WACHTELL, LIPTON, ROSEN & KATZ

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To Our Clients:

Recent Developments

(1) Tender Offer; Disclosure; Margin Regulations. The Acpo battle has given rise to a decision, Alaska Interstate Co. v. McMillian, CCH ¶ 95,276 on several important points:

(1) Where there has been no definite decision by an offeror with respect to the terms of a merger with the target, it is not necessary to disclose in the offer the various hypothetical exchange ratios that have been considered by the offeror and the banks which have supplied the financing for the offer. The court said: "In every tender offer looking forward to a combination of the offeror and the target, the offeror conducts analyses to determine the feasibility of the tender plan. While every case must be judged on its own facts, when no specific terms for the combination have been decided upon, reference to possible terms, even if so labeled, will not ordinarily provide a basis for informed stockholder judgment and will hold some potential for miscommunication".

(2) An offeror which has good faith rational support for such statement can state in its offer that it anticipates that its cash flow will be sufficient to service the tender-offer loan. The offeror does not have to dislcose in the offer the cash flow projections which provide the basis for such statement -- it is not practical to supply information of this type for analysis by the shareholders of the target.

(3) In a partial offer with intent for a second-step merger, the offeror which is a reporting company and which is not in precarious financial condition does not have to include in the offer its financial statements or other specific information about itself. It is sufficient to refer in the offer to the availability of such information.

(4) In a situation where the offeror is seeking control of a third company through purchasing control of the target and the offeror has reason to believe that its efforts will be resisted by litigation, the probability of such litigation is a material disclosure item. The same reasoning would apply to disclosure of the probability of litigation by a target company in cases where the offeror has been rebuffed by the target in pretender offer discussions.

(5) A broker which does not initiate or negotiate the tender offer loan for the offeror but does participate in the arrangements with the lending bank does not violate the Regulation T proscription against "arranging" if its activities do not rise to the level of those without which the loan would not have been supplied. Mere attendance at bank meetings and expression of opinion as to the desirability of the acquisition do not consititute "arranging" within this test.

(6) A tender offer loan does not violate Regulation U if the offeror and the lending bank make arrangements with another bank to relieve the lending bank of its position in a stock secured loan and then the lending bank makes the tender offer loan on an unsecured basis. The mere existence of the separate secured loan and acceleration of the tender offer loan upon default of the secured loan does not taint the tender offer loan as being "indirectly" secured by the collateral pledged under the secured loan.

(7) The disclosure obligations of an offeror who has been furnished soft information by the target are limited. There is no requirement to disclose forecasts and estimates that were not designed for public dissemination and which do not show a significant reversal of trend from that reflected in publicly available information. (We question this holding.) Absent receipt of liquidating value appraisals from the target, the offeror has no duty to disclose its own judgment regarding the liquidating values of the target's assets. Where the target has furnished such appraisals, the offeror can disclose them and state that it has not relied on them and state the reasons for such nonreliance.

(8) Where liquidation of the target is the purpose of the offer, any legal or contractual impediment to prompt liquidation is a material disclosure item.

(9) The purpose of the Schedule 13D disclosure requirement as to financing of the tender offer is to provide the shareholders of the target with information to enable them to judge whether the offer can pay the tender price. Accordingly, in a situation where the shares of the target are to be pledged it is not necessary to disclose that inability to refinance the tender offer loan could result in control of the target being surrendered to the bank making the tender offer loan.

(2) <u>Mutual Funds; Derivative Actions; Directors Have Business Judgment Discretion To Determine Whether To Sue Advisor</u>. In <u>Lasker v. Burks</u>, N.Y.L.U. Oct. 2, 1975, p. 1 col. 2. (S.D.N.Y. 73-552, Sept. 25, 1975) the court was faced with the question whether the disinterested directors of a mutual fund had the power to take over and then dismiss a derivative action against the advisor alleging violation of the Investment Company and Investment Advisers Acts in connection with a bad investment by the fund. A committee of the disinterested directors had retained independent counsel who advised that there had been no violation of the Acts and the committee determined that continued prosecution of the action was not in the best interests of the shareholders of the fund. The court said:

> This court cannot accept plaintiffs' argument that because the allegations of the complaint concern violations of the Investment Company Act and the Investment Advisers Act, the board has no power to exercise its busines judgment because of the strong public policies behind those Acts.
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> Unlike Section 16(b) of the Securities Exchange Act, which allows shareholders to bring suit if the directors decline a demand, Congress has made no such statutory provision with respect to suits brought under the Investment Company and Investment Advisers Acts.
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> It is true that causes of action under those Acts are implied rights of action . . . It does not necessarily follow that because the right is implied, a derivative suit should always be allowed despite the good faith exercise of business judgment by the directors not to sue.
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> This court is of the opinion that absent a statutory exception, whether a cause of action is expressly authorized or is "implied," the directors of a corporation should be given the chance to perform their duties in running the business of the corporation, including whether to prosecute a cause of action.
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> If they have exercised their business judgment in good faith, then a decision not sue should be final.

