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COMMENTARY
The Federal Securities Code in Flux: Limited Offerings and Tender Offers

ROBERT T. LANG* and GERALD S. BACKMAN**

In light of increased criticism of the proposed Federal Securities Code, the authors, as securities practitioners, adopt a favorable outlook towards the codification effort. While acknowledging that further changes may be necessary in the bid to get congressional approval, it is submitted that the Code has succeeded in its attempt to bring order to the confusing mass of existing statutory and administrative law. To illustrate their conclusion, the authors offer an extensive analysis of the limited offering and tender offer sections of the Code with several salient insights into their advantages over existing law.

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The authors gratefully acknowledge the assistance of Cathy L. Marks and Stephen I. Erlichman, Members, New York Bar, in the preparation of this article. This article was originally drafted in March 1979, and was updated in October 1979. On November 29, 1979, the Securities and Exchange Commission promulgated new tender offer rules. SEC Release Nos. 33-6158, 34-16384, IC-10958 [Current] Fed. Sec. L. Rep. (CCH) ¶ 82,373. (Nov. 29, 1979). On the same date, in consecutively numbered releases, the SEC requested comments on a new group of proposed rules. SEC Release Nos. 33-6159, 34-16385, IC-10959 [Current] Fed. Sec. L. Rep. (CCH) ¶ 82,374. Both the new rules and the proposed rules impact upon that portion of this article dealing with tender offers, particularly the provisions of the new rules relating to preemption, duration of tender offers and filing requirements, and the provisions of the proposed rules containing a suggested definition of the term "tender offer."
I. INTRODUCTION

The panel discussion held at the University of Miami School of Law to discuss the ALI Proposed Federal Securities Code focused primarily on one overriding issue: whether Congress should adopt the Code in its present form. While extolling the virtues of the overall effort and the painstaking dedication of the Reporter, Professor Louis Loss, most of the participants criticized the draftsmen for failing to reexamine policy questions such as the basic disclosure philosophy of the securities laws, or for failing to conduct empirical studies to determine whether these laws have served any useful purpose. In fact, the tenor of the panel discussion was that the Code, contrary to Professor Loss' statement of its objectives, did make major decisions of an essentially political nature and did endeavor to make substantive changes in areas that are not necessarily "lawyer's law."

What the critics failed to recognize is that those who are most directly affected by the federal securities laws, namely the publicly held and privately owned companies that come into contact with these laws on a daily basis, are constantly faced with the problem of good faith compliance with the current laws. This problem is readily apparent to the members of the securities bar who not only have the obligation of advising their clients but who have also been frequently placed in the unenviable position of answering to the public at large. From the standpoint of day to day compliance, it

3. "In general . . . the Code is not presuming to make major decisions of an essentially political nature. That is to say, the substantive changes are fundamentally in the area of what might be called 'lawyers' law.'" Loss, Introduction: The Federal Securities Code — Its Purpose, Plan and Progress, 30 VAND. L. REV. 315, 324 (1977).

In a recent case, two partners of a New York law firm were temporarily suspended from practice before the SEC because they allegedly participated in violations of the 1934 Act and failed to carry out their professional responsibilities to their corporate client in insuring it—with respect to the company's financial condition during the period immediately preceding its bankruptcy. In re Carter, SEC Ad. Proc. No. 3-5464, [1979] 494 Sec. Rec. & L. REP. (BNA) A-13, F-1.
is submitted that it is more important to develop a clear and understandable body of law than to attempt to resolve each and every one of the political considerations affecting the wide range of subjects covered, as long as the major substantive changes effected in the process of codification do not do violence to the existing structure. In this we believe the Code has succeeded.

From the vantage point of the securities law practitioner, the establishment of objective standards for "limited offerings" (thirty-five non-institutional purchasers) and "tender offers" (thirty-five offerees) is a worthwhile effort whether or not one agrees with the "magic number" selected by the draftsmen. Similarly, at the very least the codification of the antifraud rules enables the practitioner to focus his attention on a relatively limited series of statutory provisions. Although commentators may validly raise policy questions with respect to the conclusions reached by the draftsmen and as to whether there has been unwarranted "reform," Congress will not be precluded from considering these questions in the context of the codification effort as a whole.

On the other hand, one cannot overlook the practical realities of a proposed codification of the federal securities laws. As Professor Loss stated at the commencement of the lectures, the drafters of the Code were not interested in spending a decade drafting "what we thought was a perfect Code that would have very little chance of adoption . . . . Codification is a compromise. There has been a great deal of it, and I am sure there will be more before the Code becomes law."9

One of the major problems impacting upon the development of the Code has been the dramatic changes that have been made in the legislative, administrative and judicial developments of the federal securities laws during the course of the codification effort. As one commentator has noted, "[t]he draftsman of the Code had a particularly challenging and frustrating assignment, since he was charged with capturing a moving target."10 In addition, each Tentative Draft of the Code has been subjected to intensive analysis, criticism and debate to which the drafters had to be particularly sensitive, since many of the commentaries were presented by attorneys whose major concerns were directed toward the practical appli-

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7. Id. § 299.68.
8. Id. part XVI.
cation of the Code as a regulatory structure. The limited offering exception to the definition of distribution is illustrative of one of the major areas of interest to which the Code has been particularly responsive, not only in relation to developments in the law but also in relation to the constructive criticism advanced by the commentators. Although numerous practical and theoretical problems still remain, the treatment of limited offerings in the Code represents a major advance in the development of a comprehensive body of law and one that may not require significant change in order to be adopted by Congress.

In contrast to the limited offering provisions, the law of tender offers has been in such a constant state of flux that it has virtually outpaced the Code draftsmen. In the last decade, the tender offer has become a preferred method of acquiring control of publicly held companies and is thus an area of major interest. Not only have a large number of states adopted legislation covering the subject, but the Securities and Exchange Commission (SEC) has recently proposed comprehensive new rules in an effort to codify existing law. This illustrates some of the obstacles facing the draftsmen in their push for congressional approval. Indeed, unless Congress were to conclude that the Code should be adopted in its present form for the sake of codification and continuity alone, without making any significant changes, it appears that even more compromise will be required in the tender offer field before congressional adoption is forthcoming.

II. THE LIMITED OFFERING

The “limited offering” is the Code’s answer to the confusion which has surrounded the nonpublic or private offering exemption.
of section 4(2) of the 1933 Act\(^7\) and rule 146,\(^8\) the latter representing the SEC's attempt to provide "objective standards upon which responsible businessmen may rely in raising capital under claim of the Section 4(2) exemption . . . ."\(^9\) But as Professor Loss stated:

> We used to think we knew what "public offering" meant in the early days of the Commission. If you did not sell to more than twenty-five people or so, it was private. It was fairly simple.\(^10\) But then the courts delved into the problem and began to talk like law school professors. They discussed the purpose of the statute—having financial sophistication and having the ability to "fend for yourself"\(^11\)—to the point where nobody knows what a public offering is anymore. The Commission adopted a four or five page rule, which I should think would be just a bit harder to comply with than registering.\(^12\)

Because of the need to redefine the private placement exemption in unambiguous terms, the Code—again to use Professor Loss' term—has started from "scratch" by providing for a "limited offering" that would be exempt from the required filings if initial buyers are comprised of institutional investors\(^13\) and no more than thirty-

\footnotesize{17. 15 U.S.C. § 77(d) (1976).}  
\footnotesize{18. 17 C.F.R. § 230.146 (1978).}  
\footnotesize{19. Id. at Preliminary Note 3.}  
\footnotesize{20. This rule of thumb was never given official status as a rule but was espoused by the Commission's first general counsel, John J. Burns. SEC Release No. 33-285, 1 Fed. Sec. L. Rep. (CCH) ¶ 2740-44 (Jan. 24, 1935).}  
\footnotesize{21. In SEC v. Ralston Purina Co., 346 U.S. 119 (1953), the only Supreme Court decision which has ruled on § 4(2), the Court rejected a numerical criteria and stated that the applicability of § 4(2) should turn on "whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering'." Id. at 125.}  
\footnotesize{22. Loss, supra note 9, at 1438 (footnotes supplied). Professor Loss is not the only commentator to express dismay at the perils of complying with rule 146. See Casey, SEC Rules 144 and 146 Revisited, 43 Brooklyn L. Rev. 571 (1977); Kinderman, The Private Offering Exemption: An Examination of its Availability Under the Outside Rule 146, 30 Bus. Law 921 (1975); Rosenfield, Rule 146 Leaves Private Offering Waters Still Muddied, 2 Sec. Reg. L.J. 195, 212-13 (1974); Kripke, SEC Rule 146: A 'Major Blunder', 172 N.Y.L.J., July 5, 1974, at 1, col. 3. Even a member of the SEC staff admits that "[r]ule 146 is not entirely without thorns and soft, subjective conditions." Alberg & Lybecker, New SEC Rules 146 and 147; The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities, 74 Colum. L. Rev. 622, 643 (1974).}  
\footnotesize{For opinions on the earlier proposed version of the rule, see Cassidy & Berkowitz, Proposed Rule 146, 6 Rev. Sec. Reg. 949 (1973).}  
\footnotesize{23. An institutional investor is defined as}  
\footnotesize{(a) a bank, insurance company, or registered investment company, a fund, trust,}
five additional persons, or the seller so reasonably believes. Resales during the first three years must not result in more than thirty-five owners (apart from institutional investors and persons who become owners otherwise than by purchase), unless any such excess results from resales pursuant to an offering statement or an exemption. This limitation would be reduced to one year if the company has been filing regular reports with the SEC for one year (the "one-year registrant").

