

SECTION 13(d) DISCLOSURE: GUIDELINES FOR GROUP THERAPISTS

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I. INTRODUCTION

Prior to 1968, the cash tender offer¹ represented the last uncivilized frontier on the corporate takeover landscape. Unlike exchange offers, which involved a distribution or public offering of securities and were thus subject to the registration and prospectus delivery requirements of the Securities Act of 1933,² cash tender offers had been treated simply as large scale market purchases. Not even the name of the buyer was required to be disclosed. Much of the concern over the non-regulation of the cash tender offer was dispelled by the passage of the Williams Act³ in 1968. The Williams

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¹ The term "tender offer" ordinarily is associated with that technique of corporate takeover which is accomplished by the publication of "tombstone" type advertisements in the larger metropolitan daily newspapers. The advertisements offer present shareholders of the target corporation an opportunity to exchange their shares for either cash or securities, or a combination of the two. In contractual terms, it is the shareholder who is actually the offeror. The party seeking to acquire control of the issuer is simply requesting the shareholder to offer his shares. To distinguish between those "tender offers" involving straight cash consideration and those involving securities, the terms "cash tender offer" and "exchange offer" have been coined. See Comment, Section 13(d) and Disclosure of Corporate Equity Ownership, 119 U. Pa. L. Rev. 853 n.2 (1971) [hereinafter cited as U. Pa. Comment]. In recent years the term has been broadened to include some rather unusual transactions within its scope. See generally Note, The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934, 86 Harv. L. Rev. 1250 (1973). But see *D-Z Investment Co. v. Holloway*, [— Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,771, at 96562-63 (S.D.N.Y. 1974); *Nachman Corp. v. Halfred, Inc.*, [1973-74 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,455, at 95590-93 (N.D. Ill. 1973).

The subject of cash and exchange tender offers has generated a substantial amount of literature both prior and subsequent to the 1968 passage of regulatory legislation, discussed in text accompanying notes 3-22 *infra*. See sources cited in: U. Pa. Comment, *supra*, at 853 n.2; R. Jennings & H. Marsh, *Securities Regulation—Cases and Materials* 940, 952, 964 (3d ed. 1972). For more recent comment on this subject, see generally E. Aranow & H. Einhorn, *Tender Offers for Corporate Control* (1973); V. Brudney & M. Chirelstein, *Cases & Materials on Corporate Finance* 657-715 (1972); Robinson & Mahoney, *Schedule 13D: Wild Card in the Takeover Deck*, 27 Bus. Law. 1107 (1972); Griffin & Tucker, *The Williams Act, Public Law 90-439—Growing Pains? Some Interpretations with Respect to the Williams Act*, 16 How. L.J. 654 (1971).

² 15 U.S.C. §§ 77a-77aa (1970).

³ Act of July 29, 1968, Pub. L. No. 90-439, 82 Stat. 454, amending Securities Exchange Act of 1934 §§ 12-14, 15 U.S.C. §§ 78f, 78m-78n (1970). The Securities and Exchange Commission has announced plans to conduct a broad investigation into the takeover and acquisition field, with particular emphasis on the Williams Act's amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-jj (1970). SEC Securities Exchange Act Release No. 11003, reprinted in [1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,956, at 84460-65 (Div.

Act closed this gap⁴ in the scheme of federal securities regulations by requiring detailed disclosure by the soliciting party simultaneous with the publication of the request for tenders. Congress recognized, however, that a disclosure requirement triggered only by the actual announcement or extension of a cash tender offer would be incomplete.⁵ Hence, the 1968 legislation also added sections 13(d) and (e)⁶ to the Securities Exchange Act of 1934 (the Act)⁷ which, acting as a legal backstop to sections 14(d) and (e) of the Act,⁸ in certain cases require disclosure of substantial acquisitions of an issuer's equity securities to the management of the issuer as well as to the Securities and Exchange Commission (SEC or the Commission) within ten days of such acquisitions.

Most of the focus during the debate over the Williams Act was

Corp. Fin., Sept. 9, 1974); Wall Street Journal, Sept. 10, 1974, at 3, col. 2. One of the specific questions the Commission poses in the release is "[w]hether the Commission should define the term 'group' or otherwise adopt rules for the purpose of [§] 13(d)(3) . . . to provide greater certainty with respect to the commencement and termination of a group's reporting requirements." [1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,956, at 84463.

