BECAUSE WE SAID SO: THE SEC'S OVERREACHING EFFORTS TO REGULATE MINI-TENDER OFFERS

By Miriam R. Albert*

I. INTRODUCTION

A "mini-tender offer" is a tender offer to buy less than 5% of a class of securities. Because § 14(d)(1) of the Securities Exchange Act of 1934 (the "1934 Act")[1] requires bidders to register only those tender offers that will result in beneficial ownership of more than 5% of a class of securities, a bidder can complete a mini-tender offer without registering the offer with the Securities and Exchange Commission ("SEC").[2] While mini-tender offers were initially used most frequently to acquire illiquid limited partnership interests, the use of mini-tender offers has expanded over time.[3] Now bidders are making mini-tender offers

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1. 15 U.S.C. § 78n(d)(1) (2003). All statutory citations herein are to the 1934 Act, unless otherwise indicated.

2. *See* Commission Guidance on Mini-Tender Offers and Limited Partnership Tender Offers*,* Exchange Act Release No. 34-43069, at 2246, 64 FR 46581 (July 24, 2000) [hereinafter Mini-Tender Offer Release].

3. *See* Daniel G. Berick, *SEC Issues Guidance to Broker-Dealers Participating in "Mini-Tenders," available at* http://www.modaq.com (Oct. 15, 2001) [on file with the Author]. *See also* Troy Flint, *Beware the Lure of Mini-Tenders; Check Price Before Biting at Purchase Offer,* THE PLAIN DEALER, Mar. 15, 1999, at 1C; Toddi Gutner, *Psst! Wanna Lose More Money?*, BUS. WK., Aug. 19, 1996, at 65; Edward D. Herlihy & Trevor S. Norwitz, *SEC Provides Mini-Tender Guidance, at* http://www.wrhambrecht.com/comp/ma/news/pdf/sec_guidance-08_03_00.pdf (Aug. 3, 2000).

The typical mini-tender offeror would find an illiquid and under-valued limited partnership and solicit the limited partners to buy them out. Once the bidder accumulated a toe-hold interest, he became entitled as a limited partner to a list of partners, a necessary starting point for the mini-tender offer. Since many limited partners might not realize that an active secondary market may exist for their limited partner interests, the bidder might be able to buy up to 4.9% of the outstanding units at a price less than the secondary market price. *See* Gregory V. Varallo & Russell C. Silberglied, *Litigation Involving 'Takeovers' of* for corporate securities, particularly in the high-tech arena, and for shares of exchange-listed closed-end funds.[4] To the SEC and to issuers, mini-tender offers are a coercive takeover abuse, violating the protective spirit of the Williams Act through insufficient and deceptive disclosure. To mini-tender offerors, it is an efficient and legal mechanism to buy securities from willing sellers.[5]

However characterized, mini-tender offers have rocketed in popularity in the past five years, as noted by the SEC.[6] The Depository Trust Corporation ("DTC") reported thirty-nine mini-tender offers in 1997, and 537 in 1998.[7] DTC noted a sharp rise in mini-tender offer volume during 1999, the last year for which annual volume statistics are publicly available; in the first five weeks of 1999 alone, DTC received more than 300 mini-tender offers.[8] As of January 2001, DTC was processing thirty to forty mini-tender offers each month on behalf of the

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Limited Partnerships, INSIGHTS, Nov. 1997, at 7. A commentator presciently wrote in 1997 that if mini-tenders:

> come to be an accepted way of buying securities, it is possible that this technique could be used to acquire other undervalued but illiquid securities. If the level of disclosure provided in the typical mini-tender is accepted as legally sufficient, mini-tenders could be used to manipulate market prices or to put companies 'in play.'

Edward D. Herlihy & Trevor S. Norwitz, *A New Takeover Abuse: 4.9% Mini-Tender Offers,* 1 M&A LAW. 1, 22 (1997).

4. Mini-Tender Offer Release, *supra* note 2, at 2247. *See also* Herlihy & Norwitz, *SEC Provides Mini-Tender Guidance, supra* note 3. This is so, despite the fact that buying less than 5% of the equity of a publicly traded company through a tender offer does not seem necessary, as that size block can be amassed in the open market with relative ease, albeit at the market price. *See* Herlihy & Norwitz, *A New Takeover Abuse, supra* note 3, at 22.

5. *See* Barbara Martinez, *How the Master of Minitenders Makes it Work,* WALL ST. J., Jan. 28, 1999, at C1.

6. Mini-Tender Offer Release*, supra* note 2, at 2247. The mini-tender offer phenomenon has crossed the border into Canada, since U.S. firms like IG Holdings, Inc. have begun making mini-tender offers to Canadians. *See infra* notes 116–32 for additional information about IG Holdings and its interactions with the SEC. The Canadian Securities Administrators issued a public warning about mini-tender offers in September 1999, followed by a list of guidelines backed by the threat that regulators would seek cease and desist orders for violations thereof. *See Watchdogs Seek to Rein in Mini-Tenders,* TORONTO STAR, Dec. 14, 1999. According to Stan Magidson, director of takeovers at the Ontario Securities Commission, "[i]t's our hope that these guidelines will be sufficient, but if not, the next step would be rules or regulations." *Id.*

7. DTC is a subsidiary of The Depository Trust & Clearing Corporation, a member of the Federal Reserve system, and a registered clearing agency with the SEC. *See Subsidiaries & Joint Ventures, available at* http://www.dtcc.com/AboutUs/affiliates.htm (last visited Dec. 24, 2002). DTC functions as a clearing house for the settlement of trades in corporate and municipal securities and performs securities custody services for its participant banks and broker-dealers. *See* In the Matter of IG Holdings, Inc., 1999 SEC LEXIS 1649, at *2 (Aug. 19, 1999).

8. *See* http://www.dtcc.com/AboutUs/1999annual/asset.html (last visited Dec. 25, 2002). *See also* Flint, *supra* note 3.

securities firms and clients it serves.[9] In 2002, DTC processed 531 mini-tender offers.[10]

The increasing popularity of mini-tender offers has highlighted a gap in the federal tender offer rules.[11] According to the SEC, mini-tender offers are not subject to the filing, disclosure, and procedural requirements of § 14(d) of the 1934 Act and Regulation 14D thereof, but are subject to the 1934 Act's anti-fraud provisions of § 14(e) and Regulation 14E.[12] Thus, mini-tender offerees are, absent any additional statutory or administrative assistance, denied certain protections of the tender offer rules, including proration and withdrawal rights.[13]

The SEC has been vocal about the dangers it perceives from mini-tender offers, bringing enforcement actions against mini-tender offerors, and issuing

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9. *See* Mike Barry, *SEC Approves DTC's Policy on Mini-Tender Offers* (Dec./Jan. 2001–02), *available at* http://www.dtcc.com/Publications/dtcc/jan01/minitender.html.

DTC's policy with respect to mini-tender offers is:

> (i) to make an offeror's information about a low volume [mini] tender offer available to DTC's Participants through DTC's Reorganization Inquiry for Participants Service (RIPS) on the condition that the offeror uses DTC's Automated Tender Offer Program (ATOP); and
> (ii) to make securities available to the offeror at the conclusion of a low volume [mini] tender offer processed through ATOP only after DTC has received payment for the securities from the offeror.

Id.

In order to assure that its participants receive the benefits of ATOP, as a matter of policy DTC does not announce a low volume tender offer in RIPS unless the offer is processed in ATOP. Those ATOP benefits include more detailed information in the RIPS announcement and an indication of a tendered position in participants' daily statements from DTC. *Id.* DTC requires the offeror in mini-tender offers processed through ATOP to send payments to DTC for any securities in the offer before DTC will make such securities available to the offeror, "to give its participants the efficiency and safeguards of payment through DTC's facilities." *Id. See also* Len Boselovic, *He Turns Mini-Tenders Into Maxi Profits,* PITTSBURGH POST-GAZETTE, Aug. 21, 2000, at B1. The SEC approved a DTC request to charge a $2700 processing fee to the offering company for all mini-tender offers, effective February 11, 1999. *See* Flint, *supra* note 3.

10. According to DTC, approximately 65% of these were odd lot offers. DTC does not solicit these offers; if a mini-tender offer is made and pays the $2700 fee approved by the SEC for mini-tender offers, DTC will then publish the mini-tender offer to its participant banks and broker-dealers. *See* E-mail from Jay Gottlieb of DTC (Dec. 26, 2002) (on file with Author).

11. Mini-tenders also have tax implications and raise significant fiduciary issues for the general partner that are beyond the scope of this Article. *See* Herlihy & Norwitz, *A New Takeover Abuse, supra* note 3, at 22–24 for a discussion of these issues.

12. Mini-Tender Offer Release, *supra* note 2, at 2247.

13. 15 U.S.C. § 78(d)(5)–(7) (2003). *See* Herlihy & Norwitz, *A New Takeover Abuse, supra* note 3, at 19. Proration rights protect tender offerees when the bidder seeks less than an entire class of outstanding securities, and shareholders tender more shares than the bidder seeks. In such case, the bidder must purchase the tendered shares on a pro rata basis. *See* 15 U.S.C. § 14(d)(6) (2003). *See also* 17 C.F.R. § 240.14d-8 (2003).

Withdrawal rights permit tender offerees to withdraw their tendered shares at any time while the tender offer is open. *See* 17 C.F.R. § 240.14d-7.

investor alerts and an interpretive release.[14] This Article examines the legalities of mini-tender offers and of the regulatory responses thereto. Part II traces the legislative history and operation of the Williams Act and its application to mini-tender offers. This Part concludes that mini-tender offers likely do not constitute tender offers under the Williams Act as currently constituted. Part III evaluates the regulatory response to mini-tender offers, demonstrating the insufficiency of the SEC's efforts to curb abuses in mini-tender offers. This Part raises questions about the statutory support for some such efforts; to date, such efforts include the SEC's issuance of an interpretative release containing "recommended" disclosures for mini-tender offerors, and a handful of enforcement actions for alleged violations of § 14(e). Part IV proposes several possible solutions to the problems created by unregulated mini-tender offers. The Article concludes that the SEC must take steps to bring mini-tender offers conclusively within the definition of tender offer for purposes of the Williams Act, and then must promulgate binding regulations to achieve the desired investor protections.

II. THE LEGALITIES OF MINI-TENDER OFFERS: WHAT LAW APPLIES?

A. The Williams Act

A central tenet of the federal securities laws is that full disclosure is a necessary element of investor protection.[15] Nevertheless, prior to the adoption of the Williams Act,[16] tender offerors were under no obligation to disclose any information to security holders when making their bid.[17] A tender offeror could operate in absolute secrecy, failing to disclose his true identity, the source of his funds, the identity of his associates, and what he intended to do with the target if he gained control.[18] As a result of price premiums, time limits, specified number of shares to be bought, and "first-come, first-served" purchase policies, target company security holders were often forced to act hastily on tender offers, without the benefit of full disclosure.[19] In response to the growing use of tender offers to achieve corporate control, Congress passed the Williams Act amendments in 1968 to protect security holders from unfair or deceptive tactics in tender offers, and to create a level playing field between bidders and targets.[20]

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14. *See* Part III *infra* for a discussion of these efforts.

15. Wellman v. Dickinson*,* 475 F. Supp. 783, 823 (S.D.N.Y. 1979). The SEC considers its "primary mandate under the federal securities laws is to protect investors and to act in the public interest." *Tender Offers,* Securities Act Release No. 33, 5731, at 2 (Aug. 2, 1976).

16. 15 U.S.C. § 78n(d)–(e) (2003).

17. Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 55 (2d Cir. 1985).

18. *Id*.

19. *See* Notes*: The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934,* 86 HARV. L. REV. 1250, 1259 (1973) [hereinafter *The Developing Meaning of "Tender Offer"*].

20. H.R. REP. NO. 1711, at 2 (1968). *See also* SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945, 948 (9th Cir. 1985).