Rule 146 was expressly made nonexclusive. In the Adopting Release and in the preliminary notes to rule 146, the SEC pointed out that all the conditions of the rule must be satisfied in order for the exemption to be available. Thus some practitioners, concerned with inadvertently failing to meet its multiple demands, have structured offerings to satisfy the requirements judicially engrafted upon the section 4(2) exemption. Many commentators, however, believe that even if the statutory law has survived the accession of rule 146, "the task of persuading a court of law that an offering has met the requirements of the variant interpretations under section 4(2) is

or other account with respect to which a bank or insurance company has investment discretion, or a person who controls any such person, except to the extent that the Commission provides otherwise by rule with respect to any such class of persons on the basis of such factors as financial sophistication, net worth, and the amount of assets under investment management, or (b) any other person of a class that the Commission designates by rule on the basis of such factors.

FED. SEC. CODE § 275.
24. Id. § 242(b)(1)(A).
25. Id. § 242(b)(1)(B).
26. Id. § 242(b)(2)(A).

Under the Code, the present registration scheme is eliminated. Instead, a company will register as such when it has $1,000,000 in assets and 500 holders of all securities. Id. § 402. Such a company is referred to as a "registrant."

A "one-year registrant means a registrant that has been continuously a registrant for one year." Id. § 299.16.

29. Because of the difficulty and impracticality of applying rule 146 in many situations, many issuers continue to rely upon the residual law surrounding the statutory exemption. See Federal Regulation of Securities Committee, American Bar Association, Section 4(2) and Statutory Law, 31 Bus. LAW. 485 (1975); Committee on Developments in Business Financing, American Bar Association, Institutional Private Placements Under the Section 4(2) Exemption of the Securities Act of 1933, id. at 515. Generally, in these authors' views, the characteristics of a valid private offering are: (a) offeree qualification, which may be based upon sophistication, wealth, or personal relationship, (b) access to or actual receipt of information which may be less extensive than a registration statement (access resulting from economic bargaining power is included); (c) a limited manner of offering; and (d) the absence of redistribution. But see note 31, infra.

30. If experience under rule 144 is a guide, there is a strong possibility that the objective
far too complex and uncertain an undertaking to be seriously considered by many businesses.\textsuperscript{31}

Rule 146 has been broadly criticized for its lack of a substantial compliance standard, for the burden it imposes by requiring complicated and detailed paperwork, for the limitations imposed on disposition, for its failure to distinguish between the widely different types of transactions subsumed under the "nonpublic" offering, and for the economic burdens of the disclosure requirements of the rule which fall most heavily on small issuers.\textsuperscript{32}

Rule 146 provides that offers and sales of securities by an issuer shall be deemed not to involve a public offering within the meaning of section 4(2) if all the conditions of the rule are met.\textsuperscript{33} Those criteria of rule 146 will be read into judicial and staff interpretations of § 4(2). Connolly, Private Offering Exemption, 8 Rev. Sec. Reg. 919 (1975).

In Woolf v. S.D. Cohn & Co., 515 F.2d 591, 612 (5th Cir. 1975), rule 146 was referred to as a "useful frame of reference to an appellate court in assessing the validity of § 4(2) exemptions claimed." See Doran v. Petroleum Management Corp., 545 F.2d 893, 906 (5th Cir. 1977).

31. Casey, supra note 22, at 591. Lower court decisions since Ralston Purina have expanded and refined the Supreme Court's standard for determining whether an offering was "public" or "private."

In United States v. Custer Channel Wing Corp., 376 F.2d 675, 678 (4th Cir. 1967), the Fourth Circuit stated that investors' financial sophistication was not sufficient to secure a "private offering" exemption in the absence of an additional showing that the offerees had access to certain information about the issuer. The Tenth Circuit, in Lively v. Hirshfeld, 440 F.2d 631 (10th Cir. 1971), combined the sophistication and access principles and held that the only people who could be eligible for a legitimate private offering were those "persons of exceptional business experience, and [in] 'a position where they have regular access to all the information and records which would show the potential for the corporation.'" Id. at 633.

In Hill York Corp. v. American Int'l Franchise, Inc., 448 F.2d 680 (5th Cir. 1971), the court held that the issuer must also show that the investors in fact received the information and that information available in a registration statement may not be sufficient. Id. at 690.

SEC v. Continental Tobacco Co., 463 F.2d 137 (5th Cir. 1972), and the brief filed by the SEC staff which the court adopted, led to total confusion in this area. The SEC brief reiterated virtually every restriction mentioned by the courts over the years. SEC Staff Brief, reprinted in part in [1971] 127 Sec. Reg. & L. Rep. (BNA) A-17. The Fifth Circuit held that "the record does not establish that each offeree had a relationship with Continental giving access to the kind of information that registration would have disclosed." 463 F.2d at 158.

32. See note 22 supra. In apparent recognition of both the uncertainty surrounding rule 146 and the need to assist small business capital formation, the SEC has proposed a small issue exemptive rule. Proposed rule 242 would enable certain corporate issuers to sell up to $2 million per issue of their securities during any six-month period without registration to an unlimited number of "accredited persons," which would include institutions and persons buying at least $100,000 worth of securities, and up to 35 other "nonaccredited" persons.

If the sales are made only to accredited persons, the rule would not require that purchasers be furnished with specific information. If sales are made to both accredited and nonaccredited persons, however, the issuer would be required to furnish all purchases with the same type of information specified in Part I of Form S-18, to the extent such information is material to the understanding of the issuer, its business, and the securities being offered. [1979] 519 Sec. Reg. & L. Rep. (BNA) A-1.

33. 17 C.F.R. § 230.146(b) (1978).
conditions focus on the manner of the offering, the nature of the offerees, the access to or furnishing of information to the offerees, the number of purchasers, and the limitations imposed on disposition.

A. Manner of Offering

Paragraph (c) of rule 146 prohibits any form of general solicitation or advertising in connection with a private placement. The forbidden devices include articles, notices or other communications published in any newspaper, magazine or similar medium or broadcast over television or radio. Seminars and meetings are also proscribed unless those attending the meeting are limited to qualified offerees and their representatives. Letters or circulars are prohibited unless sent only to qualified offerees. Since an appeal to an undifferentiated public is obviously antithetical to a private offering, there has been no serious objection to these restrictions, except as they relate to other problems with the rule as a whole.

As every condition of the rule must be met, if one person who did not qualify as a permissible offeree attended a meeting or received a circular, the exemption might be destroyed, thus entitling every other offeree, even if qualified, to rescind the transaction. A further complication is the incorporation of the extremely vague "sophistication" test for defining a qualified offeree.

The Code also prohibits general advertising. The significant

34. Id. § 230.146(c).
35. Id. § 230.146(d).
36. Id. § 230.146(e).
37. Id. § 230.146(g).
38. Id. § 230.146(h).
39. For a discussion of paragraph (d) of the rule, describing who may qualify as an offeree, see notes 44-47 infra and accompanying text.
40. Since rule 146 is not the exclusive means of complying with § 4(2) of the 1933 Act, and since attempted compliance does not act as an election, a court might find that § 4(2) has been satisfied by substantial compliance with the requirements of the rule. Connolly, supra note 30, at 919.

The burden placed upon an issuer by the absence of a substantial compliance standard is exemplified by Henderson v. Hayden, Stone Inc., 461 F.2d 1069 (5th Cir. 1972). In that case, a wealthy and experienced venture capitalist, who was fully informed, was allowed to walk out of his commitment by rescinding the deal merely because the defendants could not sustain the burden of proving that the other offerees had been similarly informed. The court apparently required more than substantial compliance with the terms of rule 146, even for an exemption claimed under § 4(2), prior to the adoption of the rule. This case is an example of the use of the rule's standards by the courts under the statutory exemption. See note 30 supra.

