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THE GENEALOGY OF THE OUTSIDER'S ROLE IN DISCLOSURE OF EQUITY OWNERSHIP IN CORPORATE ACQUISITION

Melvin Robert Katskee*

I

The primary issue to be analyzed in this article is the effect which Public Law 90-439,¹ providing for full disclosure of equity ownership of securities under the Securities Act of 1934, will have on the disclosure duty of an outsider making a tender offer for control of a corporation. Resolution of this issue inevitably leads to the battle currently being fought among those learned in the area over the wisdom or lack thereof of placing any disclosure duty upon the outsider.²

II

Prior to enactment of Public Law 90-439, the status of an outsider's duty to disclose in connection with attempted corporate acquisition rested on a single decision, *Mills v. Sarjem Corp.*³ There, Chief Judge Forman of the Federal District Court for the District of New Jersey cleared the field of what were thought to be the troublesome problems. In that case, the acquirer's purpose was to buy eighty percent of the outstanding stock of a corporation and then sell the assets of the corporation to a public commission to be established for that purpose. The acquirer accomplished this at a substantial profit. Judge Forman interred the suggestion of a disclosure duty on the part of the outsider by holding that the acquisition of a controlling percentage of a corporation's securities was not sufficient to impose on the insurgent group disclosure obligations similar to those imposed on the "insider." In addition, Forman noted that an insurgent group acquiring the control of a corporation owes no duty to disclose material information concerning the issuer's affairs prior to becoming a controlling shareholder.

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¹ 15 U.S.C. §§ 78m(d), -(e), 78n(d), -(e), -(f) (Supp. 1970). The statute is set out in the Appendix.

² See, e.g., Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 DUKE L.J. 231; Cohen, "Truth in Securities" Revisited, 79 HARV. L. REV. 1340, 1399-1400 (1966). The conflicting positions of these authors will be dealt with at greater length in the course of this article.

³ 133 F. Supp. 753 (D.N.J. 1955).

To Forman it was clear that many forms of conduct are permissible in a business setting for those acting at arm's length. He demonstrated by prior case law that only those traditionally in the *locus standi* of a fiduciary had a duty to separate their interests from those of their fellows, to conduct themselves at a level above that trodden by the crowd, so as not to abuse the special opportunities growing out of their positions of trust.

As to the plaintiff's argument that defendants became such fiduciaries at the time of payment of an escrow deposit whereby Sarjem's nominees occupied positions as directors of the acquired corporation, Forman observed:

[Defendants] cannot be said at that time, by reason of their newly acquired position, to have come into any inside information unknown to the sellers of their stock. . . . They of course knew then, as they had known long before, that they intended to dispose of the Talcony-Palmyra stock at a profit. No information came to them upon their achievement of control over the stock which they had purchased, or even to those from whom they were subsequently to purchase. . . . In short, the alleged scheme to capitalize upon the ownership of the stock of Talcony-Palmyra Bridge Company was conceived and prosecuted strictly by "outsiders" upon whom there was no duty of disclosure.⁴

With regard to this portion of the holding, Professor Painter points out that the court was on "sound footing." As Painter notes: "[T]he true 'outsider' insurgent under the law prior to enactment of the Williams' Bill had no duty other than to refrain from positive misstatements of fact or possibly, 'half-truths' concerning the issuer."⁵ With this case as their lodestar, and with quiet pride, the courts have retired from the field.

In this vein, Bromberg asserts that an outsider could not be expected to provide internal information about the issuer, since that is the issuer's duty under the proxy rules:

He can, however, tell what he knows about the material facts whether insiders have been approached first and whether they have agreed to accept the offer or a better one. . . . [This duty is consistent with the SEC's view that] the outsider has the same status and duty as an insider if he has obtained inside information.⁶

⁴ *Id.* at 765.

⁵ Statement of William H. Painter, Professor of Law, University of Missouri at Kansas City. *Hearings on S. 510 Before the Comm. on Banking and Currency on Full Disclosure of Corporate Equity Ownership*, 90th Cong., 1st Sess., at 144 (1967).

⁶ A. BROMBERG, *SECURITIES LAW: FRAUD*, SEC RULE 10b-5 at 119-20 (1967). Professor Brudney notes: "If outsiders in a takeover attempt make false statements or half-truths, or manipulate the market price of securities in order to make a profit, remedies under Rule 10b-5 and

But why should the acquiring outsider disclose his reasons for the potential control of a corporation's securities? This is perhaps the thorniest issue which confronts one in this area. Bromberg suggests a solution based on the concreteness of the rewards visualized by the acquirer. As with any test which rests upon the subjective factors of intent, the waters are necessarily murky, for motivation and intent are difficult to assess.

