Open Market Purchases

By MARTIN LIPTON*

OPEN MARKET purchases, or non-formal offer purchases, is a takeover approach that is enjoying a renaissance. At one time the open market accumulation of a significant or control block of stock of a corporation was the usual way to achieve a takeover. With the enactment of the Williams Act in 1968 and the success of the Saturday Night Special kind of offer and some of the other techniques that Joe Flom discussed, the open market purchase approach fell into disuse only to be revived of late because of the impact of the state takeover statutes.

There are three basic reasons for open market purchases. One, the one that Joe mentioned, is to achieve a position of influence with the management of the target as a prelude to an approach to work out a "friendly" deal. A second reason is to build a position in the target company so that if your offer is rejected and you end up second best in an auction, you still come away from the fray with a profit. Many offerors will decide to accumulate a 4.9 percent interest in the target in order, if they are topped by another bidder when the target seeks a defensive merger, that they, the original bidder, come away with a profit. The third reason is to get a feel of the market. Frequently, the offeror and his investment banker will decide that in determining what the proper tender offer price is, it is good experience to undertake a purchase program to see at what prices the stock of the target is available in volume.

"Tender offer" was not defined by Congress in drafting the Williams Act nor by the SEC in adopting implementing rules. The SEC in Securities Act Release No. 5731, August 2, 1976, the proposed new tender offer rules, declined to define "tender offer." Case law, in defining "tender offer," has followed the Williams Act's legislative history, which makes it clear that the Williams Act was not intended to be restricted to conventional tender offers but rather was meant to encompass all methods of takeovers sought to be achieved by a large-scale stock purchase program. Shortly after the enactment of the Williams Act the SEC in Securities Exchange Act Release No. 8392, August 30, 1968, defined stock exchange special bids as "tender offers" on the grounds that they are the equivalent of a formal tender offer.

In *Cattlemen's Investment Co.* v. *Fears,*[1] the court was faced with the precise question of whether a Williams Act "tender offer" could exist in the absence of a conventional "tender offer." The court answered in the affirmative, holding that the purpose of the Williams Act:

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1. 343 F. Supp. 1248 (W.D. Okla. 1972).

> is to provide investors who hold equity interests in public corporations, material information with respect to the potential impact of any effort to acquire control of a company, sufficient time within which to make an unhurried investment decision as to whether to dispose of or retain their securities, and to assure fair treatment of the investors. We deem it abundantly clear that there is an obligation on persons attempting to gain control of a corporation by means of tender offers to make the required filings and disclosures.[2]

The Court went on to hold that the defendants' telephonic, mail, and in-person solicitations of various of the target's shareholders constituted a "tender offer," stating:

> [A]n active and widespread solicitation of public shareholders in person, over the telephone and through the mails, contain potential dangers which Section 14[d] of the statute is intended to alleviate. The defendant, in not complying with the statute, deprived shareholders of information prescribed by the Rule, which information was material to their investment decisions, and denied to them the fair treatment provided by other parts of Section 14[d]. In truth, the contacts utilized by the defendant seem even more designed than a general newspaper advertisement, the more conventional type of "tender offer," to force a shareholder into making a hurried investment decision without access to information, in circumvention of the statutory purpose. . . . When we consider the plain language of the statute and rules and the purposes to be served, we have no hesitancy in concluding that the activities of the defendant in making contact with plaintiff's shareholders by the use of the mails, telephone calls, and personal visits, for the purpose of purchasing their shares, constitute "tender offers for, or a request or invitation for tender offers of" their stock within the meaning of the statute.[3]

In *Nachman Corp.* v. *Halfred, Inc.*,[4] although finding no "tender offer" to have occurred on the particular facts before it, the court recognized that a Williams Act tender offer was not confined to a conventional tender offer. Rather, the court expressly adopted the "shareholder impact" test as reflected in Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*,[5] in reaching its determination "that the definition of ['tender offer'] should extend beyond its conventional meaning to offers likely to pressure shareholders into making uninformed, ill-considered decisions to sell, *i.e.*, offers with the same impact as the conventional tender offer." The court then went on to find that negotiations by a 30 percent

2. *Id* at 1251.
3. *Id* at 1251-2.
4. Fed. Sec. L. Rep. CCH ¶ 94,455 (N.D. Ill. 1973-74).
5. 86 Harv. L. Rev. 1250 (1973).