(3) Inside Information; State Law Fiduciary Duty Of Insiders; Trustee In Bankruptcy Not Being A Purchaser Does Not have Standing To Assert Rule 10b-5 of Section 5 Violations; Materiality. In Thomas v. Roblin Industries, Inc., CCH ¶ 95,259 (3d Cir. 1975) the court held that Delaware would follow Diamond v. Oreamuno and hold that: "as a matter of common law, a fiduciary of a corporation who trades for his own benefit on the basis of confidential information acquired through his fiduciary position breaches his duty to the corporation and may be held accountable to that corporation for any gains without regard to whether the corporation suffered damages as a result of the transaction. This obligation continues even after termination of the relationship which created the fiduciary duty." The court also held that a trustee in bankruptcy does not have standing to sue a control person of the

bankrupt corporation for violation of Rule 10b-5 or Section 5 of the 1933 Act in that the trustee does not meet the purchaser-seller requirement under Rule 10b-5 and under Section 12(1) the Section 5 action is limted to "purchasers" of the securities in question. Finally the court made a very significant addition to the line of recent cases that have backed away from the expansion of the concept of material inside information. The court held that detailed information of a corporation's financial condition and need for capital was not material inside information in light of the public disclosure of the recent operating losses and the filing of a Chapter 11 petition by the corporation.

(4) Materialtiy. In Spielman v. General Host Corp., CCH ¶ 95,267 (S.D.N.Y. 1975) Judge Weinfeld defines materiality in the exchange offer-tender offer context as follows:

> "'Materiality' in the abstract is, of course, a meaningless concept. Materiality centers about the significance of the misstatement or omission of the fact under consideration to a reasonable investor's judgment in deciding to buy or sell. Thus, it can be given content only by considering all the circumstances surrounding the transaction. The determination of materialtiy is to be made upon all the facts as of the time of the transaction and not upon a 20-20 hindsight view long after the event. The ultimate issue is whether 'any of the shareholders who tendered their shares would probably not have tendered their shares' had the alleged violation not occurred.
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> The fact that the alleged violation occurred in the context of a hotly contested battle for control of a target company is a circumstance to be considered in determining whether there has been an actionable failure to disclose material facts. In addition, the fact that there is a contest for control means that a failure to present information may be rendered harmless by disclosure from others, such as the target company, the competing tenderor or outside sources. A defendant may not be faulted for failure to repeat material information which has been publicly proclaimed in various way on other occasions. The adequacy of disclosure of material information must be evaluated by a consideration of the 'total mix' of all information conveyed or available to investors.

> The issue presented by this case, therefore, is not, as plaintiff myopically visualizes it, simply whether the General Host prospectus failed to state material facts, but whether Armour security holders were unable to make an informed investment decision because of alleged deficiencies in the prospectus, defects which, assuming any are found to exist, were never cured by information contained in other communications to Armour shareholders."

Thus Judge Weinfeld has joined the courts that are rejecting the concept of whether a particular fact might influence a reasonable investor and adopting the more realistic test of whether in the overall context of the situation investors were given or had readily available sufficient information to make an informed investment decision. Judge Weinfeld also quoted with approval the Second Circuit holding in the Piper Aircraft case that an exchange offeror has a duty to make a reasonable investigation of the target:

> "The securities laws impose upon an offeror of an exchange offer a duty to act reasonably in discovering facts material to the offer as of the time of the transaction and in disclosing fully those material facts of which the offeree is presumably unaware and which ostensibly would influence his judgment. Corporate officers have a reasonable area of discretion in determining how far to explore the facts and in deciding what facts need to be disclosed."

This is often lost sight of in exchange and tender offerors.

(5) Materiality. "Loose talk" earnings estimates by the chairman of the board of a company to a professional investor are not material in that no reasonable investor would rely on such information. Black v. Riker-Maxson Corp., CCH ¶ 95,270 (S.D.N.Y. 1975). We question whether this holding as a general proposition is good law.

(6) Materiality. Ehrler v. Kellwood Co., CCH ¶ 95,271 (8th Cir. 1975) is another case restricting the materiality concept under Rule 10b-5. Essentially the court indicates that nondisclosure of an admittedly material fact may not be a violation of Rule 10b-5 when the purchase price was so attractive that the plainitff would have sold at the same price even if he knew the material fact.

M. Lipton