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To Our Clients

Takeovers; Recent Developments

Attacking Open Market Accumulations

1. In Dan River, Inc. v. Unitex Ltd., Civ. No. 79-0217-R (E.D. Va. Mar. 30, 1979) the court held that a target company (as distinguished from its shareholders) does not have standing to attack a facially adequate Schedule 13D.

2. In Unitrode Corp. v. Dynamics Corp. of Amer., 79 Civ. 0990 (GLC) (S.D.N.Y. April 12, 1979) the court held that the failure of a timely filed Schedule 13D to disclose an intent to acquire 20% of the target did not warrant ordering rescission of the purchases effected prior to the filing of an amended Schedule 13D. The court said:

> After a review of the parties' submissions, the Court is not convinced that the remedy of rescission is warranted. The only "pure" section 13(d) case in which rescission was ordered is Financial General Bankshares, Inc. v. Lance, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,403 (D.D.C. 1978). That case, however, is distinguishable, in that the disclosure violation which prompted the rescission remedy was a total failure to file any Schedule 13D. Accordingly, selling shareholders had no way to know of the Lance group's purchases in excess of the 5 percent amount, and no reason to consider whether a takeover attempt was imminent.
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> In the instant case, DCA promptly filed its 13D when its purchases exceeded the statutory threshold, and shareholders were thereby put on notice of the purchases. Although the Court has determined that the objective to acquire 20 percent should have been disclosed, this deficiency is clearly not comparable to the total failure to file in Lance. DCA's initial 13D did put Unitrode's shareholders on notice of the purchases and the possibility that a takeover attempt could be in the making. This, of course, is the primary purpose of the required disclosure. See GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972). The failure to disclose an intention to acquire, if possible, 20 percent for accounting reasons is not so egregious to warrant rescission.

State Takeover Statutes

3. The Maine Takeover Statute applies not just to formal tender offers but to any "offers" which result in the purchase of more than 5% of the stock of the target. In UV Industries, Inc. v. Posner, Civ. No. 79-58-SD (D. Me. Feb. 26, 1979) it was held that the exception for ordinary brokerage transactions without solicitation of orders to sell did not exempt a typical block purchase of more than 5% where the buyer's broker contacted the institutional sellers. In a second decision in that case on March 13, 1979 the court ruled that where the buyer's broker merely goes to the post on the floor of the exchange and makes no bids but merely accepts offers the purchase of more than 5% through that method comes within the exception. However, the Maine Securities Division reached the opposite conclusion. The Division said:

> Distilled to its essential elements, Sharon contends that its March 7 transaction must be viewed as separate and distinct - unrelated to other events. Sharon argues that the March 7 purchase was a normal, albeit somewhat unusual, stock transaction accomplished without solicitation by the floor broker, involving no "bid" or "offer" and therefore not constituting a takeover bid under § 802(16)(A). Alternatively, Sharon argues that the transaction was exempt under § 802(16)(B)(4). In contrast UV argues that Sharon's illegal act of February 22 "conditioned the market", thus enabling Sharon to more readily effect its purchase of UV stock on March 7 without actually bidding on the floor of the New York Stock Exchange.
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> I believe it is consistent with the spirit and intent of the Disclosure Law to conclude that the March 7, 1979, purchase was a "takeover bid" or "takeover offer" within the meaning of Disclosure Law. Contrary to the arguments of Sharon, I do not believe the events of March 7 can stand alone. Rather, they were part and parcel of a continuing solicitation by Sharon to acquire UV stock which intention was stated as early as December 18, 1978, in Sharon's amended 13D Statement and was most clearly expressed in its offer and attempted purchase of February 22, 1979.
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> Sharon's conduct of February 22 clearly communicated to the financial community Sharon's interest in buying approximately 1.3 million shares of UV at a premium price. Although that sale was subsequently aborted by court order, Sharon immediately reaffirmed its intention in the 13D filing of March 2 to buy UV