41. See notes 44-47 and accompanying text infra.
42. Fed. Sec. Code § 503(b).
difference between the Code and rule 146, however, is that the ban
on advertising in the Code is not a condition of the limited offering
exemption. A violation of the Commission’s rules will not destroy
the limited offering exemption under the Code. The rationale be-
hind the change was that the concept of “general advertising” is
“inevitably vague” and therefore should not be a basis for imposing
absolute civil liability on the seller in an action for rescission or
damages.43

B. Nature of Offerees

Under paragraph (d) of the rule, the qualifications of an offeree
are examined twice to assess the degree of his “sophistication.”
Immediately prior to the offer, the issuer must have reasonable
grounds to believe, and must in fact believe, either that the offeree
is “capable of evaluating the merits and risks of the prospective
investment” because of his “knowledge and experience in financial
and business matters” or that the offeree can “bear the economic
risk of the investment.”44 Prior to any sale, the issuer must again
make reasonable inquiry and have reasonable grounds to believe
either that “the offeree has such knowledge and experience in finan-
cial and business matters that he is capable of evaluating the merits
and risks of the prospective investment,” or that the offeree and his
offeree representative together have such knowledge.45

On its face, this provision introduces the familiar uncertain
standards that are characteristic of the rule as a whole and represent
one of its principal defects. In the words of one of the many com-
mentators who have criticized the subjectivity and vagueness of this
sophistication concept, it is “elusive, complex and subjective.”46

43. Commenting on the treatment of advertising and solicitation for sales and resales
under the proposed limited offering section of the Code, the Reporters have noted that the
prohibition makes it:

Unlawful for any offeror or reseller in a limited offering to engage in “general
advertising” in contravention of the Commission’s rules. That provision [§
503(b)] is designed to preserve something of the old prohibition of public offerings
without perpetuating that difficult concept. On the other hand, precisely because
the concept of “general advertising” is inevitably vague, the provision is phrased
as a prohibition rather than a condition of the exemption, so that a violation,
though subjecting the violator to the usual public sanctions, does not impose an
absolute civil liability on the seller in an action for rescission or damages under
the successor to Sec. Act. § 12(1).

45. Id. § 230.146(d)(2). See notes 50-51 and accompanying text infra.
46. Wolfson, supra note 2, at 1505. For further criticism of the sophistication require-
According to another critic, "[p]robably the most significant elements of uncertainty, which render the entire rule inadequate in light of its avowed purpose [to provide more objective standards], are the indefinite terms 'reasonable' and 'unreasonable' which appear at least fourteen times in the new rule." 47

In adopting the rule, the Commission stated that it "believes that the determination of 'ability to bear the economic risk' will vary with the circumstances." 48 Considerations which the Commission indicated are important are "whether the offeree could afford to hold unregistered securities for an indefinite period, and whether, at the time of the investment, he could afford a complete loss." 49

One of the practical problems presented by the rule is the high cost of compliance. The cost of the paperwork and documentation required to meet the test of offeree sophistication is a significant part of the costs and burdens of the private placement exemption. 50

The innovative concept of "offeree representative" contained in the rule does not solve the problem of uncertainty inherent in the sophistication and economic risk tests. Although the offeree who can bear the economic risk can satisfy his or her sophistication requirement by employing an offeree representative, the representative

47. Kessler, Private Placement Rules 146 and 240 — Safe Harbor?, 44 FORDHAM L. REV. 37, 67-68 (1975). Kessler notes that "[o]ne need not be familiar with the two famous 'due diligence' cases under the 1933 Act to appreciate the uncertainty inherent in standards such as 'reasonable grounds for belief,' 'reasonable investigation,' and the like." Id. at 68 (footnote omitted). The two cases referred to are illustrative of the uncertainty which results from the injection of a reasonableness standard. See Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 576-81 (E.D.N.Y. 1971) ("reasonable investigation" and "reasonable grounds to believe" will vary with the degree of individual's involvement, expertise and access to data and information); Escott v. Barchris Constr. Corp., 283 F. Supp. 643, 682-703 (S.D.N.Y. 1968) (due diligence defenses of issuer, officers, directors, underwriters, and auditors).


49. Id. In the Adopting Release, the Commission also noted that the ability to invest $150,000 applies only to the provision excluding individuals from the total number of purchasers, not to the economic risk test. Id.


It has been suggested that to satisfy these obligations, the issuer should obtain, immediately prior to making an offer, responses to a written questionnaire outlining the offeree’s educational background and formal training, his business experience, and his experience in purchasing securities, including privately placed securities. The questionnaire should also
must have "such knowledge and experience in financial and business matters that he, either alone, or with other offeree representatives or the offeree, is capable of evaluating the merits and risks of the prospective investment." The subjective language defining the capability of the offeree representative is identical to that used for offerees. Furthermore, both the issuer and any person acting on its behalf must have an actual belief based upon reasonable grounds through reasonable inquiry that the offeree representative is qualified.

The offeree representative, in addition to being sophisticated, must not be "an affiliate, director, officer, or other employee of the issuer, or beneficial owner of 10 percent or more of . . . the equity securities or 10 percent or more of the equity interest in the issuer." The rule also requires the offeree representative to disclose, in writing, any "material relationship" with the issuer during the past two years and any compensation received or anticipated as a result of that relationship. While the concept of offeree representative may have practical utility in situations where professional investors have retained investment counselors, too many questions and resulting pitfalls remain for the concept to give much comfort to a small issuer attempting to comply with all the provisions of rule 146.

The Code rids the limited offering of all such requirements relating to the sophistication of offerees. In fact, the Code is not concerned with offerees and focuses only upon purchasers. Purchasers are limited only by number, not by sophistication or affluence. The comments in the Code suggest that the departure from concern over offerees is justified because nonpurchasing offerees suffer no injury. Restraint is still imposed on the breadth of the offering through retention of the prohibition of general advertising. By focusing solely upon the number of purchasers, "the Code adds preci-

52. Id. § 230.146(a)(1).
53. Id. § 230.146(a)(1)(i). This is so except where the offeree and his offeree representative are related in certain specified ways.
54. Id. § 230.146(a)(1)(iv).
55. For example, the vagueness of the term "material" is apparent from its definition as "any relationship that a reasonable investor might consider important in the making of the decision whether to acknowledge a person as his offeree representative." Id. § 230.146(a)(4).
56. FED. SEC. CODE § 242(b).
57. Id. § 227, Comment (2)(b) (Apr. 1972 Tent. Draft No. 1).
58. Id. § 503(b).
sion to a subjective and troublesome aspect of the section 4(2) ex-
emption [and rule 146]."

On its face, the limited offering exemption of the Code seems
to better accommodate the financing needs of small and large corpo-
rations than does the current exemption for private placements.
When the issuer is not a one-year registrant, however, the Commis-
sion is given the power to modify the conditions of the limited offer-
ing or to impose additional conditions considering "(A) the type of
issuer and security, (B) the kind of market if any, and (C) similar
criteria." At least some commentators believe this permits the
Commission to reimpose the sophistication and information deliv-
ery requirements of rule 146, thus subjecting small issuers to more
rigorous requirements under the private placement exemption than
large issuers and subjecting all issuers to the elusiveness of such
concepts. On the other hand, the Proposed Official Draft represents
a major improvement over earlier Tentative Drafts which would
have given broad rulemaking authority to the Commission for one-
year registrants as well.

The departure of the Code from the Ralston Purina doctrine
through the abandonment of the sophistication and relationship
tests has also been criticized for placing "the entire burden of inves-
tor protection upon its antifraud provisions and upon applicable
state blue sky laws." As James Cheek has stated: "Under the
Code's approach, the purchasers of a limited offering can be thirty-
five widows and orphans who are thoroughly unsophisticated
strangers, and who are unable to bear the economic risk of their
investment." Thus, some commentators believe that certainty is

60. FED. SEC. CODE § 252(b)(3).
61. Wolfson, supra note 2, at 1504. See also Bialkin, supra note 10, at 338.
62. The first tentative draft of the Code gave the Commission power to modify the
conditions of a limited offering or impose additional conditions with respect to all registrants.
That draft provided that the Commission need only consider, among other criteria, whether
the issuer was a one-year registrant. FED. SEC. CODE § 227(b)(3) (Apr. 1972 Tent. Draft No. 1). The current proposed draft specifically limits this rulemaking power of the Commission
to non-one-year registrants. Id. § 242(b)(3).
63. SEC v. Ralston Purina Co., 346 U.S. 119 (1953). The Court rejected the Commis-
sion's suggestion that a private placement exemption should not be available to offerings to
a large number of persons as a matter of statutory interpretation. Id. at 125. The Court
emphasized the purpose of the Securities Act, holding that the applicability of the private
offering exemption "should turn on whether the particular class of persons affected needs the
protection of the Act." Id. When the focus of inquiry is "the need of the offerees for the
protection afforded by registration," id. at 127, the Court indicated that "the exemption
question turns on the knowledge of the offerees." Id. at 126. See also note 21, supra.
64. Cheek, supra note 59, at 364.
65. Id.
procured at too high a price; while the antifraud provisions would provide a remedy for the worst abuses, the degree of disclosure required by these provisions is unclear.66

C. Access to or Furnishing of Information

Rule 146(e) provides that an offeree must have access to or receive the same type of information that registration would disclose, as well as additional information necessary to verify what the offeree has received.67 The preliminary note to rule 146(e) provides that access can only exist by reason of an offeree’s employment or family relationship or economic bargaining power with respect to the issuer.68

The access requirement has been criticized for protecting those who do not need its protection and for doing little to reduce uncertainty or to provide more objective standards.69 The concept is relatively simple if the issuer is dealing with an “insider”—an institution or a venture capital firm which possesses sufficient economic bargaining power to be an access offeree. In other cases, because the determination of the requisite relationship is so uncertain, the only safe alternative for an issuer is to furnish the information and not to rely upon access as a substitute.70 Since the issuer must comply with paragraph (e)(2) and give the offeree “the opportunity to ask questions of, and receive answers from, the issuer . . . and to obtain any additional information . . . necessary to verify”71 the information previously received, the burden is ultimately greater than registration. Furthermore, because no one can say with certainty how much additional information is enough, attempted compliance often becomes even riskier than a registered offering.72

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66. In his article, Cheek suggests that “[a]s a practical matter, an individual purchaser is better protected if the sale to him destroys the availability of the limited offering exemption and thereby subjects the seller to civil liability without the problems of proof involved in an antifraud claim.” Id. Cf. Casey, supra note 22, at 593, (suggesting that misrepresentations are more appropriately dealt with by the antifraud provisions, with the remedy of damages, rather than by rescission of the entire deal). See also Comment, Revising the Private Placement Exemption, 92 Yale L.J. 1512, 1524 (1973).