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holder to buy out 40 insiders with substantial holdings (about 3½ percent of the outstanding shares) at varying prices above the quoted market did not constitute a tender offer because none of the sellers was "pressured."

In the ordinary open market transaction the selling shareholder comes forward to sell on his own, *i.e.*, his individual decision to dispose of his stock is not influenced by the anonymous purchaser. If, however, privately negotiated or open market purchases are made at a time when it is public information that the purchaser is conducting a buying program for a percentage of the target's shares in an effort to acquire a control position in that target, the characterization of the purchase program as a tender offer could flow from the "shareholder impact" in that it could be argued that shareholders are under "pressure" to sell before the purchaser has reached its goal and stops buying. However, this argument appears to have been rejected or ignored in all the cases other than *Loews Corp.* v. *Accident & Casualty Ins. Co.*, which I will discuss shortly.

In *D-Z Investment Company* v. *Holloway*,[6] the court held that open market purchases alone cannot be a "tender offer" and that conduct involving only purchases made in privately negotiated transactions with "sophisticated" financial institutions did not constitute a "tender offer."

Other cases rejecting the open market purchases argument are: *Water & Wall Associates, Inc.* v. *American Consumer Industries, Inc.*,[7] rejecting, without consideration of the arguments, open market purchases for the purpose of control as constituting a tender offer; *Mosinee Paper Corp.* v. *Rondeau*,[8] rejecting open market purchases of 8 percent in a four-month period as a tender offer.

In *Loews Corp.* v. *Accident & Casualty Insurance Co.*,[9] all of the purchases in question had taken place on the open market. The court—applying the "shareholder impact" test—held that such open market purchases coupled with a publicized intent to acquire a specified percentage of the subject company's shares in order to prevent third persons from acquiring control constituted a "tender offer."

In addition to open market purchases, there are a number of other transactions which have raised the definition issue and throw light on the considerations to be taken into account. In *Smallwood* v. *Pearl Brewing Co.*,[10] a shareholder of a target company was found to have standing to maintain a claim that a letter from the surviving company to the shareholders of the target company describing the take-out provisions of a merger agreement was a tender offer or at least "a request or invitation for tenders" despite the fact that the offer was unopposed by management of the target company.

6. Fed. Sec. L. Rep. CCH ¶ 94,771 (S.D.N.Y. 1974).
7. Fed. Sec. L. Rep. CCH ¶ 93,943 (D.N.J. 1973).
8. ¶ 94,719 (7th Cir. 1974), *rev'ing* 354 F. Supp. 686 500 F.2d 1011 (W.D. Wis. 1973), *rev'd on other grounds*, 422 U.S. 49 (1975).
9. 74 C. 1396 (N.D.Ill. July 11, 1974) (bench opinion, July 11, 1974).
10. 489 F.2d 579 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974).

The court held that a tender offer is not limited to a hostile takeover and that a bid to purchase securities is no less a "tender offer" when it is unopposed by management of the target company than when it is opposed; the term "tender offer" must be interpreted so as to effectuate the broad remedial purposes of the securities laws.

In *Yellow Freight System, Inc.*,[11] the Staff of the SEC took the position that a company, whose contract to buy a 70.8 percent interest in another company contained a clause permitting other shareholders to become selling parties, may not purchase additional shares of that company to assure itself of being an 80 percent parent corporation through open market purchases, despite the fact that the other shareholders had a right to withdraw their tendered shares. The purchases on the open market would be violative of rule 10b-13 since the clause in the purchase contract constituted a "tender offer" for the purposes of section 14(d).