The Williams Act amended § 14 of the 1934 Act by adding disclosure provisions in § 14(d) and anti-fraud provisions in § 14(e).[21] The disclosure provisions of § 14(d)(1) prohibit tender offers for any class of a registered stock unless a Schedule 13D and any other required information have been filed with the SEC if, after the consummation thereof, the offeror would beneficially own more than 5% of the class.[22] Regulation 14D applies only to tender offers subject to § 14(d)(1), and sets out specific disclosure requirements and mandates certain procedural protections for those who tender.[23]

The general anti-fraud provisions of § 14(e) prohibit fraudulent, deceptive, and manipulative acts in connection with any tender offer.[24] Regulation 14E sets out the requirements for all tender offers.[25] Significantly, neither § 14(e) nor Regulation 14E contain the 5% threshold contained in § 14(d)(1), or language limiting their application to tender offers for equity securities.[26] Thus, § 14(e) and Regulation 14E apply to all tender offers for any type of security, registered and unregistered (except exempt securities under the 1934 Act), including debt.[27]

Congress intended the Williams Act to be construed flexibly, in order to effectuate its remedial purpose of protecting security holders from coercive tactics

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21. *See* 15 U.S.C. § 78n(d)–(e) (2003).
22. 15 U.S.C. § 78n(d)(1).
23. *See* 17 C.F.R. § 240.14d (2003).

> The disclosure [in Regulation 14D] focuses on the terms of the offer and information about the bidder. The procedural protections include the right to withdraw tendered securities while the offer remains open, the right to have tendered securities accepted on a pro rata basis throughout the term of the offer if the offer is for less than all of the securities, and the requirement that all security holders of the subject class of securities be treated equally. Also, Regulation 14D requires the bidder to file its offering documents and other information with the Commission and hand deliver a copy to the target and any competing bidders . . . . Regulation 14D also requires the target to send to security holders specific disclosure about its recommendation, file a Schedule 14D-9 containing that disclosure, and send the Schedule 14D-9 to the bidder.

Mini-Tender Offer Release, *supra* note 2, at 2246–47.

24. 15 U.S.C. § 78n(e).
25. "As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of Section 14(e)," rule 14e-1 provides that all tender offers must be open for at least 20 business days. *See* 17 C.F.R. § 240.14e-1(a) (2003); all tender offers must remain open for at least ten business days after any change in the offering price or percentage of securities being sought. *See* 17 C.F.R. § 240.14e-1(b); and the bidder must promptly pay for or return securities when the tender offer expires. *See* 17 C.F.R. § 240.14e-1(c). In addition, the target must state its position on the offer within 10 business days after the offer begins. *See* 17 C.F.R. § 240.14e-2 (2003). The target must state that it either recommends its security holders accept or reject the offer, it expresses no opinion and remains neutral with respect to the offer, or it is unable to take a position on the offer. *See* 17 C.F.R. § 240.14e-2(a).
26. *See* 15 U.S.C. § 78n(e). *See also* 17 C.F.R. § 240.14e.
27. Mini-Tender Offer Release, *supra* note 2, at 2247.

in tender offers.[28] A determination that a particular offer constitutes a tender offer under the Williams Act is thus a condition precedent to the applicability of any protections thereunder. When the Williams Act became law, there existed a general understanding among securities practitioners as to what constituted a tender offer.[29] The legislative history of the Williams Act focused exclusively on this conventional tender offer model. While the SEC and Congress have made it clear that the scope of the tender offer rules exceeds any conventional definition, the term has never been defined by statute or regulation. Commentators and judges have suggested that the absence of a definition was intentional, so that the term could encompass transactions not yet contemplated, with characteristics atypical of traditional tender offers.[30] This flexibility comes at a cost. Those who structure

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28. Wellman v. Dickinson, 475 F. Supp. 783, 825 (S.D.N.Y. 1979) (citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963)). *See also* Russell L. Hirschhorn, Note*: Discounted Mini-Tender Offer: A Fraudulent Business Scheme,* 29 HOFSTRA L. REV. 627, 640 (2000).

29. *See The Developing Meaning of "Tender Offer," supra* note 19, at 1251.

> A tender offer has been conventionally understood to be a publicly made invitation addressed to all shareholders of a corporation to tender their shares for sale at a specific price. Cash or other securities may be offered to the shareholders as consideration; in either case, the consideration specified usually represents a premium over the current market price of the securities sought.

Id.

30. *Wellman,* 475 F. Supp. at 825.

> The SEC's initial position was that "a definition of 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.'

Tender Offers, supra note 15, at 12.

At one point, the SEC did propose a definition for the term.

> Recognizing the dynamic nature of these activities [tender offers], the Commission has proposed a definition which would include within its coverage at least certain of these diverse forms of transactions. The Commission has done so because it believes that in substance many of these transactions are in reality tender offers and that the public is entitled to the benefits that would flow from their specific inclusion within the provisions of the Williams Act.

Proposed Amendments to Tender Offer Rules, Securities Act Release No. 33, 6159, at 6–7 (Nov. 29, 1979); 44 Fed. Reg. 70349, 70350. The proposed definition is as follows:

> (1) The term "tender offer" includes a "request or invitation for tenders" and means one or more offers to purchase or solicitations of offers to sell securities of a single class, whether or not all or any portion of the securities sought are purchased, which
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> > (i) during any 45-day period are directed to more than 10 persons and seek the acquisition of more than 5% of the class of securities, except that offers by a broker (and its customer) or by a dealer made on a national securities exchange at the then current market or made in the over-the-counter market at the then current market shall be

commercial transactions, as well as those who evaluate the legalities of such transactions, have spent countless hours trying to determine which transactions constitute tender offers for purposes of the Williams Act. The SEC has had to engage in a case-by-case analysis of transactions, to evaluate possible violations of the tender offer rules, without having the benefit of an objective statutory or regulatory standard.

In the absence of a statutory definition for tender offer, the courts have interpreted the term using the legislative history of the Williams Act, guidance from the SEC, and binding judicial precedent. The judicial evolution of the definition of tender offer began almost immediately after the Williams Act was enacted.[31] Since then, the term has been interpreted quite liberally by the courts to

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> excluded if in connection with such offers neither the person making the offer nor such broker or dealer solicits or arranges for the solicitation of any order to sell such securities and such broker or dealer performs only the customary functions of a broker or dealer and receives no more than the broker's usual and customary commission or the dealer's usual and customary mark-up; or
> (ii) are not otherwise a tender offer under paragraph (b)(1)(i) or this section, but which
> > (A) are disseminated in a widespread manner,
> > (B) provide for a price which represents a premium in excess of the greater of 5% of or \$2 above the current market price, and
> > (C) do not provide for meaningful opportunity to negotiate the price and terms.

Id. at 70358. After consideration, the SEC intentionally chose to leave the term undefined so courts could be more flexible in finding the existence of a tender offer when evaluating the new schemes and mechanisms that would no doubt be invented. "Aware of 'the almost infinite variety in the terms of most tender offers' and concerned that a rigid definition would be evaded, Congress left to the court and the SEC the flexibility to define the term." Hanson Trust PLC v. SCM Corp*.,* 774 F.2d 47, 56 (2d Cir. 1985).

The SEC's current thinking on what constitutes a tender offer can be found on its website, which defines tender offer as a 'broad solicitation by a company or a third party to purchase a substantial percentage of a company's shares or units for a limited period of time." *See Tender Offer*, *at* http://www.sec.gov/answers/tender.htm (last visited Dec. 25, 2002). The tender offer must be for a "fixed price, usually at a premium over the current market price, and is contingent on shareholders tendering a fixed number of their shares or units." *Id*.

31. Courts typically start the judicial interpretation of the term with the description of a tender offer contained in the House Report by the Committee on Interstate and Foreign Commerce, which held hearings on the Williams Act amendments. The Report identified the relevant attributes of a tender offer to include a bid, a premium price, tender by solicitee, and the conditional nature of the buyer's obligation. *See Wellman,* 475 F. Supp. at 821, citing S. REP. NO. 90-550 (1967) and H.R. REP. NO. 90-1711 (1968), U.S. Code Cong. & Admin. News 1968, p. 2811.

> The offer normally consists of a bid by an individual or group to buy shares of a company usually at a price above the current market price. Those accepting the offer are said to tender their stock for purchase. The person making the offer obligates himself to purchase all or a specified portion of the tendered shares if certain specified conditions are met.

include transactions well beyond the conventional understanding of the term, typically involving an offeror seeking to gain control of the target company. Courts evaluate whether a given transaction poses the same potential dangers that prompted Congress to enact the Williams Act. This may seem appropriate at first glance, as it seeks to further the Congressional intent. However, the approach is ultimately problematic, requiring a case-by-case subjective analysis. As a practical matter, applying the proration, withdrawal, and increased price rights of § 14(d)(5)–(7) to individual stock purchases would also be logistically difficult.[32] Yet in the absence of a binding uniform definition, courts have no alternative.

The first judicial expansion of the term was the 1972 Oklahoma district court decision in *Cattlemen's Investment Co. v. Fears*, holding that a series of negotiated purchases from a large number of security holders in a short time period constituted a tender offer for purposes of §§ 14(d) and (e).[33] The Court based its conclusion on the security holders' need for the disclosure and protections required by §§ 14(d) and (e), finding the defendant's use of the mails, telephone calls, and personal visits to contain "potential dangers which Section 14(d) of the statute is intended to alleviate."[34] While the Court does not mention mini-tender offers, its focus on "persons attempting to gain control of a corporation by means of tender offers" mitigates against the inclusion of mini-tender offers in its definition of tender offer.[35]

Not all courts have been as expansive with the definition of a tender offer. In 1978, the Second Circuit had occasion to consider a Williams Act claim.[36] The plaintiff in *Kennecott Copper Corp. v. Curtiss-Wright Corp.* sought a very broad interpretation of tender offer.[37] The trial court rejected Kennecott's claim that Curtiss-Wright's acquisition had been made by a tender offer, finding it had purchased substantially all the stock on national exchanges.[38] Potential sellers were merely asked whether they wished to sell, offered no premium, and given no deadline.[39] The trial court also found that the off-market purchases were mostly

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Id.

32. Section (d)(5) provides withdrawal rights for those who tender; tendered securities may be withdrawn until seven days after definitive copies of the offer were first published or sent to security holders, and after 60 days from the date of the original tender offer. *See* 15 U.S.C. § 78n(d)(5) (2003).

Section (d)(6) provides proration rights; if an offer for less than all the outstanding equity securities of a class is oversubscribed within ten days of the start of the offer, the bidder must purchase shares on a pro rata basis. *See* 15 U.S.C. § 78n(d)(6).

Section (d)(7) provides increased price protection; if the bidder varies the terms of the offer by increasing the consideration offered, the bidder must pay such additional consideration for all tendered shares, even those tendered before the increase. *See* 15 U.S.C. § 78n(d)(7).

33. 343 F. Supp. 1248, 1251 (W.D. Okla. 1972).

34. *Id.* at 1251–52.

35. *Id.* at 1251.

36. Kennecott Copper Corp. v. Curtiss-Wright Corp., 584 F.2d 1195 (2d Cir. 1978).

37. *Id.*

38. *Id.* at 1206.

39. *Id.* at 1207.

made from sophisticated institutional investors, who the court found "unlikely to be forced into uninformed, ill-considered decisions."[40] This finding is consistent with the holding in *Cattlemen's,* since these security holders were deemed not to need the protections of §§ 14(d) and (e).