67. 17 C.F.R. § 230.146(e)(1). The Adopting Release explains that the term “access” is used in the rule “in the same sense that it has been used by the courts and the Commission in the past—to refer to the offeree’s position with respect to the issuer.” SEC Release No. 33-5487, 1973-74 Fed. Sec. L. Rep. (CCH) ¶ 2710 (Apr. 23, 1974). The same release, however, also states that “the Commission is of the view that an offeree need not be an insider such as an officer or director of the issuer” to have the requisite access. Id.

68. 17 C.F.R. § 230.146(e) (1978).

69. See Rosenfield, supra note 22, at 206. See also Kripke, supra note 22, at 6, col. 3.

70. See Rosenfield, supra note 22, at 206; Kripke, supra note 22 at 6, col. 3.


72. See Rosenfield, supra note 22, at 205-06.
The access provision of rule 146 contains a modification of the information requirements for issuers required to report under the 1934 Act. In addition, an ameliorative provision for nonreporting issuers is included, which because it is also couched in vague terms, does little to lessen the burden of providing each offeree with a virtual registration statement. An issuer who is not a reporting company under sections 13 or 15(d) of the 1934 Act may condense the registration information or omit details, but only if such issuer can show that "under the circumstances, the omitted information is not material or the condensation of information does not render the statements made misleading." Therefore, only a foolhardy issuer's lawyer would rely on the permission to omit or condense where his client has the burden of proof of nonmateriality.

As previously noted, the Code is unconcerned with offerees and thus the limited offering exemption has no provisions concerning access or information to be delivered to purchasers other than the potential for such a requirement for issuers who are not one-year registrants under the Commission's rulemaking authority. One of the most troublesome aspects of the provisions of the Code, from the practitioner's standpoint, will be the determination of the scope of information to be furnished to investors to avoid liability under the antifraud rules.

The groundwork has already been laid under the section 4(2) exemption for investor protection through use of the antifraud provisions. In Steir v. Smith, the Fifth Circuit held that the sale of unregistered stock to a sophisticated purchaser, subject to the occurrence of a public offering, violated rule 10b-5 when the seller failed to inform the buyer of information about the public offering which would have influenced the buyer's decision.

The antifraud rule was applied to purchasers of unregistered securities sold in a distribution that had failed to qualify for a section 4(2) exemption in Woolf v. S.D. Cohn & Co. The Fifth Circuit held that rule 10b-5 does provide a remedy where an issuer's failure
to disclose all the information that compliance with Schedule A would have revealed becomes, at a certain point, "an act, practice or course of business which operates or would operate as a fraud or deceit' upon the offerees, in violation of the third clause of [rule 10b-5]." The rationale of the court for this extension in Woolf was:

Under any view of how far 10b-5 should extend, the area of private offerings of securities under the exemption afforded by § 4(2) of the 1933 Act is so closely related to the fairness of the public and private securities markets and the allocation of investment capital that it must come within the scope of the rule.\[81\]

The SEC has stated that section 17(a) of the 1933 Act and section 10(b) and rule 10b-5 of the 1934 Act are violated when an issuer, in connection with the private placement of securities, fails to inform fully the purchaser as to "the circumstances under which he is required to take and hold the securities."\[82\]

Indeed, to remedy a failure to comply with rule 146 or the statutory exemption for private offerings by awarding rescission for nonregistration either aborts too many small financings or forces them into a registration process which is not appropriate and was never intended for them. Simple business deals between a few people—where a 10b-5 action would be an adequate remedy for any misrepresentation, overreaching, or other fraud—should be made safe without imposing the time-consuming and expensive registration requirements.\[83\] Furthermore, although most of the cases decided since Ralston Purina were resolved in favor of purchasers of stock seeking rescission, "[t]hese decisions should have turned on an uncamouflaged acknowledgment that the facts showed a clearly public distribution or an offering tainted by omissions or misrepresentations or both."\[84\]

The problem of relying upon the antifraud provisions in this area, however, is the potential for runaway holdings by the courts.

80. Id. at 608 (quoting rule 10b-5(3)).
81. Id. at 607.
84. Id. at 581 (emphasis added).
or overly expansive Commission rules which expand the duty to disclose because of the lack of access and/or information and sophistication requirements. By so doing, it is possible that the certainty sought to be afforded to issuers under the Code could be greatly reduced.

D. Number of Purchasers and Limitations Imposed on Disposition

Rule 146 modifies the pre-Ralson Purina rule of thumb used by the SEC to determine the number of permissible offerees (twenty-five) by increasing the number to thirty-five and by making the limitation applicable to purchasers instead of offerees. The purchaser's spouse, relatives living in the same house, trusts, estates or corporations in which they have the entire interest, or purchasers of $150,000 worth of securities need not be included in the thirty-five. The sophistication and information requirements apply, however, to all purchasers. Under the original version of the rule, a good faith issuer, who had exercised reasonable care in determining the number of purchasers, faced a potential loss of the exemption if one of the purchasers deceived him by purchasing for other accounts. In 1975, rule 146 was amended to provide that "[t]he issuer shall have reasonable grounds to believe, and after making reasonable inquiry, shall believe, that there are no more than thirty-five purchasers."

Unfortunately, this improvement was cast in the same uncertain standards of "reasonableness" that are characteristic of the rule.

Rule 146(h) requires the issuer and any person acting on its behalf to exercise "reasonable care" to assure that the purchasers are not "underwriters," and sets forth the minimum standard that

85. See note 20, supra.
87. Id.
88. Id. § 230.146(g)(1) (as amended by 40 Fed. Reg. 21,710 (1975)).
89. See note 47 and accompanying text supra.
90. "Underwriters" is defined here by reference to the definition contained in section 2(11) of the 1933 Act, as follows:

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

the issuer must meet in order to carry the burden of "reasonable care." In addition, the issuer must also fulfill the rule 146(e) requirement that it inform each offeree in writing that the securities are restricted and may not be resold unless registered or exempted from registration.

The Code is similar to rule 146 in that the number of purchasers who may buy under its limited offering is also thirty-five, but the number of institutional investors is unlimited. Moreover, unlike the private placement exemption of section 4(2) and rule 146, the exemption is not limited to issuers but applies to secondary resales as well. Under the Code, no resales may be made that result, at any one time, in more than thirty-five owners of the securities sold in the limited offering, excluding institutional investors and those who become owners by means other than through purchase. This restriction applies for three years after the last sale to any initial buyer unless the issuer is a one-year registrant at the time of a particular resale, in which case the restrictive period is one year. This is significantly different from rule 146 in that the issuer need not concern itself with the investment intent of the purchaser. Thus, "[r]esales may be made immediately and frequently during the applicable restrictive period if the maximum number of owners does not exceed thirty-five."

The Commission, in section 242(b)(3), is given power to modify or impose additional conditions upon the resale provisions if the issuer is not a one-year registrant. In addition, the Commission is also given rulemaking power in section 242(b)(4) to require that the seller or any reseller obtain an appropriate undertaking from the buyer that the security be subject to appropriate restrictions on transferability and "that any transfer agent be given an appropriate stop-transfer notice, in each case designed to avoid a distribution that would violate section 502(a)."

91. "Reasonable care" includes making reasonable inquiry into the purchaser's purpose in acquiring the securities, placing restrictive legends on the certificates, making appropriate "stop transfer" notations and instructions with the issuer and/or transfer agent, and obtaining a letter of investment intent from the purchaser. 17 C.F.R. § 230.146(h) (1978). This is, however, expressly noted as being a non-exclusive list of requirements. Id.
92. Id. § 230.146(e)(3)(ii).
93. Fed. Sec. Code § 242(b)(1)(A). Allowing an unlimited number of institutional investors will have a practical effect similar to the exclusion of large purchasers (over $150,000) from the 35 in rule 146. See 17 C.F.R. § 230.146(g)(2)(i)(d).
95. Id.
96. Cheek, supra note 59, at 366.
97. Fed. Sec. Code § 242(b)(4). Id. § 502(a) is equivalent to § 5 of the 1933 Act which requires registration of a security unless it is exempted. 15 U.S.C. § 77c (1976).
The new approach to resales is not without problems. The reseller may have difficulty:

in determining when the restrictive period begins and ends and whether thirty-five or fewer owners, other than institutions or recipients of securities in nonsale transactions, are involved. The latter problem is particularly complex because the term 'owner' rather than 'persons' is used and because the term includes indirect as well as direct ownership, thus requiring an issuer or reseller to ferret out the number of beneficial, indirect owners when the record owner is a nominee, partnership, or similar entity.

