WACHTELL, LIPTON, ROSEN & KATZ December 5, 1978

To Our Clients:

Creeping Tender Offers

The decision in U.S. v. Chiarella, ______ F.2d ______ (2d Cir. Nov. 29, 1978), which held that trading on confidential market information (knowledge of an impending tender offer) violated Rule 10b-5, expressly holds that the tender offeror itself is free to buy up to 5% of the target's stock in anticipation of its tender offer. The decision thus rejects the argument that preoffer purchases by a bidder should be integrated with the offer and therefore such preoffer purchases violate Section 14(d) of the Securities Exchange Act of 1934. The decision also implicitly adopts the argument that only conventional tender offers or buying programs that are accompanied by the kind of publicity that is associated with conventional tender offers are "tender offers" within the Williams Act.

The Court said:

> "We are not to be understood as holding that no one may trade on nonpublic market information without incurring a duty to disclose. Indeed, as Chiarella has persistently reminded us, a would-be tender offeror may purchase up to 5 percent of the stock of its prospective target without making any disclosure at all. General Time Corp. v. Talley Industries, Inc., 403 F.2d 159, 164 (2d Cir. 1968), cert. denied, 393 U.S. 1026 (1969); see 15 USC Section 78m(d); Kennecott Copper Corp. v. Curtiss-Wright Corp., No. 78-7187, slip op. at 4866-70 (2d Cir. Sept. 28, 1978). Because offerors may trade, and because he obtained his information from them, appellant would have us conclude that he, too, could purchase target stock before the tender offer is announced, subject only to the 5 percent limitation of the Williams Act, 15 USC Sections 78m(d), 78n(d). But the offerors and Chiarella occupy entirely different positions with respect to trading on news of an impending tender offer.

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It is clear, at the outset, that an offeror is not a "market insider" as this term has been defined above. It does not regularly receive nonpublic information concerning any stock but its own. Indeed, with respect to tender offers, it does not receive information but creates it.

Moreover, in making a tender offer at a premium above the pre-offer market price, the offeror is undertaking a substantial economic risk that his tempting target will prove to be a "white elephant." Although it knows that the price of the target stock will rise when the takeover bid is announced, the offeror has no alchemic power to transform this knowledge into a certain profit. The only reason it can be confident that its purchases will soon appreciate in value is that it will soon place a much greater sum of money at risk. When the price goes up, the offeror will be buying, not selling.

The offeror's pre-offer market purchases thus represent its willingness to back its judgment that target stock is undervalued by the market. This course of action is entirely consistent with the principles underlying the securities laws. The legislative history of the 1934 Act emphasizes "[t]he idea of a free and open public market [that] is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 11 (1934); accord, S. Rep. No. 1455, 73d Cong., 2d Sess. 81 (1934). Nor are these principles in any way diminished by the 5 percent limit on pre-offer market purchases established by the Williams Act, 15 USC Sections 78m(d), 78n(d). That legislation was not designed to interfere with an offeror's exercise of its economic judgment. Rather, its principal purpose was to prevent the "stampede

effect" that the publicity associated with tender offers has on target shareholders. See, *e.g.*, *Rondeau* v. *Mosinee Paper Co.*, 422 U.S. 49, 58 & n.8 (1975); E. Aranow, H. Einhorn & G. Berlstein, Developments in Tender Offers for Corporate Control 10-16 (1977)."

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