However, the obligation of an issuer to repurchase shares of stock pursuant to the exercise of dissenters' rights in connection with a proposal submitted to shareholders to eliminate pre-emptive rights was held not to be a tender offer in *Leighton* v. *American Telephone & Telegraph Co.*[12]

In addition to the question of what is a tender offer, the Williams Act raises an interpretation question when open market purchases are followed by a formal tender offer—the "creeping tender offer" problem. The Staff of the SEC retracted the position it originally took in *American General Insurance Co.*,[13] and in *LSL Corp.*[14] refused to take a no-action position on a 30 percent holder increasing ownership to 50 percent through accepting unsolicited offers from time to time. Subsequently, the Staff of the SEC took the position in *Jewelcor Inc.*,[15] that the filing of a Schedule 13D statement disclosing the possible acquisition of shares of another company by means of a tender offer, as one of several possible alternatives for acquiring control, was not a "public announcement" of a tender offer for the purpose of rule 10b-13 and would not prohibit additional open market and private purchases of stock. The Staff did not express any opinion as to whether the purchase of 6 percent, the Schedule 13D disclosure and the possible future purchases might be integrated to constitute a tender offer for the purpose of Section 14(d). However, in *Cargill, Inc.* v. *Missouri Portland Cement Co.*,[16] the staff refused to take a no-action position on a 19 percent holder increasing its position by means of open market and privately negotiated transactions. The holder said it had no existing plan for a tender offer but it did not rule out the possibility of a future tender offer.

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11. 1972-73 Fed. Sec. L. Rep. [CCH] ¶ 79,192 (avail. Dec. 15, 1972).
12. 397 F. Supp. 133 (S.D.N.Y. 1975).
13. 1971-72 Fed. Sec. L. Rep. [CCH] ¶ 78,588 (avail. Dec. 22, 1971).
14. 1973-74 Fed. Sec. L. Rep. [CCH] ¶ 79,715 (avail. Feb. 7, 1974).
15. 1974-75 Fed. Sec. L. Rep. [CCH] ¶ 80,014 (avail. Oct. 10, 1974).
16. 1974-75 Fed. Sec. L. Rep. [CCH] ¶ 80,050 (avail. Oct. 31, 1974).

Gulf & Western Industries Inc. v. *Great Atlantic & Pacific Tea Co.*,[17] and *General Host Corp.* v. *Triumph American, Inc.*,[18] rejected the argument that pre-formal tender offer purchases of less than five percent of the shares of the target requires Williams Act disclosure. In *Texasgulf, Inc.* v. *Canada Development Corp.*,[19] the court said: "Thus, it is evident that [Canada Development Corp.'s] undisclosed purchases and conscious avoidance of the 5 percent triggering requirement, whether alone or together with Noranda, are not a violation of the law." *Copperweld Corp.* v. *Imetal*,[20] rejected the argument that open market purchases of an aggregate of 4.4 percent of the target's stock during a three-month period ending more than 60 days prior to the tender offer would constitute a tender offer, even if the offeror, at the time of the purchases, intended to make a tender offer. SEC Release 5731 proposes a 40-business-day cooling-off period following a tender offer, but does not propose a precommencement cooling-off period. The SEC has invited comment on the need for a precommencement rule.

In *Missouri Portland Cement Co.* v. *H. K. Porter Co.*,[21] the court said that if open market purchases by an offeror prior to a formal tender are deemed to be a creeping tender offer and therefore in violation of the Williams Act, the shareholders who sold in the open market would have an adequate remedy at law for damages and the target is therefore not entitled to an injunction on the basis of such purchases.

In *Applied Digital Data Systems, Inc.* v. *Milgo Electronics Corp.*,[22] Judge Weinfeld provided an interesting rationale for the cases that have rejected the creeping tender offer argument.

SEC Release No. 5731 states:

> . . . the Commission's position at this time is that a definition of

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17. 356 F. Sup. 1066 (S.D.N.Y.), *aff'd*, 476 F.2d 687 (2d Cir. 1973).
18. 359 F. Supp. 749 (S.D.N.Y. 1973).
19. 366 F. Supp. 374, 404 (S.D. Tex. 1973).
20. 403 F. Supp. 579 (W.D. Pa. 1975).
21. 535 F.2d 388 (8th Cir. 1976).
22. Current Fed. Sec. L. Rep. [CCH] ¶ 95,824 (S.D.N.Y. 1977); "The cases cited by defendants to support their position cannot be read to indicate that sections 14 (d) and 14 (e) are not applicable once a public announcement of an imminent exchange offer has been made. Nearly all of these cases deal with the question whether purchases of a potential target company's stock prior to the filing of a Schedule 13D and prior to *any* announcement of a tender offer should themselves be characterized as part of the offer. Under such circumstances, the target company itself is not likely to be aware of the possibility of an offer, and the purchaser will not have indicated that one is contemplated since he will not have reached the five per cent holding of securities that triggers the requirement of filing a Schedule 13D. At that early stage, there is no contest for control with the attendant dangers of misrepresentations, nor has the purchaser acquired a large enough block of stock to warrant shareholder concern over possible shifts in corporate management. Thus, the purposes of the Williams Act would not be materially furthered by applying it to the offeror or the target company. When, however, a public announcement of a proposed offer has been made, the very dangers that the Act was intended to guard against come into play, and the application of sections 14 (d) and 14 (e) is thus appropriate." (Footnotes omitted.)