The Second Circuit noted that some courts and commentators had taken the position that "other unique methods of stock acquisition which exert pressure on shareholders to make uninformed, ill-considered decisions to sell, as is possible in the case of tender offers, should be treated as tender offers for purposes of the statute."[41] Nevertheless, the Second Circuit declined to broaden the definition of tender offer, focusing on the difficulty in applying withdrawal, proration, and increased price provisions of § 14(d)(5)–(7) to ordinary stock purchases.[42] The Court concluded "[i]f this Court is to opt for an interpretation of 'tender offer' that differs from its conventional meaning, this is not the case in which to do it."[43] This is further evidence of the cost of the flexibility gained by leaving the term undefined. The Court would not need to make such a choice if the term were defined by statute or regulation.

The 1978 Massachusetts district court opinion in *S-G Securities v. Fuqua* also examined whether the defendants' method of acquisition of stock created the same pressures and dangers that the Williams Act was designed to prevent.[44] The Court found this a difficult question in light of the absence of a statutory definition, since the defendants' actions did not constitute a conventional tender offer.[45] The Court crafted a test to determine the existence of a tender offer, finding that when the bidder publicly announced the intention to acquire a substantial block of stock to gain control, and then rapidly acquired large blocks of stock, the transaction constituted a tender offer.[46]

While some courts have followed the *S-G Securities* test, more have not.[47] The Ninth Circuit characterized the *S-G Securities* test as "vague and difficult to

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40. *Id.*

41. *Id.*

42. *Id.*

> Kennecott's interpretation would render the five percent filing provisions of section 78m(d)(1) meaningless except in cases where the purchaser did not intend to obtain a controlling interest. It would also require courts to apply the withdrawal, pro rata, and increased price provisions of section 78n(d)(5)–(7) to ordinary stock purchases, a difficult if not impossible task.

Id.

43. *Id.*

44. 466 F. Supp. 1114, 1125 (D. Mass. 1978).

45. *Id.* at 1124.

46. The test requires that there be: (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 (2) a subsequent rapid acquisition by the purchaser of large blocks of stock through open market and privately negotiated purchases. *Id.* at 1126–27.

47. Courts that have opted for the *S-G Securities* test include: Panter v. Marshall Field & Co., 646 F.2d 271, 286 (7th Cir. 1981) (also citing *Wellman*); Hoover Co. v. Fuqua Indus., 1979 U.S. Dist. LEXIS 11809 (N.D. Ohio June 11, 1979) (also citing *Wellman*); Nachman Corp. v. Halfred, Inc. [1973–74 Transfer Binder] Fed. Sec. L. Rptr. (CCH) para

apply," and found a determination thereunder to be subjective, made in hindsight as an *ex post facto* evaluation of the marketplace's response.[48] According to the SEC, courts generally apply the eight-factor test commonly referred to as the *Wellman* test, designed to provide guidance "as to the traditional indicia of a tender offer."[49] Referring to the *Wellman* factors as a "test" is a bit optimistic, as this "test" does not generate uniform, objective results; not all of the factors have to be present to find a tender offer, and not all the factors need to be afforded equal weight.[50] Although the *Wellman* test has been widely utilized, the list of factors has never been codified.[51] The factors include whether the transaction:

1. involves active and widespread solicitation of security holders;
2. involves a solicitation for a substantial percentage of the issuer's stock;
3. offers a premium over the market price;
4. contains terms that are fixed as opposed to flexible;
5. is conditioned on the tender of a fixed number of securities;
6. is open for a limited period of time;
7. pressures security holders to respond; and

95,589, at 95,590 (N.D. Ill. July 13, 1973); Cattlemen's Inv. Co. v. Fears, 343 F.Supp. 1248, 1251 (W.D. Okla. 1972), *vacated per stipulation*, No. l 75-152 (W.D. Okla. 1972).

Courts that have instead opted for the multi-factor *Wellman* test include*:* SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945, 950 (9th Cir. 1985); Kennecott Copper Corp. v. Curtiss-Wright Corp., 548 F.2d 1195, 1207 (2d Cir. 1978); Brascan Ltd. v. Edper Equities Ltd., 477 F. Supp. 773, 791–92 (S.D.N.Y. 1979); D-Z Inv. Co. v. Holloway [1974–75 Transfer Binder] Fed. Sec. L. Rptr. (CCH) para 94,771 at 96,562–63 (S.D.N.Y. 1974).

48. *SEC v. Carter Hawley Hale Stores, Inc.*, 760 F.2d at 953.

49. *See* Mini-Tender Offer Release*, supra* note 2, at 2246; *SEC v. Carter Hawley Hale Stores, Inc*., 760 F.2d at 950. The *Wellman* test was first articulated by the United States District Court for the Southern District of New York in 1979 in Wellman v. Dickinson, 475 F. Supp. 783 (S.D.N.Y. 1979). The test is not universally revered; commentators have criticized the test as inadequate, subjective, and unduly formalistic. *See* Nathaniel B. Smith, *Defining "Tender Offer" Under the Williams Act,* 53 BROOK. L. REV. 189, 205 (1987).

50. "Of course, in any particular factual context, the various factors may be entitled to different weight in the final decision." *Hoover Co.*, 1979 US Dist. LEXIS, at *10. *See also Wellman,* 475 F. Supp. at 824.

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> The elevation of such a list to a mandatory "litmus test" appears to be both unwise and unnecessary. As even the advocates of the proposed test recognize, in any given case a solicitation may constitute a tender offer even though some of the eight factors are absent or, when many factors are present, the solicitation may nevertheless not amount to a tender offer because the missing factors outweigh those present.

Hanson Trust PLC v. SCM Corp.*,* 774 F.2d 47, 57 (2d Cir. 1985). So this list is so flexible as to lose any semblance of a "test."

8. would result in the bidder acquiring a substantial amount of securities.[52]

B. The Williams Act and Mini-Tender Offers

Questions as to what provisions of the Williams Act, if any, apply to mini-tender offers arose as early as 1972.[53] The Williams Act and its regulations do not define, or even mention, mini-tender offers. According to the SEC, mini-tender offers are subject only to § 14(e) and Regulation 14E.[54] By implication, then, the SEC's *de facto* position is that § 14(d) and Regulation 14D are inapplicable to mini-tender offers.[55] With respect to § 14(d)(1), this position is supportable as a matter of pure statutory analysis. Mini-tender offers are beyond the literal scope of § 14(d)(1) since mini-tender offers are, by definition, made for less than 5% of a class of securities.[56]

However, with respect to § 14(d)(2)–(8), this position contains an inherent inconsistency. By their terms, both § 14(d)(2)–(8) and § 14(e) apply to all tender offers, without the 5% threshold required by § 14(d)(1). Thus the applicability of § 14(d)(2)–(8) to mini-tender offers hinges on how tender offers are defined. The flexibility sought by the courts and SEC in leaving the term "tender offer" undefined has generated this uncertainty. If mini-tender offers are within the definition of tender offer for purposes of the Williams Act, then mini-tender offers are within the literal scope of § 14(d)(2)–(8). Those who tender thereunder would be entitled to the withdrawal and proration rights provided therein. However, if mini-tender offers are not subject to § 14(d)(2)–(8), it follows that they must not be tender offers. If mini-tender offers are not tender offers for purposes of § 14(d), how can they then be tender offers for purposes of the anti-fraud provisions of § 14(e)? The SEC's overly narrow interpretation of the statute raises the possibility that mini-tender offers are not tender offers for purposes of the Williams Act.

The legislative history of the Williams Act is helpful in evaluating whether mini-tender offers are within the conceptual scope of § 14(d)(2)–(8). The statute's underlying purpose is to provide adequate information to security holders

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52. Mini-Tender Offer Release*, supra* note 2, at 2246 n.3.

53. *See The Developing Meaning of "Tender Offer," supra* note 19, at 1258 n.49; Herlihy & Norwitz, *A New Takeover Abuse, supra* note 3, at 20–21. The *Wellman* court weighed in on mini-tender offers:

> The buyer need not seek one hundred percent or even a majority of the stock of a company in order for its bid to qualify as a tender offer. The Williams Act was drafted to cover only those tender offers resulting in ownership of more than 10% (now 5%) of the stock of a corporation. Thus, the Act recognizes the possibility that a purchase of even less than 5% might be a tender offer, although exempted from regulation.

Wellman, 475 F. Supp. at 821–22, quoting S. REP. NO. 90-550, at 9 (1967).

54. Mini-Tender Offer Release*, supra* note 2, at 2247.

55. *Id.*

56. As a result, security holders who tender in mini-tender offers are denied the protections of Regulation 14D, which by its terms, applies only to tender offers subject to § 14(d)(1). *See* 17 C.F.R. § 240.14d (2003).

confronted with a cash tender offer, analogous to that received in proxy contests.[57] The protections of § 14(d)(5)–(7) further this purpose by mitigating pressures on security holders to make uniformed and hasty decisions to sell, through statutory withdrawal, proration, and increased price protections. Security holders facing mini-tender offers would certainly benefit from the availability of these protections, even though the bidder was not able to, and perhaps thus not seeking to, acquire control through the mini-tender offer.[58] Congress' specific interest in regulating tender offers was centered on attempts to acquire control.[59] The statute

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57. However, disclosure alone constitutes a remedy for only one type of potential abuse suffered by tender offerees. Other remedial action was required to eliminate other abuses, including the disparate payments for shares tendered at different times in the same offer, the lack of withdrawal rights and the lack of a fixed termination date. *See* James J. Moylan, *Exploring the Tender Offer Provisions of the Federal Securities Laws,* 43 GEO. WASH. L. REV. 551, 556 (1974–75). In an effort to safeguard security holders from being stampeded into tendering, the tender offer rules in Regulation 14D depart from the "disclosure only" philosophy of the federal securities laws, and prescribe certain transactional terms for third-party tender offers. The main purpose of these provisions is to assure equal treatment for all security holders of the target. *Id.* at 564.

The provisions of Regulation 14D include: tender offers must be open to all security holders of the same class, for a minimum of 20 business days and for 10 more days after any change in the offering price or the percentage of securities being sought. *See* 17 C.F.R. § 240.14c-1(b) (2003); security holders are permitted to withdraw their shares [revoke their tenders] at any time while the tender offer is open. *See* 17 C.F.R. § 240.14d-7; all security holders must be paid the best price paid to any other security holder, and if the bidder offers consideration alternatives [like a choice of cash or debentures], each security holder can choose. *See* 17 C.F.R. § 240.14d-10(c)(1) (2003); 17 C.F.R. § 240.14d-10(a)(2); when the bidder seeks less than all the shares, and security holders tender more than the bidder seeks, the bidder must purchase the tendered shares on a pro rata basis and return unpurchased shares. *See* 15 U.S.C. § 78n(d)(6) (2003); 17 C.F.R. § 240.14d-8 (2003); the bidder must pay for or return securities when the offer expires. *See* 17 C.F.R. § 240.14c-1(c); and while the bid is pending, the bidder cannot purchase outside the tender offer. *See* 17 C.F.R. § 240.14c-5 (2003). *See also* Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 55 (2d Cir. 1985), quoting Piper v. Chris-Craft Industries, 430 U.S. 1 (1977); SEC v. Carter Hawley Hale Stores, Inc., 760 F.2d 945 (9th Cir. 1985), citing H.R. REP. NO. 90-1711 (1968); *Wellman,* 475 F. Supp. at 822; S-G SEC. v. Fuqua Inv. Co., 466 F.Supp. 1114, 1125 (D. Mass 1978), quoting Cattlemen's Inv. Co. v. Fears, 343 F. Supp. 1248, 1251 (W.D. Okla. 1972).

58. *See The Developing Meaning of "Tender Offer," supra* note 19, at 1258 n.49.

59. *Id.* at 1253.

> It must be presumed, therefore, that Congress was not interested in relieving pressure on security holders in all situations where it exists, but only in those situations primarily thought to represent potential takeover situations, with such situations to be isolated through the operation of the 5% condition in section 14(d)(1) and the 2% and issuer exemptions in section 14(d)(8).

