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THE APPLICATION OF SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934 TO TENDER OFFERS

by
Larry E. Ribstein*

The tender offer for control¹ presents a significant potential for liability under section 16(b) of the Securities Exchange Act of 1934,² because it usually entails stock purchases that are large enough to make the tender offeror a "beneficial owner" within the meaning of the section, and because of the risk that the offeror will fail to achieve its objective, possibly necessitating a precipitous sale. Moreover, any argument in favor of liability under 16(b) will probably be pressed by the issuer, the principal enforcer under 16(b), because of the often cool relationship between the tender offeror and incumbent management.

On the other hand, because tender offers are usually made by outsiders, and in all events must be accompanied by full disclosure, tender offers do not involve a possibility of the type of abuse of inside information at which 16(b) was aimed. Additionally, because it is often the single tender offer transaction that makes the offeror a beneficial owner, there is a question whether the tender offer purchases are within the exemptive clause of 16(b) by reason of *Foremost-McKesson, Inc. v. Provident Securities Co.*³

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1. "Tender offer" will be used here in the commonly accepted sense of a public offer to purchase stock. See E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 70 (1973); Bromberg, *Tender Offers: Safeguards and Restraints—An Interest Analysis*, 21 CASE W. RES. L. REV. 613 (1970); Hamilton, *Some Reflections on Cash Tender Offer Legislation*, 15 N.Y.L.F. 269, 271-72 (1969); Moylan, *Exploring the Tender Offer Provisions of the Federal Securities Laws*, 43 GEO. WASH. L. REV. 551, 580 (1975). The term will include both cash and stock offers. It will not include offers by a company to purchase its own stock, since there is no question that 16(b) does not apply to that kind of transaction.

2. Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) (1970), provides:

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, 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, unless such security was acquired in good faith in connection with a debt previously contracted, 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. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such and within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended with the purpose of this subsection.

3. 423 U.S. 232 (1976).

Despite these considerations, the courts have failed to analyze the applicability of 16(b) to purchases in tender offers as a distinct type of transaction. Rather, some dispositions by tender offerors were exempted in *Reliance Electric Co. v. Emerson Electric Co.*,⁴ *Kern County Land Co. v. Occidental Petroleum Corp.*⁵ and *American Standard, Inc. v. Crane Co.*⁶ This approach has left uncertain the status of tender offers under 16(b).

This Article examines the relevant case law and offers an approach to the analysis of the application of 16(b) to purchases in tender offers.

I. TENDER OFFERS AND THE PURPOSE OF SECTION 16(b)

Although tender offers involve the potentiality for many kinds of abuse, an argument can be made that they necessarily do not present the possibility of the specific kind of abuse at which 16(b) was aimed.

During the congressional hearings on the provision that became 16(b), and in the preamble to the enacted section, Congress made it clear that section 16(b) was specifically concerned with the abuse by corporate fiduciaries of their inside knowledge of the affairs of their companies. Thomas Corcoran, the principal drafter of the provision, said that the function of 16(b) was to protect the investor "from being double crossed on the inside by men who know more about the stock than he does,"⁷ and described it as "simply an application of an old principle of the law that if you are an agent and you profit by inside information concerning the affairs of your principal, your profits go to your principal."⁸ The House Report put this principle as follows: "Men charged with the administration of other people's money must not use inside information to their own advantage."⁹

Tender offers are not likely to involve the kind of abuse of inside information 16(b) was intended to reach, because they are generally employed by *outsiders* to gain control where there is some resistance by incumbent management.¹⁰ Some commentators have concluded that tender offerors should not have a general duty to disclose information about the target because they are outsiders.¹¹ Congress seems to have agreed with this conclusion by not explicitly requiring in the Williams Act¹² disclosure by cash tender offerors of information about the target.

It is true that tender offerors may engage in speculation. During the congressional hearings on the Williams Act concern was expressed that tender offerors may sometimes be motivated more by the quick profits made

4. 404 U.S. 418 (1971).

5. 411 U.S. 582 (1973).

6. 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975).

7. *Hearings on H.R. 7852 & H.R. 8720 Before the House Interstate and Foreign Commerce Comm.*, 73d Cong., 2d Sess. 132 (1934).

8. *Id.* at 133.

9. H.R. REP. NO. 1383, 73d Cong., 2d Sess. 13 (1934).

10. See Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 135-39 (1967); Comment, *Economic Realities of Cash Tender Offers*, 20 ME. L. REV. 237, 238-40 (1968).

11. See Bromberg, *Securities Law of Tender Offers*, 15 N.Y.L.F. 459, 541 (1969); Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317, 347-49 (1967); *Hearings on S. 510 before the Subcomm. on Securities of the Comm. on Banking and Currency*, 90th Cong., 1st Sess. 143-44 (1967) (statement of William H. Painter).

12. Securities Exchange Act of 1934, §§ 13(d)-(f), 14(d)-(f), 15 U.S.C. §§ 78m(d)-(f), 78n(d)-(f) (1970).

possible by a merger by the target in reaction to the tender offer (a "defensive merger") than by a wish to achieve control. The suggestion was made not only that 16(b) be used to deal with the problem, but that it be strengthened by giving the Securities and Exchange Commission enforcement powers under the section.¹³

As the then chairman of the SEC acknowledged,¹⁴ however, 16(b) was not intended to curb this kind of speculation. The tender offeror's activities are analogous to those of arbitrageurs, which are specifically exempted from section 16,¹⁵ in that the profits of the tender offeror, like those of the arbitrageur, are based on a knowledge of the market rather than on inside information.¹⁶ The Supreme Court noted in *Kern* that "[c]alculations of this sort . . . whether speculative or not and whether fair or unfair to other stockholders . . . do not represent the kind of speculative abuse at which the statute is aimed"¹⁷

If the tender offeror does not have a substantial inside position in the company, the offeror's activities are not within the intended scope of 16(b) even if it is not an adversary of target management and is receiving inside information as a tippee. The argument that outside tippees should not be reached by 16(b) has been advanced persuasively,¹⁸ and the Supreme Court accepted this argument in not imposing liability on a deputization theory in *Blau v. Lehman Bros.*¹⁹ That interpretation is supported by the legislative history of 16(b); congressional investigation of insiders focused on those who used their position to control corporate events.²⁰ A provision separate from 16(b) in the original bill,²¹ which was ultimately dropped, covered tippees. All of this indicates that Congress intended to distinguish tippees and those covered by 16(b).²²

Even if the tender offeror is a 16(b) insider, its special disclosure obligations under the Williams Act justify excluding it from the operation of 16(b). In recognition of their outsider status, cash tender offerors are not explicitly required to make disclosures about the target, and the courts have been reluctant to impose liability on tender offerors under the Williams Act for failure to disclose information about the target.²³ The courts, however, have recognized a duty on the part of the tender offeror to disclose information

13. *Hearings on H.R. 1711 & S. 510 Before the Subcomm. on Commerce and Finance of the Comm. on Interstate & Foreign Commerce*, 90th Cong., 2d Sess. 30, 75 (1968).

