956).

an amendment to 10b-6 to make its policy explicit, but the proposed rule was never adopted. This leaves the matter in a state of limbo. One source indicates that the matter was dropped because of substantial opposition to the proposal on the grounds that it "would impede legitimate transactions and was unnecessary."[224] Nevertheless, it appears that the SEC staff continues to follow this position.[225] If officers, directors and controlling shareholders are equated with the issuing corporation for purposes of 10b-6, the effect is not limited to restricting purchases by those groups during a period in which the corporation is distributing its securities. Carrying it to its logical extension the corporation would be prohibited from repurchasing its shares while any officer, director or controlling shareholder is distributing his holdings in the corporation. The rationale for such a restriction is that an insider could use his position in the corporation to institute a repurchase program in order to manipulate the market, thereby facilitating distribution of his shares at the desired price.[226] While such conduct is not to be condoned it is questionable whether the benefit to be gained from such a rule outweighs the cost in further emasculating the repurchase power. Perhaps a "purpose" requirement, like that of Section 9(a)(2), is all that is needed. Thus where there is a legitimate corporate purpose underlying the repurchase program the repurchases should be permitted despite a distribution by an officer, director or controlling shareholder.

2. Rule 10b-6 Exceptions

Several of the 10b-6 exceptions are applicable to the issuing corporation. Subsection (a)(ii) permits large private purchases not effected through a broker or dealer, provided the purchases are not solicited by the corporation. If the corporation is required to repurchase securities to satisfy a sinking fund or similar obligation, these purchases may be made forty days after the commencement of the distribution.[227] In 1955 the rule was amended by adding

---

224 Foshay, *supra* note 198, at 926.

225 *See* DISCLOSURE REQUIREMENTS, *supra* note 39, at § 3.704, at 136 (statement of Irving M. Pollack, Dir., Div. of Trading & Markets, SEC).

226 *See id.* § 3.705, at 137 (statement of Melvin Katz.). This would be a violation of Rule 10b-5 as well. *But cf.* Comment, *supra* note 203, at 838 n.135 ("The inference to be drawn from the current policies behind regulation of unregistered secondary distributions is that application of 10b-6 to these situations is intended to curb only the market activities of broker-dealers. No indication has been given that an issuer will be prosecuted for an inadvertent bid or purchase during such an offering.").

227 17 C.F.R. § 240.10b-6(a)(3)(iii) (1971).

subsection (e) so that it no longer applies to a distribution of securities to the issuer's employees, those of its subsidiaries, or a trustee acting in their behalf pursuant to a stock purchase plan calling for periodic payments and purchases or a "qualified" option or purchase plan consistent with the definitions appearing in Sections 422, 423 and 424 (b) of the Internal Revenue Code. There is no analogous exception permitting repurchases to supply stock for these plans if the issuer is otherwise engaged in a distribution of its securities. This statement may be qualified by the last provision worthy of note, subsection (f), which gives the Commission the power to make ad hoc exemptions from Rule 10b-6, either unconditionally or under specified conditions. When originally promulgated subsection (f) was intended to apply "only on rare occasions"—that is, to those "unusual situations which may fall within the literal language of [Rule 10b-6] but can be demonstrated not to be comprehended within its purpose."[228] Fortunately, however, the Commission has been much more liberal in granting exemptions, specifically where the repurchases are aimed at providing stock to satisfy the requirements of employee option and pension plans.[229] In granting such exemptions the SEC will generally place limits on the purchases in order to minimize the manipulative potential. A strong argument may be made for granting a complete exemption under subsection (f) where the purchases are for a benefit plan administered by a trustee independent of the control of the corporation who has complete discretion as to the time, price and extent of purchases for there is no reason to fear that such purchases will be manipulative.[230] In a 1964 "no action" letter, the SEC staff indicated that it would not recommend any action by reason of purchases by such an independent trustee during the course of a corporate distribution.[231] But in 1966 the Commission reversed its position.

Two proceedings concluded in 1966 are declarative of the Commission's revised thinking about Rule 10b-6 and its application to purchases for employee benefit plans. The SEC brought a complaint against Georgia-Pacific Corporation alleging that while the company was engaged in an exchange offer and a merger in which

---

228 SEC Securities Exchange Act Release No. 5194, at 3 (July 5, 1955).

229 *See generally* Foshay, *supra* note 199, at 934-37.

230 *See* Comment, *supra* note 203, at 837-39.

231 *See* Baker, *Purchases By a Corporation of Its Own Shares For Employee Benefit Plans*, 22 Bus. Law. 439, 447 (1967); Comment, *supra* note 203, at 837 and n.131, citing Memorandum to Clients by Sullivan & Cromwell, at 13, May 12, 1966.

its stock was to be issued, purchases of Georgia-Pacific stock were being made for employee bonus plans in such manner as to raise the price of the stock in order to reduce the company's obligation to pay additional shares.[232] (The number of shares to be paid by Georgia-Pacific for these acquisitions was to be determined by the market price of Georgia-Pacific stock at certain valuation periods.) Since the acquisition plans constituted "distributions" within the meaning of Rule 10b-6, the stock repurchases made during this period violated the Rule. The defendants acceded to a judgment which set out certain conditions under which future repurchases were to be made.[233] Where no distribution is in progress the weekly repurchases can not exceed ten percent of the weekly trading volume averaged during the preceding four weeks, and daily repurchases may not exceed fifteen percent of the average daily volume during the same period. Purchases are to follow, rather than lead, the market. That is, only one broker is to be used at a time, no purchases or bids are to be made at the opening of the New York Stock Exchange, or within one hour of closing, and no bid may be placed or purchase made at a price exceeding the last sale price or the highest current independent bid. The corporation may also make unsolicited private purchases of 1,000 or more shares; however, if they are made through a broker or dealer, the price may not exceed the price on the New York Exchange. Upon the commencement of serious negotiations aimed at some acquisition agreement requiring the exchange of Georgia-Pacific shares, the corporation must advise the other party of any repurchases undertaken on its own behalf, through trusts or employee plans, or by officers, directors or ten percent shareholders. Repurchases must cease during a distribution, and in the case of the acquisition plan, as soon as an agreement in principle has been reached, regardless of whether or not there is a formal contract. This complete prohibition will last until there is a vote of the shareholders of the acquired corporation, if such vote is required, or until the number of shares of Georgia-Pacific stock to be exchanged is fixed by a binding contract.[234] If the exchange offer is subject to registra-

---

232 SEC v. Georgia-Pacific Corp., [1964-66 Transfer Binder] CCH FED. SEC. L. REP. § 91,680 (April 27, 1966) (complaint).

233 *Id.* at ¶91,692 (S.D.N.Y. May 24, 1966) (consent decree).