Id. at 1277–78. Some commentators dispute the importance of the role acquiring control plays in the definition of tender offer. "Since it is possible to make a tender offer for less than five percent of a target's securities and since such an amount does not approach a controlling interest, the statutory language implies that the attempt to acquire control is not an element in the term's definition." *See* Smith, *supra* note 49, at 197.

reflects this Congressional focus by authorizing the SEC to enact rules or regulations that exempt all tender offers "not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purpose of this subsection" from the provisions of § 14(d)(1).[60] By definition, mini-tender offers cannot be used to bring about a change in control.[61] Thus mini-tender offers, and all other tender offers not designed to bring about a change in control, arguably are beyond the conceptual scope of § 14(d)(2)–(8).[62]

Judicial interpretation of the term tender offer also supports the conclusion that mini-tender offers are not tender offers for purposes of the Williams Act. Mini-tender offers are not tender offers under the *S-G Securities* test. The first prong of the test, which requires a publicly announced intention to acquire a substantial block of stock for the purpose of acquiring control, is clearly not satisfied.[63] While mini-tender offers do involve a publicly announced intention to buy stock, the amount of stock sought, by definition, can be no more than 5%, which is insufficient to acquire control. The second prong of the test requiring a subsequent rapid acquisition of large blocks of stock is not satisfied either, since mini-tender offer announcements are followed by acquisition of up to 5% of a

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60. 15 U.S.C. § 78n(d)(8)(C).

61. However, "the mini-tender affords the bidder an opportunity to amass a block of securities which can put the bidder in a position to influence governance or position the bidder to solicit other holders to pursue a desired course of action." *See* Berick, *supra* note 3.

62. The 5% threshold in § 14(d)(1) is arguably Congress' estimation of a material amount sufficient to raise concerns about takeovers:

> Not all tender offers were made subject to section 14(d)(1)'s disclosure requirement, apparently because Congress' principal concern was to assure the shareholder substantial, timely disclosure in situations where tender offers were potentially being used to gain control . . . .The 5% ownership level necessary to trigger section 14(d)(1), and the limitation of the section's applicability to equity securities, while not establishing takeover intent with absolute certainty, together serve as a generally reliable, objective indicator of a potential takeover situation.

See The Developing Meaning of "Tender Offer," supra note 19, at 1256–57. The threshold triggering the disclosure requirements of § 14(d)(1) was initially set at 10%, and was lowered to 5% by the Securities Act Amendments of 1970. 15 U.S.C. § 78n(h)(1)(A)(ii). The decrease was undertaken to "provide public disclosure of impending corporate takeovers at a more meaningful level." *See Investor Protection in Corporate Takeovers*, H.R. REP. NO. 91-1655; S. REP. 3431 (Dec. 2, 1970). After the enactment of § 14(d), the SEC reported to the Committee on Interstate and Foreign Commerce that some acquirors were limiting their open market purchases to less than 10%, presumably in an effort to avoid the disclosure requirements. *Id.* The Committee believed that this practice was depriving investors of material information necessary to enable offerees to decide whether to tender, and indicated that "an investment between 5 and 10 percent of the securities of a company can have significant impact on the public market for that company's stock. These acquisitions may lead to important changes in management or business of the company and the shareholders should be fully informed." *Id.* Congress could have removed the threshold entirely, and chose not to.

63. S-G Sec. v. Fuqua Inv. Co., 466 F. Supp. 1114, 1114 (D. Mass. 1978).

class of stock; these offers arguably do not constitute the purchase of large blocks of stock.[64]

Under the *Wellman* test, the status of mini-tender offers is unclear. The typical mini-tender offer satisfies half of the *Wellman* factors.[65] The first factor is satisfied by mini-tender offers made through DTC, creating an "active and widespread solicitation." The fourth factor is satisfied since the terms of mini-tender offers typically are fixed and not flexible. The sixth factor is satisfied since mini-tender offers generally are open for a limited time. And the seventh factor is satisfied since mini-tender offers put on offerees the identical pressure from which the Williams Act was designed to, and does, protect offerees in traditional tender offers.

Mini-tender offers do not satisfy the remaining *Wellman* factors. The second factor is not satisfied, as mini-tender offers are solicitations for up to 5% of a class of securities, not "a substantial percentage." The third factor is not satisfied since mini-tender offers typically are made at a discount, rather than at a premium, to market price. The fifth factor is not satisfied since the purpose of a mini-tender offer is not to gain control, so in the typical mini-tender offer, there is no minimum number of shares sought as is common with traditional tender offers.[66] The final factor is not satisfied since the mini-tender offer will not result in the bidder acquiring a substantial amount of shares.

The *Wellman* test is not dispositive on the status of mini-tender offers under the Williams Act, since all the factors do not need to be present, and do not need to be afforded equal weight. A court might weight heavily the lack of solicitation for a substantial percentage of stock, and find that a mini-tender offer does not constitute a tender offer under the Williams Act.[67] A different court, on the same facts, might be persuaded that the pressures imposed on security holders in a given mini-tender offer necessitates a finding that the mini-tender offer is a tender offer under the Williams Act. As no mini-tender offer litigation has explored this question yet, it is unclear what conclusion a court would draw on the facts of the typical mini-tender offer.

The determination that mini-tender offers are not tender offers for purposes of § 14(d)(1) has a number of ramifications. Security holders who tender in a mini-tender offer are not entitled to the specific disclosures mandated in §

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64. *Id.* However, one commentator argues that a court could justifiably conclude that a mini-tender for blocks of stock up to 4.9% of a class constituted a tender offer since those blocks may be "large" if the transaction is viewed in light of the totality of the circumstances. *See* Hirschhorn, *supra* note 28, at 647. This seems unlikely, and even if this were so, because of the failure of the first prong of the test focusing on the acquisition block of stock for the purpose of acquiring control, this argument is less than compelling.

65. *See supra* note 52 and accompanying text for a list of *Wellman* factors.

66. *See* Hirschhorn, *supra* note 28, at 646.

67. One court applying the *Wellman* test indicated that while soliciting for a substantial percentage of the issuer's stock was a necessary element of a tender offer, it was not dispositive on the issue. "Since Congress enacted the Williams Act to permit informed investor decisionmaking in the face of potential shifts in corporate control, there would be no tender offer where a substantial portion of the issuer's shares was not involved." Hoover Co. v. Fuqua Indus., 1979 U.S. Dist. LEXIS 11809, at *11 (N.D. Ohio June 11, 1979).

14(d)(1), or the protections of Regulation 14D. As a result, the benefit from the requirement of Rule 14e-1(a) mandating that all tender offers be kept open for a minimum of twenty business days is diluted; in the absence of withdrawal rights, the length of the offer is of limited utility.[68] Further, since tender offerors that are not subject to § 14(d) and Regulation 14D are not legally required to send their offer to the target, the target may not even know about the tender offer.[69]

A determination that mini-tender offers are not tender offers for purposes of § 14(d)(2)–(8) would have dramatic ramifications. If mini-tender offers are not tender offers for purposes of § 14(d)(2)–(8), then mini-tender offers are not subject to § 14(e) and Regulation 14E. Even the flexibility intentionally created by leaving the term "tender offer" undefined cannot justify two different definitions of the same term, one for § 14(d) and another for § 14(e). A conclusion that mini-tender offers are not tender offers under the Williams Act would obviate the need for the SEC's interpretative release setting out the suggested disclosures to avoid violating § 14(e), and would undermine the regulatory justification for the SEC's enforcement actions against mini-tender offerors under § 14(e).[70]

III. REGULATORY RESPONSE TO MINI-TENDER OFFERS

The SEC, as well as various industry groups, has weighed in on the regulation of mini-tender offers.[71] The SEC's primary concern is with the risk to

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68. Herlihy & Norwitz, *A New Takeover Abuse, supra* note 3, at 20–21.

69. Mini-Tender Offer Release, *supra* note 2, at 2247.

70. *See id*. *See also* Part III *infra* for a discussion of the Mini-Tender Offer Release.

71. The New York Stock Exchange ("NYSE") advised its member organizations to review mini-tender offer materials before disseminating them to customers:

> Recently, there have been a number of tender offers for shares at below market prices. The Exchange believes that, given the relationship between member organizations and their customers, it would be prudent for member organizations to conduct a review of such tender offer materials before dissemination to customers. Member organizations could thereby determine whether it is appropriate and in the best interest of their customers to tender shares at a price below the current market price of such shares.

NYSE Information Memo No. 99-11, Feb. 23, 1999. The SEC supports this position. *See* Part IIIB *infra* for a discussion of the SEC's letter to the Securities Industry Association.

The Securities Industry Association ("SIA") was concerned that investors might believe incorrectly that they had to accept the below market offer, or that their broker-dealer was endorsing or recommending the mini-tender by virtue of having sent it to them. The SIA suggested that the SEC consider adopting a rule requiring mini-tender offerors to disclose in plain English and in large size type: the offering price; whether the offer is at, below or above current market prices; any marketplace events that may have caused an unusual fluctuation in the market price of the securities; that an offer well below market price would be a poor investment decision in most cases; and that investors are under no obligation to tender their shares. *See SIA Letter to SEC,* dated Mar. 15, 1999. To date, the SEC has declined to do so.

The National Association of Securities Dealers ("NASD") has no rule requiring members to forward tender offer information to their customers. Yet some members do investors from insufficient disclosure in mini-tender offers.[72] The SEC has mounted a two-prong approach to end what it perceives as abuses in mini-tender

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forward such information, without regard to the merits of the offer. To deal with security holders who tender in error or from a lack of knowledge about the effect of an offer, the NASD sent a memo to its members, suggesting that those who do forward tender offer materials consider including certain disclosures. For members who have not reviewed the transmitted offer, the suggested disclosure is that forwarding the offer is not an endorsement of the offer. For members who have reviewed the transmitted offer, the suggested disclosures included whether the member is endorsing the offer and whether the member is providing other information to assist the customer in deciding on the offer. The NASD suggests that in any case, members should disclose that the customer is not required to accept the offer. *See NASD Notice to Members 99-53, NASD Regulation Offers Guidance to Members Forwarding Mini Tender Offers to their Customers* (1999).

The National Securities Clearing House Corporation ("NSCC") filed a proposed rule change with the SEC to permit it to process securities that were the subject of mini-tenders through its continuous net settlement system ("CNS"). The securities involved were McDonalds Corp., USX-Marathon GR., and Blackrock Inc. *See* SEC Release *Self-Regulatory Organizations: National Securities Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Related to Certain Mini-Tender Offers*, Release No. 34-42873, 2000 SEC LEXIS 1114, at *2 (May 31, 2000). *See also* 65 FR 36205 (June 7, 2000).

The Commission found the proposed rule change consistent with the requirements of the 1934 Act. "Allowing these securities which are subject to mini-tender offers to continue to be processed in the CNS system should help ensure the securities will be promptly and accurately cleared and settled." SEC Release, 2000 SEC LEXIS, at *2.

72. According to the SEC website:

> "Mini-tender" offers are tender offers for less than five percent of a company's stock. The people behind these offers—also known as "bidders"—frequently use mini-tender offers to catch shareholders off guard. They count on investors jumping to the conclusion that the price offered includes the premium usually present in larger, traditional tender offers. But with mini-tender offers, the price offered may actually be *below* the market price.
>
> Bidders in mini-tender offers usually limit the offer to under five percent so that they do not have to comply with many of the investor protections that are in place for larger tender offers. For instance, shareholders in mini-tender offers don't receive documents that describe the tender offer in detail.
>
> Investors who surrender their shares without fully investigating the offer may be shocked to learn that they cannot change their minds and withdraw. In the meantime, they've lost control over their securities and may end up selling at below-market prices.

Mini-Tender Offers, *at* http://www.sec.gov/answers/miniten.htm (last visited Dec. 25, 2002).

