McGeorge Law Review

Volume 12 | Issue 3 Article 4

1-1-1980

Federal Regulation of Issuer Tender Offers

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Articles

Federal Regulation Of Issuer Tender Offers

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Scope of the article:

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During the last half of 1979, the Securities and Exchange Commission (hereinafter referred to as SEC) adopted three rules that, at least in part, regulate tender offers by companies for their own securities, *i.e.*, "issuer tender offers."[1] These rules include Rule 13e-4[2] and related Schedule 13E-4 which specifically regulate certain issuer tender offers; Rule 13e-3,[3] which regulates "going private"[4] transactions, including

1. For purposes of this article, the term "issuer tender offer" will refer to an announced offer by a company to repurchase from its security holders all or a specified number of shares of a security issued by it at a specified price or formula. The term includes both cash tender offers and exchange offers. Although the federal securities laws do not define the term, a "tender offer" in its traditional form is "a bid by an individual, group, or company to buy a specified number of shares of a corporation's stock from the public at a specified price which is set above the going market price in order to make the offer more attractive." Remarks of Senator Williams, 113 CONG. REC. 855 (1967).

Certain transactions not clearly encompassed within the above definition have been deemed to constitute a tender offer. *See, e.g.*, S-G Securities, Inc. v. Fuqua Inv. Co., [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶96,750 (S.D. Mass. 1978); Cattlemen's Inv. Co. v. Fears, 343 F. Supp. 1248 (W.D. Okla. 1972); E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 1-34 (1977). In addition, the SEC has proposed for comment a definition of "tender offer." *See* SEC Securities Act Release No. 6159 [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,374 (1979).

2. 17 C.F.R. §240.13e-4 (1980).
3. 17 C.F.R. §240.13e-3 (1980).

transactions that involve issuer tender offers; and Rule 14e-1,[5] which imposes certain requirements with respect to both issuer and third party tender offers. Together, these rules impose a substantial regulatory framework upon a corporate activity which previously received little attention. This article will analyze the provisions of the above rules, and certain related proposed rules under the Securities Exchange Act of 1934 (hereinafter referred to as Exchange Act),[6] relating to issuer tender offers. The statutory authority for such regulation also will be examined. First, a review of the history of Rule 13e-4 and a review of previous regulations applicable to issuer tender offers will be undertaken.

THE REGULATION OF ISSUER TENDER OFFERS: BACKGROUND

A. History of Rule 13e-4

During the 1960's purchases by corporations of their own securities became a substantial market force. In 1954, companies listed on the New York Stock Exchange repurchased only about 5.8 million shares of their own stock.[7] By 1965 the number of shares reacquired by such companies had jumped to 37.2 million.[8] In early 1967 the staff of the SEC, in response to this increased activity, submitted to certain members of the business community a preliminary draft of a proposed rule which was intended to provide comprehensive regulation of issuer repurchases.[9] This proposed rule, designated as Rule 10b-10, would have imposed various restrictions on issuers with respect to open market purchases, private transactions not involving broker or dealer, and tender offers. With respect to tender offers, proposed subsection (c)(4) of Rule 10b-10 would have made it unlawful for any issuer to repurchase its stock pursuant to a tender offer unless certain provisions, designed to assure fairness in the tender offer, were satisfied.[10]

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4. "Going private" literally refers to the attempt by a publicly-held company to return to private status. For a discussion of the "going private" phenomenon, *see* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1365-70. *See generally* Swanson, *The Elimination of Public Shareholders: Going Private*, 7 CONN. REV. 609 (1975).

5. 17 C.F.R. §240.14e-1 (1980).

6. 15 U.S.C. §§78a-78hh (1976 & Supp. III 1979).

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

8. C. ELLIS & A. YOUNG, THE REPURCHASE OF COMMON STOCK 4 (1971). By 1973, the amount of stock repurchases by companies listed on the New York Stock Exchange was 143.8 million shares. *See generally* NEW YORK STOCK EXCHANGE, 1973 FACT BOOK.

9. *See Hearings on S.510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 30 (1967) (testimony of Manuel F. Cohen, then Chairman of the SEC), [hereinafter cited as *1967 Senate Hearings*].

10. Proposed subsection (c)(4) prohibited issuer tender offers unless:

A. the same offer is made to all holders of such security or to all holders of less than a specified number of shares or units of such security;

At approximately the same time, Congressional hearings were scheduled on S.510, the so-called "Williams Bill."[11] The primary purpose of the Williams Bill was to regulate the use of tender offers to obtain control of a corporation and to provide disclosure of pertinent information concerning persons seeking to obtain control of a corporation.[12] One provision of the bill, however, granted the SEC rule-making authority with respect to issuer's repurchases. In its original form, S.510 would have authorized the SEC to adopt such rules and regulations with respect to issuer repurchases as would be "necessary or appropriate in the public interest *or* for the protection of investors *or* in order to prevent such acts and practices as are fraudulent, deceptive, or manipulative."[13]

There had been no intention, however, to grant the SEC such broad rule-making authority and the bill subsequently was amended to clarify that rules and regulations could be adopted only to prevent acts and practices that are fraudulent, deceptive, or manipulative.[14] Conse-

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> B. the formula or basis on which the price to be paid for each share or unit, and the number of shares or units to be purchased from each security held, is determined, is the same for all holders of such security;
> C. the procedures followed by the issuer in accepting securities tendered by security holders do not afford any particular security holder any advantage over other holders of the same security; and
> D. no securities are purchased by the issuer, except in the manner provided in this subparagraph (4), during the period beginning ____ days before any such tender offers solicited, and ending ____days after all purchases have been made pursuant thereto.

1967 Senate Hearings, supra note 9, at 215-16.

11. *See 1967 Senate Hearings, supra* note 9. The bill was enacted in 1968, Pub. L. No. 90-439, 82 Stat. 454 (July 29, 1968). The sections added to the Exchange Act by it—Sections 13(d), 13(e), 14(d), and 14(e)—are commonly referred to as the Williams Act.

12. *See* SENATE COMM. ON BANKING AND CURRENCY, FULL DISCLOSURE OF CORPORATE EQUITY OWNERSHIPS AND IN CORPORATE TAKEOVER BIDS, S. REP. No. 550, 90th Cong., 1st Sess. 1 (1967).

13. *See 1967 Senate Hearings, supra* note 9, (emphasis added). Manuel F. Cohen, then Chairman of the SEC, noted in his testimony on S. 510:

> The provisions of this bill would make it unlawful for an issuer to purchase its own securities in contravention of rules and regulations which the Commission adopts because they are necessary or appropriate of the public interest, or to protect investors, irrespective of the question whether, or our ability to prove that, such activity is or may be fraudulent, deceptive or manipulative. The language, for this reason, is broader in its scope than presently applicable provisions of the Exchange Act.

1967 Senate Hearings, supra note 9, at 27.

14. HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, DISCLOSURE OF CORPORATE EQUITY OWNERSHIP, H.R. REP. No. 1711, 90th Cong., 2d Sess. 7 (1968), reads in pertinent part:

> The third amendment was made by the subcommittee following consideration of the original language of the subsection which was in the disjunctive and lent itself to the possible though improbable interpretation that the Commission had authority to issue rules or regulations regarding the corporate purchase of its own securities in the public interest, or for the protection of investors, quite apart from whether designed solely to prevent acts and practices that are fraudulent, deceptive, or [sic] manipulative. The revised language makes it clear that such rules and regulations may be adopted only for these purposes. It is not the intent that these rules and regulations be designed to prevent the legitimate purchase by the issuer of its own securities for normal activities such as acquisitions for distribution under a stock option, employees stock purchase, bonus, or incentive plan.

quently, Section 13(e)[15] of the Exchange Act, makes it unlawful for an issuer[16] "to purchase any equity security issued by it if such purchases are in contravention of such rules and regulations as the Commission . . . may adopt (a) to define acts and practices which are fraudulent, deceptive or manipulative, and (b) to prescribe means reasonably designed to prevent such acts and practices."[17] The SEC did not obtain the broader authority to regulate issuer repurchases that it had sought.

The Williams Bill was enacted on July 29, 1968.[18] During the next two years, the SEC substantially revised proposed Rule 10b-10, and redesignated it as proposed Rule 13e-2. In 1970, the SEC formally proposed the rule for comment.[19] In its revised form, the tender offer provisions had been deleted from the proposed rule apparently due to the SEC's conclusion that additional time and consideration were required to determine both the contents and timing of disclosures and the substantive conditions to govern issuer tender offers. This deletion resulted in a gap in the proposed regulation of issuer repurchases which was not remedied until Rule 13e-4 was proposed in December of 1977. Rule 13e-4 and related Schedule 13E-4 were enacted on August 16, 1979.[20]

B. Prior Regulation of Issuer Tender Offers

Although there was no direct federal regulation of issuer tender offers prior to the adoption of the rules discussed above,[21] certain limited restrictions are imposed by other provisions of the Exchange Act and the rules thereunder, as well as by state law requirements. A brief description of such provisions follows.

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15. Provisions of the Exchange Act are referred to by section number while all SEC regulations are referred to by Rule number.

16. In this context "issuer" refers solely to issuers subject to Section 13 of the Exchange Act, that is, an issuer of stock which as a class of equity securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. §§ 78a-78hh (1976 & Supp. III 1979), or which is a closed-end investment company registered under the Investment Company Act of 1940, 15 U.S.C. §§80a-1-80b-22 (1976 & Supp. III 1979).

17. 15 U.S.C. §78m(e) (1976 & Supp. III 1979).

18. Pub. L. No. 90-439, 82 Stat. 454 (July 29, 1968).

19. SEC Exchange Act Release No. 8930, [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶77,837 (1970). A revised version of proposed Rule 13e-2 was proposed for comment in 1973, SEC Exchange Act Release No. 10539, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶79,600 (1973), and again more recently in October 1980, SEC Exchange Act Release No. 6248, [1980-1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,669 (1980).

20. Two weeks prior to the adoption of Rule 13e-4, the SEC adopted Rule 13e-3 and related Schedule 13E-3 to regulate "going private" transactions (as defined in the rule) by public companies and their affiliates; the provisions of Rule 13e-3 are applicable to issuer tender offers which involve going private. In addition, on November 29, 1979, the SEC announced the adoption of new rules and a related schedule pertaining to tender offers. SEC Securities Act Release No. 6158 (November 29, 1979). Among the rules adopted was Rule 14e-1, which requires that all issuer and third party tender offers, whether for securities of a public or private company, comply with certain substantive provisions.