⁴ There continues to exist a body of opinion that no "gap" ever existed in the regulation of the cash tender offer. See, e.g., Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 Duke L. J. 231. One argument in support of the theory that a gap existed was to the effect that a tender offer was directly analogous to a solicitation of proxies under § 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1970) and Reg. 14A, 17 C.F.R. § 240.14a (1973), promulgated thereunder. This argument was refuted forcefully by Professor Robert H. Mundheim's testimony at the hearings on S. 510, the bill which eventually became the Williams Act:

[A proxy contest is] a really different matter than a tender offer. In a proxy contest, both parties are asking for the right to manage somebody else's money. In that kind of situation I think that the person who is being asked to give up his right to manage his money is entitled to a certain amount of information.

In a cash tender offer the man to whom the tender offer is made is asked to terminate his relationship with the company. This seems a wholly different matter.

I think in many ways the much more accurate analogy for the cash tender offer is a normal market transaction.

Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 118 (1967). Despite this cogent analysis, it is difficult to understand the rationale behind objections to fuller disclosure in the cash tender offer area.

⁵ Purchasers seeking to acquire control could and did move quietly into the market and purchase enough shares to assure victory in a subsequent request for tenders. 111 Cong. Rec. 28258 (1965) (remarks of Senator Williams). A thorough examination of the legislative history and purpose of the Williams Act is contained in U. Pa. Comment, *supra* note 1, at 859-66. Relying on Senator Williams' remarks during the congressional debate on S. 2731, the unenacted predecessor to S. 510, the bill which eventually became the Williams Act, that comment took the position that any aggregation of the statutory percentage of a class of the issuer's equity securities, see § 13(d)(1) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(d)(1) (1970), quoted in text at note 13 *infra*, triggers the section's filing requirements so long as there exists the potential for change in the control pattern of a corporation. U. Pa. Comment, *supra* note 1, at 862-63, 876. Although that author may be correct in arguing that if an aggregation has occurred, filing should follow, this article is addressed to the question of when the aggregation occurs.

⁶ 15 U.S.C. §§ 78m(d), (e) (1970).

⁷ 15 U.S.C. §§ 78a-78jj (1970) [hereinafter cited as the Exchange Act].

⁸ 15 U.S.C. §§ 78n(d), (e) (1970).

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on the sections dealing with cash tender offers. It is, however, section 13(d), the backstop, which has proven most troublesome. In particular, section 13(d)(3),⁹ which compels a "group" of persons to file the detailed information required by section 13(d)(1)¹⁰ when they "acquire" more than a threshold percentage¹¹ of any class of the issuer's securities, has caused the failure of many a planned corporate acquisition. The courts have imposed stringent sanctions on groups which failed to file or which filed inadequately. This article will focus on the case of a complete failure to file. It is hoped that the article will demonstrate that, while the SEC and the courts hold somewhat differing viewpoints on what constitutes a "group" under section 13(d)(3), the securities law practitioner has available comprehensible guidelines from which to formulate his counsel.

II. SECTION 13(d) REPORTING REQUIREMENTS

Although the legislative history of section 13(d) is somewhat scant,¹² the section appears to have been designed to mandate disclosure of every rapidly acquired block of securities. Its basic directive is that:

Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to [section 12 of the Securities Exchange Act of 1934] . . . is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by

⁹ 15 U.S.C. § 78m(d)(3) (1970).

¹⁰ 15 U.S.C. § 78m(d)(1) (1970).

¹¹ The term "threshold percentage" is used throughout this article to refer to five percent of any class of the issuer's equity securities. See § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970), quoted in text at note 13 *infra*.

¹² SEC Chairman Cohen argued that § 13(d) was a necessary addition to the insider disclosure provisions of § 16 of the Exchange Act, 15 U.S.C. § 78p (1970). See Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Commerce, 90th Cong., 1st Sess. 24-25 (1967) (remarks of Securities & Exchange Commission Chairman Manuel F. Cohen). Several other witnesses argued the redundancy of § 13(d) to § 16. Hearings, *supra* at 128-29 (remarks of Arthur Fleischer, Jr.); *id.* at 246-47 (letter from Milton H. Cohen to Senator Williams). Little else in the way of justification or rationale for § 13(d)'s disclosure provisions appears in any of the other legislative materials. See generally Hearings on H.R. 14475 and S. 510 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 90th Cong., 2d Sess. (1968); S. Rep. No. 550, 90th Cong., 1st Sess. (1967); H.R. Rep. No. 1711, 90th Cong., 2d Sess. (1968). The bill was enacted without significant debate on July 29, 1968, and signed into law by President Johnson the same day.