> the term "tender offer" is neither appropriate nor necessary. This position is premised on the dynamic nature of these transactions and the need of the Commission to remain flexible in determining what types of transactions, either present or yet to be devised, are or should be encompassed by the term. Therefore, the Commission specifically declines to propose a definition of the term "tender offer."
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> The Commission's position should in no way be construed to mean that the term applies only to so-called conventional tender offers whereby an offer is published by a person requesting that all or a portion of a class of a company's securities be deposited during a fixed period of time so that such person may purchase such securities at a specified price (whether cash and/or securities) and subject to specified conditions. But rather, the term is to be interpreted flexibly and applies to special bids; purchase resulting from widespread solicitations by means of mailings, telephone calls and personal visits; and any transaction where the conduct of the person seeking control causes pressures to be put on shareholders similar to those attendant to a conventional tender offer. (Footnotes omitted)

Based on the judicial decisions to date, it appears that informal purchases of more than an aggregate of 5 percent which are accomplished in a manner that does not run afoul of the shareholder impact test will not in themselves constitute a tender offer and if not immediately prior to the tender offer (a 60-day hiatus would appear more than adequate), will not be integrated with the tender offer.

Proposed Rule 14d-6 would integrate post-tender offer purchases within 40 business days of the termination of a tender offer. Securities Act Release 5731 explains the proposal as follows:

> At present, Regulation 14D does not provide for the integration of purchases by the bidder either before the commencement of the tender offer or after its termination with those purchases made by the bidder pursuant to the tender offer. Under proposed Rule 14d-6(a), open market, private or other purchases . . . within forty business days after the termination of the bidder's tender offer would be integrated with and deemed a part of the tender offer only for the purposes of Section 14(d) . . . . The proposed rule would be triggered by the termination of the bidder's tender offer. . . . Securities of the same class sought by the bidder in its tender offer would be included as well as options, warrants, rights, convertible securities or other securities which involve contractual rights, privileges or other provisions to purchase or acquire, through exercise, conversion, exchange or otherwise, securities of such class.
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> If adopted, the proposed rule would result in applying the disclosure and substantive protections, such as the best price and sixty

> day withdrawal provisions of Section 14(d) to such purchases. The effect of the rule as proposed would, in most circumstances, be to preclude such purchases . . . during the forty business day period. . . .
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> Proposed Rule 14d-6(c) would exclude certain purchases during the forty business day post-termination period from the operation of the proposed rule. These would include purchases made pursuant to a subsequent tender offer for securities of the same class sought in the bidder's previous tender offer, provided that the offered consideration in the subsequent tender offer is no lower than that offered at any time during the bidder's previous tender offer.

In addition to the tender offer definition questions, there is a further issue as to whether there is a requirement to disclose an open market purchase program. While at one time I took the position that such purchases might fall within 10b-5 disclosure requirements, Lipton, *Review of Tender Offers for Corporate Control*[23], the case law has developed to the contrary. In *Frigitemp Corp.* v. *Financial Dynamics Fund, Inc.*,[24] it was held that one of the elements for a claim under rule 10b-5 by one stockholder of a corporation against another stockholder was that the defendant have access to *"corporate inside information"* not available to the plaintiff. In this case, plaintiffs' sole contention was that defendants failed to disclose material *market information* (not "confidential corporate information") to them.[25] In *SEC* v. *Sorg Printing Co.*,[26] the SEC charged a financial printing firm and certain of its employees with violating section 10(b) and rule 10b-5 in abusing material non-public market information concerning tender offers being printed by the firm by making purchases based upon such information. And in connection with the North American Philips Corporation offer for Magnavox Company, the SEC issued an order for a private investigation into trading activity in Magnavox common stock prior to announcement of the offer. NAPC disclosed in its extended and amended tender offer that it had obtained information that certain members of its corporate staff who were not officers had purchased, directly or through relative's accounts, shares of Magnavox during the period immediately preceding announcement of NAPC's offer.[27] In *Oppenheimer & Co.*, Exchange Act Release 12319

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23. 72 Mich. L. Rev. 358, 363 (1973).

