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Herbert S. Wander

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SELECTING TARGETS AND SHAPING STRATEGY IN CORPORATE TAKE-OVERS: SECURITIES LAW CONSIDERATIONS*

by

Herbert S. Wander**

SECURITIES law experts have generally been the captains of the teams of advisors guiding offeror companies in making take-over bids. They bring to the team their familiarity with securities regulation and also a corporate law background. In the past, these have been the essential areas of law involved. To maintain their pre-eminence in this field, however, securities lawyers will have to expand their horizons and become knowledgeable in other disciplines. Today, for example, the anti-competitive problems associated with mergers and acquisitions have moved to center stage.¹ And, although not as prominent as the antitrust aspects, the Tax Reform Act of 1969 necessitates a thorough grasp of the changes in the Internal Revenue Code that might affect mergers and acquisitions.² Indeed, the principal outside advisor to a company's take-over program, whether he be a securities or antitrust lawyer or investment maker, will have to maintain a flexible attitude. He cannot become wedded to any fixed position. Instead, he must approach each offer fresh with new ideas and imagination, and he must recognize the important shifts taking place in the economy that require new methods in order to plan and execute a successful tender offer. This is strikingly illustrated by reviewing statements made by the experts only a few years ago. They concluded, and most securities lawyers agreed, that in a contested take-over situation, a cash offer was necessary to prevail, whereas a stock exchange offer, which has to be made through a registration statement, had little or no chance to succeed.³ However, as market conditions and interest rates have changed, it has become apparent that cash is not essential. In testifying before the Senate Subcommittee on Banking and Currency in early 1969, Chairman

* This Article is an adaptation of a paper delivered at the Eighth Annual Corporate Counsel Institute held at Northwestern University School of Law on October 8 and 9, 1969.

** B.A., University of Michigan; LL.B., Yale University. Attorney at Law, Chicago, Illinois.

¹ The Antitrust Division of the Justice Department has vigorously attacked some proposed acquisitions and has indicated a desire to halt the combination of large conglomerates where the Division believes such combinations will be anti-competitive. See, e.g., *United States v. Northwest Indus., Inc.*, 1969 Trade Cas. ¶ 72,853 (N.D. Ill. 1969). Target companies have also been raising the antitrust issue with more success than in the past. Compare *Lunkenheimer Co. v. Condec Corp.*, 268 F. Supp. 667 (S.D.N.Y. 1967), with *Allis-Chalmers Mfg. Co. v. White Consol. Indus., Inc.*, 414 F.2d 506 (3d Cir. 1969), and *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, 1969 Trade Cas. ¶ 72,890 (S.D.N.Y. 1969). The Federal Trade Commission is also studying the merger movement. See the Staff Report of the Federal Trade Commission entitled "Economic Report on Corporate Mergers," reprinted in *Hearings on Economic Concentration Before Senate Subcomm. on Antitrust and Monopoly of the Comm. on the Judiciary*, 91st Cong., 1st Sess. pt. 8A (1969).

² The Tax Reform Act of 1969 should be carefully analyzed. The two principal revisions affecting take-over bids are the limitation of interest deduction and the use of the installment method of reporting gains where certain types of debt securities are offered. See Tax Reform Act of 1969, §§ 411-12, 415, amending INT. REV. CODE OF 1954, §§ 279, 453(b), 385.

³ See B. BLAIR, *THE STRATEGY OF TENDER SOLICITATIONS* 1-2 (1967); Hayes & Tausig, *Tactics of Cash Take-Over Bids*, 45 HARV. BUS. REV. 135 (1967).

Budge of the SEC revealed that from the adoption of the Williams Act in late July of 1968 through February of 1969, the SEC had fifty-four tender offer filings involving approximately \$1 billion 424 million. In contrast, during essentially the same period, 104 registration statements for offerings of securities in exchange for other securities were registered with the Commission. The amount of these securities was approximately \$9 billion.⁴

In addition to being alert to the changing economic climate, the professional take-over advisor should also warn his client that possible future market changes must be considered before a take-over attempt is made. Of course, the ultimate decision to proceed with the bid rests with the client, but the client should recognize the implications of his proposed course of action. Unless the client has satisfactorily answered some of the following questions, then perhaps he should not undertake a contested take-over bid:

1. What if the interest rate changes?
2. Because the normal contractual warranties will be absent in a contested take-over situation, what if the offer is successful and then the offeror learns that what he owns is not as attractive as he originally anticipated?
3. What if the offeror acquires some securities of the offeree, but not control? How will this affect his corporate image? Further, what if there is a market drop and he cannot dispose of these securities except at a significant loss? What is his exposure to derivative suits by his own shareholders for faulty business judgment?
4. How much will the offer cost him? (Do not forget protracted litigation expenses as well as the time and energy of key executives.)

The foregoing are merely a few of the many questions that must be asked and answered. The remainder of this Article shall discuss briefly the recent Williams Act amendments to the Securities Exchange Act of 1934,⁵ giving a broad overview of the Williams Act and describing some of its more important aspects. Then, in order to keep current, a number of topics beyond the scope of the Williams Act which directly affect take-over bids and which are being discussed today will be examined.

I. THE WILLIAMS ACT

The Williams Act amendments to the Securities Exchange Act of 1934 are designed primarily to regulate take-over bids. The Williams Act, how-

⁴ See prepared statements of Chairman Hamer H. Budge in *Hearings on Pressing Problems Confronting the Commission Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 14 (Feb. 25, 1969); *Hearings on Certain Questions Arising Under the Federal Securities Laws Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 91st Cong., 1st Sess. 13-14 (Mar. 6, 1969); *Hearings on Corporate Acquisitions and Combinations Before the House Comm. on Ways and Means*, 91st Cong., 1st Sess. 2366 (Mar. 12, 1969); *Hearings on S. 1373 Before the Senate Comm. on Commerce*, 91st Cong., 1st Sess. 5 (Mar. 18, 1969) [hereinafter cited as *Budge Statements*, by date].