The Code, however, protects an issuer or reseller from liability if such person acts in good faith reliance upon a statement from his buyer as to the number and nature of the owners, the issuer's status as a one-year registrant or the date which concludes the restricted period. Here, again, the Official Draft represents a marked improvement over earlier Tentative Drafts that were subject to criticism for not providing this protection.

As the foregoing discussion indicates, the treatment of the limited offering exemption in the proposed Federal Securities Code substantially resolves the major difficulties that have plagued the securities bar over the years. Although the uncertain application of the antifraud rules still has an impact upon the scope of the information required to be furnished to investors, in most respects there will be objective standards that appear to strike a reasonable balance between the need for private investment capital and the need to protect investors.

III. TENDER OFFERS

Analysis of the tender offer provisions is a more difficult task than that presented by limited offerings. Not only has the law in
this area been expanding at a rapid pace, but numerous provisions of the Code appear to be in conflict with the views of the Commission. Because it is likely that changes will be made in the Code provisions prior to adoption by Congress, it is far more difficult to determine whether the final result will reflect the same level of objective standards as are presented for limited offerings and maintain the balance of interests originally sought by the Williams Act.  

A. Preemption

Section 1904(c) of the Code states that the tender offer provisions are "exclusive and plenary" to the extent that these sections involve a Code "registrant." But if the target company is not a registrant or if, with respect to any state, "(A) the registrant to whose security holders the tender offer is directed has its principal place of business and (B) more than 50 percent of the record or beneficial holders of its outstanding voting securities holding more than 50 percent of those securities are residents," then the state tender offer statutes are not preempted. To some commentators, the preemption of state takeover statutes is "the single most important channel made by the Code" in this area because "the recent proliferation of state takeover statutes has had a chilling effect on tender offers." The Code, however, has also changed the federal substantive provisions relating to tender offers by adding several characteristics of the state laws, such as the definition of the term "tender offer," the requirements of prospective filing, the publication of advance notice, and the provision for extended offer periods.

According to Professor Loss, "the only way politically" that the drafters of the Code could preempt "the thirty-five state statutes, which are blatantly pro-management, . . . was to tighten up some-

102. See note 26, supra.
103. FED. SEC. CODE § 1904(c). Obviously, this exception will apply to a limited category of target companies. It should be noted that the only state laws displaced by the Code are those regulating tender offer transactions as tender offers. Thus, ordinary blue sky requirements concerning the sale side of an exchange tender offer will be unaffected.
105. FED. SEC. CODE § 299.68.
106. Id. § 606(d)(1).
107. Id. § 606(d)(2).
108. Id. § 606(e).
When Congress adopted the Williams Act in 1968, only one state regulated tender offers. This being the case, there was no reason expressly to preempt state legislation in this area, and, when necessary, reliance could be had on section 28(a) of the 1934 Act if any potential conflicts arose. Now, depending upon which commentator one reads, there are between thirty-one and thirty-seven states that regulate such transactions. With this proliferation of state laws, there has also been a growing body of criticism of these statutes based primarily upon what is perceived as a substitution of an antitakeover philosophy by the states for the Williams Act's deliberate neutrality among the contestants in a tender offer.

The conflict between federal and state laws culminated with the decision of the Fifth Circuit in Great Western United Corp. v. Kidwell. There, the court held that the Idaho takeover statute was preempted by the Williams Act and created an unconstitutional burden on interstate commerce. In reaching its holding on

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110. VA. CODE §§ 13.10528-.10541 (Supp. 1970). When the first tentative Draft of §§ 605(b) to 607 of the Code was approved, only Nevada and Ohio had joined Virginia with legislation in this area.
111. Section 28(a) of the 1934 Act provides in pertinent part: "Nothing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." 15 U.S.C. § 78bb(a) (1976) (emphasis added).
112. See note 15 and accompanying text supra.
115. Id. at 1280, 1286. Since this decision, almost every contested takeover offer now includes a challenge to the legal validity of the law of any state which may have some possible connection with the offer. Thus, the Supreme Court's reversal on grounds of improper venue does not put an end to the issue of the validity of state takeover laws. See, e.g., Dart Industries Inc. v. Conrad, 462 F. Supp. 1 (S.D. Ind. 1978) (Indiana and Delaware laws unconstitutional and preempted); proposed offer by Daylan, Inc., for stock of Uarco, wherein the Federal District Court of the Northern District of Illinois enjoined the application of the Illinois tender offer statute. Televest, Inc. v. Bradshaw, [1979] 519 SEC. REG. & L. REP. (BNA) at A-2 (E.D. Va. 1979) (invalidating Virginia's takeover statute).

Recently, however, there have been indications that the courts may reconsider the issue of the constitutionality of the state takeover statutes. For example, in UV Indus., Inc. v. Posner, 466 F. Supp. 1251 (D. Me. 1979), the court issued a preliminary injunction against an offer for alleged violations of Maine's takeover statute, declining to decide at that time whether or not the statute was unconstitutional. More recently, in City Investing Co. v.
preemption grounds, the Fifth Circuit analyzed the conflict between the Idaho takeover statute and the Williams Act. The court concluded that the Idaho statute favored the target company and incumbent management. Thus, it was so inconsistent with the purposes and objectives of Congress that the state law was an obstacle to the accomplishment and execution of such objectives.

The issue to be resolved is whether the Code is incorporating those aspects of state legislation that would improve the regulatory scheme without sacrificing neutrality or merely facilitating the preemption contemplated by section 1904(c). The observation has been made, for example, that "one might have thought that codifiers who wanted to reexamine matters with an eye toward improving investor protection without interfering with honest business would have been reluctant to add to the burdens of those making tender offers" by including state characteristics which are, in the drafters' own words, "blatantly pro-management." What such criticism fails to recognize, however, is that the new tender offer rules which have been proposed by the SEC and which have been

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Simox, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,942 (S.D. Ind. 1979), the court upheld the constitutionality of Indiana's takeover statute. In a conclusory opinion, the court simply noted that the state statute was not "an obstacle to the accomplishment of the purpose of the Williams Act," and that it was not preempted by virtue of provisions "different from those chosen by Congress in enacting the Williams Act." Id. at 95,946.


Congressional enactments that do not exclude all state legislation in the same field nevertheless override state laws with which they may conflict . . . . The criterion for determining whether state and federal laws are so inconsistent that the state laws must give way is firmly established in our decisions. Our task is 'to determine whether, under the circumstances of this particular case, [the State's] law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' Hines v. Davidowitz, 312 U.S. 52, 67 (1941) . . . . This inquiry requires us to consider the relationship between state and federal laws as they are interpreted and applied, not merely as they are written.

Id. at 525-26 (citations omitted).

117. The stated purpose of the Williams Act was to protect investors. See Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977). This goal was to be accomplished by requiring that regulatory schemes remain neutral and therefore there must be "extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bid." S. Rep. No. 550, 90th Cong., 1st Sess. 3 (1967).

118. See notes 102-03 and accompanying text supra.

119. West, supra note 2, at 1489.
commended for their “thoroughness, orderliness and precision,” go much further than the Code in many respects in “tipping the balance in favor of the target.” Thus, notwithstanding the adoption of the Code, prospective bidders might still be faced with a set of new rules that are far more onerous than those necessary to further investor protection.

Moreover, because the recommendations of the SEC will be crucial in determining whether the Code provisions concerning tender offers are adopted by Congress, political pressures of a practical sort are posed by the Commission’s views as reflected in the Proposed Rules. Although Professor Loss has “little doubt that [the drafters] shall achieve agreement with the SEC,” the timing of the Proposed Rules has a direct relationship to the submission of the Code to Congress.

Although the SEC cannot preempt state law through its rule-making powers, and is therefore bound by section 28(a) of the 1934 Act, it is likely that the SEC will agree with the drafters of the Code concerning preemption of state takeover laws. In addition, both the drafters of the Code and the SEC seem to be in agreement that tender offers must remain open for a longer time than is presently allowed by the Williams Act. Even though the Code and the Proposed Rules differ in their implementation of this objective, it is likely that the Commission and the drafters will be able to reach some compromise that is satisfactory to both sides. A major area of concern that remains a problem, however, is whether the SEC will be willing to accept the definition of “tender offer” in the Code.

B. Definition of “Tender Offer”

The Williams Act does not attempt to define “tender offer” and

120. Sommer, supra note 13, at 25, col. 4.
121. Loss, supra note 2, at 1449.
122. In its discussion of proposed rule 14e-1(a), which would require that any tender offer must remain open for at least 30 business days, the SEC notes that the “excessively short duration” of tender offers permitted under the Williams Act “may have provided part of the stimulus for some of the 36 states which have enacted antitakeover statutes since 1968.” The Commission believes that although the “attempt to alleviate the problem was laudable,” it has resulted in an inconsistent, overlapping and often counterproductive pattern of regulation and in many instances may have tipped the carefully construed balance between bidder and subject company envisioned by the Williams Act in favor of [the] subject company. Accordingly, the Commission believes that a uniformly applied federal regulation would better serve the purposes and policies of the Williams Act, including the interests of investors.

until quite recently the SEC had consistently declined to define the term.\[^{123}\] In February of 1979, the SEC formally took this position in the context of explaining its proposals for new tender offer rules.\[^{124}\]

It should not be surprising, therefore, that the issue of what constitutes a tender offer,\[^{125}\] at least in its more unconventional sense, has been litigated time and time again.\[^{126}\] The Code attempts to put an

\[^{123}\] In a 1976 Release, the SEC stated that:

*at this time . . . 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.”*


Recently, SEC Commissioner John R. Evans, in an interview with a reporter from the Securities Regulation & Law Report, stated:

*The Commission wants to provide a much certainty [in defining a tender offer] as possible so people know what the regulatory requirements are. Businessmen need this so that they'll know how to comply with the laws. At the same time, this is an area where too specific a definition can easily be circumvented.*


When asked whether the Commission has asked the staff to draw up a definition of a tender offer, Evans replied that the “staff is trying to evaluate whether a definition could be workable and what it might be. There has not been a decision to adopt a definition . . . . We would want to retain our flexibility and the staff may not be able to come up with anything that we would accept.” [1979] 520 SEC. REG. & L. REP. at AA-9.