24. Fed. Sec. L. Rep. [CCH] ¶ 94,907 (S.D.N.Y. 1974), *aff'd*, 524 F.2d 275 (2d Cir. 1975).

25. *See also* Fleischer, Mundheim and Murphy, *Initial Inquiry into the Responsibility To Disclose Market Information*, 121 U. Pa. L. Rev. 798 (1973); General Time Corp. v. Talley Indus. Inc., 403 F.2d 159 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969); Pacific Ins. Co. v. Blot, 267 F. Supp. 956 (S.D.N.Y. 1967).

26. 1974-75 Fed. Sec. L. Rep. [CCH] ¶ 94,767 (S.D.N.Y. 1974).

27. SEC v. Healy, 74-C-4305 (S.D.N.Y. Nov. 18, 1974), Lit. Rel. 6589 (announcement of entry of consent judgments). *See also* SEC v. Cox, 74-C-3363 (N.D. Ill. Nov. 26, 1974), Lit. Rel. 6607 (tippee of Reliance Group director bought before announced tender offer for corporation's stock). *Cf.* SEC v. Rosenberg, 74-C-3633 (S.D.N.Y. Aug. 21, 1974), Lit. Rel. 6487 (counsel and assistant secretary of Barbara Lynn Stores, learn-

(April 2, 1976), the SEC stated that there is "no question that the misuse of undisclosed, material 'market information' can be the basis of antifraud violations." While it would appear that rule 10b-5 proscribes purchases by third parties who have learned confidential information about intended purchases by someone who may make a tender offer, the purchaser itself has no obligation to disclose its intentions to make open market purchases or its consideration of a possible tender offer until the 5 percent threshold is reached and such disclosure is required by Schedule 13D.

The following is an example of a Schedule 13D disclosure with respect to future open market purchases, tender offer or a two-step transaction:

> The Corporation did not at the time of the purchases described herein and does not presently have any plan to acquire control of the Issuer. The Corporation has in the past analyzed the results of and considered the possibility of acquiring control of the Issuer. The Corporation may consider seeking representation on the Board of Directors of the Issuer in the future. The Corporation may suggest business strategies, which might include acquisitions, dispositions and changes in dividend policy and management, to the Issuer in the future. The Corporation may consider the possibility of acquiring control of the Issuer in the future. The Corporation has not had any discussions with the Issuer with respect to acquisition of control, representation on the Board of Directors or business strategies. Since the Corporation may consider seeking to acquire control of the Issuer or obtain representation on the Board of Directors of the Issuer, or since the Corporation may suggest business strategies to the Issuer, the Corporation's position cannot be considered solely that of a passive investor. However, it should not be assumed that the Corporation will formulate a plan to acquire control of the Issuer or seek representation on the Board of Directors of the Issuer or suggest business strategies to the Issuer. The Corporation has been buying and may continue to buy shares of the Issuer. Subject to the conditions set forth below, the Corporation is presently seeking a significant position in the Issuer which might amount to about 20% of the shares of the Issuer. The Corporation intends to continuously review its position in the Issuer and may, depending on its evaluation of the Issuer's business and prospects and upon future developments (including, but not limited to, the attitude of the Board of Directors and management of the Issuer, general economic conditions and money and stock market conditions), determine to cease buying shares of the Issuer or to increase or decrease its position in the Issuer. The Corporation does not presently intend to make a tender offer for shares of the Issuer or

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ing proposed "going private" merger during the course of his duties as such, bought company's stock prior to public disclosure of merger).

propose to the Issuer a merger or similar transaction. As part of its continuing review of its position in the Issuer, the Corporation may change its present intention and determine to make a tender offer for shares of the Issuer or propose to the Issuer a merger or similar transaction.