Section 13(d) has been discussed at length in a number of articles which have appeared since its passage in 1968. In addition to U. Pa. Comment, *supra* note 1, see generally Griffin & Tucker, *supra* note 1, at 664-93; Brown, *The Scope of the Williams Act and Its 1970 Amendments*, 26 Bus. Law. 1637-41 (1971).

registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors¹³

The statute requires the "person" who acquires a five percent interest to disclose, *inter alia*: the identities and background of all persons by whom or on whose behalf the purchases have been effected;¹⁴ the source and amount of the funds used or to be used in making the purchases;¹⁵ whether the purchaser intends to merge,

¹³ Exchange Act § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970). As originally enacted § 13(d) required filing only after ten percent of a class of any equity security had been "acquired." In 1970 the threshold percentage was lowered to five percent because of evidence that acquirers were purchasing up to, but slightly less than, the ten percent "triggering" percentage and then seeking to gain control of the issuer, usually through a cash or exchange tender offer. Act of December 22, 1970, Pub. L. No. 91-567, § 1(a)(2), amending Exchange Act § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970).

When the threshold percentage was reduced, objection was made by stock exchange specialists, underwriters, over-the-counter market-makers, and investment companies. They complained that the lower level would compel filing of Schedule 13D statements in instances where purchases were not meant to influence control. See Hearings on S. 336 and S. 3431 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 91st Cong., 2d Sess. 13, 108, 115-17 (1970); Hearings on H.R. 4285, S. 3431 and S. 336 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce, 91st Cong., 2d Sess., ser. 91-75, at 58-59, 68-69 (1970). The congressional response was Exchange Act § 13(d)(5), 15 U.S.C. § 78m(d)(5) (1970), which permits the filing of a short notice instead of the more detailed Schedule 13D, 17 C.F.R. § 240.13d-101 (1974). The short notice requires the purchaser's name, size of holdings, acquisition date, and such other information as the SEC may require. It can be used only when the acquisition was in the ordinary course of business. The Commission has not yet developed a short form Schedule 13D. It is still unclear "whether a broker-dealer managing discretionary accounts which own in the aggregate more than 5 percent of the issuer's equity securities must file a Schedule 13D statement." E. Aranow & H. Einhorn, *supra* note 1, at 93 n.74.

¹⁴ Exchange Act § 13(d)(1)(A), 15 U.S.C. § 78m(d)(1)(A) (1970). This subparagraph also requires disclosure if the purchases "*are to be* effected." *Id.* (emphasis added). It is difficult to understand precisely what this clause means since § 13(d) merely requires that disclosure be made subsequent to acquisition. Even assuming some rather unusual interpretations of the word "acquisition," no one has yet suggested that § 13(d) requires pre-acquisition disclosure. It has been pointed out that, as originally proposed, S. 510 would have required that the statement by a tender offeror be filed with the Commission five days in advance of the making of the offer. Schmuls & Kelly, *Disclosure in Connection with Cash Take-Over Bids*, 24 Bus. Law. 19, 24 n.12 (1968). The requirement was deleted, as a result of opposition of the New York Stock Exchange, which feared that such a pre-offer filing would be inconsistent with NYSE public announcement requirements. *Id.* Schmuls and Kelly attribute the use of certain future tense language in the instructions to Schedule 13D to the fact that Schedule 13D is also designed to cover the disclosure required by § 14(d) when a full-fledged tender offer is involved. *Id.* at 22.

¹⁵ Exchange Act § 13(d)(1)(B), 15 U.S.C. § 78m(d)(1)(B) (1970). This subparagraph also requires a description of any transaction in which funds were borrowed for the purpose of acquiring securities of the issuer. Such disclosure can be crucial to the success or failure of a

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liquidate or "make any other major change" in the business or corporate structure of the issuer;¹⁶ the number of shares of "such security" beneficially owned by the purchaser as well as the number of shares which the purchaser has a right to acquire;¹⁷ and, finally, information as to any contracts, arrangements, or understandings involving the securities of the issuer.¹⁸

Section 13(d)(1) also contains the usual grant of authority to the Commission to prescribe, through administrative rulemaking, disclosure of such additional information as it deems necessary to carry out the statutory purpose. Pursuant to this authority, the Commission has developed Schedule 13D¹⁹ which is the form which must be filed to fulfill the requirements of section 13(d)(1). Under section 13(d) and Rule 13d-1,²⁰ the information required by Schedule 13D

cash tender offer. Cf. Schmuts & Kelly, *Cash Take-Over Bids—Defense Tactics*, 23 Bus. Law. 115, 122 (1967). The names of the parties to any loan transaction must be included in the description of the transaction. However, "where a source of funds is a loan made in the ordinary course of business by a bank," the name of the bank will not be made available to the public if the person filing so requests. Exchange Act § 13(d)(1)(B), 15 U.S.C. § 78m(d)(1)(B) (1970).