14. *Id.* at 75-76.

15. Securities Exchange Act of 1934, § 16(e), 15 U.S.C. § 78p(e) (1970).

16. See *Falco v. Donner*, 208 F.2d 600, 604 (2d Cir. 1963).

17. 411 U.S. at 597.

18. H. MANNE, *INSIDER TRADING AND THE STOCK MARKET* 30-31 (1966); Wagner, *Deputization under 16(b): The Implications of Feder v. Martin Marietta Corp.*, 78 YALE L.J. 1151 (1969).

19. 368 U.S. 403 (1961). *But see Feder v. Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970); *Lowey v. Howmet Corp.*, [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,836 (S.D.N.Y., Jan. 20, 1977).

20. S. REP. NO. 1455, 73d Cong., 2d Sess. 33-69 (1934).

21. S. 2693, 73d Cong., 2d Sess. (1934).

22. The deletion of the tippee provision may have been due solely to problems of enforceability. See 14 ALA. L. REV. 439, 443 (1962); 3 B.C. INDUS. & COM. L. REV. 561, 568 (1962); 14 STAN. L. REV. 194, 195 (1961); *Hearings, supra* note 7, at 135-37. Even if it was, that does not refute the fact that Congress did not intend to deal with the tippee problem in 16(b).

23. See *Missouri Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851, 873 (2d Cir.), *cert. denied*, 419 U.S. 883 (1974); *Mesa Petroleum Co. v. Aztec Oil & Gas Co.*, 406 F. Supp. 910, 915 (N.D. Tex. 1976); *Alaska Interstate Co. v. McMillan*, 402 F. Supp. 532 (D. Del. 1975).

about the target where the offer would be misleading without such disclosure.²⁴ Moreover, the Second Circuit has stated that a cash tender offeror may be held liable for a material misstatement or omission if it "knew the material facts that were misstated or . . . failed or refused to ascertain such facts when they were available to him or could have been discovered by him with reasonable effort."²⁵ The effect of these cases is that the tender offeror will usually face civil liability under the Williams Act if it fails to disclose whatever material information it has, or may reasonably obtain, about the target. That is because the tender offeror is required to disclose such information as its plans for the target, and, therefore, must make some affirmative statements about the target and the target's prospects.²⁶ Furthermore, stock tender offerors have been held to the high disclosure requirements of the 1933 Act notwithstanding their lack of access to the target.²⁷

Both the commentary²⁸ and the cases²⁹ have recognized that full disclosure may eliminate the possibility of 16(b)-type abuse, at least where the disclosure is in connection with the insider's opening transaction.³⁰ While these authorities have dealt with corporate transactions such as mergers and reclassifications in which the insider and all shareholders are treated alike, such equal treatment is irrelevant to the opportunity to make short-swing profits and, therefore, does not serve to distinguish these transactions from tender offers. If all material information has been disclosed at the time of the opening transaction, the tender offeror must buy at a price that reflects inside information, and, therefore, cannot realize 16(b)-type short-swing profits. A tender offeror is, therefore, not likely to be a 16(b) insider. Even if it is, it arguably does not have an opportunity for 16(b)-type abuse. Nevertheless, as discussed below, whether tender offers are the subject of any general exclusion from the operation of 16(b) remains open to question under the present case law.

II. CURRENT APPLICATION OF 16(b) TO PURCHASES IN TENDER OFFERS

The courts that have given any consideration to whether purchases in tender offers should be subject to 16(b) have touched upon two points: First, whether tender offer purchases are "unorthodox" transactions and, there-

24. See *Sonesta Int'l Hotels Corp. v. Wellington Assocs.*, 483 F.2d 247 (2d Cir. 1973); *Commonwealth Oil Ref. Co. v. Tesoro Petroleum Corp.*, 394 F. Supp. 267 (S.D.N.Y. 1975).

25. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 364 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973). It is not clear whether the 10b-5 scienter standard applied in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), will be applied to cases under § 14(e).

26. Securities Exchange Act of 1934, §§ 13(d)(1)(C), 14(d)(1), 15 U.S.C. §§ 78m(d)(1)(C), 78n(d)(1)(1970).

27. *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971).

28. Lang & Katz, *Liability for "Short-Swing" Trading in Corporate Reorganizations*, 20 Sw. L.J. 472, 487 (1966); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 MICH. L. REV. 592, 610-11 (1974).

29. See *American Standard, Inc. v. Crane Co.*, 510 F.2d at 1051; *Gold v. Sloan*, 486 F.2d 340, 346-47 (4th Cir. 1973), *cert. denied*, 419 U.S. 873 (1974); *Petteys v. Butler*, 367 F.2d 528, 537 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967); *Ferraiolo v. Newman*, 259 F.2d 342, 346 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959); *Roberts v. Eaton*, 212 F.2d 82, 85 (2d Cir.), *cert. denied*, 348 U.S. 827 (1954).

30. *But see Champion Home Builders Co. v. Jeffress*, 490 F.2d 611, 619 (6th Cir.), *cert. denied sub nom. Jeffress v. Kramel*, 416 U.S. 986 (1974) (disclosure in connection with closing transactions).

fore, eligible for a "purpose" analysis under 16(b); and secondly, the appropriate treatment of tender offer purchases under the exemptive clause of 16(b).³¹ None of the courts have engaged in any extensive analysis.

The courts have identified two types of transactions for purposes of 16(b): "Cash-like," or "orthodox," transactions that resemble purchases or sales under contract law in the sense that an interest in a corporation is exchanged for some bargained-for consideration, and "unorthodox" transactions such as conversions, mergers, exchanges, reorganizations, reclassifications, and transactions in options and warrants.³² The courts have excluded only "unorthodox" transactions from 16(b).³³

Under this bifurcated approach, tender offers would probably be included in 16(b) irrespective of whether they present a possibility of 16(b)-type abuse simply because they are cash-like transactions. There is little clear authority on this point. In *Allis-Chalmers Mfg. Co. v. Gulf & Western Industries, Inc.*³⁴ Gulf & Western argued in the trial court that its exchange offer should be treated as unorthodox because there was no possibility for speculative abuse, thus reversing the usual order of analysis. The court responded that there was a possibility for speculative abuse without clearly articulating its reasons, and without considering the orthodox-unorthodox question.³⁵ On the other hand, in *Reliance* the defendant's argument that it was not an insider and, therefore, not liable was rejected by the trial court on the ground that the transaction was a "simple, conventional acquisition of stock for cash."³⁶

The problem of subjecting tender offerors to liability in the face of the exemptive clause was recognized at least as early as 1968 when Manuel Cohen, then Chairman of the SEC, testified at the hearings on the Williams Act that 16(b) "is not as complete as a remedy for some of the takeover situation (*sic*) to which you have referred because some of them are made by persons who either were not more than 10% holders at the time of the acquisition or perhaps never reached that point"³⁷

In *Reliance* Emerson "invited tenders of up to 550,000 shares . . . reserving the right to purchase all shares tendered."³⁸ When the offer expired Emerson elected to purchase the 152,282 shares that had been tendered.³⁹ The court referred to this election as "the stock acquisition,"⁴⁰ apparently

31. Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) (1970): "This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved"

32. See 2 L. LOSS, SECURITIES REGULATION 1069 (2d ed. 1961).

33. See *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973); *Allis-Chalmers Mfg. Co. v. Gulf & W. Indus., Inc.*, 527 F.2d 335, 351-52 (7th Cir. 1975), *cert. denied*, 424 U.S. 928 (1976); *Provident Sec. Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *aff'd*, 423 U.S. 232 (1976); *Newmark v. RKO Gen., Inc.*, 425 F.2d 348, 351 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970); *Makofsky v. Ultra Dynamics Corp.*, 383 F. Supp. 631, 637 (S.D.N.Y. 1974); *Schur v. Salzman*, 365 F. Supp. 725, 729 n.10 (S.D.N.Y. 1973). For criticism of the bifurcated approach see notes 118-25 *infra* and accompanying text.