⁵ The Williams Act consisted of the addition of §§ 13(d), 13(e), 14(d), 14(e) and 14(f) to the Securities Exchange Act of 1934. 15 U.S.C. §§ 78m(d), 78m(e), 78n(d), 78n(e), 78n(f)

ever, goes beyond such regulation and covers two other important areas. Section 13(d) and the regulations adopted thereunder require the filing of a statement with the SEC on schedule 13D by any person who acquires ten per cent of an equity security registered under section 12⁶ of the 1934 Act (or a closed-end investment company⁷), irrespective of how the ten per cent interest was acquired. In deciding whether the filing of such a statement is necessary, it is important to note that section 13(d)(3) defines "person" to include any group of persons acting together. Furthermore, the SEC has suggested to Congress that the ten per cent figure be reduced to five. Section 13(e) of the Williams Act states that it shall be unlawful for an issuer with a class of securities registered pursuant to section 12 (or a closed-end investment company) to purchase any equity security issued by it if such purchase is in contravention of such rules as the Commission may adopt defining acts and practices which are fraudulent and prescribing means reasonably designed to prevent such practices. Currently, only a few rules under this section have been adopted. This is a fascinating area that will take on added importance as soon as permanent rules are proposed.⁸

Most of the provisions of the Williams Act give the SEC broad rule-making power and particularly the power to establish the types of forms that must be filed. Immediately upon enactment of the Williams Act, the Commission adopted a set of temporary rules and indicated that permanent rules would follow. A few housekeeping and substantive rules have been promulgated,⁹ but as yet the Commission has not circulated what it considers to be the permanent rules under the Williams Act. The reason for this delay is not altogether clear. One explanation is that the Commission would like to have more time to evaluate the performance of the existing rules before final ones are adopted. Some feel that the Commission and its staff have not been able to agree on a final set of rules. Another possible reason is that the existing rules were adopted on an emergency basis as soon as the Williams Act became effective, and thus it was unnecessary under the Administrative Procedure Act¹⁰ to circulate the rules for comments before adoption. The proposed permanent rules,

(Supp. V, 1969). [Hereinafter Williams Act amendments referred to in text by section only.]

⁶ 15 U.S.C. § 781 (1964).

⁷ 15 U.S.C. § 80a-5(a) (1964).

⁸ *Budge Statements*, Mar. 6, 1969, at 15. Such legislation has indeed been proposed. See BNA SEC. REG. & L. REP. No. 37, Feb. 11, 1970, at A-9. In July 1970, the Commission proposed to adopt a rather comprehensive rule 13e-2 which, if adopted, would regulate purchases of its own securities by an issuer registered with the SEC under § 12 of the Securities Exchange Act of 1934 and closed-end investment companies. SEC Securities Exchange Act Release No. 8930 (July 13, 1970).

⁹ The first rule changes were adopted one month after the temporary rules were promulgated. See SEC Securities Exchange Act Release No. 8392 (Aug. 30, 1968). These changes essentially cleaned up unclear language in the original rules and also added rule 13d-3, 17 C.F.R. § 240.13d-3 (1968), defining how the 10% ownership requirement was to be computed.

The next rule changes merely indicated the number of copies of documents that had to be filed with the Commission. See SEC Securities Exchange Act Release No. 8556 (Mar. 24, 1969), amending rules 13d-1, 13d-2, 13e-1, 14d-1 and 14f-1, 17 C.F.R. §§ 240.13d-1, .13d-2, .13e-1, .14d-1, .14f-1 (1968).

The most substantive rule was actually adopted under § 10(b) of the 1934 Act, 15 U.S.C. § 78j(b) (1968), namely rule 10b-13, 17 C.F.R. § 240.10b-13 (1968). See note 42 *infra*.

¹⁰ 5 U.S.C. § 553(b)(3)(B) (Supp. V, 1969).

however, will have to be circulated for comments.¹¹ The circulation process has generally been painful and lengthy, and some members of the Commission staff wish to avoid it. The SEC, moreover, has suggested that Congress adopt certain revisions to the Williams Act. Perhaps the Commission is waiting until these amendments have been acted upon before it proposes its permanent rules.

In general, the Williams Act provides four types of regulation with respect to take-over bids: disclosures through statements filed with the Commission and circulated to investors, substantive requirements as to the form and content of offers, regulation of recommendations as to tender offers, and a broad anti-fraud provision.

A. Disclosure

Disclosure requirements are found in section 14(d) of the 1934 Act.¹² They apply to all tender offers (which term is not defined) for the acquisition of ten per cent of the class of equity securities registered with the Commission under section 12 of the 1934 Act or of a security issued by a closed-end investment company. Disclosure is required only when the subject securities are registered with the SEC. Insurance companies, for example, are not generally registered¹³ and are not therefore covered by the tender offer disclosure requirement. The Commission has recognized this and has asked Congress to study the matter to see whether insurance companies should be included within the coverage of the Williams Act amendment.¹⁴

Even if a tender offer is for an unregistered security, consideration should be given to the advisability of having the client use an offering circular when making both contested and uncontested offers. The offering circular would contain the information required by the SEC rules and perhaps such additional information as financial statements of the offeree. The offering circular often helps "sell" the offer, and when a full disclosure is made, it helps insure against successful attacks on the ground that the offer was fraudulent or failed to disclose material information. This is particularly important because the anti-fraud provisions of the Williams Act apply to all tender offers, not only those for registered securities.

