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To Our Clients

Toehold Acquisitions; Section 16(b)
Short Swing Profit Recovery Where 10%
Toehold Raider Sells Within Six Months

A frequent result of accumulation by a raider of a more-than-5% block is sale of the block to the target or to a White Knight. Typically such a sale follows the commencement of litigation by the target against the raider. Such litigation is sometimes supplemented by sale by the target of an equal or larger block of newly issued shares to a White Knight.

Apart from the often litigated and still not fully resolved questions as to the legal aspects of toehold acquisitions and the sale of newly issued shares to a White Knight, if the situation is resolved through a sale to the target or a White Knight by a raider who has crossed the 10% threshold of Section 16(b), any profits realized on sale of shares purchased within six months of crossing the 10% threshold are literally within the short-swing-profit-recovery provisions of Section 16(b) and must be paid by the raider to the target.

In Tyco Laboratories, Inc. v. Cutler-Hammer, Inc., CCH Fed. Sec. L. Rep. ¶ 97,370 (S.D.N.Y., Apr. 29, 1980) the raider accumulated more than 10%. The target responded with litigation and sale of newly issued shares to a White Knight. Within six months after becoming a 10% holder, the raider sold to the White Knight at a substantial profit. The Raider argued that the target's litigation and the sale to the White Knight established that the raider did not have access to inside information and was "forced" to sell in order to avoid being locked into a minority position in the target now controlled by the White Knight and thus brought its sale within the "unorthodox" transaction exception to 16(b) which was fashioned by the Supreme Court for forced "sales" that take place when the target merges with a White Knight within six months after the raider crossed the 10% threshold.

The court rejected the raider's argument. The court held that the unorthodox transaction exception is available only in the merger situation where the raider's shares are "sold" through the forced merger exchange; The exception is not available where, as here, the raider voluntarily sells to a White Knight.

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