34. 372 F. Supp. 570 (N.D. Ill. 1974).

35. *Id.* at 576-79.

36. 306 F. Supp. 588, 590 (E.D. Mo. 1969).

37. *Hearings, supra* note 13, at 30.

38. 306 F. Supp. at 589.

39. *Id.*

40. *Id.*

assuming that there was a single purchase at the time of acceptance of tenders. Nevertheless, the court held that the purchase making Emerson a ten percent holder was within 16(b).⁴¹ The court of appeals agreed with the trial court's characterization of the facts⁴² and with the trial court's holding as to the purchase.⁴³ Since Reliance's petition for certiorari was limited to the step-sale question, and no cross-petition was filed by Emerson on the purchase question, the Supreme Court did not consider that question to be before it.⁴⁴

The problem was next considered by the trial court in *Kern County*.⁴⁵ Occidental had offered to purchase up to 500,000 shares.⁴⁶ The court's findings of fact stated that "[b]y May 10, 1967, more than 500,000 shares of Old Kern stock had been tendered to Occidental, enough to make Occidental a beneficial owner of more than 10 percent of Old Kern's issued and outstanding stock."⁴⁷ This is clearly a finding that Occidental became a beneficial owner *at the point of tender*, and, therefore, that each tender constituted a separate purchase under 16(b). Nevertheless, the court said in its conclusions of law that by May 10 "[Occidental] had thus become, *by way of the single tender offer*, the beneficial owner of more than 10 percent of the capital stock of Old Kern The tender offer constituted a single act of Occidental, whereby the company became a beneficial owner of more than 10 percent of Old Kern's capital stock."⁴⁸ The court cited cases on the question of whether the purchase making one a ten percent holder is within 16(b).⁴⁹ Therefore, the court apparently concluded, as had the court in *Reliance*, that while only a single purchase was involved in the tender offer, liability nevertheless attached where this purchase made the defendant a ten percent holder. Occidental's appeal from this ruling was not discussed in the decision of the court of appeals⁵⁰ due to the court's reversal on other grounds.⁵¹

Although the question was not before the Supreme Court in *Kern* because of the defendant's victory in the court of appeals,⁵² the Court said: "Unquestionably, *one or more statutory purchases occur* when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders."⁵³

Finally, in *Allis-Chalmers* the Seventh Circuit did hold that an exchange offer involved a single purchase and was within the exemptive clause. The exemptive clause problem, however, had not been briefed,⁵⁴ and the court

41. *Id.* at 589-90.

42. 434 F.2d 918, 920 (8th Cir. 1970).

43. *Id.* at 922-24.

44. *See* 404 U.S. at 421.

45. *Abrams v. Occidental Petroleum Corp.*, 323 F. Supp. 570 (S.D.N.Y. 1970).

46. *Id.* at 574.

47. *Id.*

48. *Id.* at 579 (emphasis added).

49. *Id.*

50. *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157 (2d Cir. 1971).

51. *Id.* at 161 n.8.

52. The question of when Occidental became a "beneficial owner" was not raised. *See Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. at 595.

53. *Id.* at 584 (emphasis added).

54. Defendant argued that it was not an "insider" and referred to the exemptive clause

did not disclose its rationale for characterizing the offer as a single purchase. Therefore, it is not clear to what extent *Allis-Chalmers* would apply to other tender offers.

The Supreme Court's decision in *Foremost-McKesson* that an outsider's initial ten percent transaction is within the exemptive clause did not clarify the application of the exemptive clause to tender offers. The courts that have directly addressed the issue have agreed that a tender offer constitutes a single purchase, in which event, if it is the first purchase, it would fall within the exemptive clause under *Foremost-McKesson*. There is, however, contrary dictum in *Kern*, and whether the purchase is viewed as occurring on tender as in *Kern*, or on acceptance of tender as in *Reliance*, may be significant. The question must be considered open.

III. EXEMPTION FROM 16(b) OF SALES BY TENDER OFFERORS

The Supreme Court has shown an unwillingness to hold tender offerors liable under 16(b). In *Reliance* the Court followed an "objective" interpretation of 16(b) in permitting a tender offeror facing a defensive merger to minimize its liability by dividing its disposition into two transactions to avoid being a ten percent shareholder prior to the sale. This case is now superfluous in the light of *Foremost-McKesson*, because the last ten percent sold will now always be offset against the defendant's initial ten percent holding and will never result in liability.⁵⁵

Pursuing a very different flexible approach to 16(b) in *Kern*, the Supreme Court went further in holding that neither the granting of an option nor the exchange of shares in a defensive merger by a tender offeror constituted 16(b) sales. In this case the Court was more plainly concerned with the problem of including tender offers within 16(b).⁵⁶ The defendant⁵⁷ and the court of appeals⁵⁸ argued forcefully that imposing liability on tender offerors in a defensive merger situation would tip the delicate balance of power in a tender offer against the offeror, contrary to the interests of target shareholders and to the policy underlying the Williams Act to deal evenhandedly with tender offerors and target management.⁵⁹ In the face of these arguments the Court said that "[i]f there are evils to be redressed by way of deterring those who would make tender offers, 16(b) does not appear to us to have been designed for this task."⁶⁰

To say as the Second Circuit did in *Crane* that *Kern* created a special category under 16(b) for defensive mergers,⁶¹ may, however, be going too far. In *Kern* it was the defendant's lack of access to inside information and

problem only in a footnote. Brief for Appellee at 61-62 n.54, *Allis Chalmers Mfg. Co. v. Gulf & W. Indus., Inc.*, 527 F.2d 335 (7th Cir. 1975), cert. denied, 424 U.S. 928 (1976).

55. See *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. at 243 n.25.

56. Agreeing with this conclusion are Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period*, 20 U.C.L.A. L. REV. 1289, 1318 n.154 (1973); 58 MINN. L. REV. 689 (1974).

57. Brief of Respondent in Opposition to Petition for Certiorari at 25-27, *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

58. 450 F.2d at 163-64.