¹⁶ Exchange Act § 13(d)(1)(C), 15 U.S.C. § 78m(d)(1)(C) (1970). Because so much of the discussion involving § 13(d) focuses on the possibility that control of a corporation may change from one group to another, the term "control pattern" has been chosen to indicate the present state of voting ownership in the issuer. It is difficult to state with precision exactly what is meant by change in corporate structure or alteration of an issuer's control pattern. For purposes of this article, it is assumed that the latter subsumes the former but that the two are not synonymous. In many ways, the need for disclosure in these areas resembles the ever present question of what constitutes a material fact. The question thus becomes: would a reasonable investor need, or at least desire, to know that, because of an acquisition involving a substantial amount of the corporation's equity, there exists a possibility that the issuer's control pattern will be altered? Cf. *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 948 (2d Cir. 1969); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 404 U.S. 1005 (1971).

Little authority exists on what is meant by "any other major change in its business or corporate structure." Obviously a change in the chief executive officer or the forcing of resignations from the board of directors so as to shift control would qualify. But what about a decision to request one or possibly two seats on a twelve- or fifteen-man board? Obviously, such information would have to be disclosed once a proxy solicitation began. See SEC Rule 14a-11, 17 C.F.R. § 240.14a-11 (1974). The issue here, however, is whether such a decision triggers an obligation to file under § 13(d) on the ground that it is the element that causes group formation.

¹⁷ Exchange Act § 13(d)(1)(D), 15 U.S.C. § 78m(d)(1)(D) (1970). Presumably, the words "such security" in the section limit the required disclosure to that class of the issuer's securities of which more than five percent are held by the person required to file. In other words, if a person holds six percent of an issuer's common but only four percent of its preferred, the Schedule 13D would disclose only the holdings in the common. Item 5 of Schedule 13D, 17 C.F.R. § 240.13d-101 (1974), accords with this interpretation.

¹⁸ Exchange Act § 13(d)(1)(E), 15 U.S.C. § 78m(d)(1)(E) (1970).

¹⁹ 17 C.F.R. § 240.13d-101 (1974). The Commission has also developed a series of rules dealing with filings under § 13(d). Rules 13d-1 to 13d-4, 17 C.F.R. §§ 240.13d-1 to -4 (1974). An excellent analysis of these regulations and those promulgated by the Commission under §§ 14(d)-(e) is contained in Schmuts & Kelly, *supra* note 14.

²⁰ 17 C.F.R. § 240.13d-1 (1974).

must be filed whenever a person has accomplished the triggering acquisition, *i.e.*, an acquisition which causes him to own in excess of five percent of any class of an issuer's equity securities.²¹

However, more important to the present discussion is the presence of section 13(d)(3), which states that:

When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of [section 13(d)].²²

It was the emphasized words which became, in the several years subsequent to the statute's enactment, the *bête noire* of those shareholders of an issuer who were collectively concerned about management's performance. To their surprise, many of them would be deemed members of section 13(d)(3) "groups" despite the fact that no one member had made any purchases pursuant to an attempted takeover, proxy fight, or other control-altering scheme. The methods and analyses that the courts and the staff of the SEC have used in reaching such conclusions are the focus of the remainder of this article.

III. EARLY INTERPRETATIONS OF "GROUP FORMATION"

*Bath Industries, Inc. v. Blot*²³ was the first decision to consider the intertwined issues of what constitutes a section 13(d) group and, assuming the existence of the group, when section 13(d) requires that group to file. For several months prior to September 1969, Emmet Blot, a New York financier and member of the board of Bath Industries, Inc., had been attempting to gain support among the other directors for a move to oust the chief executive officer of Bath. When his advances were spurned by the Bath management, Blot turned to several other major stockholders in an attempt to wrest control. The district court found as a fact that sometime before mid-summer 1969, Blot and his confederates, including an English merchant bank and its American subsidiary, had "pooled" their voting shares in Bath with a view to acquiring more Bath shares

²¹ An interesting empirical study could be made of the number of tender offers not undertaken as a direct result of the legislation's effect of internalizing various costs of disclosure. If the Senate Committee had had the benefit of some recently developed economic wisdom, it is possible that the thrust of this legislation would have been markedly different. See generally *Economic Policy and the Regulation of Corporate Securities* (H. Manne, ed. 1969); J. Lorie & M. Hamilton, *The Stock Market: Theories and Evidence* (1973).