Bromberg's test, in essence, states that if the offeror perceives no readily ascertainable and reasonably certain values, the interest, under a balancing test of sorts, lies in favor of nondisclosure; if the values which the offeror perceives do in fact materialize, the offeror will not be deprived of the concomitant rewards. On the other hand, if the values are existing ones, the interest lies in favor of disclosure.⁷ Such a test revolves around the underlying consideration that a person should not be penalized for making a shrewd business judgment. This type of rationale would explain the result reached in the *Sarjem* case. There Chief Judge Forman proclaimed that the scheme of the defendants was "highly speculative and uncertain, both as to ultimate materiality and its legality."⁸

In a seminal article in this area, Milton H. Cohen rejected such distinctions, casting his lot for complete disclosure.⁹ Cohen argued that where a person engages in a program to gain control of a corporation and change that corporation's management and policies, he is the only source of material information. Such a person, observed Cohen, although technically an outsider, in fact stands in the position of an insider, and possesses knowledge and information of great import to the investor.

Yet existing law does not specify any affirmative disclosure requirements; even Rule 10b-5 probably imposes no affirmative disclosure obligation in these circumstances, as distinguished from the negative obligation to avoid fraud or misrepresentation in whatever communications are used.¹⁰

Thus, with a paucity of case law in this area and many conflicting issues necessary of resolution, a view of the competing business considerations involved in the tender offer, as it relates to whether a disclosure obligation should be placed on the outsider, is in order.

otherwise appear available." Brudney, *A Note on Chilling Tender Solicitations*, 21 RUT. L. REV. 609, 634 (1967) (footnotes omitted). In this regard, see *Cooper v. North Jersey Trust Co.*, 226 F. Supp. 972 (S.D.N.Y. 1964) and *Cochran v. Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962).

⁷ A. BROMBERG, *supra* note 6, at 121.

⁸ 133 F. Supp. at 767.

⁹ Cohen, *supra* note 2. Subsequently, Cohen has questioned disclosure in certain areas.

¹⁰ *Id.* at 1399.

III

The leitmotif of the Securities Act of 1934 is disclosure. However, the question arises whether this policy in any way conflicts with the basic business considerations of the tender offer. Assuming that the tender offer possesses legitimate merit, would the benefits that might be derived from disclosure remove the blessing with the bane?

Cohen's remarks may be used to set the stage for the problem at hand:

There is . . . one area, now largely neglected, where an outsider may well be the only possible source of material information: where he is embarking on a purchase program with the intent or the potential of obtaining control, changing management, adopting new policies, moving on in new directions [In this instance] the outsider is actually an insider, and his inside information may be of great importance to investors.¹¹

The Second Circuit Court of Appeals recently agreed that the outsider has had no such disclosure duty. In *Iroquois Industries, Inc. v. Syracuse China Corp.*¹² a tender offeror brought suit against a corporation under section 10b of the Securities Act of 1934, alleging false and misleading information to that corporation's own stockholders, reports of sham merger negotiations, and activities of like kind in an effort to defeat the tender offer. After holding that the courts could not expand the coverage of section 10b beyond that intended by Congress, Judge Wyatt noted:

That Congress enacted the new Section 14(C) to prohibit fraud by "any person" in respect to tender offers is at least an indication that in tender offer contests such as that at bar there was no standing to sue under Rule 10b-5 by either the tender offeror or by the target corporation.¹³

With this gap in existing law in view, Senator Harrison Williams (Dem. N.J.) introduced a bill in 1965 which provided that any person or related group of persons proposing to acquire more than five percent of a class of equity securities registered under the 1934 Act would have a duty to file a statement in advance, indicating identity, background, source of funds, and purpose of the intended acquisition.¹⁴

That version of the disclosure provisions died in the eighty-ninth Congress. Its successor, Public Law 90-439, introduced by Senators Williams and Kuchel (Rep. Cal.), embodies alterations and modifications which the SEC has consistently advocated. The

¹¹ *Id.*

¹² 417 F.2d 963 (2d Cir. 1969).

¹³ *Id.* at 969.

¹⁴ S. 2731, 89th Cong., 1st Sess. (1965).

present law offers greater protection to offerees than the 1965 version. However, whereas the prior bill was, in the words of Professor Brudney, "more frankly designed to discourage take-over bids,"¹⁵ the successor bill, according to Senator Williams, reflected a conscious attempt to "balance the legitimate interests of a corporation, management and shareholders without unduly impeding cash takeover bids."¹⁶

The present provision amends section thirteen of the 1934 Act by providing that a person, after acquiring the beneficial ownership of more than ten percent of the equity securities of a given class, shall within ten days send to the issuer and each exchange where the security is traded, as well as file with the SEC, a statement containing identity of purchasers, source of funds, ultimate purpose of the acquirer (such as whether liquidation, merger or other change in corporate structure is planned), and similar information.¹⁷ The act exempts a person from filing if, within the preceding twelve months, he acquired less than two percent of the securities of that class.¹⁸

Another provision, amending section fourteen of the 1934 Act, is framed in language similar to that of Rule 10b-5 and gives broad rule-making authority to the SEC regarding sending of the filed information with each offer to purchase.¹⁹ If the consideration to be paid for shares is varied, the offeror is liable to all other shareholders for the amount of any increased consideration.²⁰

¹⁵ Brudney, *supra* note 8, at 610 n. 2.