59. See 113 CONG. REC. 24664 (1967) (remarks of Senator Williams in introducing the bill).

60. 411 U.S. at 597-98.

61. 510 F.2d at 1053.

inability to control the transaction that persuaded the Court not to impose liability. As the Court said: "We do not suggest that an exchange of stock pursuant to a merger may never result in Sec. 16(b) liability. But the involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information convinces us that Sec. 16(b) should not apply to transactions such as this one."⁶² A disposition in a defensive merger by a tender offeror that had some ability to control the transaction and some access to inside information may not be among "transactions such as this one" and would be within 16(b) under *Kern*. How little control or access the defendant must have to satisfy the *Kern* test is not clear.

With respect to what constitutes the requisite control under *Kern*, there is a question whether the test is satisfied even if an insider is able to prevent the transaction, although this might entail substantial cost and inconvenience. In *Gold v. Sloan*⁶³ a defendant was held not liable under *Kern*, although he cast the deciding vote for the merger, in part because "the practical disadvantages of [opposing the merger] appear so obvious as to have made unrealistic any assumption that he might have done so."⁶⁴ In *Makofsky v. Ultra Dynamics Corp.*,⁶⁵ and in the Ninth Circuit decision in *Foremost-McKesson*,⁶⁶ however, sufficient control was found under *Kern* where the defendants' bargaining position gave them some voice in the terms and timing of the transactions, but where issuers had significantly greater leverage.

Access to inside information under *Kern* would seem to be something more than is implied from large stockholdings or official position since Occidental did acquire a more than ten percent interest in Old Kern at the latest upon conclusion of its first offer.⁶⁷ Therefore, *Kern* would arguably retain significance even after the holding in *Foremost-McKesson* that, at least as to large stockholders, technical insider status prior to the first purchase is a prerequisite for liability.

Some of the cases applying *Kern* have so interpreted it. In *Gold* the court distinguished between the chief operating officer who actually participated in negotiations with the issuer and the chairman of the board who did not. *Crane* held that a defendant which received information was not liable because it did not receive the information by virtue of a position in the company, even though it was a ten percent shareholder at the time.

On the other hand, it is not clear whether the defendant may be deemed to have access to information if it is only slightly closer to the source than was *Occidental*. In *Provident*, *Gold*, and *Allis-Chalmers* the courts found opportunities for 16(b)-type abuse under *Kern* on the part of defendants who did

62. 411 U.S. at 600.

63. 486 F.2d 340 (4th Cir. 1973), cert. denied, 419 U.S. 873 (1974).

64. *Id.* at 350.

65. 383 F. Supp. 631 (S.D.N.Y. 1974).

66. 506 F.2d 601 (9th Cir. 1974). See Brief of Respondent at 4-5, *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 93 U.S. 232 (1976), to the effect that the resale of stock was the result of the issuer's insistence on using its own securities as part of the purchase price.

67. See Comment, *Exchange of Stock Pursuant to a "Defensive Merger" is not a "Sale" Within the Meaning of Section 16(b)*, 72 COLUM. L. REV. 1090, 1100 (1972).

not have positions in the issuers, but merely conferred with the issuers' non-hostile management in connection with acquisitions. In fact, the trial court in *Allis-Chalmers* said that there is sufficient access where the defendant is not "locked . . . outside so effectively that [it] . . . could not have acquired inside information had it wanted to."⁶⁸ These cases indicate that *Kern* may be satisfied if the defendant is in a position to receive information as a tippee.⁶⁹

Kern would seem not to exempt a defendant who has access to inside information but no ability to control the transaction. Prior to *Kern* it had been recognized that an insider may make a short-swing profit by buying the security of one issuer knowing the nonpublic fact that the security might soon be exchanged for stock having a greater market value.⁷⁰ That possibility of abuse of inside information exists as long as the merger does not involve the exchange of "economic equivalents," or securities that are substantially the same from a market standpoint.⁷¹ Because the insider's profits result from knowing at the time of the purchase that the merger will take place, it should make no difference whether the insider can control the closing transaction.⁷²

Finally, the *Kern* rule clearly does not apply to orthodox transactions, and the argument that "forced" cash sales should be exempted from 16(b) has been consistently rejected.⁷³ Therefore, *Kern* does not help tender offerors faced by such problems as the threat of an antitrust action, the application of the Investment Company Act of 1940,⁷⁴ or pressing loan obligations.⁷⁵

The *Kern* rule is, therefore, far from an exemption of all tender offers from 16(b). It is, rather, a rule of uncertain application which may amount to

68. 372 F. Supp. at 579.

69. See text accompanying notes 18-22 *supra* for an argument *contra*.

70. See *Newmark v. RKO Gen., Inc.*, 425 F.2d at 353-55; compare *Abrams v. Occidental Petroleum Corp.*, 450 F.2d at 162-63. In the latter case the court distinguished *Newmark* on the ground that Occidental, unlike RKO, had no knowledge of the impending merger.

71. As to what constitutes "economic equivalence" under 16(b) compare *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002 (1967), *Pettys v. Butler*, 367 F.2d 528, 537 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967), and *Ferraiolo v. Newman*, 259 F.2d 342, 346 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959), with *Blau v. Mission Corp.*, 212 F.2d 77 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954), *Marquette Cement Mfg. Co. v. Andreas*, 239 F. Supp. 962 (S.D.N.Y. 1965), and *Blau v. Hodgkinson*, 100 F. Supp. 361 (S.D.N.Y. 1951). See also Securities and Exchange Commission rule 16b-7, 17 C.F.R. § 240.16(b)(7) (1976), which exempts merger exchanges from 16(b) only where, in the view of one commentator, they "are of relatively minor significance to the stockholders of the liquidated corporation and present no significant opportunities for trading on the basis of advance information concerning the prospect of a merger." 2 L. Loss, *supra* note 32, at 1119.

72. See Comment, *supra* note 67, at 1100-01; 58 MINN. L. REV. 689, 699-700 (1974). *Contra*, *Makofsky v. Ultra Dynamics Corp.*, 383 F. Supp. at 640, in which the court would impose liability only upon a finding of some control over the transaction by defendant, and Weinstock, *Section 16(b) and the Doctrine of Speculative Abuse: How to Succeed in Being Subjective Without Really Trying*, 29 BUS. LAW. 1153 (1974), arguing that control should be the principal factor in determining whether the transaction is within 16(b).

73. See *Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965), *cert. denied*, 382 U.S. 987 (1966) (sale in the face of antitrust action); *American Standard, Inc. v. Crane Co.*, 346 F. Supp. 1153, 1163 (S.D.N.Y. 1972), *rev'd on other grounds*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975) (same); *Allis-Chalmers Mfg. Co. v. Gulf & W. Indus., Inc.*, 372 F. Supp. at 579 (dividing of quarterly dividend by target); *Alloys Unlimited, Inc. v. Gilbert*, 319 F. Supp. 617, 619 (S.D.N.Y. 1970) (sale by pledgee); *Volk v. Zlotoff*, 285 F. Supp. 650 (S.D.N.Y. 1968) (need to raise working capital on behalf of issuer).