The SEC posted on its website "Mini-Tender Offers: Tips for Investors" to highlight potential problems with mini-tender offers and to provide steps for investors to take when asked to tender their shares in a mini-tender offer. These steps include:

- Find out whether the tender offer is a mini-tender offer
- Get a copy of the offering document
- Determine whether the bidder has adequate financing
- Identify the current market price for your securities
- Find out the "final" tender offer price after all deductions are taken

offers by putting pressure on two constituent groups it hopes to influence: mini-tender offerors and the broker-dealers who process the mini-tender offers. Both groups arguably have a vested interest in keeping the SEC happy on the issue of mini-tender offers, to smooth over future interactions on other issues. Yet even under this two-pronged approach, the SEC can only make recommendations, and then bring enforcement actions on a case-by-case basis for any perceived failures to take such recommendations to heart, that result in violations of § 14(e). The availability of these enforcement actions presupposes that mini-tenders are tender offers for purposes of § 14(e). A judicial determination to the contrary would eliminate the limited power of the SEC to bring *ex post facto* enforcement actions against mini-tender offerors.

A. SEC Pressure on Mini-Tender Offerors

The first prong of the SEC's approach to curbing abuses in the mini-tender offer process is evidenced by its July, 2000 interpretive release *Commission Guidance on Mini-Tender Offers and Limited Partnership Tender Offers* (the "Release").[73] The SEC hoped that the Release would help bidders comply with their legal obligations, including those arising under the anti-fraud provisions.[74] To put some teeth in its "recommendations," the SEC has brought a handful of enforcement actions for alleged violations of § 14(e).[75] The SEC's primary concerns about mini-tender offers center on inadequate disclosure to security holders, insufficient dissemination of such disclosure, and late payment for tendered shares.[76]

With respect to the quality of disclosure in mini-tender offers, the SEC has acknowledged that the disclosure provisions of § 14(d)(1) and Regulation 14D are not applicable to mini-tender offers.[77] Nonetheless, the SEC has expressed concern over the quality of the (admittedly voluntary) disclosure made in the

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- Ask when you'll be paid for the shares you tender
- Consult with your broker or other financial advisor
- If you want to sell your shares, determine where you can get your best price
- Remember that once you agree to a mini-tender offer, you are probably locked in

The publication contains contact information for the SEC's Office of Investor Education and Assistance, and contains a link to submit a complaint to the SEC. *See Mini-Tender Offers: Tips for Investors, at* http://www.sec.gov/investor/pubs/minitend.htm (last visited Dec. 25, 2002).

73. Mini-Tender Offer Release*, supra* note 2.

74. *Id.* at 2245. The Release contains a discussion of the application of the tender offer rules to tenders for limited partnership interests that is beyond the scope of this Article. The suggested disclosures focus on offer price and price changes, withdrawal rights, pro rata acceptances, target recommendations, identity of the bidder, ability to finance offer, conditions to the offer, and extensions of the offer. *Id.*

75. *See* Part IIIA-2 *infra* for a discussion of these enforcement actions.

76. Mini-Tender Offer Release, *supra* note 2, at 2250.

77. *Id.* at 2247.

typical mini-tender offer, in two primary areas: offering price and offeror financing.[78]

Mini-tender offerors typically fail to disclose that certain fees or expenses will be deducted from the offer price.[79] This lack of disclosure can make it difficult for security holders to determine the actual price they would receive, and whether that price is below market.[80] Mini-tender offerors also typically fail to disclose whether the offer price is below the market price.[81] This may be misleading to security holders, since third party tender offers have historically been made at a premium over the market price.[82] But just because an offer is characterized as a "tender offer" does not mean that the price is at a premium to the market. While there are securities that trade so infrequently that it can be hard to ascertain the market price, the market price of publicly-traded securities is available, and investors should educate themselves before tendering.[83] Admittedly, offerees have varying levels of sophistication. Yet the SEC makes no distinction between sophisticated and unsophisticated investors in describing the need to protect investors from the dangers of below-market offers. Pushing the limits of credulity, the Ontario Teachers' Pension Plan Board (the "Board"), a Canadian $59.1 billion pension plan, brought suit against IG Holdings, Inc. ("Holdings"), alleging among other things, fraud in connection with Holdings' January 1999 mini-tender offer for up to 2% of Trizec Hahn Corp. debentures.[84] The Board claimed that Holdings failed to disclose that the offer price was below market.[85] In truth, the offering materials disclosed that the purchase price might not represent fair market value.[86] Apparently, the use of the term "tender offer" by Holdings was misleading to the Board, and the Board claimed Holdings "exploited the conventional understanding that tender offers are made at a premium to the market."[87] The Board further argued that Holdings failed to disclose a trading history for the bonds in an effort

78. *Id.* at 2247–52.

79.

> These fees often are disclosed only in the fine print in the documents that the security holders send back to the bidder to accept the offer, but not in the disclosure document itself. We believe that these disclosure practices may, under certain circumstances, be "fraudulent, deceptive or manipulative practices" within the meaning of Section 14(e).

Id. at 2248.

80. *Id.*

81. Most of these mini-tenders are done via summary letter to securityholders, usually a page or two in length, setting out the principal offer terms. Almost no information is provided about the identity and background of the bidder, the value of the underlying partnership assets, the bidder's calculations underlying the offer price, any appraisals or valuations the bidder got, the bidder's purpose in making the tender, bidder's plans about the partnership, soliciting arrangements, financial data on the bidder, or risks associated with the offer. Herlihy & Norwitz, *A New Takeover Abuse, supra* note 3, at 20.

82. Mini-Tender Offer Release, *supra* note 2, at 2248.

83. *See* Berick, *supra* note 3, at 2.

84. *See* Ont. Teachers' Pension Plan Bd. v. IG Holdings, Inc., 2000 LEXIS 12591 (S.D.N.Y. Aug. 31, 2000).

85. *Id.* at *6.

86. *Id.* at *14.

87. *Id.* at *10.

to obscure the fact that the offer was at a discount to the market price.[88] The District Court dismissed the complaint, finding that the Board could have educated itself as to the market value and trading history of these publicly-traded bonds.[89] The Court's decision illustrates that in the case of publicly traded stock, it is unnecessary and inappropriate for the securities laws to protect security holders who fail to do the minimal investigation of ascertaining the market price of their securities.

In the Release, the SEC reveals that it considers both the failure to disclose deductions from the final offer price, and the failure to disclose if the offer price is below market, to constitute violations of § 14(e).[90] The SEC's paternalistic approach is misguided. The SEC is authorized under § 14(e) to promulgate rules to further the purpose of the statute.[91] It did so, promulgating Regulation 14E, which it claims is binding on mini-tender offers.[92] To date, the SEC has not promulgated any regulations dealing with mini-tenders specifically. Accordingly, while the Release is a good indication of what the SEC considers "fraudulent, deceptive and manipulative practices" for purposes of § 14(e), it lacks the force of law. The language of the Release itself demonstrates that it is not binding law, but rather interpretative guidance. The Release is intended to "help bidders, subject companies, and others participating in tender offers meet their obligations under the applicable statutes and rules, including the antifraud provisions."[93] In general, SEC releases are recommendations of how parties can fulfill their obligations under the securities laws, and serve as an indication of the direction the SEC is headed on the issues in the release.[94] Currently, there is no binding law in § 14(e) or Regulation 14E that delineates what disclosures are sufficient thereunder.

Mini-tender offerors also typically fail to disclose whether, at the commencement of the offer, they have adequate financing to purchase the shares sought.[95] A mini-tender offer made without adequate financing likely violates Rule 14e-8(c) which prohibits a person from publicly announcing a tender offer if that person "[d]oes not have the reasonable belief that the person will have the means to purchase the securities to complete the offer."[96] A bidder without adequate financing could keep the mini-tender offer open until the market price rises above the offer price.[97] Since the SEC's view is that those who tender in a mini-tender

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88. *Id.* at *6.

89. *Id.* at *12.

90. In 2000, the SEC brought an enforcement action under this fact pattern. *See* In the Matter of City Inv. Group, LLC, 2000 SEC LEXIS 1206 (June 12, 2000).

91. 15 U.S.C. § 78n(e) (2003).

92. *See* Mini-Tender Offer Release, *supra* note 2, at 2246.

93. *Id.* at 2245.

94. *Ont. Teachers' Pension Plan Bd.*, 2000 U.S. Dist. LEXIS, at *19–20.

95. Mini-Tender Offer Release, *supra* note 2, at 2250.

96. 17 C.F.R. § 240.14e-8(c) (2003).

97.

> Some bidders have devised schemes to confuse security holders about the actual offer price. For example, we have seen situations where a bidder makes an offer at a price above market but never intends to purchase the shares in the offer at a premium. In these cases, the bidder holds the shares tendered and continuously extends the offer until the

offer are not entitled by law to withdrawal rights under § 14(d)(6), the bidder essentially has a free option on the tendered shares.[98]

The SEC's second area of concern is the actual dissemination of sufficient disclosure to security holders in mini-tender offers.[99] Until the Release, mini-tender offerors had no way of determining what methods of dissemination would pass muster with the SEC, unless and until they were informed of an enforcement action. Mini-tender offerors typically send their offers by providing DTC with the offering documents, relying on DTC to disseminate the offer to the relevant security holders through its participant broker-dealers and banks.[100] DTC forwards an electronic notice to its participant broker-dealers and banks, but these entities do not always request copies of the offering documents.[101] Even if they do, they do not always pass along the full offering materials to the security holders; the information the broker-dealers and banks send is often limited to the notice of the mini-tender offer, the expiration date of the offer, and, in some cases, the price.[102]

The SEC considers this an inadequate approach to dissemination, in violation of § 14(e).[103] Rule 14e-1(a) requires all tender offers to be held open for twenty business days from the date the tender offer is first "published or sent to security holders."[104] But neither § 14(e) nor Rule 14E provide any guidance on how tender offers should be "published or sent to security holders." The SEC recommends that mini-tender offerors follow the guidance of Rule 14d-4 in disseminating their offers, although the Rule, by its terms, is inapplicable to mini-tender offers.[105] According to the SEC, the purpose of Rule 14d-4 is to "add content and clarity to the term 'published or sent or given' in § 14(d)(1)."[106] The rule provides three non-exclusive, voluntary methods of dissemination for cash

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> market price rises above the offer price. During this time, security holders generally are not permitted to withdraw their securities from the offer. Then the bidder purchases the shares at the offer price. In these situations, the bidder does not disclose this plan to security holders. We believe these practices are "fraudulent, deceptive or manipulative practices" within the meaning of Section 14(e), and we recently brought an enforcement action to stop such practices.

Mini-Tender Offer Release, *supra* note 2, at 2248. The SEC's position is that security holders in a mini-tender offer are not entitled to withdrawal rights under § 14(d), so once they tender, they are locked in and cannot take advantage of any new information or opportunities to tender outside the tender offer, or at a higher price. *Id.* at 2248.

98. *See* Herlihy & Norwitz, *SEC Provides Mini-Tender Guidelines, supra* note 3.

99. The SEC comes back to this concern in its efforts to compel broker-dealers to improve the quality of their disclosure in mini-tender offers. *See infra* Part IIIB for a discussion of the SIA Letter.

100. Mini-Tender Offer Release*, supra* note 2, at 2248.

101. *Id.*

102. *Id*.

103. *Id.* at 2251.

104. 17 C.F.R. § 240.14e-1(a) (2003).

105. All of Regulation 14D is solely applicable to tender offers subject to § 14(d)(1). *See* 17 C.F.R. § 240.14d (2003).