¹⁶ 133 CONG. REC. 444 (daily ed. Jan. 18, 1967).

¹⁷ Section (2) (d) (1). See Appendix.

¹⁸ Section 2(d) (5) (B).

¹⁹ Section 3(d).

²⁰ Section 3(d) (7). In this regard, consider a recent SEC release: "[Text] Where securities are purchased for a consideration greater than that of the tender offer price, this operates to the disadvantage of the security holders who have already deposited their securities and who are unable to withdraw them in order to obtain the advantage of possible resulting higher market prices. Additionally, irrespective of the price at which such purchases are made, they are often fraudulent or manipulative in nature, and they can deceive the investing public as to the true state of affairs. . . . Accordingly, by prohibiting a person who makes a cash tender offer or exchange offer from purchasing equity securities of the same class during the tender offer period otherwise than pursuant to the offer itself, the rule accomplishes the objective of safeguarding the interests of the persons who have tendered their securities in response to a cash tender offer or exchange offer; moreover, once the offer has been made, [Rule 106-13] removes any incentive on the part of holders of substantial blocks of securities to demand from the person making a tender offer or exchange offer a consideration greater than or different from that currently offered to public investors. [End Text]"

Within one month after the enactment of the Williams Bill, temporary rules were adopted by the SEC to give the Act immediate impact. Under Rule 13d-1 a schedule 13D must be filed by any person who becomes a ten percent stockholder.²¹ This schedule must contain source of funds, names of parties, and purpose of the purchase. It has been suggested that in determining when a person becomes a "beneficial owner" of ten percent of the equity securities of a company, the "law and lore" of section sixteen of the 1934 Act and Rule 13d-3, which restates Rule 16a-2(b), will prove of aid.²²

A recent article in the *Wall Street Journal* contained an example of the conduct the Act seeks to attack:

A group of unidentified investors offered to buy 500,000 shares of Studebaker Corp. common stock at \$30 a share. . . . [Lehman Brothers, one of two investment banking houses representing the bidders,] declined to identify the prospective purchasers. . . . The 500,000 shares constitute about 18% of Studebaker's outstanding stock.²³

"The rule does not prohibit a person who, at the commencement of the offer, owns securities convertible into or exchangeable for securities of the class which are the subject of the offer from converting or exchanging such holdings into such securities.

"[Text] The rule deals with purchases or arrangements to purchase, directly or indirectly, which are made from the time of public announcement or initiation of the tender offer or exchange offer, until the person making the offer is required either to accept or reject the tendered securities. As used in the rule an offer could be publicly announced or otherwise made known to the holders of the target security through a published advertisement, a news release, or other communication by or for the person making the offer to holders of the security being sought for cash tender or exchange. Moreover, any understanding or arrangement during the tender offer period, whether or not the terms and conditions thereof have been agreed upon, to make or negotiate such a purchase after the expiration of that period would be prohibited by the rule. Purchases made prior to the inception of that period are not specifically prohibited under the rule. . . . Of course, the general anti-fraud and anti-manipulation provisions could apply to such pre-tender purchases. The prohibition of Rule 10b-13 applies to exchange offers when publicly announced even though they cannot be made until the happening of a future event. [End Text]

"The Commission may, unconditionally or on terms and conditions, exempt any transaction from the operation of the rule, if the Commission finds that the exemption would not result in manipulation or deception within the purpose of the rule, but this exemptive provision will be narrowly construed and an exemption granted only in cases involving very special circumstances." SEC Release No. 8712 (Oct. 8, 1969). Cited in 38 U.S.L.W. 2221 (Oct. 14, 1969).

²¹ 17 C.F.R. § 240.13d-1 (1970).

²² Schmullts & Kelly, *Disclosure in Connection with Cash Takeover Bids: The New Regulations*, 24 BUS. LAW. 19, 20 (1968).

²³ *Wall Street Journal*, Feb. 8, 1966, at 1, col. 2.

