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To Our Clients

Going Private

On February 18, 1976, the Second Circuit, in Green v. Santa Fe Industries, Inc., held that Rule 10b-5 was applicable to a typical short-form cash merger and that if such a merger does not have a "justifiable corporate purpose" it is a per se violation of Rule 10b-5. Thus in a five-day period (Marshel v. AFW Fabric Corp. [Concord Fabrics] was decided on February 13) the Second Circuit has held that the federal securities laws override state corporation law as to both long-form and short-form cash mergers and that even though full disclosure was made and state appraisal remedies were available, minority shareholders could not be frozen out.

Santa Fe is a particularly significant holding. Unlike Concord Fabrics which involved insiders taking a company public at a high price and then taking it private at a low price, Santa Fe presented the typical situation for which the short-form merger statutes were designed -- a parent company which had for a number of years owned 95% of a subsidiary eliminating the minority through a short-form cash merger. Concord Fabrics presented a situation likely to induce a court to seek a remedy; Santa Fe presented the least likely case for a radical extension of Rule 10b-5 (except that the court appeared to be influenced by the fact that an appraisal indicated an asset value of $772 per share while the short-form merger was effected at $150 per share).

In light of the Second Circuit decisions and the recent state court decisions in Bourns, Concord Fabrics and Power/Mate, it is clear that the courts will look askance at going-private and going-private-type transactions. However, each of the cases has presented an especially egregious set of facts. In each case it was apparent against a clear objective standard that the freezeout price was grossly inadequate and in each case the minority had no voice in determining whether it was to be eliminated. Also, in each case there was an absence of a reason for the freezeout other than the mere desire to go private.

As is often true, bad cases make bad law. If the transactions are properly structured, corporations should be able to go private -- either through long-form mergers or short-form mergers. The following guidelines create a structure that would satisfy all of the cases:

(1) The transaction should be determined by a committee of independent directors.

(2) The price should be fair by objective standards and in the opinion of an investment banker or other expert.

(3) The public shareholders should be given the right to vote pursuant to a full proxy solicitation. The insiders should vote their shares only in accordance with the majority of the minority.

(4) While in theory none should be necessary, a justifiable corporate purpose or business reason should be advanced for the transactions. The opinion in _Santa Fe_ indicates that the Second Circuit would be satisfied with elimination of potential conflicts or reduction of expenses as a "justifiable corporate purpose". These reasons did satisfy the court in _Grimes_ v. _Donaldson, Lufkin and Jenrette, Inc._

(5) Despite the rejection of the coercive tender offer argument by the Delaware Chancery Court on January 22, 1976 in _Lynch_ v. _Vickers Energy Corp._, the two-step going-private transaction where the insiders first cause the corporation to tender and then do a merger should be avoided. In addition to the now probable acceptance of the coercive tender offer argument by the federal courts, it also presents the possibility of integration of the tender and subsequent merger.

(6) If there are sophisticated holders of a significant part of the public interest in the corporation, direct negotiation of the going-private price with one or more of such holders is desirable.

(7) Second-step acquisitions following third-party tender offers should be disclosed in the original tender offer and consummated as quickly as possible after the tender offer.

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