

May 1, 1978

To Our Clients

Cash Options Acquisitions

The cash option acquisition allows the shareholders of the target to choose between receiving taxable cash consideration for their shares or a tax-free exchange of stock. The cash option is attractive to high tax basis shareholders or those who, for whatever reason, would prefer to have cash. The stock option is attractive to low tax basis stockholders who do not wish to recognize their gain at the time of the transaction. The cash option acquisition is particularly significant where there is a large arbitrage position or a desire to encourage a large arbitrage position. In order for the stock portion of the transaction to be tax-free, the cash portion is limited to 49% of the shares of the target.

The cash option acquisition has proved to be a very useful and effective acquisition technique and its popularity has increased markedly in recent years.

While there are numerous variations of the cash option acquisition, the two most frequently used are (1) the statutory merger pursuant to which shareholders of the target receive the option to elect either cash or stock in the merger exchange and (2) the cash tender offer for up to 49% of the shares of the target to be followed by a stock merger.

Questions under the securities laws have existed with respect to both forms of cash option acquisition. These questions have now been largely settled in Securities Act Release No. 33-5927, April 24, 1978. The SEC has now made clear that the cash option merger will be treated in a routine fashion and that it will routinely grant the requisite exemption from Rules 10b-6 and 10b-13. The SEC has also made it clear that it will not deem to be "gun-jumping" under the 1933 Act a description in a tender offer of the securities to be issued in a second-step stock merger following a cash tender for 49% of the shares of the target.

May 1, 1978

The SEC's position represents a reversal of the position taken in the Division of Corporation Finance's November 30, 1976 Bendix letter to the effect that a registration statement under the 1933 Act is required where an agreement in principle on a cash option merger is reached and thereafter the acquiring company determines to seek to effect the cash portion of the transaction by way of a tender offer. The revised position assumes that the purpose of the disclosure as to the merger transaction in connection with a tender offer is not to condition the market with respect to the security to be issued in the combination, but rather to effect compliance with the tender offer disclosure requirements.

The revised position is consistent with the decision in the recent Humana-American Medicorp litigation wherein the Court held that it was not a violation of the 1933 Act for Hilton International to have set forth information with respect to its planned second-step merger transaction with American Medicorp if its offer were successful. In that litigation, the SEC took an amicus position to the effect of its position in its recent release. Accordingly, under the revised SEC position, a hostile offeror may include in its offering documents more definite information with respect to an anticipated or planned second-step transaction.

The Release does not address the question of whether open market purchases may be effected in lieu of a tender offer to accomplish the cash portion of the transaction. In the Ex-Cell-O no action letter and in other letters, the Staff has taken the position that limited open market purchases may be made.

The Release does not alter the requirement of obtaining an exemption under Rule 10b-6 in connection with cash option mergers.

The Release does not address the question of whether a Rule 10b-13 exemption must be obtained. Rule 10b-13 prohibits the purchase of securities during a tender offer otherwise than pursuant to the tender offer and the Staff of the Division of Market Regulation has stated that the cash option portion of a cash option merger may be deemed to be a tender offer for Rule 10b-13 purposes. While the Release does state that a tender offer filing is not required in connection with a cash option merger where shareholders must elect cash before the shareholders' meeting, this position -- which is the position of the Division of Corporation Finance -- apparently has not been coordinated with the Division of Market Regulation. Accordingly, it would appear that the current practice of obtaining 10b-13 exemptions should continue to be followed.

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