Another article, after noting that companies and individuals seeking acquisitions by tender offer usually cite their reason as being "for investment purposes only," continues that another problem is that the tender-maker may make subsequent offers at a higher price if its initial offer for shares does not prove successful.²⁴

The Act, whose purpose, according to its title, is "Full Disclosure of Corporate Equity Ownership of Securities," met with wide-scale support while it was before the Congress. Former SEC Chairman Manuel Cohen observed that since such acquisitions of voting securities were merely alternatives to proxy solicitations as methods of gaining corporate control, the protection provided in the bill was a necessity. Alteration of control, noted Cohen, led to different operating results and hence different investment results. He stressed that the provisions of the bill for contested tenders were analogous to the present proxy solicitation rules.²⁵

²⁴ New York Times, April 2, 1967. Quoted in Hearings on S. 510, *supra* note 5, at 251-57. The *Times* cites by way of exemplification two separate incidents. In the first, Fifth Avenue Coach Lines made an offer to buy 260,000 shares of Austin Nichols and Company, a liquor distributor, at \$20 per share. At the time, the Austin stock was selling at \$14 a share. Thwarted in its effort to obtain all the shares it desired, Fifth Avenue made a second offer for \$27.50 per share, at a time when the shares were selling at a market price of \$22.

In the second case, Paul Revere Corporation, a holding company, completed a tender of \$132 million for 4 million shares at \$33 per share. Prior to the offer, Avco shares were selling for \$26. The *Times* article notes that in the aftermath of the Revere offer the price per share rose to a level equal to that of the offer price by Revere, declined slightly when Revere accepted 4 million of the 9 million shares tendered, and then mounted steadily to \$44 a share, \$11 above the tender price, after news of a proposed merger with Revere.

Many additional examples are collected and set forth in Swanson, *S. 510 and the Regulation of Cash Tender Offers: Distinguishing St. George from the Dragon*, 5 HARV. J. LEGIS. 431, 448-54 (1968). Swanson treats at great length the recent tender offer for the shares of Columbia Pictures Corporation.

It may be of interest to note here that under the temporary rules adopted by the SEC to give the Act immediate effect, a discernible "deadening effect" on the style of tender offer advertisements has occurred. This is so since all soliciting material must contain a summary of the information required by schedule 13D under the rules. Examples of this "deadening effect" are: The Wall Street Journal, Aug. 19, 1968, at 15 (offer of International Control Corp. for Electronic Specialty Co.); The Wall Street Journal, Sept. 6, 1968, at 17 (offer of Allegheny Corp. for Jones Motor Co., Inc.); The Wall Street Journal, March 31, 1970, at 23 (offer of International Utilities Corp. for Pacific International Express Co.).

For an interesting article on the requirements of the new rules see Schmults & Kelly, *Disclosure in Connection with Cash Takeover Bids: The New Regulations*, 24 BUS. LAWYER 19 (1968).

²⁵ Statement of Manuel F. Cohen, *supra* note 5, at 33-35.

Senator Kuchel likened tender offers to the machinations of the "Six Per Cent Club" of 1792, of whom Jefferson had declared: "[T]he credit and fate of the nation seem to hang on the desperate throws and plunges of gambling scoundrels." Kuchel pointed out that he supported Senate 510 because:

Today, there are those individuals in our financial community who seek to reduce our proudest businesses into nothing but corporate shells. They seize control of the corporation with unknown sources, sell or trade away the best assets, and later split up the remains among themselves. The tragedy of such collusion is that the corporation can be financially raped without the management or shareholders having any knowledge of the acquisitions. . . .²⁶

Professor Painter had encomiums for the broad language of the bill, which left to the SEC, "who is best equipped to examine the ramifications of the problem," the opportunity for further study and rule making, and afforded a deterrent effect to corporate takeovers by "undesirable elements" through "sheer uncertainty of its application."²⁷

On the other hand, some authorities testifying at the hearings would have no truck with mere analysis of the provisions of the bill aloof from salutary business considerations in favor of tender offers. Professor Samuel L. Hayes, of the Columbia University Graduate School of Business, brought the crucial issue to the fore—do takeover bids serve the public welfare? According to Hayes:

Our study shows that the typical company that has been the subject of a takeover bid has been relatively unprofitable in the past and excessively liquid. . . . Thus, the takeover bid can serve a useful purpose when it either goads [their] sluggish managements into more productive activity or permits a new management to try its hand at making better use of the assets.²⁸

Arthur Fletcher, Jr., and Professors Stanley A. Kaplan and Robert Mundheim concurred in this assessment, and offered reference to generalized viewpoints and implications for future situations. This triumvirate felt that a statement of plans in advance could stifle potential tender offers, a fact not in the public interest since the threat of tender offers had kept corporate management competitive and efficient by not allowing it to become too secure. In addition, Professor Kaplan took particular issue with section

²⁶ Statement of Senator Thomas Kuchel, *id.* at 45-46. See Swanson, *S. 510 and the Regulation of Cash Tender Offers: Distinguishing St. George from the Dragon*, 5 HARV. J. LEGIS. 431, 449 (1968).