When asked whether the Commission had set forth eight factors to determine the existence of a tender offer, See note 139 infra. When asked why the Commission does not set forth the eight factors as Commission policy, Evans replied that these factors “are a framework by which it can be determined whether something is a tender offer. They don't say what a tender offer is, but they can be used as a measuring stick.” [1979] 520 SEC. REG. & L. REP. at AA-9.

\[^{124}\] [T]he Commission affirms its position that a definition of the term “tender offer” is neither appropriate nor necessary at this time. The Commission wishes to emphasize that in its view the term should be understood in a context which furthers the purposes of the Williams Act. Thus, this position should in no way be construed to mean that the term applies only to a so called “conventional” tender offer . . . . In the Commission's view, the term “tender offer” is to be interpreted flexibly in accordance with the intended purposes of Sections 14(d) and 14(e) of the Williams Act. Therefore, the determination of whether a transaction or series of transactions constitutes a tender offer depends upon consideration of the particular facts and circumstances in light of such purposes.


\[^{125}\] The conventional meaning of “tender offer” was described in a leading article as “a publicly made invitation addressed to all shareholders of a corporation to tender their shares for sale at a specified price.” Note, *The Developing Meaning of ‘Tender Offer’ Under the Securities Exchange Act of 1934*, 86 Harv. L. Rev. 1250, 1251 (1973) (footnotes omitted).

\[^{126}\] See, e.g., Smallwood v. Pearl Brewing Co., 489 F.2d 579 (5th Cir.), cert. denied, 419 U.S. 873 (1974). When confronted with a contested takeover, the Fifth Circuit stated:

In conventional tender offers the offeror typically offers to purchase all or a portion of a company's shares at a premium price, the offer to remain open for a
end to this spate of litigation by defining tender offer as follows:

"Tender Offer" means an offer to buy a security, or a solicitation of an offer to sell a security, that is directed to more than thirty-five persons, unless

1. it (A) is incidental to the execution of a buy order by a broker, or to a purchase by a dealer who performs no more than the usual function of a broker or dealer, or (B) does no more than state an intention to make such an offer or solicitation, and

2. satisfies any additional conditions that the Commission imposes by rule. \(^{127}\)

The question remains, however, whether the new definition of tender offer in the Code affects the nonconventional methods of acquiring control, either on the open market or in privately negotiated purchases?

1. OPEN MARKET PURCHASES IN GENERAL

It is well settled that open market purchases\(^{128}\) of securities do not per se constitute a tender offer.\(^{129}\) In *Kennecott Copper Corp. v. Curtiss-Wright Corp.*,\(^{130}\) Curtiss-Wright purchased nearly 9.9% of Kennecott's outstanding shares primarily in open market transactions during a four-month period. The court held that these transactions did not constitute a tender offer. According to the court, although Congress and the SEC have deliberately left the definition

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\(^{127}\) Id. at 597 n.22.


\(^{130}\) 449 F. Supp. 951, aff'd in part, rev'd in part on other grounds, 584 F.2d 1195 (2d Cir. 1978).
of tender offer vague, it was clear that the term embraces more than formal conventional communications to shareholders. It is, however, "equally well settled that [open] market purchases of stock, however aggressive, do not constitute a tender offer."131

Similarly, in Financial General Bankshares, Inc. v. Lance, each of four investors purchased nearly five percent of the outstanding securities of the target in open market transactions during a six-week period. The court held that a tender offer had not occurred, and that "open market purchases made without widespread public knowledge of the purchasers' intention do not constitute a tender offer."133

Under the Code, it also appears that open market purchases do not constitute a tender offer per se. The Code specifically excludes from the thirty-five person limitation ordinary market transactions either through a broker or directly with a marketmaker.134 The Code explains that "[t]he purpose of § 299.68(a)(1)(A) is to exclude ordinary market transactions, whether the intermediaries are brokers or dealers."135 Thus, the Code makes no substantive changes in this area of the law.

2. PRIVATELY NEGOTIATED PURCHASES IN GENERAL

Under present law, the courts consider various factors in determining whether privately negotiated purchases constitute a tender offer. These factors are, inter alia, the number of shareholders solicited, the percentage of outstanding shares held by solicitees, the sophistication of the solicitees, the method of communications with the solicitees, and the time period which the solicitees are given to respond. While properly constructed private purchases may not constitute a tender offer, these criteria are indicative of the confused state of law in the area of privately negotiated tender offers. The confusion is illustrated by two conflicting decisions, both by the Southern District of New York.

In Wellman v. Dickinson, the court stated that the acquisition by Sun Company of approximately thirty-four percent of th
outstanding stock of a target company in negotiated off-market purchases through the solicitation of thirty-nine individuals and institutions amounted to a tender offer in violation of the filing requirements of the Williams Act. In *Brascan Ltd. v. Edper Equities Ltd.*, however, the court rejected the argument that a tender offer had been made even though defendant engaged in a program of open market purchases, carefully made so as to avoid causing a price increase, while defendant’s brokerage firm solicited purchases from between thirty and fifty institutional holders and about twelve large individual holders.

Both cases reviewed the legislative history of the Williams Act as well as eight factors put forth by the Commission to be considered in determining whether privately negotiated purchases constitute a tender offer. While the court in *Dickinson* accepted the Commission's eight factors, the court in *Brascan* rejected them, stating doubts as to “whether the Commission’s view constitutes either a permissible or a desirable interpretation of the [Williams Act].”

As to permissibility, the court questioned whether the factors expanded congressional intent. Moreover, the factors were considered too vague and thus would introduce a crippling uncertainty.

The *Brascan* court reviewed the legislative history of the Williams Act and concluded that Congress was aware of privately negotiated acquisitions of control and chose not to regulate in this area. In contrast, the *Dickinson* court reviewed the same legislative history and concluded that Congress intended to regulate all transactions having the same effect as a conventional tender offer. To be sure, while arguments can be made that either case was correctly decided, it cannot be true that both were correctly decided.

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139. The eight factors were described and applied in Hoover v. Fuqua Indus., Inc., No. 79-1062A (N.D. Ohio June 11, 1979), cited in Wellman v. Dickinson, ¶ 96,918 at 95,842. They are: (1) Whether there is an active and widespread solicitation of shareholders; (2) whether the solicitation is for a substantial percentage of the issuer's stock; (3) whether the offered price is a premium over the market price; (4) whether the terms of the offer are firm rather than negotiable; (5) whether the offer is contingent upon a tender of a fixed minimum number of shares; (6) whether the offer is open for only a limited period of time; (7) whether the offerees are subjected to pressure; and (8) whether public announcements of a purchasing program concerning the target company precede or accompany a rapid accumulation of large amounts of target company securities. *Id.*
141. *Id.*
142. Wellman v. Dickinson, ¶ 96,918 at 95,839-41.
In *Cattlemen’s Investment Co. v. Fears,*\(^{144}\) the purchaser made an “active and widespread solicitation of public shareholders in person, over the telephone and through the mails,”\(^{145}\) during a six week period and thereby obtained over seven percent of the shares outstanding. The court concluded that such activity:

> deprived shareholders of information . . . which . . . was material to their investment decisions, and denied to them the fair treatment provided by other parts of Section 14[d]. In truth, the contacts utilized by the defendants seem even more designed than a general newspaper advertisement, the more conventional type of “tender offer,” to force a shareholder into making a hurried investment decision without access to information, in circumvention of the statutory purpose.\(^{146}\)

Therefore, these privately negotiated transactions were deemed to constitute a tender offer.

On the other hand, the purchaser in *Nachman Corp. v. Halfred, Inc.*,\(^{147}\) solicited approximately forty of six hundred shareholders and succeeded in obtaining approximately 7.5% of the outstanding shares of the target corporation. The solicitees, many of whom were either directors or substantial shareholders of the target, were “presumed to be powerful enough not to be pressured . . . into making uninformed, ill-considered decisions to sell.”\(^{148}\) The court thus held that these privately negotiated purchases did not constitute a tender offer:

> To characterize [the purchaser’s] negotiations with a relatively small and powerful group of shareholders as a tender offer or tender offers would not serve the purposes of §§ 14(d) and (e). In fact, to so extend the application of these sections would have a disruptive effect upon private, negotiated purchases which Congress probably did not intend, . . . and could upset the balance of burdens upon management and the offeror which the Williams Act seeks to strike.\(^{149}\)

Finally, in *D-Z Investment Co. v. Holloway,*\(^{150}\) the court thought that defining a tender offer as “any offer to purchase secu-
rities likely to pressure shareholders into making uninformed, ill-considered decisions to sell" was much too broad. Even using the shareholder impact test, however, the court held that the purchaser's telephone calls to two dozen sophisticated persons, and the resulting purchases of 97,200 shares from four highly sophisticated financial institutions, did not amount to a tender offer.