Disclosure is provided by requiring the person making the offer to file a schedule 13D with the Commission prior to making the tender offer. Copies of the material must also be sent to the target company.

¹¹ See 5 U.S.C. § 553(b) (Supp. V, 1969).

¹² Section 14(d), 15 U.S.C. § 78n(d) (Supp. V, 1969), and the rules thereunder apply to tender offers. The acquisition of a 10% equity interest in a registered issuer other than by a tender offer must be disclosed under § 13(d), 15 U.S.C. § 78m(d) (Supp. V, 1969). Schedule 13D is the disclosure document filed under both sections.

¹³ Section 12(g)(2)(G) of the 1934 Act, 15 U.S.C. § 78l(g)(2)(G) (1964), exempts insurance companies from registration under § 12(g) if their domiciliary states require certain disclosures similar to those required by §§ 13, 14, and 16 of the 1934 Act.

¹⁴ *Budge Statements*, Mar. 6, 1969, at 16. In February 1970, Senator Harrison A. Williams proposed an amendment to the Act which would place insurance companies under its provisions. BNA SEC. REG. & L. REP. No. 37, Feb. 11, 1970, at A-9.

The schedule 13D is not extensive, and it resembles the schedule 14B required to be filed in the event of a proxy contest under the Commission's proxy rules.¹⁵ It requires information concerning the name of the target company, the identity and background of the persons making the offer, the source and the amount of funds used in making the offer, the purpose of the transactions, a statement of the interest the offeror may already have in the securities of the target company, a description of any contracts or arrangements with respect to the securities of the target company, the names of persons employed to solicit tenders, and copies of soliciting material. If any material change in the information occurs, an amendment to the schedule 13D must be promptly filed with the Commission.¹⁶ The soliciting material sent to investors and published in the newspaper must contain some of the information set forth in the schedule 13D and certain other information, such as the dates before and after which security holders may withdraw their shares.

The foregoing requirements have not been difficult to satisfy. Indeed, they now provide specific guidelines as to what must be disclosed, whereas prior to the Williams Act it was uncertain as to what was necessary. There are, however, two areas that deserve particular attention in preparing the schedule 13D. First is the definition of "person" required to file the statement.¹⁷ This definition includes two or more persons acting as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer. This is an extremely broad definition and requires very careful consideration as to who is included within this category. It has also resulted in litigation. In *Bath Industries, Inc. v. Blot*¹⁸ the target company was able to obtain an injunction against a group competing for control because the "group" was not sufficiently described in the schedule. A safe approach might be to include everyone. This, however, does have some hidden dangers, especially under section 16 of the 1934 Act.¹⁹

The second area of importance concerns the requirement that the offeror disclose plans or proposals which he may have to liquidate the issuer, to sell its assets, or to merge it with any other person or make any other major change in its business. Some of the litigation under the Williams Act has focused on this problem. In the Susquehanna battle for Pan American Sulphur, an SEC Hearing Examiner in an administrative hearing and a federal district court concluded that Susquehanna had not adequately revealed its plans for Pan American, but the Fifth Circuit disagreed and reversed the district court.²⁰ In its schedule 13D filed with the

¹⁵ See rule 14a-11, schedule 14B, 17 C.F.R. §§ 240.14a-11, .14a-102 (Supp. 1970).

¹⁶ As to the timing of filing amendments and as to the mechanics of completing the schedule, see generally, Tobin, *Disclosure Requirements in Connection with Tender Offers*, in *TEXAS GULF SULPHUR—INSIDER DISCLOSURE PROBLEMS* 369 (PLI 1968).

¹⁷ 15 U.S.C. § 78m(d)(3) (Supp. V, 1969).

¹⁸ 305 F. Supp. 526 (E.D. Wis. 1969), *aff'd*, 427 F.2d 97 (7th Cir. 1970). See also BNA SEC. REG. & L. REP. No. 19, Oct. 8, 1969, at A-2 (SEC injunction suit involving the Roosevelt Raceway fight).

¹⁹ See notes 56-58 *infra*, and accompanying text.

²⁰ See SEC Securities Exchange Act Release No. 8512 (Feb. 4, 1969); BNA SEC. REG. & L. REP. No. 15, Sept. 10, 1969, at A-1; BNA SEC. REG. & L. REP. No. 25, Nov. 19, 1969, at A-10;

Commission, Susquehanna stated that it did not have any plan to liquidate Pan American, sell its assets, or merge it with any other person. It went on to state, however, that at some future time it might propose such action if Susquehanna felt it appropriate. Susquehanna had admitted that it had an idea or hope for some future acquisition involving Pan American, but that these "hopes" were not sufficiently definite to be labeled "plans." The district court and the SEC Hearing Examiner disagreed. The Fifth Circuit, however, concluded that disclosure by Susquehanna was sufficient and that it was impossible to require parties engaged in a takeover fight to be perfect. Citing Judge Friendly's remarks in the *Electronic Specialty* case, the court ruled that "basic honesty" is all that is required.²¹

B. Substantive Requirements

Sections 14(d)(5) through (7) establish certain substantive requirements governing regulated tender offers. First, investors may withdraw their securities during the first seven days of the offer and at any time after sixty days of the original offer if their shares have not been taken up by then. Second, if an offer is for less than all the securities of the target company and a greater number are deposited within ten days, then the offeror must take up the securities on a pro rata basis. Third, if the offeror increases the consideration offered before the expiration of his bid, such consideration must be given to all tendering investors, including those whose securities were purchased prior to the increased offer. In connection with this last requirement, the Commission has also adopted rule 10b-13²² which, in effect, prohibits a person making a cash or exchange offer from purchasing the same securities during the tender offer period other than pursuant to the offer itself.