21. See notes 7-20 and accompanying text *supra*.

1. Rule 10b-6[22]

Rule 10b-6 prohibits an issuer, or other person on whose behalf a distribution of securities is being made, from directly or indirectly bidding for or purchasing any security which is the subject of such distribution or any security of the same class or series. The rule also precludes any right to purchase any such security, or any attempt to induce any person to purchase such security or right, until after such person has completed participation in the distribution.[23] There is no definition of "distribution" for purposes of Rule 10b-6. The staff of the SEC, however, has taken the view that "distribution" includes not only an offering of substantial magnitude but also the presence of warrants, certain options, or securities convertible into the security in question.[24]

Prior to the adoption of Rule 13e-4, issuers desiring to make a tender offer for their securities were required to request an exemption from Rule 10b-6 if warrants for or securities convertible into the securities to be purchased were outstanding. Exemptions from Rule 10b-6 were routinely granted by the Division of Market Regulation of the SEC where these "technical" distributions existed,[25] provided that certain

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22. 17 C.F.R. §240.10b-6 (1980).
23. *Id.*
24. *See, e.g.*, Letter from the Division of Market Regulation, SEC re: Ethyl Corporation, Feb. 24, 1977, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶81,105 (1970) (the only "distribution" of common stock in progress or pending was the outstanding preferred stock which was convertible into common stock); letter from the Division of Market Regulation, SEC re: Cyclops Corporation, July 7, 1979 (the "distributions" were the presence of convertible securities and employee stock plans). Despite the position of the SEC staff, it is highly unlikely that warrants, options or convertible securities represent an ongoing distribution of the security they are exercisable for or convertible into unless there is a reasonable likelihood that conversions will occur during the immediate future. In SEC Exchange Act Release No. 11766, [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶80,316 (1975), the SEC enunciated what should constitute a "distribution" for purposes of Rule 10b-6:

> Rule 10b-6, on the other hand, is designed to prevent manipulation in the markets. To that end, it precludes a person from buying stock in the market when he is at the same time participating in an offering of securities which is of such a nature as to give rise to a temptation on the part of that person to purchase for manipulation purposes. The term distribution in Rule 10b-6 should therefore be interpreted to identify situations where that temptation may be present.

Unless there is a reasonable possibility that the proposed purchases could facilitate the conversion of convertible securities or the exercise of outstanding warrants or options, a distribution should not be considered to exist.

On March 13, 1980, Rule 10b-6 was amended to provide an exemption from the rule's proscription with respect to tender offers subject to Rule 13e-4 or Section 14(d) if the only "distribution" present is outstanding securities immediately convertible into, or exchangeable or exercisable for, the target security. 17 C.F.R. §240.10b-6(f) (1980). At the same time, the SEC proposed for comment an amendment to Rule 10b-6(e) which would explicitly except from the rule any distribution of securities by an issuer to its employees pursuant to any employee plan. SEC Exchange Act Release No. 16646, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,477 (1980). This paragraph presently applies only to certain employee plans, although the staff has in practice applied the exception to all such plans.

25. Between January 1, 1971 and December 31, 1979, the Division of Market Regulation responded to approximately 450 requests for an exemption or no-action position under Rule 10b-6 to permit an issuer tender offer.

conditions were satisfied.[26]

2. Rule 10b-13[27]

Rule 10b-13 prohibits a person making a tender offer for any equity security from purchasing, directly or indirectly, such security (or a security immediately convertible into or exchangeable for such security) other than pursuant to the tender offer, from the time the offer is publicly announced or otherwise made known by the offeror to holders of the subject security until the expiration of the offer.[28] As a result, a corporation cannot purchase its securities on the open market or by privately negotiated purchases during its tender offer.[29]

As will be discussed later,[30] the SEC has proposed to replace Rule 10b-13 with Rule 14e-5.

3. Rule 10b-4[31]

Rule 10b-4 prohibits the short tendering of securities pursuant to a tender offer.[32] This rule regulates the activity of security holders rather than of the offeror. Prior to the adoption of the rule in 1968, there had been an increasing practice, in connection with tender offers for fewer than all of the outstanding shares of the class being sought, to tender or

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26. The conditions generally imposed were: (1) appropriate notice of the offer was given to all holders of the subject security; (2) the issuer complied with conditions substantially equivalent to the withdrawl, pro rata and increased consideration provisions of Section 14(d)(5)-(7) of the Exchange Act; and (3) no purchases of the subject security were made otherwise than pursuant to the offer from the time the offer was announced until two weeks after its termination. For example, see note 24 *supra* (letters re: Ethyl Corp. and Cyclops Corp.).

27. 17 C.F.R. §240.10b-13 (1980).

28. Rule 10b-13(a) declares in part:

> No person who makes a cash tender offer or exchange offer for any equity security shall, directly or indirectly, purchase, or make any arrangement to purchase, any such security (or any other security which is immediately convertible into or exchangeable for such security), otherwise than pursuant to such tender offer or exchange offer, from the time such tender offer or exchange offer is publicly announced or otherwise made known by such person to holders of the security to be acquired until the expiration of the period, including any extensions thereof, during which securities tendered pursuant to such tender offer or exchange offer may by the terms of such offer be accepted or rejected.

29. 17 C.F.R. §240.10b-13(c) (1980). Exemptions are provided, however, for the purchase of a security pursuant to a stock option plan involving only "qualified stock options" or qualifying as an "employee stock plan" as those terms are defined in Sections 422 and 423 of the Internal Revenue Code of 1954, as amended, or "restricted stock options" as defined in Section 424(b) thereof, or pursuant to a stock purchase plan providing for both (i) periodic payments (or payroll deductions) for acquisition of securities by or on behalf of participating employees and (ii) periodic purchases of securities by participating employees, where the persons acquiring the securities do so for the account of such employees.

30. See text accompanying note 142 *infra*.

31. 17 C.F.R. §240.10b-4 (1980). An amendment to Rule 10b-4 was proposed for comment in 1977, SEC Exchange Act Release No. 14157, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CHH) ¶81,363 (1977) to also deal with the problem of short sales, loans of subject securities for purposes of facilitating such short sales, and guarantees of delivery. No action has been taken yet with respect to this proposal.

32. "Short tendering" is the practice whereby a security holder tenders more shares pursuant to a tender offer than he actually owns.

guarantee the tender of more securities than were actually owned in situations where prorationing was anticipated in order to have more of the owned securities actually accepted. If, for example, only 50% of tendered securities were accepted, a person who had tendered twice as many securities as he or she owned would have all of his or her securities accepted.

4. Anti-Fraud Provisions

There are two principal anti-fraud provisions of the Exchange Act which may be applicable to issuer tender offers: Sections 10(b)[33] and 14(e).[34] Rule 10b-5,[35] adopted by the SEC under Section 10(b), is probably the most used and best known rule or section of the entire federal security law. Basically the rule proscribes any material misrepresentation or omission by a purchaser or a seller of securities.[36] Despite the reference in Rule 10b-5 to fraudulent acts, the prohibitions of Section 10(b), under which the rule was adopted, are limited to "any manipulative or deceptive device or contrivance."[37] Consequently, a cause of action can be stated under Rule 10b-5 "only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute."[38] Despite this limitation, the rule clearly requires an issuer to provide full and fair disclosure to those from whom

33. 15 U.S.C. §78j(b) (1976).
34. *Id.* §78n(e).
35. 17 C.F.R. §240.10b-5 (1980).
36. *Id.* The rule provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any National Securities Exchange,

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

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

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

37. 15 U.S.C. §78(j) (1976). Section 10 declares in pertinent part:

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

. . . (b) to use or employ, in connection with the purchase or sale of any security. . ., any *manipulative or deceptive* device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. (emphasis added).

38. Santa Fe Indus. Inc. v. Green, 430 U.S. 462, 473-74 (1977). Prior to the Supreme Court decision in *Santa Fe*, a number of lower courts had held that the combination of a controlling influence and unfairness could constitute a violation of Rule 10b-5 even if there was full disclosure. *See, e.g.*, Shell v. Hensley, 430 F.2d 819 (5th Cir. 1970); Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied*, 395 U.S. 906 (1969); Albright v. Bergendahl, 391 F. Supp. 754 (D. Utah 1974). For an analysis of the impact of *Santa Fe* on "new fraud", *see* Jacobs, *How Santa Fe Affects 10b-5's Proscriptions Against Corporate Mismanagement*, 6 SEC. REG. L.J. 3 (1978).

it repurchases its stock, whether by means of a tender offer or otherwise. Nevertheless, there has been little litigation concerning this issue outside of the context of "going private" transactions.[39]

Section 14(e) of the Exchange Act proscribes fraudulent, deceptive, or manipulative acts or practices in connection with a tender offer. Unlike Section 14(d), which regulates third party tender offers involving a class of equity security registered pursuant to Section 12 of the Exchange Act and certain other equity securities, Section 14(e) applies to *all* tender offers, whether by a third party or an issuer, and is limited only by the jurisdictional limits of the Exchange Act itself.[40] Moreover, unlike Rule 10b-5,[41] private actions for damages under Section 14(e) have not been limited to purchasers and sellers.[42] This permits a security holder whose securities were not accepted or to whom the offer was not extended to bring an action under this section.

A potentially greater difference between Section 14(e) and Rule 10b-5 is the fact that Section 14(e) specifically proscribes fraudulent as well as manipulative and deceptive acts.[43] Theoretically, the case law prior to *Santa Fe Industries, Inc. v. Green*[44] with respect to "new fraud" involving unfairness, whether or not there is deception,[45] could be applied to suits under Section 14(e). To date, however, this has not generally been the case.[46]

5. State Regulation

In addition to the federal regulations discussed above, issuer tender offers also are subject to various state regulations. All fifty states specifically grant corporations the power to repurchase their securities,[47] al-

39. "Tender offers by issuers . . . look like a fertile field for 10b-5, but so far they have produced more discussion than litigation." 2 A. BROMBERG & L. LOWENFELDS, SECURITIES FRAUD & COMMODITIES FRAUD §6.4, at 127 (1979).

40. Letter from the Division of Corporation Finance, SEC re: Henry Hiede Incorporated, [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶78,838, at 81,836 (May 1, 1972):

> The provisions of Section 14(e), the antifraud portion of the Williams Act, are applicable with respect to all tender offers, requests or invitations for tenders without regard to the class or kind of security involved. The applicability of Section 14(e) is not restricted to tender offers falling within the ambit of Section 14(d)(1) of the Act.

41. The Supreme Court has held that a private cause of action for damages under Rule 10b-5 can only be brought by a purchaser or seller of securities. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

42. *See* Smallwood v. Pearl Brewing Co., 489 F.2d 579, 596 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974). For a discussion of standing to sue under the Williams Act, *see* Pitt, *Standing to Sue Under the Williams Act After Chris-Craft: A Leaky Ship on Troubled Waters*, 34 BUS. LAW. 117 (1978).