106. Mini-Tender Offer Release*, supra* note 2, at 2250.

tender offers.[107] The application of Rule 14d-4 to mini-tender offers, in addition to lacking statutory support, poses a logistical complication in that mini-tender offerors are not entitled to a stockholder list under Rule 14d-5.[108] Thus, mini-tender offerors without a stockholder list must publish an advertisement in a newspaper of national circulation. This may prove cost-prohibitive in light of the small number of securities involved in the typical mini-tender offer, a result that would not likely trouble the SEC.[109]

The SEC's third area of concern is delayed payment to mini-tender offerees in violation of Rule 14e-1(c). Bidders often wait as long as 30 days after the expiration of the offer to pay for the tendered shares.[110] By this time the market price may well exceed the offer price, allowing the bidder to pay the seller, and then immediately resell at a profit.[111] Rule 14e-1(c) requires payment or the return of the securities "promptly" after the termination or withdrawal of the tender offer.[112] However, the term "promptly" is not defined in the Williams Act, clouding the applicability of this payment provision and leaving a determination of what constitutes "prompt" to be made from the practices of the financial community, including current settlement practices.[113] In the Release, the SEC describes payment within three business days of the transaction as "prompt" for purposes of Rule 14e-1(c).[114] Although the Release lacks the force of law, as a practical matter, bidders who exceed this time period do so at their peril.

In addition to the interpretative release, the SEC has also used its administrative powers to bring enforcement actions against mini-tender offerors for alleged violations of § 14(e).[115] A judicial determination that mini-tender offers are not tender offers under the Williams Act would remove any statutory support for the SEC's enforcement efforts. Since no such determination has been made to date, a description of the SEC's enforcement actions against mini-tender offerors follows, to highlight the SEC's desire to curb the abuses it perceives in mini-tender offers by finding violations of § 14(e) for conduct prohibited in the non-binding Release.

1. IG Holdings Inc.[116]

The first proceeding instituted by the SEC against a mini-tender offeror was the August, 1999 enforcement action against IG Holding, Inc.[117] The suit

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107. The dissemination methods are: (1) publishing the offering documents in a newspaper; (2) publishing a summary advertisement in a newspaper, and mailing a copy of the full offering document to security holders upon request; (3) mailing the offering document to security holders using a security holder list. *See* 17 C.F.R. § 240.14d-4.

108. Stephen I. Glover & James J. Moloney, *SEC Provides Guidance on Mini-Tender Offers and Limited Partnership Tender Offers*, 4 N.5 M&A LAW. 1, 4 (Sept. 2000).

109. *Id.* at 6.

110. Mini-Tender Offer Release*, supra* note 2, at 2251.

111. *Id.* at 2248.

112. *See* 17 C.F.R. § 240.14e-1(c) (2003).

113. Mini-Tender Offer Release*, supra* note 2, at 2251.

114. *Id.*

115. *Id.* at 2247.

116. In the Matter of IG Holdings, Inc., 1999 SEC LEXIS 1649 (Aug. 19, 1999).

highlighted the SEC's concern that investors targeted for mini-tender offers typically receive insufficient disclosure.[118] The defendant, IG Holdings, Inc. ("Holdings"), an Arizona corporation engaged in the business of investing in securities, made over 200 mini-tender offers (mostly for 2% of a particular issuer's outstanding stock) between June 1998 and August 1999.[119] Holdings would provide an information services firm with the names of target companies, the size of the offers, the offering price, and the beginning and ending dates for the tender offers.[120] The information services firm would then prepare a one or two page offering document with that information, plus instructions on how to tender, and would then forward the document to DTC.[121] If DTC found it could process a particular offer through its facilities, it would announce the offer to its participant banks and broker-dealers through an electronic announcement system.[122] The banks and broker-dealers in turn sent the information on to their clients.[123] Thus, Holdings used DTC's electronic broadcast system to distribute their mini-tender offers to thousands of security holders at only a nominal cost to itself.[124]

The SEC determined that Holdings violated § 14(e) for failing to sufficiently monitor the means used to disseminate its below-market mini-tender offers.[125] As a result, security holders did not receive material information about

117. On the same day it issued the order in *IG Holdings, Inc*., the SEC issued a second order against a mini-tender offeror based on a literal violation of § 14(d). In the Matter of Peachtree Partners, 1999 SEC LEXIS 1650 (File No. 3-9980) (Aug. 19, 1999), at *2. The defendant, Peachtree Partners, a general partnership in Arizona, was engaged in the business of investing in securities, primarily through making tender offers. *Id.* at *1. On July 5, 1998, Peachtree made a mini-tender to purchase 4.9% of the outstanding limited partnership interests of Shearson Murray Realty Fund. At the time of the mini-tender, Peachtree already owned approximately 1% of these securities as a result of another mini-tender in February, 1998. This pushed its ownership over 5%, triggering the filing, disclosure, and procedural requirements of § 14(d) and Regulation 14D. *Id.* at *3. The SEC determined that Peachtree Partners violated § 14(d) and Regulation 14D. In anticipation of the institution of administrative proceedings by the SEC, Peachtree Partners submitted, and the SEC accepted, an Offer of Settlement under which it consented to a cease and desist order, without admitting or denying the findings of the SEC. *See* Offer of Settlement of Peachtree Partners, July 15, 1999 (File No. 3-9981) [on file with the Author]. Since the case deals only with a technical violation of § 14(d), and not disclosure or investor protection issues, further discussion herein is not called for, except to note that Peachtree Partners is affiliated with Ira J. Gaines, who ran Holdings. *See IG Holdings Settles* '*Mini-Tender*' *Case, SEC Says,* BLOOMBERG NEWS, Aug. 19, 1999. *See also infra* note 111.

118. *See SEC Sues IG Holdings, Inc. in First Ever "Mini-Tender Offer" Case; Warns Investors to Carefully Scrutinize Offers to Buy Their Stock*, *available at* http://www.sec.gov/ news/ press/ pressarchive/1999/99-101.txt (Aug. 19, 1999).

119. *In the Matter of IG Holdings, Inc*., 1999 SEC LEXIS, at *3.

120. *Id*.

121. *Id.*

122. *Id.* at *4.

123. Flint, *supra* note 3.

124. DTC has since instituted a $2700 processing fee for mini-tender offers. *Id. See also* Mike Barry, *SEC Approves DTC*'*s Policy on Mini-Tender Offers* (Dec./Jan. 2001–02), *available at* http://www.dtcc.com/Publications/dtcc/jan01/minitender.html.

125. *In the Matter of IG Holdings, Inc.,* 1999 SEC LEXIS, at *3.

the offers.[126] The missing information included the calculation of the final purchase price,[127] and disclosure that the offering price might not reflect the market price.[128] Also, security holders were not informed in every mini-tender offer that although they could not withdraw their tenders, Holdings could revoke its offer at any time prior to completion.[129] All three of these omitted disclosures later appear in the Release as required to avoid violating § 14(e). It is unclear how Holdings was supposed to know of these "recommended" disclosures, short of seeking a no-action letter for a transaction arguably beyond the scope of the tender offer rules. Yet the SEC successfully obtained an Offer of Settlement under which Holdings consented to a cease and desist order without admitting or denying findings of the SEC.[130] The SEC hoped that its first enforcement action in the mini-tender arena would serve as a warning to investors to monitor their investments carefully.[131] As the settlement is only binding on Holdings, and has no precedential effect on other mini-tender offerors, the SEC presumably hoped that there would be an *in terrorem* effect from its first enforcement action in this arena.[132]

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126. *Id*.

127. Holdings' offering prices were typically reduced by dividends or other payments made to shareholders by the targets. Holdings' offering materials did disclose that the offering price would be reduced by these payments, but failed to disclose the calculation of the revised final offering price. *Id.* at *n. 4.

128. There is no requirement that tender offers be made at a premium to the market price. But registered third-party tender offers are typically offered at some premium to the prevailing market price. *Id.* at *3.

129. *Id.* at *5.

130. *Id.* at *1.

131. *SEC Sues IG Holdings, Inc. in First Ever "Mini-Tender Offer" Case, supra* note 118 (quoting SEC Director of Enforcement Richard H. Walker).

132. *See Offer of Settlement of IG Holdings,* July 15, 1999 (File No. 3-9980) [on file with the Author]. Even that result has proved hard to achieve. At first it seemed that Holdings had learned the lesson from the 1999 enforcement action. In a mini-tender offer for Trizec Hahn debentures, Holdings did inform bondholders that they could not withdraw their tenders. Further, Holdings described the final calculation of the offer price, and that the offering price might not reflect the market price. *See* Ont. Teachers' Pension Plan Bd. v. IG Holdings, Inc., 2000 U.S. Dist. LEXIS 12591, at *22 (Aug. 31, 2000). Yet the SEC recently filed a complaint against Ira G. Gaines, the principal in Holdings, for much the same conduct. According to the complaint, from September 1999 through March 2001, Gaines, through two partnerships, made fraudulent mini-tender offers to buy up to 1% of the outstanding stock of 287 public companies. *See* SEC v. Ira Gaines, 2002 LEXIS 2242 (D. Ariz. 2002). The SEC alleges that Gaines mislead security holders by implying falsely that he had sufficient funds to accomplish the tenders, failing to disclose his offer price was below the market price, and failing to disclose that he retained the sole right to modify the offers, including the price and offer period, and that he could terminate the offers without notice at any time. *Id.* As a result of his insufficient disclosure, Gaines was able to extend offer periods to capitalize on price rises in the targeted stock, and to reduce his offer price or terminate the offer if the stock was in a declining trend, enriching himself by approximately $275,000. *Id.* The SEC used the Holdings cease and desist order to demonstrate that Gaines knew or was reckless in not knowing that security holders were not receiving this material information. *Id.*

2. In the Matter of City Investment Group, LLC[133]

In June, 2000, the SEC brought an action against CIG, John Barris, and Tigran Papazian after they made a mini-tender offer for up to 2% of the outstanding shares of Tellabs, Inc.[134] The SEC found that respondents violated § 14(e) by, among other things, failing to disclose that CIG did not have the financial ability to complete the tender offer, that the offer was contingent on financing, and that the offer would be cancelled if the market price did not exceed the offering price at the conclusion of the offer.[135]

During the offer, Tellabs security holders tendered approximately 1.2 million shares, which, based on the offering price, totaled about $75 million.[136] CIG had assets of less than $10,000 and thus could not pay for the tendered shares.[137] Respondents did not seriously seek financing until after the market price was substantially higher than the offering price.[138] Respondents terminated the offer on November 19, 1999 without buying any shares from Tellabs security holders.[139] The SEC found respondents violated § 14(e) because the missing information about their finances was material, since a reasonable investor would consider it to be important in deciding whether to tender.[140] Respondents consented to a cease and desist order, without admitting or denying findings of the SEC.[141] Again, the SEC was successful in an enforcement action for conduct not specifically prohibited by the Williams Act.

3. SEC v. Leach[142]

In November, 2000, the SEC brought an enforcement action against Jeffrey and Hubert Leach, alleging that the Leaches made fraudulent mini-tender offers through two shell companies Jeffrey Leach controlled: Carnegie Investment

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133. In the Matter of City Inv. Group, LLC, 2000 SEC LEXIS 1206 (June 12, 2000).

134. On October 1, 1999, CIG tendered for up to 2% of Tellabs outstanding shares, offering $62.50 per share, which was a 12% premium over the closing price of $55.875 on that date. The offering documents provided that tendering security holders would be paid "in cash promptly at the close of the offer" but failed to include the material information that CIG did not have the financial ability to complete the tender offer, and that the offer was contingent on financing, and that the offer would be cancelled if the market price did not exceed the offering price when the offer concluded. *Id.* at *3.

135. *Id.* at *2.

136. *Id.* at *3.

137. *Id.* at *4.

138. *Id* .

139. *Id.* at *3.

140. *Id.*

141. *Id.* at *5. *See also Offers of Settlement of City Investment Group, LLC, Tigran Papazian, and John Barris* (File No. 3-10222) [on file with the Author].

142. SEC v. Leach, Litigation Release No. 16807, *available at* http://www.sec. gov/ litigation/litreleases/ lr16807.htm (last visited Dec. 25, 2002).