C. Regulation of Recommendations as to Take-Over Bids

Section 14(d)(4) and rule 14d-4²³ regulate persons who either recommend acceptance or rejection of regulated tender offers. Presently, such persons are only required to file a schedule 14D prior to making their recommendation. In this connection, the Commission is disturbed by the narrowness of this section, because it prevents the SEC from regulating recommendations for or against registered exchange offerings. Section 14(d)(8) exempts exchange offers made through a registration statement from all of the provisions of section 14(d). This means that investors to whom an exchange offer is made through a registration statement are deprived of the substantive protection of these sections, and persons recommending for or against such offers are not subject to regulation under

Pan Am. Sulphur Co. v. Susquehanna Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,473 (W.D. Tex. 1969), *rev'd*, 423 F.2d 1075 (5th Cir. 1970). In *In re Susquehanna Corp.*, SEC Securities Exchange Act Release No. 8933, CCH FED. SEC. L. REP. ¶ 77,842 (July 17, 1970), the SEC, after the Fifth Circuit decision, took a contrary view and upheld an initial decision which held that the soliciting material and schedules violated the statute.

²¹ *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969).

²² See note 64 *infra*.

²³ 17 C.F.R. § 240.14d-4 (Supp. 1970).

section 14(d)(4). To remedy this, the Commission has asked Congress to delete the exemption in section 14(d)(8) for registered exchange offerings.²⁴

This is also one area where the Commission's rules and forms should be expanded. The existing schedule 14D does not provide investors with truly meaningful information as to the basis for the recommendation being made. Nor does the schedule give much guidance to target management as to what it must disclose when making a recommendation, particularly as to its self-interest in favoring or opposing the offer.²⁵ Some foreign countries have statutes specifically dealing with this problem. In general, they require management to state its position with respect to the bid and to disclose its ownership of securities in both the offeror and offeree and its own plans as to whether management intends to tender its shares.²⁶ The SEC is thinking of proposing a rule requiring target management to make a recommendation either for or against the offer to its shareholders. Nothing in the Williams Act specifically grants such power to the Commission, and, even if it did, target management should not be forced to make a recommendation. However, it could be required to state what the individual officers and directors intend to do with their shares.

D. Anti-Fraud Provisions

Section 14(e) contains a broad prohibition against fraud in connection with tender offers. This section is essentially similar to rule 10b-5,²⁷ except that it applies to tender offers. It is important to note that it applies to all tender offers and not only those regulated by other provisions of the Williams Act. One other important difference is that section 14(e) is self-operative and does not require the SEC to adopt rules to make it function. Indeed, the Commission is not given any rule-making power under this section, and therefore the SEC has complained to Congress that the section should be amended to allow rule-making.²⁸

There have been a number of cases decided under this section, and at this time some trends are discernible. First, the courts are accepting jurisdiction of cases brought, and they are not requiring that the plaintiff be a purchaser or seller of securities as is required under rule 10b-5 in damage actions.²⁹ In addition, the Second Circuit in *Electronic Specialty Co. v. International Controls Corp.*³⁰ recognized that take-over bids resemble

²⁴ *Budge Statements*, Mar. 6, 1969, at 15-16.

²⁵ When fiduciaries, such as corporate officers or directors, give investment advice to shareholders, they must prominently disclose their own self-interest in the transactions. See *Mills v. Electric Auto-Lite Co.*, 403 F.2d 429 (7th Cir. 1968).

²⁶ See Kennedy, *Defensive Take-Over Procedures Since the Williams Bill*, in TEXAS GULF SULPHUR: DISCLOSURE PROBLEMS 149 (PLI 1968) (the Appendix to Mr. Kennedy's outline contains portions of the Australia Act and Ontario Statutes); Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317, 353-59 (1967), reprinted in ABA, SELECTED ARTICLES ON FEDERAL SECURITIES LAW 815, 852-58 (1968).

²⁷ 17 C.F.R. § 240.10b-5 (Supp. 1970).

²⁸ *Budge Statements*, Mar. 6, 1969, at 15.

²⁹ Compare *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969), with *Iroquois Indus., Inc. v. Syracuse China Corp.*, 477 F.2d 963 (2d Cir. 1969).

³⁰ 409 F.2d 937 (2d Cir. 1969).

proxy contests and that under these circumstances it is unwise and unrealistic to impose too strict a standard on either party. A court there applied the test it had announced in a previous decision: whether "any of the stockholders who tendered their shares would probably not have tendered their shares' if the alleged violations had not occurred."³¹ The courts have also evidenced a reluctance to grant preliminary injunctions, since in many cases this would prevent investors from tendering their shares.³²

The courts feel that both sides have an ample opportunity to make their arguments and that the economic decision to tender should be left with the investor and not with the courts.³³ In the *Electronic Specialty* case, for example, the offer price was about the highest for which the stock had ever traded. Although not expressed by the Second Circuit, the court was probably reluctant to deprive investors of this attractive opportunity to sell. On the other hand, it has been demonstrated that the courts and the SEC take a closer look at whether offerors are adequately completing the schedule 13D and fully identifying their "group."³⁴

II. SECURITIES PROBLEMS BEYOND THE WILLIAMS ACT

The Williams Act has provided offerors with a relatively good legal "road map" outlining the requirements to be followed in making the actual tender offer. Moreover, the Williams Act's requirements are generally easy to satisfy, and the courts have been reluctant to block take-over bids based on alleged violations of the Act. There are, however, a host of other important problems that offerors must face prior to making a bid. A number of these problems are strictly legal in nature, while others are primarily of a business nature with legal overtones. Some of the business problems were mentioned earlier. In the securities-corporate field, the following are a number of important problem areas that must be considered.