²⁷ Statement of Professor Painter, *supra* note 5, at 144.

²⁸ Statement of Professor Hayes, *id.* at 62. See also Hayes and Taussig, *Tactics of Cash Takeover Bids—For Bidders, Incumbent Management, and Shareholders*, *id.* at 222.

3(d) (1) (7) of the Act which allows the offeree the maximum price offered whenever he deposits. Kaplan asserted that this provision warranted further study, indicating his predilection for the traditional role of bargaining considered appropriate in a free market.²⁹

At the outset, then, while it may have appeared that the drafters of Senate 510 had their eye on where they were going, some of the assumptions upon which the Act is based suddenly seem to be all shifting sands. A more profound scrutiny of these challenged assumptions must therefore be undertaken.

IV

The whirligig of discussion engendered during the debates and hearings over the Williams Bill (Senate 510), has brought forth much in the way of needed examination of those legitimate values of the tender offer which should perhaps be preserved. Hence, out of what Cardozo termed the "attrition of diverse minds" eventually emerges something of an "average value" greater than its components, which leads to what should be embodied in an Act designed to protect shareholders and management. Conversely, what should be preserved as the domain of the outside acquirer who performs certain functions of value to the investing public at large must be assessed.

The eminent case of *List v. Fashion Park, Inc.*³⁰ offers enlightenment on this point. That case involved a director's purchase of shares from a stockholder, and raised the issue of what types of plans relating to future action must be disclosed as material facts. In the *List* case the problem concerned an insider, which renders it particularly instructive here. For in that case, the Court of Appeals for the Second Circuit affirmed a finding that the adoption of a resolution to sell the corporation by the directors was not a material fact. Such a disclosure would not have dissuaded the shareholder from selling his shares since no profit was assured on the proposed sale of the corporation and in any case the possibility of sale was too remote to have affected the conduct of a reasonable investor. Thus, even when an insider is involved, if the information is of a speculative nature it need not be divulged and, if divulged, may even provide a basis for liability.³¹

²⁹ *Supra* note 5, at 130-38.

³⁰ 340 F.2d 457 (2d Cir.), *cert. denied sub. nom. List v. Lerner*, 382 U.S. 811 (1965).

³¹ For aspects of this problem, see Comment, *The Regulation of Corporate Tender Offers under Federal Securities Law: A New Challenge for Rule 10b-5*, 33 U. CHI. L. REV. 359, 367 (1966).

The tender offer depends to a great extent on celerity of movement and secrecy. In effect, the tender offer attempts to bypass a proxy contest for corporate control.

In comparison to the full-fledged proxy contest, the costs incidental to a takeover bid are relatively low because under the terms of the usual tender offer the outsiders do not have to put up the real money unless and until the shares actually needed for control are tendered to them, whereas the proxy contest entails the accumulation of shares in the open market and an expensive solicitation campaign without any assurance of ultimate success.³²

However, all of the advantages of the tender offer are not weighted in favor of the acquirer. The corporation maintains a list of stockholders indicating which of its shareholders own the large blocks of stock a tenderor would seek out. Not only can personal pressures be brought to bear, but the corporate treasury is available to incumbent management. Yet another factor in management's control is the line of attack suggested by Schmuls and Kelly of placing obstacles in the path of the tenderor of such magnitude that he will not be able to obtain voting control, rendering the company less than attractive to him or weakening his ability to carry out the offer.³³

Basically, Schmuls and Kelly outline devices such as raising the annual dividend, announcing a stock split to increase the number of shares, communicating with stockholders as to the adequacy of the price offered, and purchasing the corporation's shares on the market at or near the tender price. Proposal of a new issuance under Rule 135 of the Securities Act of 1933, with first right to purchase to present shareholders, making overtures to acquire a third company which would create anti-trust problems for the acquirer, and making an equally attractive counter-offer are also suggested.³⁴

³² Schmuls & Kelly, *Cash Takeover Bids—Defense Tactics*, 23 BUS. LAW 115 (1967).

³³ *Id.* at 117. For an interesting example of behind-the-scenes pressure, note the case of Glen Alden Corp. which sought control of McKesson and Robbins, Inc. There, it was said that the chairman of McKesson used his persuasive powers on the chairman of Chase Manhattan Bank to abandon its plans to finance the Glen Alden purchase during a golf game. When Chase Manhattan withdrew, Glen Alden could not persuade other banks, by this time skeptical, to finance the purchase. The upshot of this was that Glen Alden sold its one million McKesson shares of Foremost Dairies, Inc., which the McKesson management had approved. *Wall Street Journal*, Feb. 11, 1966, at 1, col. 6. Quoted in Swanson, *supra* note 25, at 448 n. 62.