43. 15 U.S.C. §78n(e) (1976).

44. 430 U.S. 462 (1977).

45. See note 38 *supra*.

46. *See, e.g.*, Berman v. Gerber Products Co., 454 F. Supp. 1310, 1318 (W.D. Mich. 1978); Marshel v. AFW Fabric Co., 441 F. Supp. 299, 300 (S.D.N.Y. 1977). Neither of these cases discusses the language difference between Sections 10(b) and 14(e).

47. *See, e.g.*, CAL. CORP. CODE §207; DEL. CODE ANN. tit. 8, §160; MODEL BUS. CORP. ACT

though such right generally is limited to situations in which the capital of the corporation will not be impaired or which will not jeopardize the corporation's ability to conduct business.[48] Many states also have tender offer statutes, but issuer tender offers generally are specifically exempted from these provisions.[49]

Several state courts have declared that under common law the directors, officers, and majority shareholders of a corporation have a fiduciary duty to the other shareholders.[50] Since issuer tender offers generally do not involve coercion, however, issues of fiduciary obligations in this area generally will be limited to the propriety of the purpose for the offer and the adequacy of the disclosure provided.

At least one state has adopted "going private" regulations which affect certain issuer tender offers.[51] In 1977, the Wisconsin Securities Commissioner adopted regulations in that state with respect to transactions which could cause delisting from a national securities exchange, termination of authorization for quotation on NASDAQ, or termination or suspension of reporting requirements under either the Exchange Act or Chapter 551 of the Wisconsin Statutes.[52] The rule requires, in the case of subject tender offers, that certain withdrawal and proration rights be provided and that the terms be uniform for all holders.[53]

ANN. §6 (1971). In contrast, England historically did not permit corporations to repurchase their securities. *See* Trevor v. Whitworth, 12 App. Cas. 409 (HL 1887).

48. California, for example, prohibits stock repurchases by an issuer unless either (a) the amount of the issuer's retained earnings is sufficient to cover such repurchases, or (b) immediately after the repurchase, (i) the assets of the issuer (exclusive of goodwill, capitalized research and development expenses, and deferred charges) would be at least 1.25 times its liabilities (exclusive of deferred taxes, deferred income and other deferred credits and (ii) the issuer's current assets would equal or exceed its current liabilities (or, if the issuer's average earnings before income taxes and interest expense for its past two fiscal years was less than its average interest expense for such period, would be at least 1.25 times its current liabilities). CAL. CORP. CODE §500. In addition, an issuer may not repurchase any of its outstanding securities if the issuer "is, or as a result thereof would be, likely to be unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature." *Id.* §501.

49. For example, *see* DEL. CODE ANN. tit. 8, §203(c)(3) ("'Tender offer' does not mean: a. An offer made by a corporation to purchase its own equity securities. . . .") *Id.*

50. *See, e.g.*, Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969); Singer v. Magnavox Co., 380 A.2d 969 (Del. Sup. 1977); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977), *on remand* 402 A.2d 382 (Del. Ch. 1979); Berkowitz v. Power/Mate Corp., 134 N.J. Super. 36, 342 A.2d 566 (1975). *See also* Pepper v. Litton, 308 U.S. 295 (1939); Lebold v. Inland Steel Co., 125 F.2d 369 (7th Cir. 1942).

51. WIS. ADM. CODE §6.05, *cited in* BLUE SKY L. REP. (CCH) ¶64,605, at 56,534 (1980).

52. *See id.*

53. *Id.* at ¶64,605(2)(c):

If the transaction includes a tender offer or request or invitation for tenders, such offeror shall:

1. Permit tenders to be withdrawn at any time within 7 days and after 60 days from the date of the offer;

2. Purchase on a pro rata basis those securities tendered within 10 days from the date of the offer, if more valid tenders are received within that period than the offeror has agreed to accept; and

3. Purchase on substantially identical terms for identical compensation from all validly tendering security holders;. . .

THE REGULATION OF ISSUER TENDER OFFERS: RULE 13e-4

A. Application

Rule 13e-4 is applicable to any issuer which has a class of equity security registered pursuant to Section 12 of the Exchange Act, or which is required to file periodic reports pursuant to Section 15(d) of the Exchange Act, or which is a closed-end investment company registered under the Investment Company Act of 1940.[54] Although Section 13(e)(1) does not apply to an issuer required to file periodic reports under Section 15(d) of the Exchange Act, Rule 13e-4 was, however, also adopted under Section 14(e), which gives the SEC rule-making authority to regulate any tender offer.[55] Section 15(d) applies to issuers of a security for which a registration statement was filed under the Securities Act of 1933[56] so long as there are at least 300 holders of record of such security at the beginning of the fiscal year. In contrast, Section 12 only applies to issuers of a security registered on a national securities exchange or which have (or had) assets exceeding one million dollars and a class of equity security (other than an exempted security) held of record by 500 or more persons.[57] In adopting Rule 13e-4, the SEC stated its belief that "tender offers by issuers subject to the requirements of Section 15(d) represent the same potential for abuse as other issuer tender offers covered by the Rule. . . ."[58]

Rule 13e-4 also applies to an offer by an affiliate of an issuer for that issuer's securities.[59] The authority for such inclusion is provided by Section 13(e)(2)[60] in recognition of the fact that purchases by these per-

54. 17 C.F.R. §240.13e-4(a)(1) (1980).
55. See note 40 *supra*.
56. 15 U.S.C. §§77a-77aa (1976).
57. *Id.* §78l(b), (g)(1). Section 12(g) requires an issuer with both one million dollars in assets and 500 holders of record of a non-exempt equity security to register such security with the SEC; in addition, any other equity security may be voluntarily registered pursuant to Section 12(g). Once a security is registered pursuant to Section 12(g), such registration cannot be terminated until such time as the issuer has fewer than 300 record holders of the equity security in question.
58. SEC Exchange Act Release No. 16112, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,182, at 82,209 (1979) [hereinafter cited as *Adoptive Release*]. All page references are to CCH.
59. 17 C.F.R. §240.13e-4(a)(2) (1980).
Although there is no definition of an "affiliate" under Rule 13e-4 (presumably due to an oversight), both Rule 13e-3 under the Exchange Act, and Rule 405 under the Securities Act of 1933 define "affiliate" as a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the issuer." 17 C.F.R. §§230.405, 240.13e-3(a)(1) (1980). Control is defined by Rule 405 as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. §230.405(f) (1980). The presence or absence of control is a factual determination and can be quite perilous. For a general discussion of the issue of control, *see* Sommer, *Who's "In Control"?* 21 BUS. LAW. 559 (1966).
60. 15 U.S.C. §78m(e)(2) (1976). This section provides that "a purchase by or for the issuer or any person controlling, controlled by, or under common control with the issuer or a purchase subject to control of the issuer or any such person, shall be deemed to be a purchase by the issuer."

sons raise the same potential for fraud, deceit, or manipulation as an offer by the issuer itself.[61]

Paragraph (g)(4) of Rule 13e-4 exempts from the rule any tender offer which is subject to Section 14(d).[62] This provision excludes most tender offers by affiliates from the rule, since the only affiliates not subject to Section 14(d) are affiliates of issuers subject to the reporting obligations of Section 15(d). However, the fact that a tender offer by an affiliate for the issuer's securities may be subject to Section 14(d) should not excuse such offer from the more stringent requirements of Rule 13e-4.[63] To the extent that such additional requirements reflect the fiduciary obligation of the issuer to its shareholders, they should be equally applicable to persons in a control relationship with the issuer.[64]

B. Fraud, Deception, and Manipulation

As written, Section 13(e)(1) apparently requires the SEC, in adopting rules and regulations concerning issuer repurchases under that section, to first define acts and practices which are fraudulent, deceptive, or manipulative before prescribing means reasonably designed to prevent these acts and practices.[65] To meet this preliminary requirement, paragraph (b)(1) of Rule 13e-4 defines certain fraudulent, manipulative, or deceptive acts simply as fraud, manipulation, or deception.[66] Para-

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61. *1967 Senate Hearings, supra* note 9, at 27-28.' Statement by Manuel F. Cohen, then Chairman of the SEC:

> We have found that purchases by a parent or a subsidiary of the issuer, or anyone else in a control relationship with the issuer, or by a welfare or pension fund subject to the influence of the issuer's management, give rise to similar problems. . . .

62. The exemption reflected the determination "that additional regulation of such tender offers at this time by application of Rule 13e-4 is unnecessary." *Adoptive Release, supra* note 58 at 82,207.

63. Rule 13e-4, for example, imposes an initial withdrawal and prorationing period of ten business days, compared to the seven and ten calendar day requirements, respectively, imposed by Section 14(d). In addition, certain information required by Schedule 13E-4 is not required by Schedule 14D-1. The SEC declared during the hearings on the Williams Bill that an issuer making a tender offer for its securities "probably should disclose substantially more information with respect to its own business and prospects than can reasonably be expected of a third party." Supplemental Memorandum of the SEC with Respect to Certain Comments on S.510, *1967 Senate Hearings, supra* note 9, at 202. Ironically, such information has not been required by Schedule 13E-4 to any significant extent.

64. In reality, the provisions of the Williams Act and of the existing and proposed rules and regulations thereunder relating to third party tender offers generally are at least as stringent as the provisions of Rule 13e-4, and would continue to apply to a tender offer by an affiliate of an issuer.

65. 15 U.S.C. §78m(e)(1) (1976). Section 13(e)(1) declares in part:

> It shall be unlawful for an issuer which has a class of equity securities registered pursuant to Section 12 of this title, or which is a closed-end investment company registered under the Investment Company Act of 1940, to purchase an equity security issued by it if such purchase is in contravention of such rules and regulations as the Commission, in the public interest or for the protection of investors, may adopt (A) to define acts and practices which are fraudulent, deceptive, or manipulative, and (B) to prescribe means reasonably designed to prevent such acts and practices.