The Code would clarify this area of the law by providing that an offer to buy a security directed to more than thirty-five persons is a tender offer. "Person" is defined as including "a natural person, company, government, or political subdivision, agency, or instrumentality of a government." Therefore, an offer to no more than thirty-five persons is not a tender offer, notwithstanding the amount of pressure or lack of decisionmaking time involved. In contrast, an offer to thirty-six or more persons is a tender offer even if there is no pressure and a sufficient amount of time and information is given to the solicitees to allow a fully informed investment decision. Given the high percentage of institutional owners of companies listed on the New York Stock Exchange, the definition of tender offer in the Code would allow effective control of a substantial number of companies to be transferred.

3. OPEN MARKET AND/OR PRIVATELY NEGOTIATED PURCHASES ACCOMPANIED BY PUBLICITY

Until quite recently, it was unclear whether open market and/or privately negotiated purchases, which by themselves probably would not constitute a tender offer, could be transformed into one by means of accompanying publicity. In the unreported case of *Loews Corp. v. Accident & Casualty Insurance Co.*, the purchaser made a public announcement of its intention to acquire target company stock. The court, without explaining its reasoning, enjoined the acquiring company from making future acquisitions of target company stock in "block purchases, private purchases off the market or any purchases other than open market purchases." On the

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151. Id. at 96,563.
152. In light of the conflict in the case law, the SEC has recently reversed its position and asked its staff to draft a rule to settle the difficult question of what constitutes a tender offer. Wall St. J., July 18, 1979, at 1, col. 2. See note 123, supra.
153. FED. SEC. CODE § 299.68(a).
154. Id. § 299.24(a).
155. Block & Schwarzfeld, supra note 136, at 138.
156. No. 74-C-1396 (N.D. Ill. Aug. 20, 1974).
157. Loews Corp. v. Accident & Cas. Ins. Co., slip op. at 12 (emphasis added) (as cited in Einhorn & Blackburn, supra note 128, at 387).
other hand, the court in Nachman stated in dictum that "there is no evidence that the market purchases were preceded by any public announcement which might have caused them to be a tender offer," implying that open market purchases preceded by publicity may constitute a tender offer. One of the latest reported decisions in this area, S-G Securities, Inc. v. The Fuqua Investment Co., is consistent with Nachman.

In Fuqua, the purchases were preceded by widely publicized press releases explaining the buying program. Despite the fact that sellers in the privately negotiated transactions (as opposed to the open market sales) appeared to be sophisticated (some, indeed, were arbitragers) and had knowledge that the acquirer was seeking control, the court still held that:

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 there; and
2) a subsequent rapid acquisition by the purchaser of large blocks of stock through open market and privately negotiated purchases; ... constitute a tender offer.

The court based its decision on the purposes underlying the Williams Act: The legislative history [of the Williams Act] indicates that the defendants' open market and privately negotiated purchases per se do not come within the ambit of the statute. ... In each of the cited cases, however, the purchases in question were consummated prior to any widespread public announcement of a conventional tender offer or an independent buying program proposed or actual. In two of the aforementioned opinions, the courts specifically observed that the market purchases in question were made prior to any public announcement and without any widespread public knowledge of the purchasers' intention that would result in a tender offer subject to the Williams Act.

Defendants' purchases, in the case at bar, were preceded by two and, in part, by three widely publicized press releases issued by defendants that outlined with some specificity the details of the proposed buying program. The publicity created a risk of the pressure on sellers that the disclosure and remedial tender offer provisions of the Williams Act were designed to prevent. ... The conditional language in which defendants' proposals were couched does not obviate the public shareholders' need for the protections of the tender offer provisions of the Williams Act once such proposals have been made public with the specificity and apparent genuineness evident in this case.

Fuqua made a subsequent offer for the Hoover Company, which resulted in the SEC charge that Fuqua made a "firm tender offer" when it sent letters to some of the Hoover family members offering to buy their stock, which amounted to forty-one percent of the shares of the Hoover Company. This activity was accompanied by numerous press releases emanating from both Hoover and Fuqua. Fuqua settled the suit by agreeing to set up an acquisitions
In comparison to the present case law, the Code's thirty-five person test makes no reference to the effect of publicity on open market purchases or privately negotiated transactions. The SEC is given rulemaking authority\textsuperscript{163} that would enable it to promulgate regulations dealing with publicity. Yet, apparently this authority will only enable the SEC to exclude from the tender offer definition those transactions that would otherwise constitute a tender offer under the thirty-five person test.

4. \textbf{INTEGRATION: THE CREEPING TENDER OFFER}

An acquirer will often make purchases of target company stock in the open market or by means of negotiated transactions prior to formally announcing a tender offer. The courts, however, have refused to hold that these prior purchases will be integrated with the subsequent tender offer so that the actual tender offer will be deemed to have begun on the date of the initial purchases.\textsuperscript{164}

In \textit{Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Co.},\textsuperscript{165} the acquirer bought less than five percent of the target's stock in open market purchases during a one year period prior to its tender offer announcement. The court refused to integrate the prior market purchases with the tender offer, stating that "the 5 percent limit included in Section 14(d) permits that amount to be purchased in the open market without regard to any subsequent tender offer."\textsuperscript{166}

Similar results have been reached with respect to negotiated purchases made prior to a tender offer, despite the acquirer's private communication of its intent to make a tender offer. In \textit{Sunshine Mining Co. v. Great Western United Corps.},\textsuperscript{167} the acquirer notified the New York Stock Exchange on March 18, 1977 that it intended to purchase more than five percent of the target company's stock from two shareholders and then to make a tender offer. Later that day, the acquirer consummated the privately negotiated purchase.

\textsuperscript{163} For discussions of this area of the law, see \textbf{M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZOUTS} 123-26 (1978); \textbf{H. EINHORN, WHAT IS A "TENDER OFFER"?} (Tenth Annual Institute on Securities Regulation (PLI)) 333, 441-43, 358-63 (1978).

\textsuperscript{164} \textit{FED. SEC. CODE} § 299.68(a)(2).

\textsuperscript{165} \textit{356 F. Supp. 1066 (S.D.N.Y.), aff'd on other grounds, 476 F.2d 687 (2d Cir. 1973).}


\textsuperscript{167} \textit{1977-78 Transfer Binder} \textbf{FED. SEC. L. REP. (CCH) ¶ 96,049 (D. Idaho 1977).}
Three days later, the acquirer issued a press release announcing a tender offer for up to approximately thirty-four percent of the target company's outstanding stock. The court refused to integrate the private purchase and the tender offer, stating that the prior purchase of more than five percent of the target's stock from the two shareholders was "a transaction separate and independent from the proposed tender offer announced by [the acquirer] and was consummated prior to any public announcement of the proposed tender offer by [the acquirer] and is not a part of that offer."\footnote{168}

The definitional section of the Code could apply to certain of these purchases prior to formal tender offers. In defining multiple tender offers, the Code states that:

A tender offer is separate from any other tender offer (or from an offer to buy a security, or a solicitation of an offer to sell a security, that is directed to not more than thirty-five persons) if (1) it is for a different class of securities, or (2) it is for additional securities of the same class but is substantially distinct on the basis of such factors as manner, time, purpose, price, and kind of consideration.\footnote{169}

An acquirer, therefore, can avoid the integration problem if its pre-tender offer purchases result from offers that are substantially distinct from the tender offer. The distinction is to be made on the basis of factors such as "manner, time, purpose, price and kind of consideration." Arguably, open market and privately negotiated purchases are substantially distinct in manner from formal tender offers, at least when they are not accompanied by publicity. Furthermore, depending upon the circumstances of each case, there may be distinctions on the basis of time, purpose, price and type of consideration. It is in this area, however, that the Commission's rulemaking power under section 606(c) of the Code could dramatically impact upon pre-tender purchases.

The Commission's Proposed Rules, while not defining open market or privately negotiated purchases as tender offers, would regulate such purchases when made prior to a formal tender offer. Proposed Rule 14e-2(c) would make it a fraudulent, deceptive or manipulative act or practice for a bidder to purchase subject company securities after a determination to make a tender offer which has not been publicly announced unless the bidder makes a public


169. \textit{Fed. Sec. Code} \S 299.68(b) (emphasis added).}
announcement prior to any such purchase. Thus, the bidder would be permitted to "test the market" by buying in the open market so long as no determination has been made to make the tender offer. The obvious problem with this rule lies in choosing a method to ascertain when one has "determined" to make a tender offer.