234 Suppose that the contract calls for the payment by Georgia-Pacific of certain additional shares sometime in the future depending upon the earnings performance of the corporation and the market performance of its stock during that period. Arguably, the number of shares to be exchanged is not fixed until the end of this period so that the distribution is not over, and the absolute prohibition on trading in its

tion under the 1933 Act, then the prohibition will cease when the offer is finally terminated. The employee benefit plan received special treatment. The Commission found that the original trustees were not independent of the control of the corporation, and provision was made for the appointment of a truly independent fiduciary. When there is no distribution, the trust is subject to the same limitations as the corporation, except that its daily purchases may not exceed ten percent of the average daily volume. Although purchases by the trust are credited to the corporation in determining whether repurchases by the corporation are within the permitted boundaries, the trust is not limited by other purchases by Georgia-Pacific. And the trust is not obligated to get out of the market during a distribution, nor is it required to give notice of its purchases to one about to receive Georgia-Pacific stock in an exchange offer.

The second proceeding involved Genesco, Inc. The SEC brought no formal action against Genesco but held up the effectiveness of a registered public offering of Genesco common stock by certain shareholders until requested disclosures had been made in the prospectus and the corporation had agreed to restrict future repurchases in accordance with terms specified by the Commission.[235] The disclosures involved the fact that during the period between January 1, 1961, and October 29, 1965, substantial amounts of Genesco common stock had been purchased for two employee stock purchase plans and a retirement trust[236] while the corporation exchanged over one million of its shares for stock and assets of other companies, and that these transactions may have resulted in violations of Rules 10b-5 and 10b-6. The restrictions were very similar to those placed on Georgia-Pacific, the only differences being that the daily and weekly volume limitations were twenty percent and fifteen percent respectively, and the Commission used the phrase "definite arrangement" rather than "agreement in principle" to define the beginning of the absolute prohibition on trading. The effect of these restrictions is to minimize the impact of the repur-

own shares continues in effect. The decree in the *Georgia-Pacific* case is not clear on this point. However, a preferable reading of the case would permit the corporation to repurchase its stock during this period pursuant to the limitations specified therein.

235 Genesco, Inc., [1964-66 Transfer Binder] CCH. FED. SEC. L. REP. ¶77,354 (prospectus of May 10, 1966).

236 For the 58-month period these purchases comprised approximately 75 percent or more of the total reported trading in Genesco stock during 4 of the months, 50 percent or more during 19 months, and 25 percent or more during 43 months.

chases, thereby limiting their usefulness as a device for manipulating the market. In so acting, the Commission has recognized implicity that adequate disclosure, by itself, may not be sufficient to provide the necessary degree of market insulation.[237]

V. SECTION 16(b) AND INSIDER TRADING— FURTHER PROTECTION FOR THE CORPORATION AND ITS SHAREHOLDERS

In the context of the earlier discussion of Rule 10b-5 it was recognized that corporate insiders having access to material information unavailable to the market in general (including knowledge of a substantial stock repurchase) have an unfair advantage over those investors who sell to or purchase from the insiders, absent disclosure of the information. Rule 10b-5 provides a remedy for investors injured by such transactions, one that is predicated on the inherent unfairness of the situation.[238] Rule 10b-5 also protects the corporation whose insiders use their positions of power to induce the corporation to repurchase its shares, which repurchase is unfair to the corporation.[239] Section 16(b) of the 1934 Act[240] provides yet another remedy and disincentive to insider trading.

Unlike 10b-5, 16(b) is not based on any notion of fairness. It is merely a prophylactic, a crude rule of thumb. It does not require that the insider, defined as an officer, director or beneficial owner of more than ten percent of any registered equity security, actually possess any inside information. Rather, it recognizes the difficulty of proving the use of inside information and makes the unrebuttable presumption that the insider has such information. Section 16(b) then deters him from using it by compelling him to account to the corporation for any profits realized on the sale of any stock in the

---

237 *See* Loomis, *supra* note 77, at 684.

238 *See generally* Part II, pp. 196-211 *supra*.

239 *See generally* Part III, pp. 211-24 *supra*.

240 15 U.S.C. § 78p(b) (1970):

"For the purpose of preventing the unfair use of information which may have been obtained by [a beneficial owner of more than ten percent of any class of equity security registered pursuant to Section 78Z], director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months, . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . ."

corporation that has been held for less than six months.[241] Thus an insider who induces the corporation to purchase a block of his shares at a price exceeding that of the market must account for any profits resulting from the subsequent purchase of shares at the lower market price, if made within six months. (He must also account for profits if he purchased any shares within six months of the sale to the corporation.) Section 16(b) applies both to private sales and sales on the market. And the insider can not circumvent the operation of the rule by causing the corporation to repurchase its shares by way of a "tender offer," for it has been held that an acceptance of an offer by the issuer to tender shares is a "sale" for the purposes of 16(b).[242]

VI. THE REGULATION OF TENDER OFFERS—THE IMPACT OF THE WILLIAMS ACT

A. Tender Offer as a Means of Repurchase

A corporation that intends to repurchase its stock, for whatever reason, need not go to established trading markets or rely on private purchases. Instead, the corporation may make a "tender offer." A tender offer consists of a notice to shareholders inviting them to submit all or part of their holdings in exchange for a specified amount of cash, property or other securities. The offer is limited to a stipulated period, though the corporation may retain an option to extend this period. It may be a firm offer, obligating the corporation to purchase all shares tendered pursuant to the offer, or it may be conditional, permitting the corporation to withdraw the offer under certain circumstances, such as a significant decrease in the market price of the stock or the inadequacy of the number of shares being tendered, or, if the number of tendered shares exceeds that requested by the corporation, allowing it to take not more than the number requested, perhaps on a pro rata basis. Shareholders desiring to sell their shares to the corporation must deposit their shares with designated transfer agents. For them the deposit is irrevocable, and they cannot call back their shares if a subsequent rise in the market price makes the tender unprofitable.