66. 17 C.F.R. §240.13e-4(b)(1) (1980) defines certain fraudulent, manipulative or deceptive acts:

graph (b)(2) then sets forth the requirements "reasonably designed" to prevent the acts and practices "defined" in the paragraph (b)(1).[67]

Defining fraud or deceit as a fraudulent, deceptive, or manipulative act for purposes of Section 13(e) is hardly in compliance with the spirit, and perhaps not even the letter, of that section. As originally proposed by the SEC, Rule 13e-4 had defined specific situations with respect to an issuer tender offer as being fraudulent, deceptive, or manipulative.[68] Regardless of whether the SEC's original definition is considered to be adequate, the approach certainly was more in keeping with the intent of Congress than the circular definition finally adopted by the SEC. Unfortunately, the original approach was abandoned "to obviate concern as to whether the Commission intended to introduce unfamiliar concepts of fraud, deceit and manipulation. . . ."[69] To avoid those concerns, the SEC adopted a "definition" so meaningless as to jeopardize the statutory basis for the rule. An alternative approach would be to specifically define the fraudulent, manipulative, or deceptive acts or practices which the rule was reasonably designed to prevent, either in a preface thereto or as a separate release.

(i) to employ any device, scheme, or artifice to defraud any person;

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

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

This language is identical to that of Rule 10b-5. It is uncertain whether this means that Rule 13e-4(b)(1) is intended to have the same scope as Rule 10b-5, as delineated by the United States Supreme Court in *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

67. 17 C.F.R. §240.13e-4(b)(2) (1980) provides:

(a) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices in connection with any issuer tender offer, it shall be unlawful for an issuer or an affiliate of such issuer to make an issuer tender offer unless:

(i) such issuer or affiliate complies with the requirements of paragraphs (c), (d), (e) and (f) of this section; and

(ii) the issuer tender offer is not in violation of paragraph (b)(1) of this section.

Paragraph 4(c) indicates the material to be filed with the SEC; paragraph 4(d) sets forth the disclosure obligations; paragraph 4(e) states the permissible methods of disseminating the offer; and paragraph 4(f) enumerates substantive requirements concerning the structure of the offer.

68. SEC Securities Act Release No. 5886, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,383 (Dec. 8, 1977). As originally proposed by the SEC, Rule 13e-4 defined as fraudulent, deceptive or manipulative any issuer tender offer:

(1) as to which adequate disclosure of the terms of the offer, its purpose and other material information relevant to the offer has not been made;

(2) which unreasonably discriminates among holders of securities which are the subject of the offers;

(3) which is of unduly short duration or unduly restricts the right of persons tendering in response to the offer to withdraw their tendered securities;

(4) as to which the issuer unduly delays either the payment for securities tendered and accepted or the return of securities not accepted; or

(5) which is employed by an issuer, directly or indirectly, for the purpose of creating or sustaining false or misleading market prices for the securities which are the subject of the offer.

69. *Adoptive Release*, *supra* note 58, at 82,208.

C. Disclosure

Prior to or as early as possible on the date the tender offer commences, the issuer or affiliate making an offer subject to Rule 13e-4 must file with the SEC ten copies of Schedule 13E-4.[70] Schedule 13E-4 requires specific information concerning among other things, the nature of the tender offer, the issuer, the target security, the purpose of the offer, recent transactions or arrangements in the target securities, certain contracts relating to the target securities, and persons compensated to make solicitations or recommendations in connection with the tender offer.[71]

In addition to filing Schedule 13E-4 with the SEC, the issuer or the affiliate making the tender offer must provide a statement to the secur-

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70. 17 C.F.R. §240.13e-4(c)(1) (1980).

71. Schedule 13E-4 requires the following information:

1. Information concerning the target security and the issuer.
2. The source and aggregate amount of funds or other consideration to be used for the purchase of the maximum amount of securities being sought.
3. The purpose(s) of the tender offer, the proposed disposition of securities acquired, and any plans or proposals which relate to or would result in (a) certain specified events (including the acquisition or disposition of securities of the issuer by any person; any material change in the business or structure of the issuer; or "going private").
4. A description of any transactions involving the target security effected during the past 40 business days by the person filing the Schedule or by any associate or subsidiary of such person.
5. A description of any contract, arrangement, understanding or relationship, relating directly or indirectly to the tender offer, between the person filing the Schedule and any person with respect to any securities of the issuer.
6. The identification of all persons employed, retained or to be compensated by or on behalf of the offeror to make solicitations or recommendations in connection with the tender offer, and a summary of the material terms of the agreement.
7. Financial information concerning the issuer, including, if material: (a) the audited financial statements required to be filed with the issuer's most recent annual report on Form 10-K for the last two fiscal years; (b) the unaudited balance sheets, comparative year-to-date income statements, statements of changes in financial position, and related earnings per share amounts which were required to be included in the issuer's most recent quarterly report on Form 10-Q; (c) ratio of earnings to fixed charges for the two most recent fiscal years and the interim periods provided above; and (d) book value per share as of the most recent fiscal year end and as of the date of the latest interim balance sheet provided above. In addition, if material, pro forma data should be provided disclosing the effect of the tender offer on each of the above.
8. Any other information material to a decision by a security holder as to whether to sell, tender or hold securities being sought in the tender offer, including, but not limited to: (a) any present or proposed contracts, arrangements, understandings or relationships between the issuer and its executive officers, directors or affiliates not otherwise required to be disclosed; (b) any applicable regulatory requirements which must be complied with or approvals which must be obtained in connection with the tender offer; (c) the applicability of the margin requirements of Section 7 of the Exchange Act and the regulations promulgated thereunder; and (d) any material pending legal proceedings relating to the tender offer.
9. Copies of the following documents, which are to be filed as exhibits to Schedule 13E-4: (a) the tender offer material; (b) any loan agreement referred to in Item 2 of the Schedule; (c) any documents setting forth the terms of any contracts, arrangements, understanding or relationships referred to in Items 5 or 8(a) of the Schedule; (d) any written legal opinion pertaining to the tax consequences of the tender offer prepared at the request of and communicated to the offeror; (e) any prospectus filed with the SEC in connection with a registration statement pertaining to securities to be offered in exchange for the target security; and (f) if any oral solicitation of security holder is to be made by or on behalf of the offeror, any written instructions, forms or other material furnished to the persons making the oral solicitation for their use, directly or indirectly, in connection with the tender offer. *See* 17 C.F.R. §240.13e-101 (1980).

ity holders.[72] This statement must contain the information required by Schedule 13E-4 or a fair and adequate summary thereof; the termination date of the offer and whether it may be extended; the specific dates prior to which and after which tendered securities may be withdrawn and, in the case of a tender offer for less than all of the outstanding securities of a class, the exact dates of the period during which securities will be accepted on a pro rata basis and the manner in which securities will be accepted for payment and in which securities may be withdrawn. Any material change in the above information must be disclosed promptly.[73]

If the tender offer is disseminated by means of a summary publication, the summary may disclose only: (a) the identity of the offer; (b) the amount and class of securities being sought and the price being offered; (c) the scheduled termination date of the offer and whether it may be extended; (d) the applicable withdrawal and pro rata periods; (e) a statement of the purpose of the offer; (f) instructions on how to obtain a copy of the tender offer statement (at the expense of the offeror); and (g) a statement to the effect that the information contained in the tender offer statement is incorporated by reference. The summary advertisement may not contain a transmittal letter for the tender of securities.[74]

Within ten days after the termination of the issuer tender offer, an amendment to Schedule 13E-4 must be filed reporting the results of the tender offer.[75]

D. Dissemination of the Offer

Rule 13e-4(e) requires that one of three specified methods be used to disseminate the offer. The offer may be mailed to all shareholders of record, published in one or more newspapers, or published in summary form in one or more newspapers with a copy of the offer and letter of transmittal promptly furnished upon request.[76] The latter two methods are only available in certain instances, as discussed below.

A tender offer subject to Rule 13e-4 always can be disseminated by mailing the offer directly to the shareholders, and this method *must* be used if the offer involves consideration other than cash.[77] If this method is employed, the offeror must mail the offering statement to each shareholder of record on the most recent shareholder list of the

72. 17 C.F.R. §240.13e-4(d) (1980).
73. *Id.* §240.13e-4(d)(2).
74. *Id.* §240.13e-4(d)(3).
75. *Id.* §240.13e-101 General Instruction D.
76. *Id.* §240.13e-4(e).
77. *Id.*

issuer. With respect to beneficial owners, the offeror must determine the number of copies, furnish such copies, and reimburse nominees for reasonable expenses incurred in forwarding the offering statements. Unfortunately, the rule is silent as to when the inquiry concerning beneficial ownership must be made. The inquiry should be made prior to the commencement of the offer if beneficial owners are to be provided an adequate opportunity to review the terms of the offer prior to its expiration. If, however, such inquiry is made prior to the commencement of the offer and no formal announcement of the offer has yet been made, the brokers contacted could easily surmise the reason for the inquiry and might acquire positions in the issuer's stock or suggest that their customers do so. To avoid this problem, the offeror would have to give public notice of the proposed offer no later than when the number of beneficial owners was determined, presumably several days prior to the offer. This, though, might tend to drive up the market price of the target security, and possibly force the offeror to increase the consideration offered.

Cash tender offers also may be disseminated either by publishing the complete offer in one or more newspapers or by publishing a summary in one or more newspapers and furnishing the actual offer and letter of transmittal upon request. It is the obligation of the offeror to insure that the newspaper or newspapers employed will provide adequate publication of the offer or summary. The use of the summary publication is not permitted if the offer is subject to Rule 13e-3, *i.e.*, if the offer reasonably could involve a "going private" transaction.[78]

As originally proposed, Rule 13e-4 did not limit the availability of either the long form publication or short form publication in disseminating an offer. In the case of exchange offers, however, such procedures would conflict with the requirements of the Securities Act of 1933, and so these procedures were limited to cash tender offers.[79]

Unexplained by the SEC is why an issuer should be permitted under *any* circumstances to make a tender offer for its securities without disseminating the offer directly to its shareholders. Although alternative means might be necessary in the case of an affiliate of an issuer subject to the reporting requirements of Section 15(d) in the unlikely event that the issuer is unwilling to provide such affiliate with its shareholder list,[80] no justification has been presented for allowing an issuer to use

78. With respect to the applicability of Rule 13e-3, see the text accompanying note 122 *infra*.
79. As a practical matter, it would be impossible to comply with the prospectus requirement of Section 5 of the Securities Act of 1933, as amended, by means of a publication in a newspaper.
80. Rule 14d-5, 17 C.F.R. §240.14d-5 (1980), allows persons making a tender offer pursuant to the Williams Act to either obtain a stockholder list or have the subject company distribute the

such a clearly less efficient method of notifying its holders concerning the offer. Indeed, it is questionable whether, prior to the adoption of Rule 13e-4, any issuer ever made an offer to its shareholders other than by a direct mailing. The importance of notifying all shareholders concerning the tender offer outweighs whatever cost benefits might be achieved by using newspaper publications in lieu of a direct mailing. The rule consequently should be amended to require that the tender offer materials be disseminated by means of a recent stockholder list unless, in the unlikely case of an offer by an affiliate subject to the rule, the issuer refuses to provide such stockholder list.