²² 15 U.S.C. § 78m(d)(3) (1970) (emphasis added).

²³ 305 F. Supp. 526 (E.D. Wis. 1969), *aff'd*, 427 F.2d 97 (7th Cir. 1970).

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and ultimately obtaining control of the corporation.²⁴ At no time did Blot or any one of his supporters own as much as ten percent²⁵ of any class of Bath's securities. Collectively, however, they owned close to fifty percent.²⁶

The district court held that since the actions of the defendants had caused them to become a "group" formed for the purpose of holding and acquiring the Bath stock, they violated section 13(d) by failing to file within ten days of formation.²⁷ Because of its further finding that the group contemplated a vigorously contested proxy fight which would, in the court's word, "chill" Bath's chances for obtaining a lucrative ship building contract, the court enjoined all of the defendants from proceeding with their plan to oust the incumbent Bath management "until it is determined that the 13(d) statements that have been or will be filed by the defendants are legally sufficient."²⁸ The defendants appealed the grant of the preliminary injunction to the United States Court of Appeals for the Seventh Circuit.

In May 1970 the Seventh Circuit handed down the first major explication of the Williams Act "group" problem.²⁹ The legislative history of the Williams Act was found to demonstrate a congressional purpose to "*protect the individual investor* when substantial shareholders or management undertake to acquire shares in a corporation for the purpose of solidifying their own position in a contest over how or by whom the corporation should be managed."³⁰ The Seventh Circuit consequently decided that Blot and his supporters had formed a statutory group and had failed to file within the prescribed time.³¹ Attempting to steer its way between the Scylla of non-disclosure of pre-Williams Act days and the Charybdis of "tip-ping the scales in favor of . . . management,"³² the court held that

²⁴ 305 F. Supp. at 531.

²⁵ The entire transaction took place prior to December 22, 1970, the date on which the amendment lowered the threshold percentage from ten to five percent. See Pub. L. No. 91-567, § 1(a)(2) (1970), amending Exchange Act § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970).

²⁶ 305 F. Supp. at 532.

²⁷ Id. at 538.

²⁸ Id. at 539. Immediately after commencement of the Bath action against them, several of the defendants had filed Schedule 13D's. At the hearing on the preliminary injunction, plaintiff urged the legal insufficiency of these filings. Obviously, the court's acceptance of plaintiff's position augured heavily in the choice of remedy. The court could have enjoined the Blot group's plan until the remaining members filed, at which time the control contest would have ensued. By yielding to plaintiff's urging that the existing filings were false and misleading, id., the court changed the nature of the case from one dealing with timing to one dealing with adequacy.

²⁹ 427 F.2d 97 (7th Cir. 1970) (Hastings, J.).

³⁰ Id. at 109, citing 113 Cong. Rec. 24664 (1967) (remarks of Senator Williams).

³¹ 427 F.2d at 111.

³² Id. at 109, quoting 113 Cong. Rec. 24664 (1967) (remarks of Senator Williams).

compliance with the Act's disclosure requirements was necessary when, but only when, a group of stockholders, who among themselves own ten percent or more of the outstanding shares of any class of an issuer's securities, agree to act in concert to acquire additional shares.³³ The Seventh Circuit also held that once the plaintiff has shown that a group agreed to pursue a common objective and that thereafter any member of the group purchased shares of the issuer's stock, a rebuttable presumption arises that such purchase was made pursuant to an agreement to acquire additional shares entered into as of the date of the purchase.³⁴ Compliance with the Act's disclosure provisions would be required within ten days of such purchase.³⁵

The court of appeals never attempted to define the term "acquisition" as it appears in section 13(d)(1).³⁶ Its decision that the trial court was not clearly in error in finding that an agreement to purchase additional shares had been reached sometime during the summer of 1969, followed by several purchases of Bath securities by members of the group, obviated further consideration of the question of the acquisition. More important for present purposes, however, was the court's failure to elucidate which of the facts, stated in the opinion in some detail, caused it to conclude that a statutory group had indeed been formed. The opinion does allude to the plaintiff's problem of proving an agreement, but limits the problem to that of proving an agreement to purchase further shares *after* a group has been formed.³⁷ Furthermore, the court's language—"once the group agrees to act in concert to acquire shares"³⁸—indicates that the Seventh Circuit believed that it was not the agreement itself