74. See E. ARANOW & H. EINHORN, *supra* note 1, at 192-200.

75. See *id.* at 41-45.

an exemption of some tender offers, but on which tender offerors would be ill-advised to rely.

IV. AN ANALYSIS OF THE APPLICATION OF 16(b) TO PURCHASES IN TENDER OFFERS

As indicated above, there are two principal questions with respect to the application of 16(b) to tender offer purchases. First, are purchases in a tender offer by one whose pre-offer purchases did not exceed ten percent of a class of target securities excluded under the exemptive clause? Secondly, aside from the exemptive clause, may tender offer purchases be excluded from 16(b) under a "purpose" approach although they are cash-like, "orthodox," transactions?

A. *The Time of Purchase and the Exemptive Clause*

When the tender offer makes the purchaser a beneficial owner of more than ten percent of a class of the target's securities, the transaction will be exempt under *Foremost-McKesson* if the tender offer constitutes a single purchase. On the other hand, if the tender offer is viewed as a series of separate purchases, the tender offeror becomes a ten percent beneficial owner prior to its purchase of all the shares in the tender offer and its purchase of the remaining shares will be within the proscription of 16(b). A comparison of *Reliance* and *Kern* suggests that the courts will be more willing to view the tender offer as consisting of a single purchase if the purchases occur simultaneously, as, for example, where all tenders are accepted at one time. Therefore, an analysis of tender offers under the exemptive clause is necessary to determine precisely when the purchase takes place for 16(b) purposes.⁷⁶

A 16(b) transaction has generally been deemed not to have occurred on passage of title, but rather when the opportunity for speculative abuse first arises. That, in turn, has been held to be when the parties' rights and obligations become fixed.⁷⁷

The argument has been advanced that the purchase transaction should be deemed to occur as soon as the insider has obtained a binding option to buy at a certain price, since at that point he may sell knowing that a profit is assured.⁷⁸ In recognition of this opportunity for speculation, the SEC con-

76. Of course, the time of purchase also determines when a sale can be made without incurring liability under 16(b). The considerations in connection with determining the time of purchase under 16(b) do not differ according to whether an exemptive clause or length of period problem is involved.

77. *Morales v. Mapco*, [1976] FED. SEC. L. REP. (CCH) ¶ 95,704 (10th Cir., Aug. 27, 1976); *Silverman v. Landa*, 306 F.2d 422 (2d Cir. 1962); *Stella v. Graham-Paige Motors Corp.*, 232 F.2d 299 (2d Cir.), cert. denied, 352 U.S. 831 (1956); *Blau v. Ogsbury*, 210 F.2d 426 (2d Cir. 1954); *Morales v. Reading & Bates Offshore Drilling Co.*, 392 F. Supp. 41 (N.D. Okla. 1975); *Lewis v. Realty Equities Corp.*, 373 F. Supp. 829 (S.D.N.Y. 1974); *Lewis v. Dwyer*, 365 F. Supp. 607 (D. Mass. 1973); cf. *Brenner v. Career Academy, Inc.*, 467 F.2d 1080 (7th Cir. 1972) (transaction held not to occur until proceeds were received, and profits were thereby realized).

78. See R. JENNINGS & H. MARSH, JR., *SECURITIES REGULATIONS* 1305-06 (3d ed. 1972); Hardee, *Stock Options and the 'Insider Trading' Provisions of the Securities Exchange Act*, 65 HARV. L. REV. 997 (1952); Comment, *The Application of Section 16(b) to Mergers: A Hidden Hazard*, 47 TEXAS L. REV. 1417 (1969); Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period*, 20 U.C.L.A. L. REV. 1289 (1973); Note, *The Scope of 'Purchase' and 'Sale' Under Section 16(b) of the Exchange Act*, 59 YALE L.J. 510 (1950).

siders an optionee to be a beneficial owner for reporting purposes under 16(a).⁷⁹ In *Newmark v. RKO* the Second Circuit followed this reasoning in holding the defendant to be a beneficial owner for purposes of 16(b) as of when it acquired an option to purchase, so that defendant's first purchase was not exempt.⁸⁰

There is also some authority that the transaction occurs when the insider is obligated to perform even if it does not have a right to performance. This result is more difficult to justify under 16(b) because unless the other party is committed to the transaction, the insider has no position in the security against which to engage in short-swing speculation.⁸¹ In *Provident*, however, the Ninth Circuit held that the sale by Provident to the underwriters took place on execution of the underwriting agreement rather than upon closing even though the underwriters had the benefit of an "out" clause and, therefore, were not irrevocably bound to perform until closing.⁸² The Supreme Court criticized this holding,⁸³ but did not reach the issue. *Blau v. Allen*⁸⁴ and *Bershad v. McDonough*⁸⁵ also held that the granting of an option triggered liability, but did so on the ground that the transaction was really a disguised sale.⁸⁶

Thus, a 16(b) transaction may be deemed to occur when the insider either has both binding rights and obligations or merely a right to performance. It probably does not occur when an insider has only an obligation to perform. But when do the respective parties in a tender offer become bound for purposes of 16(b)?

A *binding contract* is created upon the stockholder's tender of shares in response to a tender offer.⁸⁷ Although many tender offers are styled "invitation for tenders,"⁸⁸ and others that are styled "offer" also state that an agreement is created only upon acceptance by the purchaser,⁸⁹ the usual tender offer is a true offer in that it displays an intention by the tender offeror to enter into a contract upon tender.⁹⁰ Moreover, the mere existence of conditions precedent to the duty of one party to perform will not usually

79. SEC rule 16a-2, 17 C.F.R. § 240.16a-2 (1976). But see SEC rules 16b-3, 16b-6, 17 C.F.R. §§ 240.16b-3, .16b-6 (1976), for apparently conflicting positions, and the discussion at note 112 *infra* concerning the difference between the functions of 16(a) and 16(b).

80. *Newmark v. RKO Gen., Inc.*, 425 F.2d at 356. Although the court's reasoning as to the effect of the acquisition of the option appears sound, it is difficult to understand how an insider can be a "beneficial owner" prior to its first purchase, or, in other words, how there can be two first purchases.

81. See *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. at 601-02; *Silverman v. Landa*, 306 F.2d 422, 424 (2d Cir. 1962); R. JENNINGS & H. MARSH, *supra* note 78, at 1306; Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period*, 20 U.C.L.A. L. REV. 1289, 1320-23 (1973).

82. 506 F.2d at 606-07.

83. 423 U.S. at 238-39 nn.7 & 8.

84. 163 F. Supp. 702 (S.D.N.Y. 1958).

85. 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971).

86. Compare *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. at 603.

87. See *Lowenschuss v. Kane*, 520 F.2d 255 (2d Cir. 1975); *Bache & Co. v. International Controls Corp.*, 324 F. Supp. 998 (S.D.N.Y. 1971); *Levenburg v. Merrill, Lynch, Pierce, Fenner & Beane*, 334 Mich. 508, 54 N.W.2d 626 (1952).