Use of a tender offer may have certain advantages over open market transactions. For example, if the corporation's stock is traded in only small quantities, it may be impossible for the corpo-

---

241 *See* Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

242 Blau v. Allen, 163 F. Supp. 702 (S.D.N.Y. 1958).

ration to purchase a sufficient number of shares, at least within the desired time period. And time may be crucial, particularly if the shares are needed to finance an acquisition program. Even if an ample number of shares is available on the market, the corporation may be unable to make the requisite purchases for fear that it will be charged with manipulating the market. The tender offer may also be preferable to private purchases. If the intended sellers are corporate insiders, who are likely to own a substantial portion of the outstanding stock, then to the extent the terms are favorable to these insiders, they run the risk of a 10b-5 action. By couching the repurchase in the form of a tender offer, thereby opening up the repurchase to all shareholders, management does much to neutralize a claim of unequal opportunity and breach of a fiduciary duty, particularly if the corporation agrees to pick up the tendered shares on a pro rata basis.

There is one major disadvantage to making the repurchase by way of a tender offer. In order to acquire the desired number of shares, the corporation's offer will generally exceed the going market price of the stock, the premium varying from case to case. Thus the tender offer may be a relatively expensive way of reacquiring stock. But since excess assets might otherwise be distributed as dividends, taxable as ordinary income, there is certainly ample justification for electing the tender offer method of repurchase.

B. The Williams Bill

1. *Section 14(d)*

In 1968, as part of the Williams Bill, Congress amended Section 14 of the 1934 Act by adding 14(d)[243] which deals explicitly with tender offers. The real concern of those sponsoring the amendment was not the regulation of tender offers per se, but rather the regulation of cash tender offers as they became synonymous with "takeover bids," a means by which an outside group could acquire control of a publicly held corporation, absent support of the incumbent management. Section 14(d) requires a person making a tender offer for registered securities to disclose certain relevant information to the Commission and to the issuing corporation, the requested information being set out in Section 13(d).[244] Because the concern was with corporate takeovers, Congress excluded tender offers by the issuer from the scope of 14(d).[245] (At least this seems to be a

243 15 U.S.C. § 78n(d) (1970).

244 15 U.S.C. § 78m(d) (1970); *see* Schedule 13D, 17 C.F.R. § 240.14d-1 (1971).

245 15 U.S.C. § 78n(d)(8)(C) (1970).

reasonable explanation, and no one has suggested an alternative.) Congress did add Section 13(e) which deals specifically with corporate stock repurchases (and which will be discussed in detail in the next section), but 13(e) is not self-operative, and it relies on the adoption of rules by the SEC. Most of the information required by 13(d) is not relevant to the issuer, and surely the issuer could not be required to deliver information to itself. Yet there is important information which might not be included in the published or delivered request for tender unless otherwise required. One obvious example is information related to the purpose underlying the repurchase transaction, which, as previously indicated, may be material to the selling shareholder. This is analogous to the information required of the outside tenderee as to his intentions for the company.[246]

There is a more compelling reason for applying 14(d) to the corporate issuer. Section 14(d) does not stop with its disclosure requirements. It goes on to prescribe rules governing the form of the tender offer. Subsection (d)(5) makes a tender by shareholders revocable up to seven days after copies of the offer are published or given or sent to shareholders. This gives shareholders who tender immediately after the offer is made an opportunity to reconsider. The subsection also provides that the shareholders may withdraw tendered shares after sixty days, thereby preventing the securities from being frozen for too long a period while the party making the offer decides whether or not he will purchase them. This deters the latter from holding the offer open in order to watch the market activity; otherwise he might postpone his decision if it appears that the market price will exceed the offering price. And the Commission is given the power to alter these time periods. According to the Committee report, this may be called for if corrective material is required, in which case the shareholders might need more than seven days to evaluate the new information.[247] Subsection (d)(6) provides that where the number of securities deposited during the first ten days exceeds that which the person making the offer is bound or willing to accept, then those deposited shares must be taken up on a pro rata basis in accordance with the number deposited by each tendering shareholder.[248] This insures that the shareholders will have time to contemplate the offer. They

---

246 15 U.S.C. § 78m(d)(1)(C) (1970).

247 S. REP. No. 550, 90th Cong., 1st Sess. 10 (1967).

248 A similar rule was adopted by the New York Stock Exchange before the enactment of the Williams Bill. N.Y. STOCK EXCHANGE COMPANY MANUAL A-180 (1963).

ought not feel that they must rush in without thinking or lose the opportunity to tender their shares. This also protects shareholders who do not immediately learn of the offer. Should the person making the offer increase the consideration, then a new ten-day pro rata period will start to run, thereby insuring that all shareholders will have a fair chance to participate in the offer. Finally, subsection (d) (7) requires that if the consideration offered is increased, that increased consideration must be paid to all shareholders whose shares are accepted, whether or not they tendered their shares after the increase was announced. This assures equal treatment for all shareholders.

The aforementioned provisions are all designed with one thing in mind—"fairness"—fairness between the party making the offer and the tendering shareholder and fairness among the shareholders themselves. It seems somewhat anomalous to place such limitations on tender offers made by outsiders and to afford a lesser degree of protection when the offer is made by the issuing corporation to effectuate a repurchase program. Absent such limitations, corporate insiders having knowledge of the favorable terms of the offer could tender their shares immediately, thereby giving them an advantage over those other shareholders who, by taking the time needed to give the offer serious consideration, may lose the opportunity to tender their shares. Similarly, corporate insiders could refrain from tendering their shares when the offer is first made, with the knowledge that the corporation will eventually raise the price offered for the shares. Where equality and fairness among shareholders is at issue, traditional doctrines of corporate law suggest that the corporation, and not outside purchasers, will be held to the higher standard. But by excluding corporate repurchases from the operation of Section 14(d), Congress has opted for the contrary result.

2. Section 14(e)

Section 14(e),[249] which was also added by the Williams Act, does apply to tender offers made by the issuing corporation.[250] This section is a general anti-fraud provision, paralleling Rule 10b-5, which applies specifically to the tender offer context. Rule 10b-5 case law is relevant to the interpretation and application of 14(e). In the first appellate decision construing the 1968 amendments, *Electronic Specialty Co. v. International Controls Corp.*,[251] the

---

[249] 15 U.S.C. § 78n(e) (1970).

[250] Unlike 14(d), 14(e) is not limited to tender offers for registered securities.

[251] 409 F.2d 937 (2d Cir. 1969).

Second Circuit recognized the existence of a private right of action under 14(e). Section 14(e) goes beyond 10b-5, as presently interpreted, on the question of standing to sue. Since a nontendering shareholder is not a purchaser or seller in a tender offer, he may not be able to sue under Rule 10b-5.[252] But the Second Circuit held that he would have standing under 14(e).[253] The court also held that an application for a preliminary injunction is an appropriate occasion to adjudge Section 14 questions. Under the facts of the *Electronic Specialty* case the court did not feel that the lower court abused its discretion in denying equitable relief because of the considerable hardship this would impose on the defendant. However, if the defendant in a future case is the issuing corporation, which is less likely to suffer irreparable injury as the result of equitable relief, a court may be less solicitous.