E. Substantive Regulation

The "heart" of Rule 13e-4 consists of the substantive requirements and restrictions which it imposes. These provisions regulate the duration of the offer,[81] withdrawal rights,[82] prorationing,[83] increases in consideration,[84] payment for tendered securities,[85] and purchases after the termination of the offer.[86] Each of these provisions will be considered separately.

1. Duration of the Offer

The rule requires that subject tender offers remain open for at least fifteen business days from the date of their commencement.[87] The minimum tender offer period is intended to insure that all security holders have a reasonable opportunity to consider the terms of and to participate in the offer.[88] An offer which remains open for less than fifteen business days might cause hasty decisions to be made as well as work to the disadvantage of security holders distant from where the offer is made.[89]

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offer to its stockholders. This rule does not apply to securities of issuers subject to the reporting requirements of Section 15d.

81. 17 C.F.R. §240.13e-4(f)(1) (1980).

82. *Id.* §240.13e-4(f)(2).

83. *Id.* §240.13e-4(f)(3).

84. *Id.* §240.13e-4(f)(4).

85. *Id.* §240.13e-4(f)(5).

86. *Id.* §240.13e-4(f)(6).

87. *Id.* §240.13e-4(f)(1). In contrast, Rule 14e-1 requires that subject tender offers remain open for twenty business days. See note 127 and the accompanying text *infra*. The New York Stock Exchange Company Manual requires that tender offers remain open for at least ten days, although 30 days is recommended. N.Y.S.E. COMPANY MANUAL A-180 (1963).

88. *Adoptive Release, supra* note 58, at 82,208.

89. In 1973, for example, the Division of Corporation Finance received a complaint that a tender offer by a third party was made in a manner disadvantaging shareholders outside of the Midwest. The complaint alleged that the ten calendar days that the offer was open did not provide sufficient time for such shareholders to obtain the information necessary to make a decision. The complaint was not acted upon because at that time no minimum tender offer period was required by statute or rule. Letter from the Division of Corporation Finance, SEC re: Advanced

In the release adopting Rule 13e-4, the SEC stated that it would propose an amendment to the rule which would require that a separate minimum offering period be required following the date that notice of a material change in the terms of the offer is disseminated to security holders.[90] Such a requirement would assure security holders the opportunity to review the amended offer.

One issue not discussed by the SEC when proposing or adopting Rule 13e-4 is whether subject offers should be restricted to a certain maximum length of duration. Considering the impact that a tender offer can have upon the market for the subject security, such an offer should not continue for an excessive period of time.[91]

2. *Withdrawal Rights*

Rule 13e-4 permits tendered securities to be withdrawn during the first ten business days after the offer commences and, if not yet accepted for payment, after the expiration of forty business days from such commencement.[92] The tendered securities can also be withdrawn anytime during the first seven business days after the date another tender offer for the same class of securities is first made if they have not yet been accepted for payment.[93] Such withdrawal rights provide tendering security holders the opportunity to reconsider their decision during the initial period of the offer or after a competing offer is made, and assure that holders do not have their shares "locked in" for an excessive period of time.[94] During the interim period when withdrawal rights are not applicable, however, the offeror still is provided with a degree of certainty concerning the success of the offer and can extend, terminate, or revise the offer accordingly.[95]

The withdrawal rights provided by Rule 13e-4 for issuer tender offers exceed those provided by the Williams Act for third party tender of-

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Systems, Inc., [1973-1974 Transfer Binder] FED. SEC. L. REP. (CCH) ¶79,653, at 82,208 (Nov. 15, 1973).

90. *Adoptive Release, supra* note 58, at 82,208 n.29. Such a period should be for a lesser period of time since shareholders, once aware of the offer, would need less time to consider the amended terms.

91. The right of tendering security holders to withdraw their securities forty business days after the commencement of the offer, if such shares have not yet been accepted, will substantially deter, though not absolutely prevent offers for a longer period. Until early 1974, the Division frequently imposed a 60 day maximum offering period in granting an exemption under Rule 10b-6 for proposed issuer tender offers. *See* Letter from the Division of Market Regulation, SEC re: Whittaker Corporation July 2, 1973.

92. 17 C.F.R. §240.13e-4(f)(2) (1980).

93. *Id.*

94. *See Adoptive Release, supra* note 58, at 82,209.

95. It was for this reason that the SEC's proposal in 1967 that the Williams Bill provide unlimited withdrawal rights was rejected. *See* Memorandum to the Securities Subcommittee of the Senate Banking and Currency Committee from Donald L. Calvin and Phillip L. West, Vice Presidents, New York Stock Exchange, April 17, 1967, *1967 Senate Hearings, supra* note 9, at 92.

fers.[96] These greater withdrawal rights can be justified on the basis that the issuer has a greater obligation to its security holders than does a third party. In reality, though, the increased rights more probably reflect the experience accumulated since the Williams Act was adopted, and eventually should be extended by the Congress to third party tender offers.

The SEC has stated that it will propose an amendment to Rule 13e-4 which would require that an issuer afford additional withdrawal rights following the date that the notice of a material change in the terms of the tender offer is disseminated to security holders.[97] Unless such change is adverse or involves a change in the form of consideration offered, it is unclear why a holder who already has tendered his or her securities should receive additional withdrawal rights, particularly in light of the fact that he or she will be entitled to any increased consideration offered.[98]

3. Prorationing

Rule 13e-4(f)(3) requires that, if a greater number of securities is tendered within a specified period of at least ten business days after the offer commences, or after an increase in consideration is announced, then the offeror will accept all such securities on a pro rata basis (disregarding fractional shares). This provision is patterned after Section 14(d)(6) of the Exchange Act,[99] and is intended to assure that investors are not pressured unnecessarily to make a hasty decision in order to have their securities accepted and to provide security holders living far away a reasonable opportunity to participate. The prorationing period can be for more than ten days or for the entire period of the offer, so long as such period is specified in the offer.

Two exceptions to the prorationing requirements are permitted by the rule. The use of either or both of such exceptions is at the election of the offeror, provided notice of any variation is given in the offer.

96. Section 14(d)(5) allows the withdrawal of tendered securities during the first seven calendar days of the offer and at any time after sixty calendar days. *See* 15 U.S.C. §78n(d)(5) (1976 & Supp. III 1979).

97. *See Adoptive Release, supra* note 58, at 82,209 n.31.

98. See note 109 and accompanying text *infra*. It is also conceivable, in the case of a competing third party tender offer, that the competing offeror would attempt to "force" some change in the issuer's terms in order to allow the withdrawal of tendered securities.

99. Section 14(d)(6), 15 U.S.C. §78n(d)(6) (1976 & Supp. III 1979), was in turn patterned after the New York Stock Exchange requirement that a period be provided of not less than ten days during which tendered securities would be accepted on a pro rata basis. N.Y.S.E. COMPANY MANUAL A-180 (1963). As originally proposed, the Williams Bill would have required that all securities tendered during the offer be accepted on a pro rata basis. *1967 Senate Hearings, supra* note 9, at 12. Both Section 14(d)(6) and the N.Y.S.E. COMPANY MANUAL impose minimum prorationing periods of at least ten calendar days, whereas Rule 13e-4 imposes a minimum period of at least ten business days.

The first exception allows the offeror to accept all securities tendered by persons who own, beneficially or of record, not more than a specified number which is less than 100 shares of such security (*i.e.*, "odd lots") and who tender all their securities, before prorating securities tendered by others.[100] This allows the issuer to fully eliminate such small holdings, which tend to have relatively high shareholder servicing costs.[101] Generally, the acceptance of odd lots prior to prorationing will not have a significant effect upon the proportion of shares accepted from other security holders, and whatever impact occurs is likely to be offset by the benefit to the issuer and consequently to the other holders.[102]

The second exception allows the offeror to permit security holders who tender all their securities to tender upon the condition that none be accepted unless a specified number (including all) of such securities are accepted.[103] If this alternative is provided, the offeror must first accept all securities tendered by security holders who do not so elect. To the extent that additional securities will be accepted by the offeror after all unconditional tenders have been accepted in full, such conditional tenders will be accepted by lot. If a tender selected by lot is too large to be accepted in full, such tender is rejected and another one is selected by lot. This procedure continues until no more securities will be accepted by the offeror.[104]

This exception is intended to permit tendering security holders who so desire to avoid potential adverse income tax consequences which could result from a partial acceptance of their tendered securities. Under the redemption provisions of Section 302 of the Internal Revenue Code of 1954, as amended, the receipt of consideration by a shareholder upon the sale or exchange of the voting stock of a company owned by him or her to the company generally will be taxable as a dividend, resulting in ordinary income to the stockholder under Section

100. In the case of a tender offer limited to odd lots, the exception permits the offeror to accept tendered securities by lot if more securities are tendered than will be accepted. 17 C.F.R. §240.13e-4(f)(3)(i) (1980). This procedure permits the elimination of odd lots without pressuring holders to tender quickly.

101. *See* SEC Exchange Act Release No. 14234, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶81,380, 88,783 n.17 (Dec. 7, 1977); Young & Marshall, *Controlling Shareholder Servicing Costs*, 49 HARV. BUS. REV. 71 (1971).

102. The Division of Market Regulation regularly has permitted issuers to accept all odd lots tendered before accepting other securities tendered on a pro rata basis. *See, e.g.*, letter from the Division of Market Regulation, SEC re: Cyclops Corporation, July 7, 1979 (shares tendered by holders of fewer than 100 shares who tender all their shares could be accepted in their entirety without proration); letter from the Division of Market Regulation, SEC re: Miller-Wohl Company, Inc., July 23, 1975 (shares tendered by holders of 25 shares or less who tender all their shares could be accepted without proration).

103. 17 C.F.R. §240.13e-4(f)(3) (1980).