Management and LMC Assets.[143] The mini-tender offers were for shares of Fleming Companies, Inc., Fruit of the Loom, Ltd., and Mattel, Inc.[144]

The SEC alleged violations of § 14(e) and Rule 14e-1, stating that the offering documents contained material omissions and false statements about the offerors' intent in making the mini-tender offer, and their ability to pay for the tendered shares.[145] The Leach brothers borrowed $10 million against the value of the stock they had not yet paid for, and used the money for day trading, in which they apparently lacked expertise.[146] Thus, since defendants structured the offers without an escrow agent, they gained control of the shares before paying for them, the equivalent of an unsecured loan and call option on the tendered shares. No further information is publicly available about the status of this enforcement action, beyond the complaint filed on Nov. 21, 2000.

4. SEC v. Genesis Leasing IX, Inc. et al[147]

In January, 2002, the SEC sought, and was granted, a temporary restraining order followed by a preliminary injunction and other relief against individual defendants Hoffman, Klinger, and Paonessa. These defendants controlled and caused the corporate defendants to make at least twenty-one fraudulent mini-tender offers for the securities of five publicly-traded corporations.[148] The mini-tender offers were each accomplished through a three-page offering circular in which the offering price was on the first page, in bold typeface, with the myriad deductions therefrom in very small, closely-spaced print on the second page.[149] Because of the deductions, the defendants were able to pay, in the aggregate, $2 million less than the market price of the tendered shares.[150] The court enjoined the defendants from further violations of § 14(e), froze the defendants' assets, and permitted any investor who tendered in one of the mini-tender offers at issue to rescind its tender.[151] No further information is publicly available about the status of this enforcement action, beyond the SEC releases detailing the enforcement actions dated January 11, and 23, 2003.

These few enforcement actions have not been terribly effective in curtailing the conduct described in the Release. Mini-tender offerors are not required to file offering documents with the SEC before making the offer. In addition, since mini-tender offers are made for less than 5% of a class of securities,

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143. *See* Complaint, SEC v. Jeffrey L. Leach, Hubert A. Leach, and LMC Assets Corp., Litigation Release No. 16807, 73 S.E.C. Docket 233 (Civil Action No. 00 CV 5928, E.D. Pa. Nov. 21, 2000).

144. *See Leach, supra* note 142, at 2.

145. *Id.*

146. Floyd Norris, *Wall Street Slept as Investors Were Fleeced of Millions,* N.Y. TIMES, May 12, 2000, at C1.

147. SEC v. Genesis Leasing IX, Inc. et al, 2002 SEC LEXIS 60 (Jan. 11, 2002); SEC Litig. Release No. 17332 (Jan. 23, 2002).

148. SEC v. Genesis Leasing IX, Inc. et al, 2002 SEC LEXIS 60 (Jan. 11, 2002).

149. *Id.*

150. SEC Litig. Release No. 17332 (Jan. 23, 2002).

151. *Id.*

the dollar amount and small number of investors may not justify applying significant resources to policing efforts.[152] The actions also lack precedential authority. In one case, the enforcement action had so little impact on a mini-tender offeror found to have violated § 14(e) that the SEC had to bring a second enforcement action against him, three years later for much the same conduct.[153] The enforcement actions are useful, however, as illustrations of the SEC's position on mini-tender offers, and its willingness to push the limits of its regulatory authority to achieve its desired result.

B. SEC Pressure on Broker-Dealers

The second prong of the SEC's approach to curbing the abuses it perceives in the mini-tender offer process focuses on broker-dealers. The SEC's Office of Investor Education and Assistance issued a letter to the Securities Industry Association (the "SIA Letter") resulting from a series of discussions between the SEC and the SIA about the role of broker-dealers in mini-tender offers.[154] The SIA Letter contains "recommendations of suggested disclosures for broker-dealers disseminating mini-tender offer information."[155]

The SEC also urges broker-dealers who elect to disseminate mini-tender offer materials to their customers to inform their customers of potentially problematic bidder practices, in essence suggesting the addition of "risk factor" disclosure in mini-tender offers.[156] This risk factor focuses on the bidder conduct that the SEC finds particularly irksome, including inadequate dissemination, inadequate disclosure of price, price changes attributable to transfer fees, distributions or interest received, first-come, first-served purchase terms with no withdrawal rights, inability to finance the offer, and the exchange of liquid securities for illiquid securities.[157] The SIA Letter provides specific language for the broker-dealers to send to their customers with each mini-tender offer.[158] In the alternative, the SEC suggests the broker-dealer simply include the SEC's publication, "Mini-Tender Offers: Tips for Investors," when forwarding mini-tender offer solicitations to their customers.[159]

The SEC acknowledges that there is nothing in the Williams Act or regulations dealing with the practices of broker-dealers forwarding mini-tender offers to their clients.[160] In fact, aside from fiduciary duties under corporate law,

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152. *See* Glover, *supra* note 108, at 1.
153. *See supra* note 132.
154. *Division of Market Regulation: Letter to Securities Industry Association re: Broker-Dealer Mini-Tender Offer Dissemination and Disclosures*, *available at* http://www.sec.gov/divisions/ marketreg/ minitenders/sia072401.htm (July 24, 2001) [hereinafter "*SIA Letter"*].
155. *Id.* at 2.
156. Berick, *supra* note 3, at 2.
157. *SIA Letter, supra* note 154, at 3.
158. *Id.*
159. *Id.* at 6.
160. *Id.* at 3.

there is no requirement that the broker-dealers forward the information at all.[161] The SEC is not seeking a uniform standard of conduct with respect to dissemination of mini-tender offers. Rather, the SEC acknowledges that broker-dealers have adopted a variety of approaches to disseminating mini-tender offer information, ranging from reviewing mini-tender offers before deciding whether to send them on to customers, providing disclaimer language when forwarding the materials, to electing not to forward the materials at all.[162] The last scenario is the ultimate form of investor protection from a potentially abusive mini-tender offer; the broker-dealer is in essence making the investment decision, on behalf of its customer, and without instructions, not to tender for the client. The SEC's explicit acquiescence to this practice is further evidence of the suspicion with which it views mini-tender offers.[163]

IV. RECOMMENDATIONS: HOW CAN THE SEC'S GOAL OF IMPROVING INVESTORS PROTECTION IN MINI-TENDER OFFERS BEST BE ACCOMPLISHED?

The investor protections the SEC seeks are important and are in keeping with the purpose underlying the federal securities laws as a whole. However, the SEC's efforts to date have been insufficient to curb abuses in mini-tender offers. Because mini-tender offers are beyond the literal scope of § 14(d)(1), the SEC has no ability to review mini-tender offers before they are commenced and can bring an enforcement action only after the alleged harm has occurred.[164] The initial enforcement actions did not have the desired restraining effect, prompting the issuance of the Release. The Release also proved insufficient as a deterrent, as evidenced by the additional enforcement actions brought by the SEC thereafter, and by the publication, a full year after the issuance of the Release, of the SIA Letter seeking assistance from broker-dealers.[165]

The legal basis for the SEC's efforts raises two issues, the resolution of which will enable the SEC to achieve more effectively the investor protections it seeks in mini-tender offers. First, mini-tender offers arguably do not constitute tender offers for purposes of the Williams Act and are therefore not subject to § 14(e) and Regulation 14E. The enforcement actions brought by the SEC lack support as a matter of law, and constitute overreaching by the SEC of its legislative grant of authority. No court has yet considered the issue of whether mini-tender offers constitute tender offers.[166] Instead, the courts have allowed the

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161. *Id.* "We are aware that some broker-dealers may forward certain mini-tender offers to their customers because they have concluded that they have a fiduciary duty to do so. We do not express a view on, or address in this letter, the extent of any such fiduciary duties." *Id.* at n.5.

162. *Id.* at 1–2.

163. Berick *supra* note 3, at 3.

164. *Id.*

165. *See* Hirschhorn, *supra* note 28, at 630.

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> A mini-tender offer is not a transaction that traditionally falls within the definition of tender offer; however, this is not fatal to applying the Williams Act. The *S-G Securities* court developed its test because it had

handful of enforcement actions against mini-tender offerors to go forward, thereby tacitly supporting the SEC's position that mini-tender offers are in fact tender offers for purposes of § 14(e).[167]

Second, even if the SEC is found to have the statutory authority to bring enforcement actions against mini-tender offerors for violations of § 14(e), its use of the suggested disclosures in the Release to determine fraudulent, manipulative, and deceptive practices is inappropriate. The Release is not binding as a matter of law. Further, it is unclear what degree of deference courts will afford the Release.[168]

To guarantee the investor protections it seeks, the SEC must resolve these two issues by definitively bringing mini-tender offers within the scope of § 14(d)(2)–(8) and (e). The SEC must then utilize its statutory grant of authority to promulgate binding regulations under § 14(e) that spell out the conduct required of mini-tender offerors, and the consequences of non-compliance. To the extent necessary and appropriate, the SEC should also promulgate mandatory disclosure provisions to be used by broker-dealers when disseminating mini-tender offers to their clients.

With respect to the first issue, there are several approaches to bringing mini-tender offers conclusively within the scope of §§ 14(d)(2)–(8) and (e). First, the SEC could use its legislative grant of authority to promulgate rules applicable to both §§ 14(d) and (e) and to Regulation 14E, setting out a definition of "tender offer" that specifically includes mini-tender offers. The definition could include conventional tender offers, mini-tender offers, and any transaction with the potential to coerce security holders into making hurried, uninformed decisions, regardless of whether the offer was made with the intent to acquire control.[169] Such a definition would move beyond the Congressional intent in enacting the Williams Act, and the concurrent focus on offers to purchase securities made with the intention to acquire control.[170] Although the SEC and courts have resisted this idea since the Williams Act was enacted, the lack of clarity in this area now has begun to outweigh the flexibility gained by leaving the term undefined.

Another approach would be for Congress to amend the 1934 Act to include a definition of tender offer within the list of definitions (currently fifty-nine) included therein.[171] While the legislative history of the Williams Act reflects

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> come across a transaction that was not within the bounds of a traditional tender offer, but was one that the Williams Act had intended to govern. In due course, a court could, and should, logically expand the definition of a tender offer to include mini-tender offers in order to further implement the remedial nature of the Williams Act.

Id. at 647.

167. *See* Part IIIA-2 *infra* for a discussion of these enforcement actions.

168. *See* Hirschhorn, *supra* note 28, at 656–57.

169. *See The Developing Meaning of "Tender Offer," supra* note 19, at 1275.

170. *See id.* at 1270. "The Commission shall, for purposes of this subsection, by rules and regulations, define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive or manipulative." 15 U.S.C. § 78n(e) (2003).

171. *See* 15 U.S.C. § 78c(a)(1)–(59) (2003).

a strong Congressional reluctance to create a statutory definition for the term "tender offer," the passage of forty years and the numerous judicial opinions wrestling with the parameters of the definition may be sufficient to overcome this reluctance. A less expansive approach would be for Congress to lower or remove the 5% threshold in § 14(d)(1), providing those who tender in mini-tender offers the protections thereunder to offerees in conventional tender offers. If security holders are given the protections of § 14(d)(1), they would also be entitled to the protections of Regulation 14D, with its additional withdrawal and proration rights, and increased price protection.[172] Congress could also accomplish the same result by changing the term "tender offer" to "offer" in § 14(d)(1). While this approach would provide additional protection for those who tender in mini-tender offers, it is problematic. First, Congress had an opportunity to remove the threshold entirely in 1970 when it lowered the ownership requirement from 10% to 5%, but elected not to do so.[173] This may be indicative of a Congressional unwillingness to make either of these changes. Also, if any offer to buy stock were covered by the Williams Act, including § 14(d)(1), the cost of the typical stock purchase would dramatically increase due to the disclosure obligations. Further, numerous provisions, including the withdrawal, proration, and increased price protections in Regulation 14D, would be logistically difficult to implement in individual stock sales, and might need to be excluded. In addition to undermining the original Congressional intent in enacting § 14(d), the practical result of either action would be to render the disclosure requirements of § 13(d) meaningless, as full disclosure would already be required under this new § 14(d)(1).[174]

Once the first issue has been resolved, and mini-tender offers have been conclusively determined by judicial opinion, statute, or regulation to be tender offers for purposes of §§ 14(d)(2)–(8) and (e), the SEC must take steps to curb the conduct that it finds troublesome. The SEC should enact binding regulations setting forth the matrix of disclosure necessary to keep mini-tender offers from violating § 14(e). Although Regulation 14D is inapplicable to mini-tender offers by its terms, its regulatory approach is a good model for the new mini-tender offer regulations suggested below. Rule 14d-6 details the disclosures required in a tender offer, cross-referencing relevant sections of Form TO and Regulation M-

172. Under Rule 14d-7, those who tender are entitled to withdraw any tendered securities as long as the offer remains open. *See* 17 C.F.R. § 240.14d-7. Rule 14d-8 removes the 10 day period set out in § 14(d)(6), and requires pro rata purchases on oversubscribed offers regardless of when the offer's maximum shares was reached. *See* 17 C.F.R. § 240.14d-8 (2003). Rule 14d-10 requires the highest consideration paid to anyone who tenders be paid to everyone who tenders. *See* 17 C.F.R. § 240.14d-10.