Corporations that choose the tender offer method for repurchasing their stock should pay close attention to the development of the law under 14(e) for the escape from 14(d) written into the statute could be illusory. To the extent that the aforementioned provisions of 14(d) constitute a Congressional recognition of "fair play" in the tender offer area, any offer not meeting that standard may be held actionable. Certainly state courts may adjust state substantive law to take account of the federal standards for permissible conduct.[254] But even beyond this, federal courts could apply 14(e) so as to require adherence to the standards of 14(d) for all parties making a tender offer. It is not beyond reason to treat a tender offer as a "fraudulent, deceptive, or manipulative act or practice," if the offer is made at one price, with an undisclosed intention to raise the

---

[252] *See, e.g.,* Allied Artists Pictures Corp. v. D. Kaltman & Co., 283 F. Supp. 763, 765 (S.D.N.Y. 1967). In Iroquois Indus., Inc. v. Syracuse China Corp., 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied,* 399 U.S. 909 (1970), the court viewed the addition of 14(e) as an indication that neither the outside tender offeror nor the target corporation had standing to sue under Rule 10b-5. *But see* Boggess v. Hogan, 328 F. Supp. 1048 (N.D. Ill. 1971); Moore v. Greatamerica Corp., 274 F. Supp. 490 (N.D. Ohio 1967) (target corporation has standing to sue for injunction).

[253] 409 F.2d at 946.

[254] *See* Israels, *supra* note 24, at 766; *cf.* Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969). *But cf.* Securities Exchange Act of 1934, § 27, 15 U.S.C. § 78aa (1970). An analagous development has taken place in the area of proxy regulations. *See, e.g.,* Wyatt v. Armstrong, 186 Misc. 216, 59 N.Y.S.2d 502 (Sup Ct. 1945); Levy v. Feinberg, 29 N.Y.S.2d 550, 557-58 (Sup. Ct. 1941), *rv'd on other grounds sub nom.* Levy v. America Beverage Corp., 265 App. Div. 208, 38 N.Y.S.2d 517 (1942); *see generally* Loss, *The SEC Proxy Rules and State Law,* 73 HARV. L. REV. 1249, 1263-77 (1960).

consideration at some future date, thereby benefiting insiders who hold on to their stock until the consideration is increased. And the same may be said about a tender offer in which the corporation intends to put off the termination date until the market price has increased sufficiently to wipe out the premium, thus freezing the tendered shares for an inordinate length of time, or a non-prorata offer, which gives a decided advantage to corporate insiders. In the latter case, the tender offer form could mask what would otherwise be a private repurchase of shares from insiders at a substantial premium—a transaction which, but for the "disguise," might have been challenged as a violation of Rule 10b-5 under the *Schoenbaum* line of cases. Thus the courts may incorporate the 14(d) guidelines into 14(e) and use them as a rule of thumb for determining actionable instances of corporate mismanagement.

The SEC has already demonstrated its interest in promoting fairness among shareholders in the tender offer context by its adoption of Rule 10b-13.[255] Under the terms of this rule a party making a cash tender offer for certain securities is forbidden from purchasing any of those securities otherwise than pursuant to that tender offer.[256] That party is also prohibited from going to the open market to purchase securities that are immediately exchangeable for or convertible into those securities. The avowed purpose of the Commission, as stated in the initial release on 10b-13, was to "safeguard the interests of the persons who have tendered their securities in response to the tender offer."[257] Since the rule was promulgated under Section 10(b) rather than 14(d), it applies to the issuing corporation.[258] Thus 10b-13 prevents a corporation from paying one price to minority shareholders who tender their shares pursuant to the offer and a higher price to corporate insiders whose shares,

---

255 17 C.F.R. § 240.10b-13 (1971).

256 As originally proposed the rule would have allowed open market purchases so long as tendered shares were picked up at the tender offer price or at the highest open market price paid by the party making the tender offer, whichever was higher. SEC Securities Exchange Act Release No. 8391 (Aug. 30, 1968). The rule now applies to exchange offers as well as cash tender offers. For a criticism of the application of 10b-13 to exchange offers see Lowenfels, *Rule 10b-13, Rule 10b-16 and Purchases of Target Company Securities During an Exchange Offer*, 69 COLUM. L. REV. 1392 (1969).

257 SEC Securities Exchange Act Release No. 8391 (Aug. 30, 1968).

258 Under subsection (c) certain purchases by the issuing corporation are excluded from the general prohibition of the rule. These include purchases for specified types of employee benefit plans, the same types of plans exempted from Rule 10b-6. Subsection (d) is a saving clause for ad hoc exemptions by the Commission and is identical to 10b-6(f).

absent the rule, could be picked up by some other means during the term of the offer. Of course, unless the requirements of 14(d) are brought within the scope of 14(e), as has been suggested, corporate management could circumvent the rule by revising the original offer so as to increase the consideration offered for the shares. If the insiders then tender enough shares to bring the total over the limit requested by the corporation, they can effectively prevent minority holders from receiving the increased consideration. Rule 10b-13 does not prevent the corporation from waiting until after the termination of the offer to purchase insider shares at a higher price. But a failure to disclose this intention to the tendering shareholders is likely to be held a material omission in violation of 14(e).

VII SECTION 13(e) AND THE FUTURE OF CORPORATE STOCK REPURCHASES UNDER THE EXCHANGE ACT

Despite an overriding concern with the regulation of cash tender offers, the proponents of the Williams Bill recognized the increasing frequency of corporate stock repurchases and the marked impact that such activity was having on the securities market. Their concern prompted the adoption of another amendment to the 1934 Act, which is now Section 13(e).[259]

---

[259] 15 U.S.C. § 78m(e) (1970):

"(1) It shall be unlawful for an issuer which has a class of equity securities registered pursuant to section 78Z of this title, or which is a closed-end investment company registered under the Investment Company Act of 1940, to purchase any equity security issued by it if such purchase is in contravention of such rules and regulations as the Commission, in the public interest or for the protection of investors, may adopt (A) to define acts and practices which are fraudulent, deceptive, or manipulative, and (B) to prescribe means reasonably designed to prevent such acts and practices. Such rules and regulations may require such issuer to provide holders of equity securities of such class with such information relating to the reasons for such purchase, the source of funds, the number of shares to be purchased, the price to be paid for such securities, the method of purchase, and such additional information, as the Commission deems necessary or appropriate in the public interest or for the protection of investors, or which the Commission deems necessary or appropriate in the public interest or for the protection of investors, or which the Commission deems to be material to a determination whether such security should be sold."