Shareholder List. First, it is necessary to get a shareholder list. Secondly, a proper purpose is needed to secure such a list, particularly if suit has to be filed in a foreign jurisdiction friendly to the target company.³⁵ Finally, when the permanent rules under the Williams Act are adopted, it is most likely that the SEC will require offeree companies to send out the solicit-

³¹ *Id.* at 948, quoting from *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840, 843 (2d Cir. 1967).

³² *Cf.* *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, CCH FED. SEC. L. REP. § 92,557 (2d Cir., Jan. 8, 1970).

³³ *See, e.g.,* *Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp.*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. § 92,471 (S.D.N.Y. 1969); *Armour & Co. v. General Host Corp.*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. § 92,348 (S.D.N.Y. 1969). Even in the recent Second Circuit decision ruling that Bangor Punta violated rules 135, 17 C.F.R. § 230.135 (Supp. 1970), and 10b-6, 17 C.F.R. § 240.10b-6 (Supp. 1970), in its effort to acquire control of Piper Aircraft in competition with Chris-Craft, the court's remand did not suggest that an injunction should be issued. *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. § 92,510 (2d Cir., Nov. 6, 1969). This was also true when the Second Circuit reheard this case en banc and affirmed. 426 F.2d 569 (2d Cir. 1970).

³⁴ *See* notes 18-19 *supra*, and accompanying text.

³⁵ For an unsuccessful effort to obtain a shareholder list, see *White v. Jacobsen Mfg. Co.*, 293 F. Supp. 1358 (E.D. Wis. 1968) (no proper business purpose).

ing material of the offeror in a manner similar to the existing procedures under the proxy rules.³⁶

Accounting Aspects. The accountants for the offerors are essential members of the take-over team. The first problem facing the accountants is how to treat the acquisition, either as a pooling of interest or a purchase. There has been considerable criticism of the pooling method of accounting, and the general belief was that by May 1970, the accountants would eliminate it. Indeed, on February 23, 1970, the Accounting Principles Board of the American Institute of CPA's issued for comment an Exposure Draft of a proposed APB opinion, *Business Combinations and Intangible Assets*. In large part, the highly controversial exposure draft provided that a business combination would be treated as a pooling only in certain situations where neither party to the acquisition is more than three times the size of the other. In addition, the "goodwill" acquired in a purchase transaction would have to be written off, over a forty-year period or the remaining useful life of the assets, whichever is shorter. This write-off would reduce earnings per share.³⁷

Due in part to the controversy the exposure draft created, the Accounting Principles Board issued what appears to be compromise pronouncements in *Opinion 16: Business Combinations* and *Opinion 17: Intangible Assets*,³⁸ which establish criteria for the use of pooling and purchase methods of accounting for business combinations and for amortization of good will. In view of the number of dissents in each opinion by outstanding members of the accounting profession, the controversy over accounting for business combinations appears to be far from settled.*

In an exchange offer, the accountants will want to review the package of securities being offered to determine its effect upon earnings-per-share of the offeror company. This is particularly true if convertibles or warrants are issued because they might have to be included in computing earnings-per-share. Under the recently adopted *Accounting Principles Board Opinion 15*, the old residual-securities method of computing the number of outstanding shares is discarded and is replaced by a "common stock equivalent" concept.³⁹

Recent amendments to registration statement forms S-1, S-7, and S-10⁴⁰ require disclosure of sales and income information for any line of business constituting more than ten per cent of the total sales and revenues (or

³⁶ Rule 14a-7, 17 C.F.R. § 240.14a-7 (1969).

³⁷ AMERICAN INSTITUTE OF CPA'S, EXPOSURE DRAFT: BUSINESS COMBINATIONS (1970).

³⁸ AMERICAN INSTITUTE OF CPA'S, OPINION OF THE ACCOUNTING PRINCIPLES BOARD NO. 16: BUSINESS COMBINATIONS (Aug. 1970); AMERICAN INSTITUTE OF CPA'S, OPINION OF THE ACCOUNTING PRINCIPLES BOARD NO. 17: INTANGIBLE ASSETS (Aug. 1970).

* Editor's Note: As this Article was going to press, the Accounting Principles Board issued its final pooling pronouncements, to become effective October 31, 1970. The controversy was compromised by eliminating the previously proposed size test but essentially keeping all the other requirements.

³⁹ AMERICAN INSTITUTE OF CPA'S, OPINION OF THE ACCOUNTING PRINCIPLES BOARD NO. 15 (May 1969); 2 REV. SEC. REG. 919-20 (1969). See also SEC Securities Exchange Act Release No. 4910 (June 18, 1968).

⁴⁰ 1 CCH FED. SEC. L. REP. ¶¶ 7122, 7192, 7217 (1969).

fifteen per cent for companies with total sales of less than \$50 million). Moreover, the recently proposed revision of form 10-K (the annual report filed with the SEC) will also require the same information.⁴¹ This may have an important impact on business combinations, as it will expose the financial results of many acquisitions and might also inhibit future acquisitions designed to hide poor performance in existing lines of business.