³⁴ Schmuls & Kelly, *supra* note 31, at 117. See case cited notes 12 & 13 and accompanying text *supra*. See also Krasek, *Tender Offers: The Target Company's Duty of Disclosure*, 25 BUS. LAW 455 (1969).

This vast array of defensive tactics is used to counteract what has probably been the primary reason for the attempt to take over the corporation—inept management. Milton H. Cohen stresses this fact when he states: "A second paradox is that the typical T, the sought-after company in the tender offer, is not a glamour girl but the reverse, a wall-flower."³⁵ The end result of the tender offer has been aptly pointed out by at least one author of the growing body of literature in the area:

The takeover bid, then, is part of the larger merger and acquisition phenomenon and was developed to combat management's opposition to a merger or acquisition proposal. . . . [I]t is probably the only effective alternative available when the management of the company being sought refuses to cooperate. The other possibility is to wage a proxy contest, but this is expensive and the chances for success are generally slim.³⁶

Thus, while not even a majority of tender offers are successful, since acceptance of the offer may be based on receiving the controlling number of shares, the costs of a tender offer are far from being as great as those of a proxy battle.

With this view of the use and purpose of the takeover bid in mind, whether the 1968 amendments were wise, in a general sense, appears to be undisputed. It is indeed true that various authors, at the time Senate 510 was being considered by Congress, attacked the premises of the proposed legislation. Their arguments deserve rehearsal at this point. Professor Brudney, writing on the then proposed Williams Bill, observed:

[I]f inequalities in lawful access to information about the issuer of securities and their resultant values are to be ironed out, nothing in the origins or premises of the securities legislation suggests a purpose to eliminate all other inequalities of bargaining power—such as those stemming from disparities in intelligence, boldness, temperament, diligence, research, wealth, resources or other factors. In theory, at least, such inequalities are integral to a free market economy.³⁷

Brudney further challenges the analogy of disclosure to the offeree of a cash bid in a tender situation to that of the offeree of a bid to exchange stock in the company for that of the offeror:

[T]he analogy is wholly inapposite The inescapable fact is that the offeree of a cash bid is solicited to be a *seller*, not a buyer, that the bidder is asking the offeree to disinvest, not to invest, and is offering to *pay* cash, not soliciting the investor to pay him cash or property. As sellers, the offerees, of course, have no concern with the identity or background of the buyer . . . or with their plans for the company.³⁸

³⁵ Cohen, *Tender Offers and Takeover Bids*, 23 BUS. LAWYER 611 (1968).

³⁶ Kennedy, *Tender Moment*, 23 BUS. LAWYER 1091, 1094 (1968).

³⁷ Brudney, *supra* note 6, at 615.

³⁸ *Id.* at 616-17.

Similarly, an extensive commentary on what was Senate 510, appearing in the *Harvard Journal of Legislation*, stresses that disclosure to the shareholder is not necessary:

This philosophy cannot be applied to the tender offer situation. If a shareholder decides to tender, and eventually sell, his shares, he in effect is saying that he has no interest in the future of the corporation and would rather realize his investment or put his money to work in other corporations.³⁹

On strict logical construction and analysis, the critics point out a valid argument. However, their arguments state too much. If one views what the tender offer is designed to replace, the proxy battle, the general disclosure features of the new law are entirely consistent with present law and, indeed, fill a noticeable void. Under section fourteen of the Securities Act of 1934, where a contest for control of management of a corporation is involved the rules require disclosure of names and interests of all participants in the proxy contest. Furthermore, the SEC rules require that proposed proxy material be filed in advance for examination by the Commission for compliance with disclosure requirements.

In this light, the present extension of disclosure duties is no clear break with the past. Rather, periodic instances such as the burgeoning of the Rule 10b-5 cases suggested that the old order was on its way out and a new order on its way in.

What the present author objects to, then, in the recent amendment of section thirteen, is section 2(d) (1) (C), which requires disclosure of future plans for the corporation, such as sale, merger alteration of the business structure, and like matter. It may be recalled that in the discussion of the *Fashion Park* case at an earlier point in this article the insider was held to have no duty to disclose future plans, since they were regarded as too remote to affect a reasonable investor.⁴⁰ If the insider has no such duty, it may logically be asked why such a duty should be thrust upon the outsider.⁴¹ Not even in the prospectus, when a new company is offering an issuance to the public, is disclosure of future plans permitted, because they are regarded as of a speculative nature.

³⁹ Swanson, *supra* note 25, at 471 (footnote omitted).

⁴⁰ See note 29 and accompanying text *supra*.