"(2) For the purpose of this subsection, a purchase by or for the issuer or any person controlling, controlled by, or under common control with the issuer or a purchase subject to control of the issuer or any such person, shall be deemed to be a purchase by the issuer. The

A. OBSERVATIONS ABOUT SECTION 13 (e)

Section 13 deals generally with reports by issuers of securities registered under Section 12.[260] Section 13 (e), however, is not a reporting provision, though its implementation will probably result in the disclosure of certain information to shareholders of the corporation engaged in a repurchase. Rather, it is an anti-fraud provision. As initially proposed by the Senate, 13 (e) could have been construed as going beyond the prevention of fraud, thereby permitting the SEC to adopt rules "necessary or appropriate in the public interest or for the protection of investors" which are not designed solely for the prevention of fraudulent, deceptive or manipulative practices.[261] The House picked up this ambiguity in construction and revised the section so as to limit its scope to the prevention of fraud.[262]

Another important observation about the scope of 13 (e) is that the section is not self-operative. It does not require the corporate purchaser to do anything, nor does it prohibit him from doing anything. Instead, it relies completely on the SEC to promulgate rules and regulations controlling corporate stock repurchases in a manner consistent with the section. Section 13 (e) calls for two types of rules: (1) definitional rules, to clarify the types of acts that are regarded as fraudulent, deceptive or manipulative; and (2) prescriptive rules, to specify means for preventing such acts. The section also suggests those categories of information that are prima facie material, the disclosure of which might be required by the Commission in furtherance of the specified objective. The listed categories include the number of shares to be repurchased, the reasons for such repurchase, the price to be paid, the source of funds, and the method of repurchase. These are not meant to be exhaustive. Perhaps Congress can be faulted for not requiring disclosure of this information, rather than leaving it up to the SEC to implement the suggestion, a position which would have been consistent with what was done in Sections 13 (d) (1) and 14 (d) (1). Although

---

Commission shall have power to make rules and regulations implementing this paragraph in the public interest and for the protection of investors exemptive rules and regulations covering situations in which the Commission deems it unnecessary or inappropriate that a purchase of the type described in this paragraph shall be deemed to be a purchase by the issuer for purposes of some or all of the provisions of paragraph (1) of this subsection."

The last sentence of paragraph (2) was added in 1970.

[260] 15 U.S.C. § 781 (1970).

[261] *See* S. REP. No. 550, 90th Cong. 1st Sess. 8-9 (1967).

[262] H. REP. No. 1711, 90th Cong., 2d Sess. 7 (1968).

no reason is suggested for this approach, it is not indefensible. The House expressed a strong aversion to interfering with "the legitimate purchase by the issuer of its own securities for normal activities." And it may be that for some isolated transactions involving repurchases of small amounts of securities, some of the suggested information is immaterial. Moreover, the cost of requiring disclosure to all shareholders could be so prohibitive, considering the size of the transaction, as to prevent the issuer from making the repurchase.[263] Section 13(e) does not distinguish between repurchases made by the issuer itself and those made by a trustee independent of the issuer's control, and there may be reasons for limiting the disclosure requirement with respect to the latter. By relying on the Commission, with its established procedure of soliciting comments on proposed regulations, Congress has opted for flexibility so as to permit the entire industry to work out a set of rules providing maximum protection at a minimum cost. The real trouble with this solution is that there is no protection (outside of the application of 10b-5 and other pre-existing rules) until the necessary rules are enacted—and up to now they have not been forthcoming.

Section 13(e) recommends that the aforementioned categories of information be provided to shareholders of the repurchasing corporation. No mention is made of requiring that the information be submitted to the Commission. This is surprising since the Senate recognized that information relating to substantial repurchases is of interest to the outside investor as well as the shareholder.[264] Disclosures limited to existing shareholders may not be sufficient to reach interested outside investors. Therefore, the Commission should not feel precluded from adopting a rule which would require that information deemed material be submitted to it. Indeed, such conclusion seems consistent with the broader language of the first sentence of 13(e)(1).

B. SEC Action Under Section 13(e)

1. *Rule 13e-1*

Up to now little has been done with 13(e). There is, at present, only one rule enacted under this section, and it of limited application. Rule 13e-1[265] controls corporate repurchases during the term of a tender offer by an outside party pursuant to section 14(d).

---

[263] *See Hearings, supra* note 24, app. at 219-20 (Letter from Allan Roth to Robert Block, commenting on proposed Rule 10b-10).

[264] *See* S. Rep. No. 550, 90th Cong., 1st Sess. 5 (1967).

[265] 17 C.F.R. § 240.13e-1 (1971).

Where existing management feels threatened by the possible takeover of the party making the tender offer, management may turn to the stock repurchase as a defensive measure designed to prevent the takeover. The intended effect of such repurchase is twofold: first, it reduces the number of uncommitted shares available to the "aggressor";[266] second, the additional market activity may increase the market price of the shares, thereby making the tender offer less attractive.[267] Rule 13e-1 requires the repurchasing issuer to furnish a statement to both the Commission and its security holders, which statement is to include information concerning (1) the type and amount of securities to be purchased, the names of the persons or classes from whom the securities are to be purchased, and the market in which they are to be purchased; (2) the purpose of the purchase and the issuer's future plans for the securities to be obtained through the purchase; and (3) the source and amount of funds to be used in making the purchase.[268] Section 13e-1 thus helps to create a sort of parity between the issuing corporation, or its management, and the party making the tender offer who must make considerable disclosures in order to fulfill the requirements of Section 14(d)(1). It also alerts the shareholders to the fact that the future market price may reflect the issuer's entry into the market, thereby enabling them to make a more accurate evaluation of the merits of the tender offer.[269] Finally, since a purely defensive repurchase aimed at strengthening management's hold on the corporation may be actionable under 10b-5, the threat that such improper motives will have to be revealed could be enough to prevent management from pursuing this questionable course of action.[270]

A corporate issuer that fails to make the disclosures called for by 13e-1 can be held in violation of the rule even if it does not repurchase its own shares. Subsection 13(e)(2) attributes to the

---

266 By reducing the number of outstanding shares the repurchase may be counterproductive in that it also reduces the number of shares that the outsider must acquire in order to reach the desired percentage necessary for control.

267 If the sole purpose of the repurchase is to raise the market price of the shares, it could be construed as a manipulative device in violation of Rule 10b-5.