88. See E. ARANOW & H. EINHORN, *supra* note 1, at 69 n.18.

89. See, e.g., *Offer by Becker Industries for Commercial Solvents*, N.Y. Times, Mar. 1, 1974, at 40, col. 1.

90. See *R.E. Crummer & Co. v. Nuveen*, 147 F.2d 3 (7th Cir. 1945); RESTATEMENT OF CONTRACTS § 25 (1932); 1 WILLISTON ON CONTRACTS § 26 (3d ed. 1957).

prevent the formation of a contract,⁹¹ although the tender offeror may impose a condition which is clearly precedent not only to the creation of duties under the contract, but to the existence of the contract itself.⁹² This was the case in *Allis-Chalmers* in which the approval of Gulf & Western shareholders was necessary to validate the exchange offer.

The question of when a binding contract is formed must, however, be distinguished from the question of when the parties are irrevocably bound to perform under that contract. The tender offeror will rarely be irrevocably bound to perform prior to the time it actually purchases the shares by accepting tenders and paying for the stock.⁹³ The offer will nearly always provide that the offeror's obligation is subject to the nonoccurrence of a number of adverse events prior to the acceptance of tenders. This will especially be so following the decision in *Lowenschuss v. Kane*⁹⁴ that a tender offeror that does not protect itself with such an "out" clause may be liable as a result of not proceeding with the offer even if the offer has been enjoined. Where the offer does contain an out clause, the nonoccurrence of any event specified in the clause prior to the acceptance of tenders is a condition precedent to the tender offeror's duty of performance.⁹⁵

In the unlikely event that the offer does not contain an out clause, the offeror would be bound upon tender unless there were other conditions precedent to its duty of performance. Some offers do provide that the offeror is not bound to purchase any shares unless a certain minimum number are tendered; other offers limit the tender offeror's obligation to a maximum number of shares, in which event the offer is required by the Williams Act to provide for the pro rata purchase of shares tendered within ten days after the beginning of the offer.⁹⁶ These conditions, however, tend to deter purchases by arbitrageurs, which are important to the success of most offers,⁹⁷ and, thus, it is highly unlikely that a tender offeror would neglect to protect itself with an out clause while including one of the conditions just mentioned.

If, then, the transaction is deemed to occur for 16(b) purposes when the tender offeror is bound to perform, a 16(b) purchase in a tender offer will rarely occur before the tender offeror has actually accepted tenders. A

91. *Watson Bros. Transp. Co. v. Jaffee*, 143 F.2d 340 (8th Cir. 1944); 1 CORBIN ON CONTRACTS § 83 (1963); RESTATEMENT OF CONTRACTS § 84(f) (1932); 1 WILLISTON ON CONTRACTS §§ 43, 44, 112 (3d ed. 1957).

92. *Detroit Football Co. v. Robinson*, 186 F. Supp. 933 (E.D. La. 1960); *Los Angeles Rams Football Club v. Cannon*, 185 F. Supp. 717 (S.D. Cal. 1960); see Comment, *The Application of Section 16(b) to Mergers: A Hidden Hazard*, 47 TEXAS L. REV. 1417, 1433-35 (1969).

93. Tender offers do not generally provide for a specific date by which tenders must be accepted, although tender offerors may not delay acceptance for an unreasonable amount of time. See *Salinger v. Ling-Temco-Vought, Inc.*, 324 F. Supp. 1006 (W.D. Pa. 1971); SEC proposed rule 144-2, SEC Securities Exchange Act Release No. 34-12676, [1976] FED. SEC. L. REP. (CCH) ¶ 80,659 (requiring the tender offeror to pay the offered consideration or return the securities within ten days after the termination of the offer). If the tender offeror does delay unreasonably, it would presumably be liable for damages resulting from the delay, but it would not at that point become bound to purchase the stock.

94. 520 F.2d 255 (2d Cir. 1975).

95. See 3A CORBIN ON CONTRACTS § 741 (1951). See also *Stewart v. Griffith*, 217 U.S. 323 (1910); 8 WILLISTON ON CONTRACTS § 948C (3d ed. 1964).

96. Securities Exchange Act of 1934, § 14(d)(6), 15 U.S.C. § 78n(d)(6) (1970).

97. See E. ARANOW & H. EINHORN, *supra* note 1, at 173-91.

different conclusion is reached, however, if under *Newmark* the transaction is deemed to take place as soon as the shareholder becomes bound.

The shareholder is bound upon tender subject only to his right under section 14(d)(5) of the Securities Exchange Act⁹⁸ to withdraw his shares at any time within seven days from the commencement of the offer. After the expiration of the seven-day period, the shareholder is bound even if the offeror is not.⁹⁹ Since, as a result of the ten-day pro rata provision, a shareholder has little need to tender before the tenth day after the offer, many shareholders will await further developments and tender near the end of the ten-day period, each becoming bound separately upon tender. Therefore, there is a greater likelihood that separate purchases will be deemed to take place under *Newmark* than if the purchase occurs when the tender offeror becomes bound by acceptance of tenders.¹⁰⁰

There are two considerations, however, which militate against deeming the transaction to take place either upon tender or on expiration of the withdrawal period. First, if the tender offeror is not an insider prior to the tender offer, the date of tender is not significant in terms of the tender offeror's opportunity for speculative abuse. The acquisition of a right to purchase stock may have a presumed effect on an insider's ability to use inside information, but does not necessarily confer access to information.¹⁰¹ Where a right to buy stock is acquired from the management or controlling stockholders of a corporation, the optionee then acquires leverage with those who control the flow of information, and as a prospective purchaser may become entitled to such information under the securities laws and the theory of common law fraud. The acquisition of rights from individual stockholders, however, effects no such change in the outside tender offeror's ability to obtain inside information.

The tender offer affects the outside tender offeror's access to inside information, if at all, only when the offer results in the winning of control from a hostile management. That does not occur at least until the tender offeror has the *irrevocable* power to vote the requisite number of shares. Even if the offeror requests the delivery of proxies with the transmittal of shares, the proxies will not be irrevocable until they are coupled with an interest in the company, which will not occur at least until the offeror has an obligation, rather than merely a right, to purchase the stock.¹⁰²

Secondly, there is support in the Supreme Court's decisions on 16(b) for

98. 15 U.S.C. § 78n(d)(5) (1970).

99. See *Missouri Portland Cement Co. v. Cargill*, 498 F.2d 851, 874 (2d Cir.), cert. denied, 419 U.S. 883 (1974); 1 CORBIN ON CONTRACTS § 83 (1951); 1 WILLISTON ON CONTRACTS § 78 (3d ed. 1957).

100. This situation will be changed if the SEC promulgates proposed rule 14d-5(a), which makes the withdrawal period coextensive with the pro rata period. SEC Securities Exchange Act Release No. 34-12676, [1976] FED. SEC. L. REP. (CCH) ¶ 80,659, at 86,698-99. Under that rule most tendering shareholders will become bound at once, upon expiration of the ten-day period, and there will arguably be a single purchase.