Finally, with respect to accounting problems, the offeror will want to make certain that the offeree has certified financial statements. Because the offeror probably will not be able to make an inside investigation of the target company, and because it will not be able to obtain the warranties generally found in an acquisition agreement, the acquiring company will want some assurance that the reported financial condition of the target company is accurate. If the acquisition is significant, the offeror will be required to file with the SEC a form 8-K containing certified financial statements of the offeree company.⁴² If the offeror plans to file a registration statement with the Commission, it may need, depending on the size of the target company, certified financial statements of the target company, for the past three years.⁴³

Publicity. The New York Stock Exchange believes that the Securities Exchange Act of 1934 requires timely disclosure of material events, such as proposed acquisitions which are significant to the offeror.⁴⁴ Under this timely disclosure policy, if there is a possibility of a leak as to a proposed take-over bid, the offeror should make a public announcement and thereby lose the alleged advantage of surprise.

In addition, if the offeror is going to use securities as his exchange medium, then it will be confronted with the additional problem of "gun-jumping," which is the Commission's policy designed to restrict the use of publicity other than by means of the prospectus in connection with registered offerings.⁴⁵ Until the offeror's registration statement is filed with the SEC, it is severely limited as to what it can announce to the public. Prior to filing, rule 135⁴⁶ permits an offeror to make a brief factual statement, in effect, merely announcing the proposed offering. Many people correctly believe that the type of disclosure permitted by rule 135 is in-

⁴¹ See SEC Securities Exchange Act Release No. 8682 (Sept. 15, 1969) (proposed revision of annual report form 10-K).

⁴² See item 2 of form 8-K. The present form 8-K requires disclosure if the assets or revenues of the acquired property exceed 15% of the assets or revenues of the acquiring company. Under the proposals of the SECURITIES EXCHANGE COMMISSION, DISCLOSURE TO INVESTORS—THE WHEAT REPORT (Mar. 1969) [hereinafter cited as WHEAT REPORT], and the Commission's proposed rules implementing the Report, this figure would be decreased to 10%. WHEAT REPORT 359, and app. X-4, at 8-9; SEC Securities Exchange Act Release No. 8683, at 4, 14 (Sept. 15, 1969).

⁴³ See SEC Securities Exchange Act Release No. 4950 (Feb. 20, 1969); Machen, *Securities Act Release No. 4950—A Bad Bomb*, 25 BUS. LAW. 247 (1969).

⁴⁴ See N.Y. STOCK EXCHANGE, COMPANY MANUAL A-18 to A-20; cf. the district court judge's opinion in the *Chris-Craft* case, which was reversed on appeal (2-1 decision). *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,465 (S.D.N.Y. 1969), *rev'd*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,510 (2d Cir., Nov. 6, 1969).

⁴⁵ The Commission's "gun-jumping" policies are described in WHEAT REPORT ch. V, at 127-48.

⁴⁶ 17 C.F.R. § 230.135 (Supp. 1970).

sufficient to describe accurately the proposed exchange. The *Wheat Report* noted the difficulty of striking an appropriate balance between beneficial publicity necessary to insure the integrity of the trading markets and publicity primarily motivated to condition the market in disregard of the registration provisions of the Securities Act of 1933.⁴⁷ In applying rule 135, the Commission has taken a relatively conservative approach to disclosure and has insisted that the literal language of the rule be followed.

This approach is illustrated by the Chris-Craft-Bangor Punta-Piper Aircraft triangle. When Bangor Punta announced that it had reached an agreement with the Piper family as to a proposed exchange offering by Bangor for all Piper Aircraft common shares, the announcement also contained a statement that the value of the securities proposed to be issued to the Piper shareholders would be worth eighty dollars per Piper share. The SEC, believing that the announcement of the eighty-dollar price went beyond the exemptions permitted by rule 135, immediately filed an injunction action against Bangor Punta, who consented to the issuance of an injunction.⁴⁸ Shortly thereafter, Chris-Craft, the other Piper suitor, filed an action against Bangor Punta alleging that the latter's press release containing the eighty-dollar price went beyond the terms of rule 135. The district court disagreed.⁴⁹ It felt that disclosure of the eighty-dollar price was necessary to comply with the timely disclosure requirements of the New York Stock Exchange and the Second Circuit's opinion in the *Texas Gulf Sulphur* case.⁵⁰ The judge was particularly concerned that the eighty-dollar price was substantially above the then current market price for Piper stock, and that once some people learned of this figure they would have an unfair trading advantage over those investors who did not know about it. On appeal, with the SEC as amicus curiae, the Second Circuit in a two-to-one decision reversed.⁵¹ It held that the announcement of the eighty-dollar price went beyond the exemptions provided in rule 135. Because of the importance of this case, the Second Circuit agreed to rehear it en banc. In April 1970, it reaffirmed its former opinion, that the press release was not compelled by the so-called timely disclosure doctrine.⁵² The Court also agreed with the SEC that the categories of information permitted to be disclosed under rule 135 are exclusive. However, there were two concurring opinions and one dissent, and no doubt we will still have gun-jumping problems in the future.

Furthermore, the Commission recently issued a general explanatory release in connection with its releases proposing certain new rules to imple-

⁴⁷ WHEAT REPORT 128-31.

⁴⁸ SEC v. Bangor Punta Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,428 (D.D.C. 1969).

⁴⁹ Chris-Craft Indus., Inc. v. Piper Aircraft Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,465 (S.D.N.Y. 1969).

⁵⁰ SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

⁵¹ Chris-Craft Indus., Inc. v. Bangor Punta Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,510 (2d Cir., Nov. 6, 1969).