268 It should be noted that 13e-1 applies to the repurchase of *any* equity securities during the period of the tender offer and is not limited to the repurchase of the class of securities for which the tender offer is made.

269 *See* Schmults & Kelly, *Disclosure in Connection with Cash Take-over Bids*, 24 BUS. LAW. 19, 23 (1968).

270 *Cf.* Cary, *Corporate Standards and Legal Rules*, 50 CALIF. L. REV. 408, 418, 420 (1962).

issuer those purchases made by or for one who is in a control relationship with the issuer, whether or not the purchases are for the issuer.[271] As a measure designed to prevent the circumvention of 13 (e) the need for a provision like 13 (e) (2) is unquestionable. And 13 (e) (2) is consistent with the Commission's interpretation of the term "issuer" as applied to Rule 10b-6.[272] In the tender offer context management could try to defeat an attempted takeover by relying on purchases by a subsidiary or a controlling person instead of having the corporation repurchase its own shares. Such purchases would be favored since they do not have the negative effect of decreasing the number of outstanding shares, thereby reducing the number that the "aggressor" must pick up in order to attain the desired degree of control. Surely the shareholders have an interest in obtaining the same information about these purchases as they do with respect to purchases by the issuer itself. But the burden of 13 (e) (2) may be misplaced. At least in terms of the disclosures required by Rule 13e-1 a preferable solution might be to treat the person in a control relationship with the issuer as the issuer, thereby subjecting that person to the disclosure requirements.[273] Such person would be likely to have notice of the tender offer so as to mitigate an argument of unfairness, and this would relieve the corporation of the impossible task of policing the activities of all those who may be classed as "control persons." In addition, this would relieve the corporation of the considerable expense of filing the dual statement every time purchases are made by a member of this class. And no de minimis rule has been adopted to alleviate the burden. By shifting the disclosure requirement, and hence the expense, to the control person it is possible to insure that purchases will be made only where the need for the stock justifies the cost of making the disclosure.

If purchases by one in a control relationship with the issuer are deemed to be purchases by the issuer, we might infer that purchases by one not so related to the issuer are unaffected by Section 13 (e). However, there is an ambiguity introduced by 13 (e) (2) with respect to independent trustees purchasing the issuer's shares for employee benefit plans. The term "independent" means that there is no control relationship with the issuer. And if Rule 13e-1 is designed to

---

271 Professor Israels suggests that 13 (e) (2) is an outgrowth of the *Georgia-Pacific* and *Genesco* proceedings where the purchases were made by trustees found to be under the control of the issuer. Israels, *supra* note 24, at 764.

272 *See* pp. 233-34 *supra.*

273 *Cf.* Securities Act of 1933, § 2(11), 15 U.S.C. § 77b(11) (1970).

promote fairness as between management and outsiders making tender offers, the disclosures required by the rule may be inappropriate, or at least unnecessary, where the purchases are made by an independent trustee. Yet such purchases could be construed as "purchase[s] . . . for the issuer," so as to bring them within the scope of 13(e)(2). Congress has not been aware of the need to limit the scope of 13(e)(2). In 1970 that subsection was amended so as to empower the Commission to adopt exemptive rules covering situations in which it is unnecessary or inappropriate to attribute purchases to the issuer, thereby removing such purchases from the operation of 13(e). A good place for the Commission to start is with the question suggested herein—the application of 13(e) to purchases by independent trustees.

2. Proposed Rule 13e-2

Although Rule 13e-1 is strictly a disclosure provision, Section 13(e) is not so limited. Another goal of 13(e) is to prevent conduct which might in some way disturb the orderly functioning of the market. Cognizant of this goal, the Commission has proposed a new limitation on repurchases of registered securities.[274] Proposed Rule

[274] SEC Securities Exchange Act Release No. 8930 (July 13, 1970). The text of the proposed rule, 13e-2, is as follows:

"(a) It shall be unlawful as acts and practices which are fraudulent, deceptive, or manipulative and as a manipulative or deceptive device or contrivance for an issuer whose securities are registered pursuant to Section 12 of the Act or for any close-end investment company registered under the Investment Company Act directly or indirectly to purchase by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange any equity security it has issued unless:

(1) if bids or purchases are made on any national securities exchange:

(A) such bids and purchases are made on its behalf under the supervision and control of only one broker on any one day;

(B) no bid or purchase is made until after the opening transaction or within one-half hour before the close of trading on such exchange;

(C) no bid or purchase is made at a price higher than the highest current independent bid price, or the last sale price, on such exchange, whichever is higher;

(D) the amount of securities purchased on any one day on such exchange does not exceed 15% of the average daily volume of trading in such security on such exchange in the four calendar weeks preceding the current week, and the broker employed to effect the purchase is instructed to endeavor to keep the amount of securities

purchased during the day equal to or below 15% of that day's volume of trading on such exchange; *provided, however,* that these volume limitations shall not prohibit (i) the purchase of one unit of trading in any security on any exchange on any day, or (ii) the purchase of a block of securities involving not less than 10 units of trading at an aggregate price of not less than $250,000, if the price per unit is not higher than the highest current independent bid or the last sale price on such exchange, whichever is lower.

(2) If bids or purchases are made otherwise than on a national securities exchange from or through a broker or dealer:

(A) such bids and purchases are made on its behalf by only one broker on any day; or if purchases are not made through a broker, purchases may be made directly by the issuer from one dealer; and other purchases may be made directly from other dealers on any day in compliance with subparagraphs (B) and (C) below of this paragraph (a) (2) of this rule if the issuer establishes that such purchases were not solicited, directly or indirectly, by the issuer or on its behalf;

(B) no bid or purchase is made at a total cost to the issuer higher than the following: (i) if the principal market for such security is a national securities exchange: the higher of the highest current independent bid or the last sale price on such exchange, plus an amount equal to the minimum stock exchange commission on such exchange, except that, with respect to the purchase of a block of securities involving not less than 10 units of trading and not less than $250,000, the total cost to the issuer of each trading unit involved does not exceed the lower of the highest current independent bid or the last sale price on such exchange, plus an amount equal to the minimum stock exchange commission, or (ii) if the principal market for such security is otherwise than on a national securities exchange: the mean between the highest current independent bid price and the lowest current independent asked price for such security, plus an amount equal to a minimum stock exchange commission.