101. Compare *Newmark v. RKO Gen., Inc.*, 425 F.2d 348 (2d Cir.), cert. denied, 400 U.S. 854 (1970), with *Stella v. Graham-Paige Motors Corp.*, 232 F.2d 299 (2d Cir.), cert. denied, 352 U.S. 831 (1956), in which the court refused to hold that the initial transaction took place upon the acquisition of a right to purchase the stock.

102. See *Byrne v. Morley*, 78 Idaho 172, 299 P.2d 758, 760 (1956); *Stoelting Bros. Co. v. Stoelting*, 246 Wis. 109, 16 N.W.2d 367 (1944).

deeming the purchase to occur for 16(b) purposes on acceptance of tenders irrespective of when the opportunity for speculative abuse first arises. The Court has consistently construed 16(b) narrowly against liability. As noted above,¹⁰³ the Court held in *Reliance* that when a 16(b) sale took place depended upon how the defendant structured its transaction. Most recently, in *Foremost-McKesson*, the Court justified its narrow construction of the exemptive clause in part by noting that "[i]t is inappropriate to reach the harsh result of imposing [section] 16(b)'s liability without fault on the basis of unclear language."¹⁰⁴ Since the purchase takes place under the terms of the offer on acceptance of tenders, a narrow reading of the section would dictate that acceptance is when the purchase should be deemed to take place for purposes of 16(b).

There is, then, strong reason to believe that purchases in a tender offer do not occur for 16(b) purposes until the tender offeror's acceptance of tenders. If that is so, then the tender offeror that is not a ten percent shareholder prior to the offer can maximize the possibility that the transaction will be considered within the exemptive clause by accepting all the tenders at once, rather than separately as the tenders are made.

B. "Group" Purchases under 16(b)

Even if a tender offeror does not itself make purchases prior to the offer, the exemptive clause may not be applicable if the tender offeror can be held responsible for pre-offer purchases made by others.

To help ensure that the offer will succeed without expending its own funds, a tender offeror may employ various methods of putting target securities into friendly hands. These methods include formally agreeing to act in concert with another party in acquiring stock prior to the offer, sometimes committing itself to repurchasing the stock, or simply tipping institutional friends about the impending offer so that the institution will buy at low pre-offer prices with the purpose of tendering.¹⁰⁵ The consequences under 16(b) of such practices are not clear.

Under the Williams Act purchases by separate individuals may be aggregated if the purchasers act as a "group for the purpose of acquiring, holding, or disposing of securities of an issuer."¹⁰⁶ A group has been said to exist where there is an agreement to act together, irrespective of whether members of the group have beneficial ownership of or control over the stock held by others.¹⁰⁷ In 1960 the SEC proposed a rule under 16(a), which was later withdrawn, that would have required joint reporting by "groups" defined in

103. See text at note 55 *supra*.

104. 423 U.S. at 244.

105. For descriptions of these activities, which have been referred to as "warehousing," and their legal consequences, see E. ARANOW & H. EINHORN, *supra* note 1, at 25-29; Thomas, *Warehousing*, 3 REV. SEC. REG. 975 (1970); INSTITUTIONAL INVESTOR STUDY REPORT OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. NO. 92-64, 92d Cong., 1st Sess. 2771-849 (1971).

106. Securities Exchange Act of 1934, §§ 13(d)(3), 14(d)(2), 15 U.S.C. §§ 78m(d)(3), 78n(d)(2) (1970).

107. See *Corenco Corp. v. Schiavone & Sons*, 488 F.2d 207, 217 (2d Cir. 1973); *Texasgulf Co. v. Canada Dev. Co.*, 366 F. Supp. 374, 403-05 (S.D. Tex. 1973).

language identical to that later adopted in the Williams Act.¹⁰⁸

This group concept should not be carried over to 16(b). The pertinent provisions of the Williams Act are intended not to curb speculation by insiders, but simply to provide information about large accumulations of stock that may indicate a possible shift in corporate control.¹⁰⁹ Although 16(a) is aimed at insider trading, it is intended primarily to force disclosure of aggregations of stock which may, but need not, involve violations of 16(b).¹¹⁰

Until recently, the courts have generally declined to make a defendant responsible under 16(b) for transactions or stockholdings of another unless the defendant not only reaped benefits from the stock, but exercised substantial control over it.¹¹¹ The SEC, however, has regarded a person as beneficial owner of securities held by another for reporting purposes under 16(a) "if by reason of any contract, understanding, relationship, agreement or other arrangement he obtains therefrom benefits substantially equivalent to those of ownership."¹¹²

In *Whiting v. Dow Chemical Co.*¹¹³ the Second Circuit followed this rule in holding the defendant liable by reason of his wife's transactions when the transactions were jointly controlled but when the benefits were shared in the sense that the wife contributed to household expenses and to the joint estate. The court said that the reason for the SEC's rule was that the insider has an incentive to tip inside information when he will benefit,¹¹⁴ and that under the circumstances the present defendant could "use" inside information.¹¹⁵ *Whiting* was approved in *Altamil Corp. v. Pryor*,¹¹⁶ but in that case the husband did have control over the wife's transactions.

Whiting arguably supports the attribution of the "friends" transactions to the tender offeror. When purchases are made by allies of the tender offeror, "benefits substantially equivalent to those of ownership" are realized by the tender offeror, because the need of the tender offeror to raise funds with which to make the purchases itself is reduced.¹¹⁷ In such a situation the

108. SEC Securities Exchange Act Release No. 6435 (1960) (rule 16a-31a proposed); SEC Securities Exchange Act Release No. 6487, at 1 (1961) ("group" provision withdrawn).

109. See *GAF Corp. v. Milstein*, 453 F.2d 709, 717 (2d Cir.), cert. denied, 406 U.S. 910 (1971). See also SEC Securities Exchange Act Release No. 13,291, [1977] FED. SEC. L. REP. (CCH) ¶ 80,980, at 87,577, concerning new reporting rules under the Williams Act: "[T]he new rules are not intended to affect interpretations of the provisions of § 16 of the Exchange Act, or the rules and regulations thereunder, since the purposes of § 16 are different from those of § 13(d)."

110. See *Feldman & Teberg, Beneficial Ownership Under § 16 of the Securities Exchange Act of 1934*, 17 CASE W. RES. L. REV. 1054 (1966).

111. See *Blau v. Mission Corp.*, 212 F.2d 77 (2d Cir.), cert. denied, 347 U.S. 1016 (1954); *Popkin v. Dingman*, 366 F. Supp. 534 (S.D.N.Y. 1973); *Blau v. Potter*, [1973] FED. SEC. L. REP. (CCH) ¶ 94,115 (S.D.N.Y. 1973); *Truncala v. Blumberg*, 80 F. Supp. 387 (S.D.N.Y. 1948); 9 CREIGHTON L. REV. 629 (1976). But see *Landy v. United Fruit Co.*, 305 F. Supp. 254 (D.N.J. 1969), in which the court, without discussion, apparently considered defendant a beneficial owner of the issuer by virtue of the fact that it was 25% owned by mutual funds that owned 14% of the issuer, and *Marquette Cement Mfg. Co. v. Andreas*, 239 F. Supp. 962 (S.D.N.Y. 1965), in which the court, without discussion, attributed to defendant purchases by a corporation of which he was a 24.9% owner.