UV common stock to increase its holdings to 22% (i.e. 1.3 million shares). While not everyone heard the offer or interpreted it in the same way, some investors being in a better position than others to obtain relevant information, it was apparent that Sharon was expressing its continuing intention to buy 1.3 million shares of UV and that it was willing to pay a premium price. The only real question, therefore, was not whether Sharon would act to effect the purchase, but when it would act. That latter question was answered when, on March 7, Dennis Ward, the floor broker for Ladenburg, Thalmann & Co., a firm known to have previously represented Sharon, went onto the floor of the New York Stock Exchange and began purchasing UV stock. Regardless of the fact that Ward did not bid for stock, knowledgeable securities investors could have and did reasonably infer that Ward, when he went to the UV trading post and began buying UV stock, was there for only one purpose - to purchase UV common stock for Sharon.

In interpreting the terms "offer" and "bid" I do not believe the State is limited to looking only at conduct on the floor of the exchange. Rather, I think the Disclosure Law contemplated that the floor transactions be viewed in light of conduct and statements off the floor and preceding the purchase. To interpret these terms as Sharon argues, or to view the events of February 22 and March 7 as wholly separable transactions would defeat the purpose of the law and would permit Sharon to benefit from the effect of its violation of the law on February 22. One who commits an illegal or fraudulent act should not be entitled to benefit from that conduct. Nelson v. Serwold, 576 F.2d 1332, 1339 (9th Cir. 1978) and cases cited therein. In the circumstances of this case the offer or bid of February 22 must be imputed to the March 7 purchase and the two events viewed as part of a continuing takeover offer or bid.

That is not to say that under all circumstances separate purchases must be viewed as a continuous sequence. Whether or not an initial offer might be viewed as separable from a later unsolicited purchase depends on the circumstances of each case. Suffice it to say, however, that for purposes of this case, I find the events to be so closely related as to be inseparable.

The terms "offer" and "bid" are to be broadly construed to effect the purpose behind this statute, i.e. to protect stockholders. The term "offer" as used in the Securities and Exchange Act of 1934 has been liberally construed to encompass a variety of publicity and public relations problems. S.E.C. v. Arvida, 169 F. Supp. 211 (S.D.N.Y. 1958); Competitive Capital Corporation, et al, 44 S.E.C. 579, 582 (1971). The term "offer" has been interpreted as not limited only to offers in the common law contract sense, but includes conduct designed to effect sales or purchases of securities. Carl M. Loeb, Rhoades & Co., 38 SEC 843, 848 (1959). In the recent case of S-G Securities Inc. v. Fuqua Investment Co., Fed. Sec. L. Rep. (C.C.H.) ¶ 96,750 (D. Mass. 1978), the federal court held:

> "[W]here there is:
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> 1) a publicly announced intention by the purchaser, to acquire a substantial block of the stock of the target company for purposes of acquiring control thereof; and
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> 2) a subsequent rapid acquisition by the purchaser of large blocks of stock through open market and privately negotiated purchases:
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> such actions constitute a tender offer for purposes of § 14(d) of the statute."

A similar broad construction has been confirmed by the Maine Law Court in McKenna v. Peddle Land Developments, 229 A.2d 332 (Me., 1967).

> "In security acts, 'The terms . . . "offer for sale," and "offer" are * * * broadly defined to include ingenious methods employed to obtain money from members of the public to finance ventures.'" 229 A.2d at 337.

Finally, although the term "offer" is not defined in the Disclosure Law, § 817(4) references the Maine Securities Law, 32 M.R.S.A. Chapter 13. Although "offer" is defined in the Securities Law in terms of sales of securities, the definition when adapted to the Disclosure Law's regulation of purchases could read:

> "The terms 'offer' or 'offer to [buy]' shall include every attempt or offer to [acquire], or solicitation of and offer to [sell], a security or interest in a security for value." (emphasis supplied).

Thus defined, the conduct of Sharon from December 22, 1978 through March 7, 1979 clearly constitutes a continuous offer by it to purchase UV stock.