104. *Id.*

301. If, however, such sale or exchange terminates the stockholder's entire interest in the company or results in a "substantially disproportionate"[105] reduction in the stockholder's voting stock in the company, the consideration paid is considered to be a distribution received by the stockholder in exchange for the securities, and therefore is taxable as a capital gain or loss.[106]

While certainly a procedure should not be permitted which would favor conditional tenders over unconditional tenders,[107] the rule as adopted unfairly favors unconditional tenders by requiring that unconditional tenders be accepted in full before any conditional tenders be accepted. There is no reason why, in the case of an over-subscription, conditional tenders could not be accepted on the same pro rata basis as if all tenders were unconditional. Any conditional tenders that specified a number that would be satisfied by the proposed prorationing also would be accepted in their pro rata amount. The pro rata number of shares which otherwise would have been accepted from the remaining conditional securities would be used to form a "pool" of securities; the remaining conditional tenders then would be selected by lot to have the designated number of tendered securities accepted until the pool was no longer sufficient to satisfy a remaining conditional tender. Any remaining securities in the pool could be disregarded by the offeror or accepted as nearly as possible on a pro rata basis from unconditional tenders, at the option of the offeror. Such a procedure, which provides the greatest fairness to all tendering security holders regardless of whether such tenders are conditional or unconditional, has been per-

105. Section 302(b)(2)(C) of the Internal Revenue Code of 1954 provides the following definition of a "substantially disproportionate" distribution:

> (C) Definitions—For purposes of this paragraph, the distribution is substantially disproportionate if—
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> (i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,
>
> is less than 80 percent of—
>
> (ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.
>
> For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

106. For a general discussion (notwithstanding its title) of income tax aspects of issuer tender offers, *see* Eustice, *Going Private: Tender Offer Redemptions for Cash or Securities*, 2 J. CORP. TAX 137 (1975).

107. For example, if the offeror were permitted to accept all tenders by lot in case of an over-subscription in order that all accepted tenders would qualify for capital gains treatment, tendering shareholders who did not care whether they received capital gains or ordinary income treatment would be unfairly disadvantaged.

mitted in the past by the Division of Market Regulation.[108] There appears to be no justification for prohibiting this procedure, at least as an alternative to the procedure specified in the rule.

The pro rata provision does not explicitly require that, where the period of the tender offer by an issuer is extended, all securities tendered prior to such extension must be accepted in full before any other securities are accepted. Such a requirement is necessary to protect security holders who tendered during the original period of the offer, from having the number of accepted securities diluted as a result of the extension, and should be explicitly stated in the rule.[109]

4. *Increase in Consideration*

Rule 13e-4(f)(4) requires that, if the consideration offered is increased during the offer, such increased consideration will be paid to all security holders whose tendered securities are accepted.[110] This provision is substantially identical to Section 14(d)(7) of the Exchange Act, which was intended "to assure fair treatment of those persons who tendered their shares at the beginning of the tendered period, and to assure equality of treatment among all shareholders who tender their shares."[111] Although the principle of such a "best price" provision has been debated,[112] in practice there apparently has been little difficulty with such a requirement.

In its present form, Rule 13e-4 does not require that all holders be offered either the same consideration or substantially equal value. For example, an issuer might offer a debt security in exchange for units of 500 shares tendered, and cash for other amounts of shares tendered. If the debt securities offered had a significantly greater market value per share tendered than the cash offered for other shares, the purpose of this "best price" position would be circumvented. Although Rule 13e-4 is silent on this issue, Section 14(e) arguably could be interpreted to

108. *See* Letter from the Division of Market Regulation, SEC re: Standard-Pacific Corp., Sept. 13, 1974.

109. "I see no reason why those shareholders who have tendered during the initial period must be left in a state of uncertainty while the offeror endeavors to attract more shares." *1967 Senate Hearings, supra* note 9, at 198 (testimony of Manuel Cohen, then Chairman of the SEC, with respect to the prorationing provisions of the Williams Bill). If, however, an issuer announced at the outset of the offer that, if prorationing was necessary, all securities tendered during the offer and any extension thereof would be equally subject to prorationing, this also would appear to be equitable.

110. 17 C.F.R. §240.13e-4(f)(4) (1980).

111. SENATE COMM. ON BANKING AND CURRENCY, FULL DISCLOSURE OF CORPORATE EQUITY OWNERSHIP AND IN CORPORATE TAKEOVER BIDS, S. REP. No. 550, 90th Cong., 1st Sess. 10 (1967).

112. *See, e.g., 1967 Senate Hearings, supra* note 9, at 136 (Appendix to statement of Professor Stanley A. Kaplan); E. ARANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 136 (1973).

prohibit such a situation. Although there may be justification for offering consideration in different forms to holders of varying amounts of securities, different consideration should be of substantially equal market value unless all holders are given the option to elect either consideration. As will be discussed subsequently, the SEC has proposed for comment Rule 14e-4 which would require equal treatment of security holders.[113]

5. Payment for Tendered Securities

Once the tender offer has terminated or has been withdrawn, the offeror is required "promptly" either to pay the consideration offered or to return the tendered securities.[114] Although requiring the offeror to act promptly is commendable, a specified maximum period of time within which an offeror is required to act (such as 30 days) would avoid confusion as to what constitutes "promptness."

6. Purchases After the Termination of the Offer

Until the expiration of at least ten business days after the termination of the tender offer, neither the issuer nor any affiliate is permitted to make any purchases, other than pursuant to the offer, of either the subject security, any security of the same class and series, or any right to purchase any such securities.[115] This provision extends the proscription of Rule 10b-13[116] for ten business days after the offer terminates. This ten day "cooling off" period following the termination of the offer is intended to allow all effects of the offer on the trading market to subside before purchases which might prolong such effects are made by the issuer or an affiliate.[117] Since desired purchases could be made prior to or after the proscribed period, the provision should not constitute a substantial hardship to the issuer and its affiliates.[118]

113. See notes 136-141 and accompanying text *infra*. Offering less value for shares to some shareholders than to other shareholders might constitute a manipulative or deceptive practice in violation of the general anti-fraud proscription of Section 14(e). See text accompanying note 40 *supra*.

114. 17 C.F.R. §240.13e-4(f)(5) (1980).

115. *Id.* §240.13e-4(f)(6). In the case of an exchange offer, the issuer and its affiliates also are prohibited during such period from purchasing the security being offered, any security of the same class and series, or any right to purchase such securities. *Id.*

116. See text accompanying note 27 *supra*.

117. Purchases by an affiliate during this unsettled period would tend to have the same disruptive effects as purchases by the issuer. A study by Barron's in 1975 of the impact of 51 third party tender offers on the market price of the target security indicated that (1) the market price generally increased sigificantly as a result of the offer, and (2) the market price generally declined after the termination of the offer. BARRON'S, Dec. 8, 1975, at 70. The probable decline in market price after an offer terminates would be temporarily delayed if significant market purchases were made immediately after the offer.

118. The Division of Market Regulation imposed such a cooling period in granting exemp-

7. *To Whom the Offer Should Be Made (Not Adopted)*

As originally proposed, Rule 13e-4 would have required that the offer be made to all security holders of the class of securities subject to the offer (with the exception that odd lot tender offers would be permitted).[119] Several commentators, however, argued that in certain limited contexts there could be a legitimate business purpose for excluding certain security holders,[120] and the SEC concluded that further study of this issue was required. This provision again was proposed for comment on November 29, 1979 as part of proposed Rule 14e-4.[121]

OTHER NEW OR PROPOSED REGULATIONS

A. Rule 13e-3

Rule 13e-3 was adopted by the SEC on August 2, 1979 to regulate going private transactions by public companies or their affiliates. The rule applies to any purchase of or tender offer for an equity security by the issuer or an affiliate, as well as to certain solicitations subject to Regulation 14A and information statements pursuant to Regulation 14C.[122] The rule applies if the transaction is intended to or has a reasonable likelihood of: (1) causing any class of equity securities of the issuer, which is subject to Section 12(g) or Section 15(d) of the Exchange Act, to be held of record by less than 300 persons;[123] or (2) causing any class of equity securities of the issuer which is either listed on a national securities exchange or authorized to be quoted in an inter-dealer quotation system of a registered national securities association to be neither listed nor authorized to be quoted. Issuer tender

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tions under Rule 10b-6. *See* Letter from the Division of Market Regulation, SEC re: Ethyl Corporation, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶81,105 (Feb. 24, 1977).

119. The Division of Corporation Finance has interpreted the Williams Act as requiring that tender offers by third parties be made to all holders of the subject security. It has declared, for example:

> Furthermore, Section 14(d) speaks of a tender offer for a "class of equity security," not a class of equity security holders. Hence, a tender offer subject to Section 14(d) must be made in a nondiscriminating fashion to all shareholders of the class.

Letter from the Division of Corporation Finance re: United Cable Television Corporation, April 8, 1975. *See also* SEC Securities Act Release No. 6159, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,374 (Nov. 29, 1979). *Cf.* Letter from the Division of Corporation Finance, SEC re: Orange and Rockland Utilities, Inc., Nov. 22, 1976 (an odd lot tender offer by a third party was permitted).

120. *Adoptive Release, supra* note 58, at 82,208.

121. SEC Securities Act Release No. 6159, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,374 (Nov. 29, 1979).

122. Rule 13e-3 applies to solicitations subject to Regulation 14A and information statements subject to Regulation 14C in connection with a merger, consolidation, reclassification, recapitalization, reorganization, reverse stock split, or similar transaction.

123. Once there are fewer than 300 holders of record of a class of equity securities subject to Section 12(g) on 15(d) of the Exchange Act, the issuer's reporting obligations under the Exchange Act (*i.e.*, its obligation to file annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K) will terminate.

offers subject to Rule 13e-3 are required to disclose certain additional information not required to be disclosed under Rule 13e-4.[124] This additional information furthers an unstated purpose of Rule 13e-3 of helping public shareholders to determine whether the transaction appears fair and, if the transaction does not appear fair, to provide such shareholders with information which may help to demonstrate unfairness.[125]

B. Rule 14e-1

Rule 14e-1 was adopted by the SEC on November 29, 1979, and is applicable to both issuer and third party tender offers. The rule applies regardless of whether the subject security is publicly or privately held, provided that interstate commerce, the mail, or other jurisdictional means are employed.[126] The rule sets forth these four requirements: (1) the tender offer must remain open for at least twenty business days; (2) the tender offer must remain open for at least ten business days from the date that notice is given of an increase in the consideration offered or in the dealer's soliciting fee; (3) the offeror must either pay the consideration offered or return the securities deposited promptly after the termination or withdrawal of the offer; and (4) a press release or other public announcement concerning any extension of the tender offer must be given no later than 9:00 A.M. Eastern time on the next

124. Under Schedule 13E-3 such additional information includes: (1) a description of the frequency and the amount of any dividends paid during the past two years with respect to the subject class of securities and of any restriction on the issuer's present or future ability to pay such dividends (Item 1(d)); (2) information concerning any underwritten public offering of the subject securities for cash by the offeror during the past three years which was registered under the Securities Act or pursuant to Regulation A (Item 1(e)); (3) information concerning any purchases of the subject securities during the present fiscal year or the two fiscal years prior thereto (Item 1(f)); (4) if the offer is made by an affiliate, certain information concerning such affiliate (Item 2); (5) if the offer is made by an affiliate, certain information concerning past contracts, transactions or negotiations between such affiliate and either the issuer, other affiliates, or any unaffiliated person having a direct interest in such matter (Item 3); (6) a description of the material terms of the tender offer (Item 4); (7) a reasonably itemized statement of all expenses incurred or estimated to be incurred in connection with the tender offer (Item 6(b)); (8) the reasons for the structure of the offer and for undertaking the offer at that time (Item 7(c)); (9) the effects of the tender offer on the issuer, its affiliates and unaffiliated security holders, including federal tax consequences (Item 7(d)); (10) whether the offeror reasonably believes that the offer is fair or unfair to unaffiliated security holders, and reasonably detailed discussion of the material factors upon which such belief is based (Item 8); (11) information concerning any reports, opinions or appraisals from an outside party which are materially related to the tender offer (Item 9); (12) to the extent known, whether or not any executive officer, director or affiliate of the issuer will tender his securities pursuant to the offer and the reasons therefor, and whether any such person has made a recommendation in support of or opposed to the offer and the reasons therefor (Item 12); and (13) if the offer involves the exchange of debt securities for equity securities, whether or not the offeror will take steps to provide or assure that such securities are or will be eligible for trading on any national securities exchange or an automated inter-dealer quotation system (Item 13(c)). *See* 17 C.F.R. §240.13e-100H (1980).