⁴¹ Professor Manne also notes this problem with § 2(d) (1) (C). He further states: "It is almost inconceivable that public disclosure for future plans of operation or liquidation would not be of very keen interest to competitors. Nor is it satisfactory for the SEC to offer to keep matters confidential. This would surely put the SEC in the business of approving or disapproving changes in the plan previously disclosed. But whether the plan is disclosed or confidential, how many potential managers want to be strictly held to follow a specific pro-

Milton Cohen assumes a half-way stance on this provision.⁴² He observes that such disclosures may be essential if restricted to further steps in fulfillment of the takeover. Beyond this, with respect to the bidding corporation's plans to make any other major change in the sought-after company's business or corporate structure, problems and dilemmas abound. By way of exemplification, he cites the case of A, a total outsider, who sees a possible, or even certain, profitable transaction flowing from the use of business, assets or capital structure of T in a certain way. The query is put: should A have a duty to advise potential sellers of T's stock or T's existing management so that, presumably, they could usurp the idea or raise the selling price? Cohen answers: "I should think not, or at least not unless rights or obligations are elevated at many other points in the market place."⁴³

Of course, the problem inherent in Cohen's half-way stand is where the line of demarcation should be drawn. Other commentators have observed problems with formulating any reasonable disclosure, since plans are so indefinite.⁴⁴ Another writer in the area adds dimension to this argument by noting that when an outsider makes an evaluation as to future plans of the company he seeks to acquire, he does so as an outsider, with the same information available to shareholders, and indeed the financial community at large. A decision about future plans to merge, sell or liquidate is, then, an investment decision. The author notes that SEC rules and policy do not require disclosure of investment analysis, the facts used being generally available to the public.⁴⁵

V

In general, the provisions of Public Law 90-439 appear to be soundly constructed. The new amendments force reasonable disclosures in the tender offer area, a device used in essence to avoid the proxy regulations of section fourteen of the 1934 Act. In this

gram of operation? Outside potential managers are in an especially bad position to formulate policy of this sort, and they should not be required to do so. This may indeed be the single most damaging provision of the entire bill, and yet without it, the thrust of the SEC's major concern over cash tender offers seems lost." Manne, *supra* note 2, at 250-51.

⁴² Cohen, *Tender Offers and Takeover Bids*, 23 BUS. LAW 611 (1968).

⁴³ *Id.* at 615.

⁴⁴ See Brudney, *supra* note 6, at 621-22. Brudney's major objection centers around his argument that the offeree as seller has no vital interest in such information. It may be recalled that the present author rejected this line of reasoning as extending too far. It would in effect negate any disclosure requirements under the new law.

⁴⁵ Swanson, *supra* note 25, at 496-97.

sense, the amendments are wholly beneficial. However, as has been pointed out, section 2(d)(1)(C) extends the disclosure obligations to the point of attenuation.⁴⁶

This extension is ill-advised on at least three separate grounds: (1) it extends the disclosure obligations of the outsider beyond those required of the insider-fiduciary; (2) it imposes a penalty on prudent business judgment; and (3) it favors the interests of a management which in many cases has induced the tender offer by its ineptitude. These defects are dispositive of the question of whether there is a need to alter the new amendments.

The section goes far to prove Lon Fuller's dictum that no law is either possible or impossible, only wise or unwise, just or unjust. In this case, section 2(d)(1)(C) is unwise in the extreme. It may be hoped that the doctrine of desuetude will vitiate the consequences of the section. However, to prevent the ghost of this section from stalking about and casting its ominous shadow at unforeseen times, the section should eventually be repealed.

In place of the present section, a new section should be added, the essence of which would adopt Bromberg's distinction,⁴⁷ based upon the reasonable certitude of occurrence of the plans for the acquired corporation. Hence, if the plans are merely speculative and the values uncertain, no disclosure should be demanded.

⁴⁶ Evidence of the fact that that section is already posing problems for the courts, in terms of the specificity of the information to be included in the Schedule 13D form, may be gleaned from two recent cases: *Susquehanna Corp. v. Pan American Sulphur Co.*, 423 F.2d 1075 (5th Cir. 1970) and *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969). In the *International Controls* case, Judge Friendly noted with regard to the section under scrutiny that: "It would be as serious an infringement of these regulations to overstate the definiteness of the plans as to understate them." 409 F.2d at 948.

In the *Susquehanna* decision, Judge Ainsworth observed: "Though the offeror has an obligation fairly to disclose its plans in the event of a takeover, it is not required to make predictions of future behavior, however tentatively phrased, which may cause the offeree or the public investor to rely on them unjustifiably. . . . Target companies must not be provided the opportunity to use the future plans provision as a tool for dilatory litigation. . . ."

"Here the target corporation assails alleged false and misleading omissions and statements of the offeror. The next case may well be one in which exaggeration and overstatement is the basis of the attack. We do not approve either understatement or extravagance. A sensible middle course is the proper one." 423 F.2d at 1085-86 (citations omitted).

⁴⁷ BROMBERG, *supra* note 6.