(C) (i) if the principal market for such security is a national securities exchange, the amount of securities purchased on any one day on one or more national securities exchanges, plus the amount of such securities purchased otherwise than on national securities exchange from or through brokers or dealers, does not exceed 15% of the average daily volume in such security on all such exchanges in the four calendar weeks preceding the current week; *provided, however,* that this volume limitation shall not apply to a block of securities involving not less than 10 units of trading and an aggregate price of not less than $250,000 if the price per unit is not higher than the highest current

independent bid or the last sale price on the exchange which is the principal market for such security, whichever is lower plus an amount equal to the minimum stock exchange commission, or

(ii) if the principal market for such security is otherwise than on a national securities exchange, the amount of securities purchased in any one week does not exceed 1/25 of 1% of the number of units of the security of the same class outstanding, *provided, however,* that this volume limitation shall not prohibit the purchase of one unit of trading on any day, and shall not apply to a block of securities involving not less than 10 units of trading and an aggregate price of not less than $250,000, if the total cost per unit does not exceed the highest current independent bid plus an amount equal to a minimum stock exchange commission.

(3) If any such securities are purchased in transactions otherwise than on a national securities exchange and not involving a broker or dealer:

(A) if the principal market for such security is a national securities exchange, no purchase is made at a price higher than the last sale price or the highest current independent bid on such exchange, whichever is higher;
or

(B) if the principal market for such security is otherwise than on a national securities exchange, no purchase is made at a price higher than the mean between the highest current independent bid and the lowest current independent offer for such security in such market.

"(b) The provisions of this rule shall not apply:

(1) to the purchase of "exempted securities" as defined in Section 3(a)(12) of the Act.

(2) to the purchase of redeemable securities issued by an open-end management company or unit investment trust, as defined in the Investment Company Act of 1940.

(3) to the purchase of securities issued by a public utility holding company registered under the Public Utility Holding Company Act of 1935 or by any subsidiary company.

(4) to bids for or purchases of securities by the issuer in compliance with Rule 10b-7 or Rule 10b-8 in connection with a distribution of securities being made by the issuer.

(5) to the repayment, call or redemption of any security in accordance with the terms and conditions provided for in applicable indentures, corporate charters or other governing instruments.

(6) to the purchase of any security issued by a person organized and operated exclusively for religious, educational, benevolent, fraternal, charitable or reformatory purposes and not for profit, no part of the net earnings of which inures to the benefit of any person, private stockholder or individual.

13e-2 sets out specific price and volume limitations governing both private repurchases and repurchases made on the open market. Subsection (a) (1) relates to purchases made on a national securities exchange. Only one broker may be used on any given day. No bids or purchases may be made at a price higher than the highest independent bid or last sale price, and the issuer is forbidden from making any bids or purchases before the opening transaction or within one-half hour of closing. The volume limitation is fifteen

---

(7) to the purchase of any security, evidenced by a scrip certificate, order form or similar document which represents a fractional interest in a share of stock or similar security, if the fractional interest (i) resulted from a stock dividend, stock split, reverse stock split, conversion, merger or similar transaction, and (ii) is purchased pursuant to arrangements for the purchase and sale of fractional interests among the persons entitled to such fractional interests for the purpose of combining such interests into whole shares or for the purpose of compensating security holders for any such fractional interest not so combined.

(8) to the purchase by an issuer of securities of dissenting shareholders who have asserted rights of appraisal with respect to their shares in the course of a proceeding instituted in accordance with statutory provisions.

(9) to the purchase of a specified class of security pursuant to a bona fide tender offer made to all holders of such security or to all holders of less than a specified number of units of such security.

(10) to the purchase of a security otherwise than on a national securities exchange not made from or through a broker or dealer, if the transaction is not solicited directly or indirectly by the issuer.

(11) to any purchase or purchases which the Commission, upon written request or upon its own motion, exempts either unconditionally or upon specified terms or conditions, as not constituting a manipulative or deceptive device or contrivance comprehended within the purpose of this rule.

"(c) For the purpose of this rule, a purchase by or on behalf of any bonus, profit-sharing, pension, retirement, thrift, savings, incentive, stock purchase, or similar plan of the issuer or its employees shall be deemed to be a purchase by the issuer, unless the plan is operated and purchases are made by a trustee who is independent of the issuer. A trustee shall not be deemed independent of the issuer if the trustee or the issuer, or an affiliate of either, directly or indirectly controls, is controlled by, or is under common control with the other (provided that a common directorship shall not alone affect the trustee's independence), or if the issuer directly or indirectly has any control or influence over the time when or the price at which securities may be purchased, the amount of securities to be purchased, or the selection of the broker or dealer through or from whom they are to be purchased."

percent of the average daily volume of trading in the security on that exchange during the preceding four weeks. Moreover, the broker employed is instructed to try to keep down the purchases to fifteen percent of the trading on that day. As an exception to these limitations the purchase of one unit of trading is permitted regardless of size, and the purchase of a block comprising at least ten units is permitted if the aggregate price is at least $250,000, and if the price per unit is in line with the restrictions.

Subsection (a) (2), which applies to purchases off an exchange but executed through a broker or dealer, is more complex. If the principal market for the security is not on an exchange, no bid or purchase may be made at a higher cost than the mean between the highest current independent bid price and the lowest current independent asked price. Volume would be limited to a weekly amount not in excess of .04 percent of the outstanding shares. Block purchases are again excluded if the price per unit does not exceed the highest current independent bid. For securities the principal market for which is on an exchange, the price and volume limitations are the same as they would be if the purchases had been made on that exchange.

Subsection (a) (3) applies to private transactions not involving a broker or dealer. The price limitations are those mentioned previously. No volume limitations are imposed on such purchases.

Rule 13e-2 brings back memories of the *Georgia-Pacific* and *Genesco* cases. For a long time, going back even before those cases, the staff of the SEC has responded to requests for "no action" letters from companies who feared that their repurchase programs might run afoul of Section 9 (a) (2) by setting out a program with limitations not unlike those of the proposed rule.[275] The daily volume limitation deemed appropriate for shares traded on an exchange is fifteen percent, as has been noted. This is five percent below the limitation imposed on *Genesco*. While this difference is not enough to raise a question as to the appropriateness of the figure chosen, two observations are in order. First, the restrictions placed on *Georgia-Pacific* were more rigid than those imposed on *Genesco*. It is unclear whether or not these differences were due to differences between the two companies or their needs for stock. At any rate, the differences do suggest the need for some flexibility, though too much would obviously make the rule unworkable.

---

[275] *See* DISCLOSURE REQUIREMENTS, *supra* note 39, at § 3.711, at 152-53 (statement of Llewellyn P. Young).