A more subtle problem arises because Proposed Rule 14e-2(c) requires disclosure of (i) the identity of the bidder, (ii) the identity of the subject company, (iii) a statement that the bidder has determined to make a tender offer for a class of securities of the subject company, (iv) the amount of consideration to be offered for each such security, if determined by the bidder, and (v) the amount of securities and/or percentages of such class of securities to be sought, if determined by the bidder. According to the Commission, disclosure of 14e-2(c)(i) through (iii) alone "would not constitute the commencement of the tender offer . . . and would not be deemed under present staff interpretations to trigger the application of rule 10b-13." Disclosure of the information required in 14e-2(c)(iv) and (v), however, would constitute the commencement of a tender offer and trigger the operation of rule 10b-13.

Unfortunately, the information referred to in (iv) and (v) must be disclosed only if such facts have been determined by the bidder. Thus, we are once again faced with ascertaining what has been

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171. Id. Rule 10b-13 prohibits any person who makes a cash tender offer or exchange offer from purchasing the security "otherwise than pursuant to such tender offer or exchange offer, from the time such tender offer or exchange offer is publicly announced or otherwise made known by such person to holders of the security to be acquired until the expiration of the period." 17 C.F.R. § 240.10b-13(a) (emphasis added).

The rule also permits written requests to the Commission for exemptions of particular transactions from the rule so as not to constitute "a manipulative or deceptive service or contrivance or a fraudulent, or deceptive or manipulative act or practice comprehended within the purpose of this rule." Id. § 240 10b-13(d).


In addition to a potential rule 10b-13 violation, paragraphs (b) and (c) of Proposed Rule 14d-6 may also violate the prenotification mandates of certain state takeover statutes. See, e.g., Del. Code Ann. tit. 8, § 203 (Supp. 1977).

Under 14d-6(b) a bidder's public announcement or public statement of certain material terms—such as the identity of the bidder and the subject company and disclosure of the offer price—would be deemed to commence the tender offer, unless within 5 days of such announcement the bidder either issues another public announcement stating he has determined not to continue the offer or complies with the filing requirements and proceeds with disseminating the disclosure materials to shareholders.

Consequently, the bidder who is subject to the jurisdiction of such a state statute would be faced with the unpalatable choice of complying with one law and thereby violating another.
"determined" by the bidder. To be sure, this area will be a fertile ground for litigation if the Proposed Rules are adopted. In view of the uncertainties and risks inherent in the Proposed Rules, potential bidders may be dissuaded not only from making pre-tender purchases but from making tender offers at all.

Insofar as the Code attempts to define the term "tender offer," it is in direct conflict with the Commission's stated position that it would be undesirable to propose a definition at this time. In light of Proposed Rules 14d-6 and 14e-2(c), it appears that a compromise will have to be reached with the Commission on this point before the Code provisions on tender offers can be adopted.

C. Advance Filing and Duration of Offer

One of the principal criticisms of the Williams Act has been directed at the brief period afforded shareholders to make their decisions. State statutes, through waiting periods and potential hearings, have lengthened the time in which most tender offers remain open. A.A. Sommer, Jr., has stated that this may in fact be to the benefit of the shareholder as "experience, indeed, does suggest that the longer an offer is open the likelier it is that another bidder would enter the arena, resulting either in the original bidder prevailing with a higher bid or another bidder topping it."\(^\text{173}\)

The SEC has stated in the introduction to the Proposed Rules that it would compel disclosure on the "date of commencement of the tender offer," as this term is defined in Proposed Rule 14d-6,\(^\text{174}\)

\(^\text{173}\). Sommer, supra note 13, at 24, col. 4.
\(^\text{174}\). (a)(1) A tender offer for a class of equity securities referred to in section 14(d)(1) of the Act shall commence for the purposes of section 14(d) of the Act and the rules promulgated thereunder on the date

(i) the tender offer is first published by the bidder pursuant to Rule 14d-4(a)(1) (§ 240.14d-4(a)(1));
(ii) the summary advertisement of the tender offer is first published by the bidder pursuant to Rule 14d-4(a)(2) (§ 240.14d-4(a)(2));
(iii) the summary advertisement of the tender offer is first published by the bidder pursuant to Rule 14d-4(a)(3) (§ 240.14d-4(a)(3));
(iv) definitive copies of a tender offer, in which the consideration offered by the bidder consists of securities registered pursuant to the Securities Act of 1933, are first published, sent or given by the bidder to security holders; or
(v) the tender offer is first published, sent or given to security holders by the bidder, if paragraphs (a)(1)(i) through (a)(1)(iv) of this section are not applicable to such tender offer.

(2) With respect to a cash tender offer that is published, sent or given to security holders by more than one method of dissemination pursuant to Rule 14d-4(a) (§
instead of promulgating rules requiring advance filing and publication.\textsuperscript{178} The Commission believes that this "would facilitate the confidentiality" of the tender offer and "would be consistent with the legislative history of the Williams Act."\textsuperscript{176} Simultaneous filing and commencement of the offer is designed to create, in the words of the Commission, "an efficient filing system which will not unduly burden bidders."\textsuperscript{177} On the other hand the public announcement requirements of Proposed Rules 14d-6 and 14e-2(c) could have virtually the same effect as advance filing.

In \textit{Great Western United Corp. v. Kidwell},\textsuperscript{178} the Fifth Circuit found that the state statute favored the target company by giving it advance notice of the offer. It was, however, a combination of protarget factors and not simply the provisions for advance notice which led to this decision. The statute also had given the target the ability to delay the commencement of an offer by insisting on a hearing before the state attorney general,\textsuperscript{179} by regulating the activities of the offeror more strenuously than the activities of the target company,\textsuperscript{180} and by empowering the board of directors of the target company to exclude an offer from state regulation by approving the offer.\textsuperscript{181}

In its consideration of the Anti-Trust Improvement Act of 1976,\textsuperscript{182} Congress reaffirmed its view that regulatory provisions producing more than minimal delay could upset neutrality. Congressman Rodino stated:

Lengthy delays will give the target firm plenty of time to defeat the offer . . . . And the longer the waiting period, the more the target's stock may be bid up in the market, making the offer more costly — and less successful. Should this happen, it will mean that shareholders of the target firm will be effectively deprived of the choice that cash tender offers give to them.\textsuperscript{183}

If delay does indeed favor the target, then both the Code drafters and the SEC—like most of the state takeover laws—have increased a target company’s ability to defeat an offer by lengthy delays. The Code has done so through the use of prospective filing requirements, publication of notice and extended offer periods while the SEC has done so through the use of extended offer periods, advance public announcements and expanded withdrawal and pro-rata rights.

The SEC and the drafters of the Code seem to agree that there is a necessity for a longer offering period than the seven day minimum offering period of the Williams Act, created by the seven day withdrawal provisions of section 14(d)(5), and the ten days created by section 14(d)(6) if the offer is for less than all the shares.184 The Code expands the offering period to at least thirty days; the ten days required by section 606(d)(1) and the minimum of twenty days required by section 606(e).185

At the time that the final draft of the Code was being drawn, the SEC Proposed Rule 14e-2(a) which would have mandated that an offer be kept open for a minimum of fifteen business days.186 The Commission now proposes a minimum thirty business day offering period and a minimum ten business day period following any increase in price or dealer’s soliciting fee.187

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184. No minimum offering period is imposed expressly by the Williams Act, but section 14(d)(5) permits the shareholder to withdraw tendered shares until seven days after the first definitive copies of the offer are published. Section 14(d)(6) requires that all shares tendered during the first 10 days of any tender offer for less than all the stock in an acquired company be purchased pro rata. The New York Stock Exchange requires that cash tender offers remain open for a minimum of 10 days and the American Stock Exchange requires a minimum of 14 days.

185. Fed. Sec. Code § 606(d)(1), (e). The Code also has the potential of extending the offer for a period much longer than 30 days:

   Every tender offer, unless withdrawn is effective (1) for at least twenty days after it is made, (2) for at least fifteen days after any variation in its terms by changing the consideration offered or the amount of securities covered, (3) for at least seven days after any extension of the period of the tender offer, and (4) during whatever longer period or periods the Commission prescribes by rule.

Id. § 606(e).


It is interesting to note that rule 13e-4(f) (1) requires that an issuer tender offer remain open for at least fifteen business days from the date of commencement of the offer. In contrast
While it might be desirable to lengthen the offering period of the Williams Act, both the Code and SEC policy seem to go too far. A.A. Sommer, Jr. believes that "in this instance, the Commission may, contrary to its avowed intent, have tipped the balance in favor of the target." 188

Advance filing and duration of offer, therefore, are likely to provide additional areas of conflict between the Code and the Commission, ultimately requiring some form of compromise if these provisions of the Code are to be adopted.

IV. CONCLUSION

On balance, the Code has succeeded in its major objective of bringing order and rationality to a confusing mass of statutory and administrative law. During the course of its development, the Code has been responsive to changes in the law and to the watchful eyes of its critics. Undoubtedly, further changes will be required before the Code is adopted, and there will have to be a significant transition period for supportive rulemaking in order to complete the codification process. As illustrated by the limited offering and tender offer provisions, not all questions are answered and not all problems are solved. But from the perspective of the securities practitioner, those questions that remain appear to be far more manageable than the uncertainties and inconsistencies which presently exist.

to the minimum thirty day period of the proposed rules, the Commission believes that this will allow a reasonable opportunity to make an informed investment decision with respect to the tender offer.

188. Sommer, supra note 13, at 24, col. 4.