125. The SEC originally proposed that the rule require both procedural and substantive fairness, but presumably realized that it lacked the authority to impose such requirements.

126. See note 37-40 *supra*. See also note 131 *infra*.

business day after the scheduled expiration date.[127]

The first two requirements do not apply to a tender offer by an issuer for its own securities unless the offer is made in anticipation of or in response to another person's tender offer for securities of the same class. There is no explanation given by the SEC in the release announcing the adoption of the rule as to why issuer tender offers have been excluded from these two provisions.[128] Although Rule 13e-4 requires that a subject tender offer remain open for at least fifteen business days, there is no explicit requirement that a subject offer remain open for a minimum amount of time after notice of an increase in the consideration offered,[129] and in any event Rule 13e-4 only applies to a tender offer for certain publicly traded equity securities.[130] The potential for abuse with respect to the period of time that a tender offer remains open, either initially or upon the announcement of an increase in consideration, exists as much in the excluded situations as in the case of a third party tender offer for a privately held security.

Although the third requirement of Rule 14e-1 also is imposed by rule 13e-4, its repetition here extends the requirement to issuer tender offers not covered by Rule 13e-4. The fourth requirement is new, and consequently imposes an additional obligation on all issuer tender offers.

One serious issue raised by former SEC Commissioner Karmel is whether Rule 14e-1 is overly broad.[131] While a strong argument might be made that certain basic regulations should be imposed by the SEC on tender offers by issuers or third parties for securities not otherwise subject to Sections 13(e) or 14(d), extreme selectivity should be exercised in determining the boundaries and the "basic" regulations to be imposed.

C. Proposed Rule 14d-1(b)(1)

In addition to the rules adopted in 1979 which apply directly or indirectly to issuer tender offers, three proposals were made by the SEC on

127. If the subject securities are registered on one or more national securities exchanges, the notice of an extension must be given no later than the earliest opening time of any such exchange on the first business day after the scheduled expiration date. 17 C.F.R. §240.14e-1 (1980).

128. SEC Securities Act Release No. 6158, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,373 (Nov. 29, 1979).

129. *Adoptive Release, supra* note 58, at 82,208, n.29. The Commission indicated, in the Adoptive Release announcing the adoption of Rule 13e-4, that it would propose an amendment "in the near future" which would require that the period of an issuer tender offer be extended after notice of a material change in the terms of the offer. As of February 1981 no such proposal had yet been published for comment.

130. See note 54 and accompanying text *supra*.

131. *See* SEC Securities Act Release No. 6158, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,373 n.8 (Nov. 29, 1979). "The exercise of the Commission's jurisdiction as fully as has been done [in Rule 14e-2] is, in her judgment, doubtful." *Id.*

November 29, 1979, which would significantly affect federal regulation of issuer tender offers.[132] These proposals deal with a definition of the term "tender offer", a requirement that security holders be treated equally, and a prohibition of purchases not made pursuant to the tender offer.

Although it is beyond the scope of this article to discuss what, if any provisions should be embodied in a rule defining the term "tender offer",[133] one possible shortcoming of proposed Rule 14d-1(b)(1) is particularly relevant to issuer tender offers and consequently should be noted. As proposed, the definition apparently would not cover an offer for less than 5% of the outstanding class of securities if the price offered did not represent a premium in excess of the greater of 5% or $2.00 above the current market price.[134] This could totally exclude certain odd lot tender offers from the requirements of Rule 13e-4 and all other federal tender offer requirements, since such offers frequently involve less than 5% of the outstanding class of securities affected, and generally do not involve a premium of more than $2.00 per share.[135] The

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132. SEC Securities Act Release No. 6159, [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,374 (Nov. 24, 1979).

133. For a discussion of what does, or should, constitute a tender offer, *see, e.g.*, E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL 1-34 (1977); Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 HARV. L. REV. 1250 (1973). See note 1 *supra*.

134. The proposed definition is as follows:

> (b) *Definitions* . . . In addition, for purposes of sections 14(d) and 14(e) of the Act and Regulations 14D and 14E, the following definitions apply:
>
> (1) The term "tender offer" includes a "request or invitation for tenders" and means one or more offers to purchase or solicitations of offers to sell securities of a single class, whether or not all or any portion of the securities sought are purchased, which
>
> (i) during any 45-day period are directed to more than 10 persons and seek the acquisition of more than 5% of the class of securities, except that offers by a broker (and its customer) or by a dealer made on a national securities exchange at the then current market or made in the over-the-counter market at the then current market shall be excluded if in connection with such offers neither the person making the offers nor such broker or dealer solicits or arranges for the solicitation of any order to sell such securities and such broker or dealer performs only the customary functions of a broker or dealer and receives no more than the broker's usual and customary commission or dealer's usual and customary mark-up; or
>
> (ii) are not otherwise a tender offer under paragraph (b)(1)(i) of this section, but which (A) are disseminated in a widespread manner, (B) provide for a price which represents a premium in excess of the greater of 5% of or $2 above the current market price and (C) do not provide for a meaningful opportunity to negotiate the price and terms.

See SEC Securities Act Release No. 6159 [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 82,374 (Nov. 29, 1979).

135. For example, Kaiser Aluminum and Chemical Corp. ("Kaiser") proposed to make a cash tender offer to all holders of 25 or fewer shares of its common stock. *See* Letter from the Division of Market Regulation, SEC re: Kaiser Aluminum and Chemical Corporation (Feb. 11, 1980). Although the number of shares held by such persons represented less than two-tenths of one percent of the total shares outstanding (approximately 80,000 shares out of 41,042,843), this represented approximately 8,000 persons. Since the price to be offered each holder was to be $1.00 per share above the closing price of the stock on the last day prior to receipt of such holder's tendered shares by Kaiser, this transaction would not constitute a "tender offer" under the proposed rule.

staff of the SEC has attempted to provide a definition which includes transactions which might not have all the earmarks of a "traditional" tender offer but which tend to have the same effects. The SEC staff, however, has failed to ascertain whether all traditional offers would fit within the definition provided. The gap should be eliminated in any future proposed or adopted definition of the term.

D. Proposed Rule 14e-4

Proposed Rule 14e-4 would require that the consideration paid to any security holder be equal to the highest consideration offered to any other security holder pursuant to the tender offer and that the offer be open to all holders of the subject class of securities, subject to certain exceptions in each instance. The proposed rule, like Rule 14e-1, would apply to all tender offers which employ jurisdictional means.[136] The "best price" provision would further the purpose of the "increased consideration" requirement of Section 14(d)(7) and Rule 13e-4(f)(4) by explicitly prohibiting the initial offer of different considerations, which is not prohibited by the present provisions. The proposed rule, however, would allow tender offers by an issuer to employ a formula rather than to specify a fixed consideration, so long as the same formula was employed with respect to all such holders. The reason for this exemption goes back several years to a time when issuers, in making odd lot tender offers, commonly believed that they were obligated under state law to offer no more than the current market price for such securities because the offer was not being made to all security holders. Consequently, the staff of the SEC has granted exemptions under Rule 10b-6 to permit odd lot tender offers which stated that tendering shareholders would receive the market price for their tendered securities on the day such securities were received, or which employed some similar formula under which the price paid to different shareholders might vary.[137]

The requirement in proposed rule 14e-4 that a tender offer be open to all holders of the subject securities would codify an interpretation of the Williams Act that the staff of the SEC previously has made.[138] Although the proposition that a tender offer should be open to all is virtually unassailable, the reality of varying "blue sky" and state takeover laws makes this issue an extremely difficult one. The proposal does, however, provide for two exceptions, both of which are limited to

136. Since these rules were adopted or proposed to be adopted under Section 14(e) and are not otherwise limited in their scope, their application is coextensive with that section.

137. *See* Letter from the Division of Market Regulation, SEC re: The Fed-Mart Corporation (June 15, 1973) (the price to be paid for tendered shares was the closing price on the American Stock Exchange on the date such holder's certificates are received). See also note 135 *supra*.

138. See note 119 *supra*.

tender offers by issuers. First, an offer by an issuer can be limited to holders of odd lots. Second, an issuer can exclude its officers, directors, and affiliates from the offer. The first exception is in recognition of the legitimate reasons for odd lot tender offers.[139] The only justification for the second exception, however, is that it "would operate to reduce the proration risk to an issuer's public security holders and thus would permit them to participate in the tender offer to a greater extent,"[140] and that such persons generally voluntarily will agree not to participate in the tender offer.[141] Regardless of what officers, directors, or affiliates generally decide with respect to participating in a tender offer by the issuer, there is no justification for allowing the issuer to exclude them forcibly from the offer so long as the offer has not been structured improperly to "bail out" or otherwise improperly benefit such persons. The relationship of such persons with the issuer does not, of itself, provide a meaningful reason for excluding them just so unaffiliated shareholders will have more tendered securities accepted.

E. Proposed Rule 14e-5

Proposed Rule 14e-5 is basically a restatement of Rule 10b-13, except that the prohibition of purchases during the tender offer would extend through the first ten business days after the termination of the offer.[142] In addition, the proposed rule would apply to tender offers for non-equity as well as equity securities and varies slightly from 10b-13 with respect to the type of public announcement that will trigger the commencement of the proscription. The redesignation of Rule 10b-13 as Rule 14e-5 presumably is to place this tender offer provision with its counterparts. Considering the total disorder of the other tender offer provisions, it seems inappropriate to waste time relocating Rule 10b-13 until a more thorough reorganization of the tender offer provisions can be made.