⁵² Chris-Craft Indus., Inc. v. Bangor Punta Corp., CCH FED. SEC. L. REP. ¶ 92,648 (2d Cir., Apr. 28, 1970).

ment the *Wheat Report* recommendations concerning gun-jumping.⁵³ The general release was no doubt prompted by the Piper Aircraft fight in which the Commission's gun-jumping policies were subjected to judicial scrutiny. In the release, the Commission concurred with the conclusion of the *Wheat Report* that the expansion of timely disclosure practices was commendable, but it refused to agree that there was any conflict between this development and the restrictions on publicity regarding an issuer in registration. Despite this refusal, a conflict does exist. A majority of the problems in this area, however, can be resolved by conferring with the staff of the Commission, which has been consistently helpful.

Margin Requirements. If cash is to be used to acquire shares of the target company, care must be taken that any borrowings do not violate the margin requirements of the Federal Reserve Board as set forth in regulations G, T, and U.⁵⁴

*Sections 16(a) and (b) of the Securities Exchange Act of 1934.*⁵⁵ These are the insider reporting and short-swing profit recapture provisions of the 1934 Act. Officers, directors, and ten-per-cent shareholders of companies with securities registered with the SEC under Section 12 of the 1934 Act are required to file monthly statements as to any transactions in the securities of their issuers. Section 16(b) provides that all profits from purchases and sales or sales and purchases of the issuer's securities by an insider within a six-month period are subject to recapture by the issuer.

These sections pose special problems to companies engaged in take-over bids. For example, is there a difference between the definition of person under the Williams Act amendments, *i.e.*, a "group,"⁵⁶ and the definition of person under section 16?⁵⁷ The legislative history of the Williams Act and the opinion of many securities law experts is that they are different.

Another important problem arises when an offeror in a take-over bid does acquire more than ten per cent of the target company's securities but is unsuccessful in gaining control. If the target company then arranges a friendly merger within six months of the time that the offeror acquired

⁵³ SEC Securities Exchange Act Release No. 5009 (Oct. 7, 1969). See also SEC Securities Exchange Act Release No. 5010 (Oct. 7, 1969) (proposed revision of rule 135).

⁵⁴ 12 C.F.R. §§ 220 (reg. T), 221 (reg. U), 207 (reg. G) (Supp. 1970); SEC v. Madison Square Garden Corp., CCH FED. SEC. L. REP. ¶ 92,649 (S.D.N.Y., Apr. 29, 1970); Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,471 (S.D.N.Y. 1969); Kelly & Webb, *Credit and Securities: The Margin Requirements*, 24 BUS. LAW. 1153, 1173-74 (1969); Comment, *Application of Margin Requirements to the Cash Tender Offer*, 116 U. PA. L. REV. 103 (1967).

⁵⁵ 15 U.S.C. §§ 78p(a), (b) (1964).

⁵⁶ Securities Exchange Act of 1934, §§ 13(d)(3), 14(d)(2), 15 U.S.C. §§ 78m(d), 78n(d)(2) (Supp. V, 1969).

⁵⁷ See Securities Exchange Act of 1934, § 3(a)(9), 15 U.S.C. § 78c(a)(9) (1964); SEC Securities Exchange Act Releases Nos. 7793 (Jan. 19, 1966), 7824 (Feb. 14, 1966), reprinted at 2 CCH FED. SEC. L. REP. ¶¶ 26,030-32 (1966); proposed amendment to rule 16a-3, 17 C.F.R. § 240.16a-3 (Supp. 1970), SEC Securities Exchange Act Release No. 6453 (Dec. 12, 1960) (not adopted, SEC Securities Exchange Act Release No. 6487 (Mar. 9, 1961)); L. Loss, *SECURITIES REGULATION* 1104 n.263(a) (2d ed. Supp. 1962).

its securities, the offeror will be exposed to the recapture provisions of section 16(b).⁵⁸

The Investment Company Act of 1940. Compliance with section 17(d)⁵⁹ of the Investment Company Act of 1940 might be required if an "affiliated" registered investment company of the offeror also decides to purchase securities of the target company.⁶⁰ If the offeror and its affiliate are purchasing the securities of the target company as part of a joint participation, then the parties must apply to the SEC for approval of the transaction.⁶¹ The offeror will want to make certain that, by virtue of its tender offer, it does not become an investment company as defined in the Investment Company Act of 1940. In the event the offeror does not acquire the majority of the outstanding shares of the target company, and the value of such shares held by the offeror exceeds forty per cent of its total assets, then the offeror might be an investment company.⁶²

*Rule 10b-6 Under the Securities Exchange Act of 1934.*⁶³ This relatively obscure rule provides that it is a manipulative device for an issuer or an underwriter who is engaged in a distribution of stock of an issuer to bid for and purchase such stock. In theory, these bids would impose an artificial influence on the market because the seller would be buying and selling at the same time. The Commission believes that this rule is operative in a number of take-over bid situations. For instance, in order to defeat an unfriendly take-over bid, some target companies will agree to merge into a friendly company. In order to protect this merger, the friendly company might have to purchase stock of the target company, either in the open market or through a tender offer of its own. Even an unfriendly offeror might want to purchase securities of the offeree in the open market or from private sources rather than through the actual exchange offer.⁶⁴ Under these circumstances, the SEC considers that the

⁵⁸ See, e.g., *Allis-Chalmers Mfg. Co. v. Gulf & W. Indus., Inc.*, CCH FED. SEC. L. REP. ¶ 92,603 (E.D. Wis., Feb. 16, 1970) (motion to transfer); *Emerson Elec. Co. v. Reliance Elec. Co.*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,593 (E.D. Mo., Sept. 18, 1969); *Wall Street Journal*, Dec. 12, 1969, at 20, col. 2 (suit against Crane for sales of Westinghouse Air and American Standard stock).