112. See SEC Securities Exchange Act Release No. 34-7793, 17 C.F.R. § 241.7793 (1976).

113. 523 F.2d 680 (2d Cir. 1975).

114. *Id.* at 687.

115. *Id.* at 688.

116. 405 F. Supp. 1222 (S.D. Ind. 1975).

117. See *Fleischer, Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. PA. L. REV. 798, 814 (1973).

tender offeror obviously has an incentive to tip inside information to the technical owner.

On the other hand, the realization of benefits sufficient to provide an incentive to tip information, or an ability to "use" inside information, without more, is probably not a sufficient basis for attributing the transactions of others to the tender offeror under 16(b). The question under 16(b) should not be whether outside tippees are likely to benefit from the insider's information, or whether the insider may, in general, "use" inside information, but whether the insider is able to realize short-swing profits by virtue of the tippees' purchases. The benefits accruing to the tender offeror from its friends' purchases are not such as to enable the tender offeror to realize profits from offsetting short-swing transactions, unlike the situation in *Whiting* in which the insider and his wife shared in the *profit* resulting from their transactions. Therefore, purchases by friends of the tender offeror should not be attributed to the tender offeror for purposes of 16(b). There is no assurance, however, that the courts will not follow *Whiting* to the opposite conclusion.

C. *Tender Offers as Involving 16(b) "Purchases"*

Although many tender offers will fall within the exemptive clause under the above analysis, tender offerors may still become ten percent shareholders before purchasing additional shares through pre-offer market purchases, multiple tender offers, or acceptance of tenders in separate transactions. Therefore, it is important to determine whether, aside from the exemptive clause, tender offers may properly be considered to be within 16(b).

As discussed above,¹¹⁸ a strong argument can be made that tender offers do not present the potential for 16(b)-type abuse regardless of whether they are made by outsiders or by 16(b) insiders. Under the approach that has generally been followed in applying 16(b), however, tender offers would be included within the section even if the courts agreed with this argument because a tender offer, as an "orthodox" transaction, would not be considered eligible for a purpose analysis.

The courts' refusal to look to legislative intent in applying 16(b) to cash transactions is essentially an application of the rule that courts should not construe a legislative provision contrary to its "plain meaning."¹¹⁹ The application of 16(b) according to its "plain meaning" makes no sense in this context. If the courts have assumed that merely because "purchase" generally includes bargained-for transactions, Congress necessarily intended 16(b) to include only such transactions, then the courts are incorrect. Congress never considered the applicability of 16(b) to tender offers. If Congress had considered this question, it would, as suggested above,¹²⁰ have deemed the section inapplicable. The courts are also incorrect if they have concluded that what Congress intended is irrelevant in the face of the literal meaning of the provision. The letter of the statute should not prevail over

118. See notes 7-30 *supra* and accompanying text.

119. See generally *Caminetti v. United States*, 242 U.S. 470 (1917); 2A C. SANDS, STATUTES AND STATUTORY CONSTRUCTION § 45.02 (4th ed. 1973).

120. See notes 7-30 *supra* and accompanying text.

legislative intent. Certainly whether or not courts follow legislative intent should not depend on the form of the transaction.¹²¹

There is ample authority for applying a statute in accordance with legislative intent but contrary to its "plain meaning."¹²² Most notably, in a closely analogous situation, the Supreme Court decided in *United Housing Foundation, Inc. v. Forman*¹²³ that instruments denominated "stock" were not within the Securities Acts' definition of "security," even though "security" is defined to include "stock."¹²⁴ The Court stated:

[b]ecause securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto. Thus, in construing these Acts against the background of their purpose, we are guided by a traditional canon of statutory construction: "[that] a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."¹²⁵

The "economic realities" are certainly no less important with respect to 16(b) than they were in *Forman*.

The courts should recognize that legislative intent may be taken into account irrespective of the form of the transaction, and exclude tender offer purchases from the operation of 16(b) on the ground that they do not involve a possibility for 16(b)-type abuse.

A better solution to the problem would be for the SEC to use its power under 16(b) to exempt transactions "not comprehended within the purpose of this subsection," and promulgate a rule which exempts some or all tender offers, or at least clarifies the matter of when purchases in tender offers occur. Since tender offerors could rely on such a rule without fear of liability,¹²⁶ the rule would have the effect of creating much needed certainty in connection with the planning of business transactions.

Insofar as the power of the SEC to exempt tender offers is concerned, whether tender offers are within the literal language of 16(b) would be irrelevant.¹²⁷ On the other hand, at least one court has indicated that the SEC is not permitted to weigh the benefits and costs of bringing within 16(b) a transaction in which there is any possibility of speculative abuse.¹²⁸ Thus, a tender offer exemption might be struck down by a court that concluded that there is some possibility of 16(b)-type abuse in tender offers.

121. For other commentary critical of the bifurcated approach see Comment, *supra* note 92, at 1422-23; Note, *Involuntariness and Other Contemporary Problems Under Sec. 16(b) of the Securities Exchange Act of 1934*, 27 HASTINGS L.J. 679, 685-86 (1976); Note, *supra* note 28, at 622-24; 49 N.Y.U. L. REV. 353, 370-71 (1974).

122. See, e.g., *Cass v. United States*, 417 U.S. 72, 75-79 (1974); *Harrison v. Northern Trust Co.*, 317 U.S. 476, 479 (1943); *United States v. American Trucking Ass'ns, Inc.*, 310 U.S. 534, 543 (1940); C. SANDS, *supra* note 119, § 46.07.

123. 421 U.S. 837 (1975).

124. Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1970); Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1970).

125. 421 U.S. at 849 (citations omitted).

126. See Securities Exchange Act of 1934, § 23(a), 15 U.S.C. § 78w(a) (1970).

127. See *Perine v. William H. Norton & Co.*, 509 F.2d 114 (2d Cir. 1974).

128. *Greene v. Dietz*, 247 F.2d 689 (2d Cir. 1957).

V. CONCLUSION

The purpose of this Article was not to consider the question of whether tender offers should be regulated, but only whether they should be included within the narrow scope of 16(b). To require tender offerors to shape their activities in an effort to avoid 16(b) liability, or to disgorge their profits when they have not been nimble enough, is to exact a penalty without the corresponding benefit of deterring activities Congress has deemed harmful.

The formulation of general standards of liability under 16(b), particularly in *Kern*, has resulted in a lack of predictability in the administration of a statutory provision that was intended to be eminently predictable. Unpredictability may be, in general, a worthwhile price to pay for flexibility of operation, but it is unnecessary where a distinct type of transaction, such as the tender offer, can be recognized and dealt with in a rule of clear-cut applicability.

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