APPENDIX

AN ACT

JULY 29, 1968 [S. 510] Providing for full disclosure of corporate equity ownership of securities under the Securities Exchange Act of 1934.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled. That section 12 (i) of the Securities Exchange Act of 1934 is amended by striking out "sections 12, 13, 14 (a), 14 (c), and 16" and inserting in lieu thereof "sections 12, 13, 14 (a), 14 (c), 14 (d), 14 (f), and 16".

SEC. 2. Section 13 of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following new subsections:

"(d) (1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, is directly or indirectly the beneficial owner of more than 10 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors—

"(A) the background and identity of all persons by whom or on whose behalf the purchases have been or are to be effected;

"(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price or proposed purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3 (a) (6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public;

"(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities,

any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

“(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the name and address of each such associate; and

“(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.

“(2) If any material change occurs in the facts set forth in the statements to the issuer and the exchange, and in the statement filed with the Commission, an amendment shall be transmitted to the issuer and the exchange and shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

“(3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ‘person’ for the purposes of this subsection.

“(4) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

“(5) The provisions of this subsection shall not apply to—

“(A) any acquisition or offer to acquire securities made or proposed to be made by means of a registration statement under the Securities Act of 1933;

“(B) any acquisition of the beneficial ownership of a security which, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, does not exceed 2 per centum of that class;

“(C) any acquisition of an equity security by the issuer of such security;

“(D) any acquisition or proposed acquisition of a security which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

“(e) (1) It shall be unlawful for an issuer which has a class of equity securities registered pursuant to section 12 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 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.”

SEC. 3. Section 14 of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following new subsections:

“(d) (1) It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursuant to section 12 of this title, or any equity security issued by a closed end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 10 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or

given to security holders such person has filed with the Commission a statement containing such of the information specified in section 13(d) of this title, and such additional informations as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. All requests or invitations for tenders or advertisements making a tender offer or requesting or inviting tenders of such a security shall be filed as a part of such statement and shall contain such of the information contained in such statement as the Commission may by rules and regulations prescribe. Copies of any additional material soliciting or requesting such tender offers subsequent to the initial solicitation or request shall contain such information as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors, and shall be filed with the Commission not later than the time copies of such material are first published or sent or given to security holders. Copies of all statements, in the form in which such material is furnished to security holders and the Commission, shall be sent to the issuer not later than the date such material is first published or sent or given to any security holders.

"(2) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for purposes of this subsection.

"(3) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

"(4) Any solicitation or recommendation to the holders of such a security to accept or reject a tender offer or request or invitation for tenders shall be made in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

"(5) Securities deposited pursuant to a tender offer or request or invitation for tenders may be withdrawn by or on behalf of the depositor at any time until the expiration of seven days after the time definitive copies of the offer or request or invitation are first published or sent or given to security holders, and at any time after sixty days from the date of the original tender offer or request or invitation, except as the Commission may otherwise prescribe by rules, regulations, or order as necessary or appropriate in the public interest or for the protection of investors.

"(6) Where any person makes a tender offer, or request or invitation for tenders, for less than all the outstanding equity securities of a class, and where a greater number of securities is deposited pursuant thereto within ten days after copies of the offer or request or invitation are first published or sent or given to security holders than such person is bound or willing to take up and pay for, the securities taken up shall be taken up as nearly as may be pro rata, disregarding fractions, according to the number of securities deposited by each depositor. The provisions of this subsection shall also apply to securities deposited within ten days after notice of an increase in the consideration offered to security holders, as described in paragraph (7), is first published or sent or given to security holders.

"(7) Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder where securities are taken up and paid for pursuant to the tender offer or request or invitation for tenders whether or not such securities have been taken up by such person before the variation of the tender offer or request or invitation.

"(8) The provisions of this subsection shall not apply to any offer for, or request or invitation for tenders of, any security—

"(A) proposed to be made by means of a registration statement under the Securities Act of 1933;

"(B) if the acquisition of such security, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, would not exceed 2 per centum of that class;

"(C) by the issuer of such security; or

"(D) which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

"(e) It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

“(f) If, pursuant to any arrangement or understanding with the person or persons acquiring securities in a transaction subject to subsection (d) of this section or subsection (d) of section 13 of this title, any persons are to be elected or designated as directors of the issuer, otherwise than at a meeting of security holders, and the persons so elected or designated will constitute a majority of the directors of the issuer, then, prior to the time any such person takes office as a director, and in accordance with rules and regulations prescribed by the Commission, the issuer shall file with the Commission, and transmit to all holders of record of securities of the issuer who would be entitled to vote at a meeting for election of directors, information substantially equivalent to the information which would be required by subsection (a) or (c) of this section to be transmitted if such person or persons were nominees for election as directors at a meeting of such security holders.”

Approved July 29, 1968.