⁵⁹ 15 U.S.C. § 80a-17(d) (1964).

⁶⁰ A registered investment company becomes an "affiliate" if it owns more than 5% of the stock of an issuer. Investment Company Act of 1940, §§ 2(a)(2), (3), 15 U.S.C. §§ 80a-2(a)(2), (3) (1964).

⁶¹ See *SEC v. Talley Indus., Inc.*, 399 F.2d 396 (2d Cir. 1968). A subsequent merger of the target into the offeror will also require Commission approval of the terms of the merger under the Investment Company Act of 1940, § 17(b), 15 U.S.C. § 80a-17(b) (1964). Investment Company Act Release No. 5953, in CCH FED. SEC. L. REP. ¶ 77,774 (Jan. 9, 1970).

⁶² See Investment Company Act of 1940, § 3(a)(3), 15 U.S.C. § 80a-3(a)(3) (1964); *Prospectus of Solitron Devices, Inc.*, Jan. 23, 1968, at 5 (exchange offer for common stock of Amphenol Corp.); *Wall Street Journal*, May 18, 1970, at 5, col. 1 (the staff of the SEC is reported to have taken the position that because of its recent acquisition of Greyhound securities, General Host is within the coverage of the Investment Company Act).

⁶³ 17 C.F.R. § 240.10b-6 (Supp. 1970).

⁶⁴ Recently adopted rule 10b-13, 17 C.F.R. § 240.10b-13 (Supp. 1970), now prohibits a person making a cash or exchange offer from purchasing the same securities during the tender offer period other than pursuant to the offer itself. The operation of this rule, and rule 10b-6, 17 C.F.R. § 240.10b-6 (Supp. 1970), is explained in SEC Securities Exchange Act Releases Nos. 8391 (Aug. 30, 1968), 8595 (May 5, 1969), 8712 (Oct. 8, 1969).

friendly or unfriendly company is engaged in a distribution of its own stock via the proposed merger or exchange offer, and that by purchasing stock of the target company it is really purchasing a right to acquire its own stock and hence is in violation of rule 10b-6. Most securities law experts disagree with the Commission's position,⁶⁵ but in the *Chris-Craft-Bangor Punta* decision the Second Circuit approved it.⁶⁶

State Blue Sky Laws. The state blue sky laws are becoming increasingly important in the take-over bid situation. In the past, there was an absence of effective state regulation, particularly in cash tender offers. This is now changing. There is virtually no state regulation of cash offers, except some blue sky laws require that offers of cash or securities be made by licensed dealers. To satisfy this requirement, many offerors appoint their broker-dealer managers as their agents to make the solicitation in such states. However, as to exchange offers, most state blue sky laws give the securities commissioners much greater authority. He is generally given the power to prevent exchange offerings if he believes they are inequitable or unfair. In the *Armour-General Host* battle, Armour was able to convince a number of state commissioners to prohibit, at least temporarily, the offering in their states. With respect to the Northwest Industries offer for Goodrich, the Ohio attorney general ruled that the Northwest common stock purchase warrants did not qualify for registration in Ohio.⁶⁷ Some states have even adopted specific take-over bid legislation. Virginia has adopted a statute similar to the Williams Act, whereas Ohio, in the aftermath of the Northwest-Goodrich fight, has adopted an elaborate statute designed to prevent unwanted take-overs of Ohio corporations.⁶⁸

New York Stock Exchange Requirements. The New York Stock Exchange is also taking a more active role in take-over bids. In the past, its requirements for tender offers made by a listed company centered on the time during which the offer was left open and pro rata takings during the first ten days of the offer.⁶⁹ The Exchange has recently cautioned presidents of listed companies that the creation of securities to be used in take-over bids will be examined extensively, especially in light of the size of the company, its capital structure, interest coverage, and results of its operations.⁷⁰ In the *Armour-General Host* situation, the Exchange refused to list the General Host debentures when originally issued.

⁶⁵ Cf. J. FLOM, B. GARFINKEL & J. FREUND, DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS 129-54 (1967).

⁶⁶ *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,510 (2d Cir., Nov. 6, 1969), *reaff'd en banc*, CCH FED. SEC. L. REP. ¶ 92,648 (2d Cir., Apr. 28, 1970).

⁶⁷ See *Wall Street Journal*, Apr. 22, 1969, at 17, col. 1.

⁶⁸ See 3 BLUE SKY L. REP. ¶¶ 49,228-41 (1968) (Va.); BNA SEC. REG. & L. REP. No. 11, Aug. 13, 1969, at A-7, X-1 (Ohio).

⁶⁹ See N.Y. STOCK EXCHANGE, COMPANY MANUAL A-179 to -80; Kennedy, *Tender Moment*, 23 BUS. LAW. 1091, 1101-02 (1968).

⁷⁰ See N.Y. STOCK EXCHANGE, COMPANY MANUAL at xxii-xxiv.

III. CONCLUSION

In this fast moving field of corporate acquisitions, conclusions do not remain constant. Changing market conditions, tax revision, and a stricter antitrust policy have an immeasurable impact on take-over bids. To make the entire area more uncertain, we have a recently enacted statute (which the SEC already wants to amend), only temporary rules, and little case-law guidance. New and imaginative defensive tactics, moreover, are being tried each day while offerors are also continually revising their methods of attack. In sum, the most important advice is to maintain a flexible attitude and to anticipate or, at least, keep abreast of these changes.