Sharon also argues that, even if the purchases of March 7 were tainted by the earlier solicitations, they are exempt from the definition of "takeover bid" under § 802(16)(B)(4) since they were "effected by a broker-dealer in the ordinary course of his business without solicitations of orders to sell . . . ." Assuming that the purchases by Ward for Sharon were done in the ordinary course of a broker's business, I do not believe that the transactions can be said to have been accomplished "without solicitation of orders to sell . . . ." As discussed above, Sharon's actions prior to and on February 22 clearly constituted a solicitation of orders. That conduct, in conjunction with the 13D Statements expressing Sharon's intent to purchase UV stock, constitute unmistakeable solicitations which cannot be separated from the broker's appearance on the floor of the exchange. Sharon's narrow reading of 16(B)(4) would effectively render the entire statute a nullity by permitting an offeror to widely publicize its offers off the exchange floor so long as the floor broker silently "accepted" "unsolicted" offers of sale. I do not believe that the statute supports so strained a reading as that urged by Sharon. Moreover, and as noted above, it is reasonable to conclude as a factual matter that when Sharon's broker went onto the floor "with a bucket" he was impliedly soliciting offers for sale. Ward's conduct on behalf of Sharon, even without verbal solicitations, constitutes an offer by action that cannot be separated from the prior solicitations of Sharon.

4. The Arkansas Takeover Statute has been amended to eliminate its applicability to corporations with 35 shareholders in Arkansas.

In Sharon Steel Corp. v. Durham, CV 79-181 (Sup. Ct. Maine Mar. 26, 1979) the court expressed doubt as to the constitutionality of the Maine Takeover Statute in light of the Fifth Circuit Kidwell decision. However, the court refused to enjoin enforcement on the basis that the issue is now pending in the Supreme Court and until resolved the presumption of constitutionality should prevail. It may be expected that this will be the attitude of many courts until the Supreme Court speaks. While the attraction of the Dart-Mallory injunction against the state statutes to enable a

Saturday Night Special tender offer is strong, the danger that this approach will result in longer delay than compliance with the state statutes must be taken into account. Such is the fate of the Tyco attack on the Massachusetts Takeover Statute in the Ludlow takeover. Until the Supreme Court speaks, the strategic issues will vary from case to case in large measure dependant on the prospect of White Knights at the raider's price. In the meantime many states (such as Arkansas and Virginia) are amending or considering amending their takeover statutes to try to reduce constitutional vulnerability and to cover open market accumulations (such as in Maine).

It is interesting to further note that in the Sharon Steel case the Maine Court enjoined enforcement of the statute on the ground that the Securities Division had acted as both prosecutor and judge thereby violating fundamental fairness requirements.

Financing Takeovers

5. In a recent interpretative letter the staff of the Federal Reserve Board has approved a loan agreement provision excepting "stock" from negative covenants which but for the exception would have resulted in the loan being deemed indirectly secured within the meaning of Regulation U. The operative portion of the letter reads:

> A U.S. branch of a foreign bank proposes to extend purpose credit to a U.S. borrower. As security for the loan the borrower will agree not to pledge any of its assets, with certain exceptions. If a substantial part of these assets consist of stock, the loan will be deemed to be indirectly secured by that stock within the meaning of section 221.3(c) of Regulation U, with all its attendant ramifications.
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> During the term of the loan anywhere from 25 percent to 50 percent, and perhaps more, of the borrower's assets may consist of stock. The parties have therefore agreed to accept from the negative covenants any stock assets which exceed 25 percent of the borrower's total assets. As to that portion of stock assets in excess of such figure, the borrower will be free to sell, pledge or otherwise dispose of in any way without affecting the loan or accelerating its maturity. The end result will leave 25 percent or less of such stock subject to the restrictive covenants referred to above.
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> Since the covenants as they would then stand would not apply generally to all the borrower's assets,

and those assets to which they did apply would no longer consist substantially of stock, staff is of the opinion that the credit would not be indirectly secured within the meaning of section 221.3(c). In addition, such an arrangement serves to point out that in fact the creditor is not relying on such stock as collateral for the loan.