173. Securities Act Amendments of 1970, 15 U.S.C. § 78n(d).

174. *See The Developing Meaning of "Tender Offer," supra* note 19, at 1275. Section 13(d) requires those who acquire beneficial ownership of more than 5% of a class of securities must disclose, among other things: the background, identity, residence and citizenship of such beneficial owner; the source and amount of funds used in the purchase; the purpose of the purchase; the number of shares owned and the number of shares such beneficial owner has the right to acquire; information as to contracts, arrangements or understandings about the class of securities. *See* 15 U.S.C. § 78n(d).

A.[175] The new "Schedule 14D" regulations should detail the disclosures required in a mini-tender offer, as well as the consequences of non-compliance. All required disclosures should be made in plain English, with typeface no smaller than the typeface for the balance of the offering materials.[176] The new regulation should include, at a minimum, the following:

Summary Term Sheet: The bidder should be required to provide security holders with a summary term sheet, just as tender offerors must do under Item 1001 of Regulation M-A. [177] Item 1001 requires a brief description of the most material terms of the proposed transaction, and must provide security holders with "sufficient information to understand the essential features and significance of the proposed transaction."[178] This language is helpful as a starting point, but is insufficient as written to accomplish the SEC's goal of investor protection in mini-tender offers. Reasonable minds could arguably differ on what constitutes "sufficient information to understand the essential features and significance" of a mini-tender offer. Would simply disclosing the lack of a price premium, or the absence of withdrawal and proration rights be sufficient? The SEC should make clear in the regulation the minimum information necessary to satisfy the sufficiency requirement. A better approach would be to list the disclosures required to satisfy the regulation, including the recommended disclosures that follow.

Target Company Information: The bidder should be required to provide information about the target company, just as tender offerors must do under Item 1002 of Regulation M-A.[179] The bidder must provide the name and address of the target company, and the exact title and number of shares outstanding of the subject class of securities as of the most recent practicable date. Further, the bidder must identify the principal market, if any, on which the subject securities are traded, along with the high and low sales price for each quarter of the past two years. If there is no established trading market for this class of securities, the bidder must disclose this. Arguably, the security holder ought to know this already about the securities she owns. However, this abundance of caution will foreclose the possibility of a security holder unknowingly tendering in a below-market mini-tender offer (assuming of course that the security holder actually reads the offering

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175. *See* 17 C.F.R. § 240.14d-6 (2003). *See also* 17 C.F.R § 240.14d-100; 17 C.F.R. § 229.1000–1016 (2003).

176. *See* 17 C.F.R. §230.421(b),(d) (2003) for a description of plain English disclosure.

177.

> The summary term sheet must briefly describe in bullet point format the most material terms of the proposed transaction. The summary term sheet must provide security holders with sufficient information to understand the essential features and significance of the proposed transaction. The bullet points must cross-reference a more detailed discussion contained in the disclosure document that is disseminated to security holders.

17 C.F.R. § 229.1001.

178. *Id.*

179. *See* 17 C.F.R. § 229.1002.

materials).[180] The SIA proposed to the SEC that any regulation of mini-tender offers require the bidder to disclose any marketplace events that may have caused an unusual fluctuation in the market price of the securities.[181] This seems a matter of discretion, and in the absence of a definition of what constitutes an unusual fluctuation in the market price of the securities, this addition is not likely to add to the quality of disclosure provided to mini-tender offerees.

Identity and Background of the Bidder: The bidder should be required to provide information about itself, just as tender offerors must do under Item 1003 of Regulation M-A.[182] The bidder must disclose its name, business address, and business telephone number, including control persons and promoters, and any affiliation between target and bidder.[183] Again, this will enable security holders to make more informed decisions about whether to tender.

Terms of the Transaction: The bidder should be required to provide information about the terms of the transaction, just as tender offerors must do under Item 1004 of Regulation M-A.[184] The bidder should disclose the material terms of the transaction, including the total number and class of securities sought and the type and amount of consideration offered.[185] With respect to the offer price, bidders must prominently disclose if the offer price is below market, and list the current market price. The bidder must also disclose any intent to repeatedly extend the offer until the market price exceeds the offer price. The bidder must disclose any future tender offer plans for the target. With respect to price changes, bidders must disclose any reduction in the offering price due to distributions made to security holders, and fees imposed by the bidder, with the amount if known. If the bidder changes the price, the offer must be extended for 10 business days under Rule 14e-1(b).

The bidder must disclose the scheduled expiration date as well as any ability and intent to extend the offer.[186] The bidder must disclose the procedures for tendering and withdrawing, if available. If there are no withdrawal rights in the mini-tender offer, the bidder must disclose this, and explain that the lack of withdrawal rights continues even if the bidder extends the offer. If withdrawal

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180. The remaining requirements of Item 2002 (dividends, prior public offerings, and prior stock purchases) are beyond the scope of the investor protections sought by the SEC in mini-tender offers. In fact, the omitted items are not required when filing Schedule TO in a tender offer. *See* 17 C.F.R § 240.14d-100.

181. *See SIA Letter, supra* note 154.

182. *See* 17 C.F.R. § 229.1003 (2003).

183. *See* 17 C.F.R § 240.14d-100, *Item 3* (requiring the information set out in Item 1003(a)–(c) of Regulation M-A, 17 C.F.R. § 229.1003). *See also* Mini-Tender Offer Release, *supra* note 2, at 2249.

184. *See* 17 C.F.R. §229.1004 (2003).

185. *See* 17 C.F.R § 240.14d-100, *Item 4* (requiring the information set out in Item 1004(a) of Regulation M-A, 17 C.F.R. § 229.1004). *See also* Mini-Tender Offer Release, *supra* note 2, at 2249.

186. *See* 17 C.F.R § 240.14d-100, *Item 4,* (requiring the information set out in Item 1004(a) of Regulation M-A, 17 C.F.R. § 229.1004). *See also* Mini-Tender Offer Release, *supra* note 2, at 2249.

rights do exist, the bidder must fully explain the procedure and the manner in which securities will be accepted for payment.

The bidder must disclose whether securities will be accepted pro rata if the offer is over-subscribed.[187] If there is no pro rata provision, the bidder must disclose that shares will be purchased on a first-come, first-served basis and as a result, the offer may not remain as long as it was supposed to.

Source of Funds: Bidders should be required to provide information about the source of its funds, just as tender offerors must do under Item 1007 of Regulation M-A.[188] A mini-tender offer without adequate financing in place violates Rule 14e-8(c), which prohibits a person from publicly announcing a tender offer if that person "does not have the reasonable belief that the person will have the means to purchase the securities to complete the offer."[189] Thus, the bidder must disclose whether it has adequate financing to complete the offer at the start of the offer, including the source of funds, and any material conditions to the financing.[190]

Target Management's Response: The bidder should be required to provide information about the target management's response, just as tender offerors must do under Item 1012(a) of Regulation M-A.[191] The bidder must disclose whether the target is aware of the offer, and that if the target is aware of the offer, the target must make a recommendation to its shareholders within ten days of the start of the offer. In such case, the bidder must disclose that additional information will be coming from the target's management. The bidder must disclose all material conditions to the offer, all of which must be based on objective criteria or the offer may be illusory and violate § 14(e).

V. CONCLUSION

The SEC seems determined to stem the flow of potential abuses in mini-tender offers. But the agency lacks the authority under the present statutory scheme to bring about the mandatory disclosures it seeks. The SEC recognizes that mini-tender offers are beyond the scope of § 14(d)(1) as a result of the subsection's 5% trigger, and thus claims mini-tender offers are subject only to § 14(e) and Regulation 14E.[192] Ironically, the statutory reality threatens the SEC's authority to bring enforcement actions under § 14(e).

The combination of conclusively bringing mini-tender offers within the scope of § 14(d)(2)–(8), and the articulation of specific, legally-required

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187. *See* 17 C.F.R § 240.14d-100, *Item 4,* requiring the information set out in Item 1004(a) of Regulation M-A, 17 C.F.R. § 229.1004. *See also* Mini-Tender Offer Release, *supra* note 2, at 2249.

188. *See* 17 C.F.R. § 229.1007 (2003).

189. *See* 17 C.F.R. § 240.14e-8(c) (2003).

190. *See* 17 C.F.R § 240.14d-100, *Item 7,* (requiring the information set out in Item 1007(a),(b),(d) of Regulation M-A, 17 C.F.R. § 229.1007(a)). *See also* Mini-Tender Offer Release, *supra* note 2, at 2250.

191. *See* 17 C.F.R. § 229.1012(a) (2003).

192. *See* Mini-Tender Offer Release, *supra* note 2, at 2247.

disclosures will better enable the SEC to achieve the investor protection it seeks for mini-tender offers. In an abundance of caution, the SEC could also enact binding regulations requiring broker-dealers who disseminate mini-tender offers to craft a risk factor disclosure.[193] This option would become less necessary if the new regulations discussed herein were promulgated by the SEC.

Once mini-tender offers are brought within the scope of the Williams Act, mini-tender offerees would be entitled to the protection of § 14(d)(5)–(8). More importantly, the SEC's right to bring enforcement actions against mini-tender offers for violations of § 14(e) would be conclusive. This result, coupled with the promulgation of binding regulations setting out the required disclosures for mini-tender offers, and the consequences of failure to comply therewith, will permit the SEC to at last achieve the investor protections it has long sought in mini-tender offers.

193. The disclosure could include a definition of mini-tender offers and the resulting inapplicability of certain disclosure and procedural rules that apply to traditional tender offers. *See SIA Letter*, *supra* note 154, at 4. The broker-dealer should advise its customers to check the current market price for the security, and that mini-tender offers for above-market prices may be extended beyond their initial expiration date, during which time the market price may rise above the offer price. *Id.* The broker-dealer must disclose that certain deductions are made to the offer price for dividends, distributions and other fees. *Id.* at 5. The disclosure must indicate that there may be no proration or withdrawal rights, with complete explanations of both concepts and the potential effects on the security holder. *Id.* Further, the disclosure must indicate that just because the bidder is making the mini-tender offer is no guarantee the bidder has or will obtain adequate financing to pay for tendered shares. *Id.* Additionally, security holders may be exchanging publicly-traded securities for non-publicly traded stock, which may limit the resale possibilities after the consummation of the mini-tender offer. *Id.* As a catch-all, the broker-dealers should inform security holders that the target company is required to make a recommendation on the mini-tender offer, once it has notice of the offer, and that security holders should consult their financial advisers, as the forwarding of the mini-tender offer materials and this disclosure do not constitute any recommendation by the broker-dealer on the merits of the offer. *Id*.