STATUTORY AUTHORITY TO ADOPT RULE 13e-4

The most crucial issue concerning Rule 13e-4, which ultimately will require judicial determination, is whether the SEC has the statutory authority to adopt the substantive provisions of this rule. Although

139. See note 101 *supra*.
140. [1979-1980 Transfer Binder] FED. SEC. L. REP. (CCH) ¶82,374, at 82,611 (1979).
141. *Id.*
142. *See id.* at 82,612. Whereas the proscription of Rule 10b-13 operates from the time the tender offer is publicly announced or otherwise made known to the security holders, the proscription of proposed Rule 14e-5 additionally would be triggered by a public announcement that a tender offer might be made in the future. This provision would probably discourage announcements of future tender offer intentions.

Rule 13e-4 was adopted under seven different sections of the Exchange Act, only Sections 13(e) and 14(e), are pertinent to this determination.[143] Both of these provisions were added to the Exchange Act in 1968 by the Williams Act.

A. Disclosure Requirements of Rule 13e-4

Before considering the statutory basis for the substantive provisions, it should be emphasized that there is clear authority for the disclosure requirements. Sections 13(e) and 14(e) both specifically authorize the SEC to prescribe means reasonably designed to prevent deceptive acts. It certainly would be deceptive to omit intentionally material information relating to a tender offer, and the information required by Rule 13e-4 would or reasonably could be material. Moreover, the fact that Section 13(e)(1) authorizes the imposition of disclosure requirements,[144] further substantiates the unequivocal basis for adopting the disclosure provisions of Rule 13e-4.

B. Substantive Provisions of Rule 13e-4

Determining whether the statutory authority of the SEC includes the power to enact the substantive provisions of Rule 13e-4 is a far more difficult question. Due to the explicit authority in Section 13(e)(1) with respect to disclosure concerning issuer repurchases, certain commentators on proposed Rule 13e-4 suggested that Section 13(e) only authorized disclosure requirements.[145] Although the primary emphasis of the

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143. The rule was adopted under Sections 3(b), 9(a)(6), 10(b), 13(e), 14(e), 15(c)(1) and 23(a) of the Exchange Act. *Adoptive Release, supra* note 58, at 82,205 n.8. Section 3(b) empowers the SEC to define undefined terms; Section 9(a)(6) prohibits transactions of a national securities exchange for the purpose of pegging, fixing or stabilizing the price of such security in contravention of rules adopted by the SEC; Section 10(b) prohibits manipulative or deceptive acts in contravention of rules adopted by the SEC; Section 13(e) empowers the SEC to define acts and practices in connection with issuer repurchases which are fraudulent, deceptive or manipulative, and prescribe means reasonably designed to prevent such acts and practices; Section 14(e) prohibits material misrepresentations and omissions and fraudulent, deceptive or manipulative acts or practices in connection with any tender offer, and grants the SEC rulemaking authority with respect thereto; Section 15(c)(1) prohibits broker-dealers from purchasing securities in the over-the-counter securities market by means of any manipulative, deceptive or other fraudulent device or contravention; and Section 23(a) grants the SEC general rulemaking authority. Sections 13(e) and 14(e) clearly are the primary statutory basis for the adoption of Rule 13e-4. The other sections, particularly Section 10(b), provide additional authority for certain provisions of the rule, but do not authorize any regulation of issuer tender offers not also authorized by these two sections.

144. Such rules and regulations may require such issuer to provide holders of equity securities of such class with such information relating to the reasons for such purchase, the source of funds, the number of shares to be purchased, the price to be paid for such securities, the method of purchase, and such additional information, as the Commission deems necessary or appropriate in the public interest or for the protection of investors, or which the Commission deems to be material to a determination whether such security should be sold.

15 U.S.C. §78m(e)(1) (1976).

145. *Adoptive Release, supra* note 58, at 82,206.

Williams Act, as indicated by its Congressional title, "Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids,"[146] is in the area of disclosure, this was not its sole focus. The prorationing, withdrawal, and increased consideration requirements of Section 14(d)(5)-(7) are one example of a requirement imposed by the Williams Act which has nothing to do with disclosure. Similarly, Sections 13(e) and 14(e) each specifically authorize the SEC to adopt rules reasonably designed to proscribe manipulative, deceptive, or fraudulent acts and practices. If Congress had intended that the SEC impose only disclosure obligations pursuant to these provisions, the reference to "manipulative" and "fraudulent" acts and practices would be not only unnecessary but misleading.

What constitutes "deception" and "manipulation" has received substantial attention under the Exchange Act. "Deceptive" acts and practices involve the misstatement of a material fact or the failure to disclose a material fact. Manipulative acts and practices are activities intended to artificially affect market activity in order to mislead investors;[147] the term is "virtually a term of art when used in connection with securities markets,"[148] and includes such practices as wash sales, matched orders, and rigged prices. An argument can be made that each substantive requirement of Rule 13e-4, even if directed at "fairness", is reasonably related to preventing deception or fraud. Such an argument might be presented as follows.

1. Minimum Tender Offer Period:

The requirement that an offer remain open for at least fifteen business days prevents an issuer from appearing to make a tender offer to all security holders while in fact "bailing out" insiders or friendly parties. A "bail out" or friendly redemption, employing the disguise of a tender offer to all security holders, would be facilitated by a minimal period of the offer in that (a) if the offer were for all shares tendered, fewer shares probably would be tendered and the offer would be less expensive, or (b) if, as is more likely, the offer was for a specified number of shares, there would be a greater opportunity to avoid or at least minimize prorationing. Such an activity, unless fully disclosed in advance by the issuer (which is rather unlikely), would constitute a deceptive act.[149]

146. *1967 Senate Hearings, supra* note 9, S. Rep. No. 550, 90th Cong., 1st Sess. (1967).
147. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476 (1977).
148. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).
149. *See* SEC Exchange Act Release No. 8712, [1969 Transfer Binder] FED. SEC. L. REP. (CCH) ¶77,745 (1969).

2. Withdrawal Rights and Prorationing:

These two provisions combine to assure that security holders will not be pressured into a hasty decision. Structuring the offer in such a way that holders feel compelled to tender without studying the offering material defeats the purpose of whatever disclosure is provided, and might be viewed as itself deceptive or perhaps even manipulative. Moreover, the absence of prorationing could be used in the case of tender offers for a limited amount of securities. This would enable the issuer to buy out favored shareholders by properly structuring the offer. Adequate disclosure in such instances would again be extremely unlikely.

3. Increased Consideration:

The willingness of the issuer to increase the consideration being offered, if necessary to obtain additional tenders, might be extremely material to tendering security holders if they would not receive the increased consideration for shares already tendered. Since it might be difficult to ascertain whether the issuer had contemplated an increase in the consideration offered prior to its actual occurrence, an alternative means of preventing deception in this situation is to require that all shareholders who have tendered securities receive the increased consideration. This also prevents the possibility of "special arrangements" to provide certain shareholders a greater consideration than that offered generally under the disguise of a "late" decision to increase the consideration offered.

4. Prompt Payment or Return of Tendered Securities:

It is arguable that any undue delay in paying for or returning tendered securities upon the termination of an issuer tender offer, unless discussed in the original offering material, is deceptive in that there is a strong inference that securities will be accepted or returned upon termination without undue delay. An undue delay in returning securities might also be viewed as manipulative, since it effectively prevents such securities from being sold until they are returned and thereby reduces the float.

5. Purchases During the Offer or Within Ten Days After Its Termination:

Purchases during the offer clearly have a manipulative potential, as recognized when Rule 10b-13 was adopted. Purchases immediately after the offer terminates tend to delay the readjustment of the market, and consequently also involve a potential for manipulative abuse.

Both Section 13(e) and 14(e), unlike Section 10(b), specifically authorize the proscription of "fraudulent" acts as well as "manipulative" or "deceptive" acts. Was "fraud" intended to cover anything that was not already deceptive or manipulative? The legislative history of the Williams Act sheds no light on this question. Assuming, however, that Congress was not attempting to be redundant and that the inclusion of this term in Sections 13(e) and 14(e) when it was not included in Section 10(b) has some significance, it is possible that this language permits the SEC to adopt certain regulations designed to insure equitable treatment. If so, this would further substantiate the statutory authority for Rule 13e-4.

Since the rulemaking authority granted under Section 14(e) with respect to tender offers is substantially the same as that granted under Section 13(e) with respect to issuer repurchases of equity securities listed under Section 12 of the Exchange Act, Rule 14e-1 presumably will stand or fall with Rule 13e-4. Since Rule 13e-3 in its final form only imposes disclosure obligations with respect to "going private" transactions, its statutory basis should be far less uncertain.

CONCLUSION

Notwithstanding the particular criticisms leveled against certain aspects of Rule 13e-4, the rule as a whole represents a significant contribution to the protection of investors. The various refinements and modifications of the rule which have been suggested herein hopefully will be considered by the SEC, but even in its present form the protections provided by Rule 13e-4 clearly outweigh its shortcomings. Rule 14e-1, although generally beneficial to the extent applicable to issuer tender offers, inexplicably has excluded most issuer tender offers from certain key requirements, and also raises serious issues as to how far federal regulation of tender offers should extend. Both of these issues concerning Rule 14e-1 should be carefully examined.

One potential difficulty not previously discussed is the burden of full compliance with Schedule 13E-4 in order to make an odd lot tender offer. Considering the usefulness of such offers and their limited nature, it would be worthwhile to exempt such offers from certain of the disclosure obligations.

The predominant issue relating to Rule 13e-4 is the adequacy of statutory basis for its substantive provisions. The primary source of such authority is Section 13(e) and Section 14(e) of the Exchange Act, which authorize the SEC to adopt rules and regulations reasonably designed to prevent fraudulent, deceptive, or manipulative acts and practices.

The difficulty is that most of the substantive provisions adopted are primarily intended to insure fairness (*e.g.*, the withdrawal, prorationing, and increased consideration provisions of the rule). If "fraudulent" acts and practices do not include the unfair structural provisions of a tender offer, then the propriety of such provisions is dependent upon the extent to which they reasonably prevent deception or manipulation as well. Such an effect appears to be present overall. Since the benefit of the substantive provisions is great and their burden on the issuer is minimal, it is hoped that the rule will be given the benefit of any doubts and that it will be held to be valid.

In its nascent form approximately fifteen years ago, Rule 13e-4 was but one component of a comprehensive plan to regulate issuer repurchases. Now that this component has attained realization, the SEC has once again "dusted off" proposed Rule 13e-2; its adoption will complete the process.