6. The question of conflict of interest and misuse of confidential information in bank financing of takeovers continues to be hotly debated and litigated. In a recent letter to the Chairman of the House Banking Committee the Comptroller of the Currency has set forth the basic view that there is nothing inherently wrong in a bank financing the takeover of a target where the target is a customer of the bank, where there is a cross directorship between the bank and the raider or the target, or where the securities of the target are held by the trust department of the bank.

As to the financing of the takeover of a customer the Comptroller said:

> [S]everal recent, publicly reported examples demonstrate that a bank, particularly a large money-center or regional institution, may find itself a significant creditor of both an acquiring and the target corporation. A bank may become so cast involuntarily as a consequence of historic relationships, or voluntarily, through a conscious election among its customers. In either instance, the bank should act so as to preserve the confidential character of all customer relationships.
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> An obvious potential abuse in such situations relates to the possibility that a bank may disclose to one customer confidential credit or operating data about another. There currently are pending two cases where this issue has arisen: the January, 1979 tender offer by American Express Company for outstanding shares of common stock of McGraw-Hill Inc., wherein Morgan Guaranty Trust Company had established lending relationships with both corporations; and the January 1979 tender offer by Talley Industries, Inc. for outstanding common shares of Washington Steel Corp., wherein Chemical Bank has established lending relationships with both corporations. With respect to the Talley takeover attempt, on February 16, 1979, U.S. District Judge Simmons issued an order preliminary [sic] enjoining Chemical Bank from extending credit to Talley in connection with its tender offer. Chemical Bank, through its counsel, has announced its intention to appeal Judge Simmons' order.

> Since both cases are before the Federal courts, it would be inappropriate for this Office to comment at this time on the specific issues raised. However, it may be useful to note two similar cases where substantive resolutions have been reached. In 1975, General Cable Corporation made a takeover bid for Microdot Corporation, wherein Irving Trust Company was a lender to both corporations, and in 1978, Humanna, Inc. made a takeover bid for American Medicorp Inc., wherein Continental Illinois National Bank was a lender to both corporations. A careful reading of Senate hearings concerning the Microdot case, Hearings on Corporate Takeovers before the Senate Committee on Banking, Finance and Urban Affairs, 94th Cong., 2nd Sess. (1976), and the decisions of U.S. District Judge Lasker in the case of Humanna, Inc. v. American Medicorp, Inc., 445 F. Supp. 613 (S.D.N.Y. 1978) and [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,298 (S.D.N.Y. January 27, 1978), reveals that the facts, as developed, did not support allegations that Irving Trust and Continental Illinois breached what may be viewed as a confidential relationship with the respective target corporations in extending credit to the respective acquiring corporations. On the contrary, it would appear that both banks were aware of potential conflicts, and acted quickly and carefully to avoid impropriety.

As to the cross directorship situation the letter states

> Where a director of a bank also sits on the board of an acquiring or the target corporation whose securities are held by the bank in trust, or which has applied to the bank for credit, basic legal principles applicable to corporate directors would require that the director recuse himself from any decision by bank management to vote, tender or sell those securities, or to extend credit. Any attempt on the part of that director to informally influence the acts of another would fall outside traditional boundaries of legal force.

Where the trust department of the bank financing the takeover holds securities of the target the comptroller's position is:

> Where the lending bank holds in trust significant quantities of equity securities in an acquiring or the target corporation, a decision by the bank to vote,

sell or tender those securities must be made consistent with the best interests of the trust beneficiaries. Regulations such as 12 C.F.R. § 9.7(d) are intended to assure that such decisions are made free of the inside information available to the commercial department of the bank. The spectre of common law liability traditional to the American legal system assures that a fiduciary will loyally serve his charge consistent with the "prudent man" standard. It should be noted that a fiduciary may be precluded in the proper exercise of his duties from considering whether the particular transaction will further competition generally, or promote full employment or a non-inflationary economy, but may be confined to determining that course of action which is in the best economic interest of the various beneficiaries to whom he is bound.

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