Second, and more important, is the effect of 13(e) (2). Now all stock purchased by those in a control relationship with the issuer will reduce the number of shares that may be repurchased by the issuer. And the reduction may be substantial. In *Georgia-Pacific* the SEC did treat shares purchased by the trustees, who were controlled by the corporation, as if they were purchased by the corporation itself. But there we were concerned only with shares that were actually purchased for the issuer. Proposed Rule 13(e) (2) applies to all purchases by a controlling person, and thus the corporation will be credited with shares which are purchased for private accounts, without any benefit to the issuer and over which the issuer can exercise no control. This is mitigated somewhat by 13e-2(c) which provides that purchases made for an employee benefit plan that is operated by a trustee independent of the issuer will not be deemed to be purchases by the issuer for the purpose of this rule.[276] In *Georgia-Pacific* purchases by the trust, even when made by an independent trustee, were to be attributed to the corporation, and volume limitations were placed on the trust as well as the issuer.

The most serious objection to the volume limitations of 13e-2 is that they unduly inhibit purchases on the "third market." The third market encompasses sales of listed securities off the primary market, the national securities exchanges, by brokers and dealers who are not members of those exchanges.[277] It has developed as a response to the needs of institutional investors who desire lower costs for large transactions which are unavailable under the rigid rate schedules of the national exchanges and which at present do not grant quantity discounts. The *Special Study of the Securities Markets,* aware of the growing over-the-counter market for listed securities, concluded that any impairment of the primary market resulting from the existence of this third market is outweighed by the benefits of increased competition.[278] And a private study, while noting that oligopolistic profits do arise in the third market, recog-

---

[276] One can infer from this subsection that purchases made by independent trustees, while exempted from this rule, are not exempt from the general application of Section 13e(2), and thus such purchases will be treated as purchases by the issuer for the purpose of Rule 13e-1.

[277] *See generally* Weeden, *The Third Market,* DUKE UNIVERSITY SCHOOL OF LAW CONFERENCE ON SECURITIES REGULATION 171 (R. Mundheim ed. 1964); *see also* 5 LOSS, *supra* note 76, at 3343-46. For a brief explanation of the "third market" see Abdo, *The Third Market,* 76 COMM. L.J. 105 (1971).

[278] SPECIAL STUDY, *supra* note 194, pt. 2, at 910.

nized the lower costs and resulting decreases in prices for both buyers and sellers participating in such trading.[279]

Subsection (a) (2) (C) (i) of Rule 13e-2 would impose volume restrictions on purchases in the third market identical to those applied to transactions on the securities exchanges. While this may be prompted by a desire for evenhandedness the effect is likely to be counterproductive for such "equal treatment" could eliminate the possibility of third market trading for many corporations. The heart of third market activity is the trading of relatively large blocks of securities. If the corporation is limited to fifteen percent of the average daily volume, it is unlikely to find a block that small on the third market. Of course, there is the exemption for block purchases in excess of $250,000, but this figure discriminates against moderate-sized corporations. Either a sufficient number of shares will not be available to meet the $250,000 requirement or, even if they are available, the corporation will probably find it imprudent, in light of its needs, to repurchase such a substantial block of shares at one time. By making third market trading unfeasible for the average corporation, 13e-2 forces the corporation back to the established securities exchanges where it must incur greater expenses and where its purchases are more likely to have a manipulative effect. Moreover, even if 13e-2 will not inhibit third market trading to the degree suggested, there is no need to impose the same restrictions on such purchases for third market trading is less susceptible to the abuses at which the proposed rule is aimed. An amendment to 13e-2 is necessary and could take one of four forms: (1) abolition of the daily purchase restriction, substituting a weekly or biweekly limitation; (2) liberalization of the daily purchase restriction; (3) substantial reduction of the $250,000 limitation on the exemption for block purchases; or (4) introduction of a sliding scale for the block purchase exemption which takes account of the size of the corporation making the purchases.

Rule 13e-2 contains a number of exemptions in addition to that for purchases by an independent trustee. Most of these are of limited application and will not be discussed. Subsection (b) (9) is of some interest. This provision exempts purchases "pursuant to a bona fide tender offer." The Commission may be faulted for its failure to define the term "bona fide." It is suggested that the Commission amend the rule so as to include a definition of the term,

---

[279] Polakoff & Sametz, *The Third Market—The Nature of Competition in the Market for Listed Securities Traded Off-Board*, 11 ANTITRUST BULL. 191, 198 (1966).

incorporating the requirements of Section 14(d) (5), (6) and (7).[280] Subsection (b) (10) exempts purchases off an exchange that are not made through a broker or dealer if the issuer does nothing to solicit the transaction. Subsection (b) (11) provides for ad hoc exemptions by the Commission and is similar to 10b-6(f) and 10b-13(d).

Along with 13e-2 the Commission has proposed an amendment to Rule 10b-6. This amendment would provide an exemption from that rule for the most bothersome cases—where the prohibitions of 10b-6 would otherwise apply solely because of the existence of outstanding convertible securities. (No exemption is made for outstanding warrants.) The exemption is automatic if the issuer complies with the requirements of 13e-2. This leaves some ambiguity in the case of purchases by an independent trustee for an employee benefit plan. Most likely, the trustee's exemption from 13e-2 will carry over to this new exemption.

At this stage it is impossible to speculate whether 13e-2, as proposed, will be adopted by the Commission. But it is clear that the Commission is ready to adopt some rule of thumb for limiting corporate stock repurchases. New rules under 13(e) should be forthcoming. Some of the areas that I have suggested include the regulation of tender offers and the limitation of 13(e) (2), in light of the new amendment to that subsection. The Commission might also be advised to adopt a general disclosure rule, going beyond the tender offer context, which could draw on the case law decided under Rule 10b-5. The informational need of shareholders with respect to corporate repurchases is not limited to the period in which an outsider is making a tender offer. And the retrospective disclosures required by Form 8-K[281] are inadequate for this purpose. Rule 10b-6 is ready for a major overhaul, and the proposed amendment to the rule is only one step, albeit an important one, in this direction. Corporate management must keep appraised of the developments under 13(e). Yet, at the same time, management must not lose sight of Section 10(b), and particularly Rule 10b-6, whose impact on corporate repurchases has not been mooted by the adoption of 13(e).

---

280 *See* pp. 240-42 *supra*.

281 Form 8-K, Item 8, 2 CCH FED. SEC. L. REP. ¶31,003 (1954) (Current Report); *see generally* 17 C.F.R. § 240.13a-11 (1971). The SEC has proposed two new forms, Form 10-Q and Form 7-Q, to replace Form 8-K. SEC Securities Exchange Act Release No. 8683, 8684 (Sept. 15, 1969).