³³ 427 F.2d at 109. The court cited the following provisions from the House Report's section-by-section analysis of the bill as support for the proposition that an actual purchase was not necessary before a "group" could be held to have violated § 13(d):

[Section 13(d)(3)] would prevent a group of persons who seek to pool their voting or other interests in the securities of an issuer from evading the provisions of the statute because no one individual owns more than 10 percent of the securities. The group would be deemed to have become the beneficial owner, directly or indirectly, of more than 10 percent of a class of securities at the time they agreed to act in concert. Consequently, the group would be required to file the information called for in section 13(d)(1) within 10 days after they agree to act together, whether or not any member of the group had acquired any securities at that time. This provision is designed to obtain full disclosure of the identity of any person or group obtaining the benefits of ownership of securities by reason of any contract, understanding, relationship, agreement or other arrangement.

H.R. Rep. No. 1711, 90th Cong., 2d Sess. 8-9, reprinted in 1968 U.S. Code Cong. & Ad. News 2811, 2818, cited at 427 F.2d at 110.

³⁴ 427 F.2d at 110.

³⁵ *Id.* The practical effect of the rebuttable presumption was to require filing only after the later purchase of purchases occurred. See U. Pa. Comment, *supra* note 1, at 871.

³⁶ See 427 F.2d at 110.

³⁷ *Id.*

³⁸ *Id.* (emphasis omitted).

that caused group formation. Apparently, the court's acceptance of the subsequent purchases criterion caused it to conclude that a strict analysis of statutory group formation was not necessary in the factual context.

About a year and a half after the Seventh Circuit's decision in *Bath Industries*, the Second Circuit addressed the issues of group formation and disclosure-timing under section 13(d) in *GAF Corp. v. Milstein*,³⁹ which involved an allegation of group formation without any claim of purchases subsequent to the group formation. The district court dismissed plaintiff's claim that the organization of a group, the members of which owned, in the aggregate, more than ten percent of an outstanding class of the issuer's equity securities, triggered the filing requirement without any further purchases.⁴⁰ Holding that *group formation* itself was the triggering event,⁴¹ the Second Circuit reversed. The court based this conclusion on its belief that

[t]he history and language of section 13(d) make it clear that the statute was primarily concerned with disclosure of *potential changes* in control resulting from new aggregations of stockholdings and was not intended to be restricted to only individual stockholders who made future purchases and whose actions were, therefore, more apparent.⁴²

The *GAF* court's holding that group formation itself was the event triggering the duty to report meant that if, after formation, a group held in excess of the threshold percentage, "formation" would constitute the equivalent of a statutory acquisition. In so deciding, the Second Circuit broadened the scope of section 13(d) from a simple requirement to file after an "overt act," *i.e.*, purchases of the issuer's securities, to an attempt to regulate the kaleidoscope of corporate control patterns. The court in *GAF* espoused the view that the statutory purpose was the protection of the general investing public in all circumstances involving potential shifts in corporate control. Under *GAF*, the triggering acquisition⁴³ could occur prior

³⁹ 453 F.2d 709 (2d Cir. 1971) (Kaufman, J.), cert. denied, 406 U.S. 910 (1972). The *Bath Industries* decision had been vigorously criticized in the interim before the *GAF* decision. See generally Griffin & Tucker, The Williams Act, Public Law 90-439—Growing Pains? Some Interpretations with Respect to the Williams Act, 16 How. L.J. 654, 682-83 (1971); U. Pa. Comment, *supra* note 1, at 868-72. The Griffin & Tucker article criticizes the *Bath Industries* court for its failure to recognize that group formation itself embodied an acquisition triggering § 13(d)'s filing requirement. Griffin & Tucker, *supra*, at 682-84.

⁴⁰ *GAF Corp. v. Milstein*, 324 F. Supp. 1062, 1068 (S.D.N.Y. 1971) (Pollack, J.).

⁴¹ 453 F.2d at 718.

⁴² *Id.*

⁴³ District Judge Pollack had urged in *GAF* that, although § 13(d) nowhere defined

to the formation of group intent to acquire more shares. Of course, that group intent may or may not have been the purpose or one of the purposes for which the group was formed. The court indicated concern with the impact such rapid accumulations of particular securities, aimed at controlling the issuer, might have upon the market price of those securities.⁴⁴ Its apparent policy judgment was that requiring disclosure of the potential effect of the accumulation at the earlier stage would more effectively fulfill the statutory purpose.⁴⁵

Although it will become apparent⁴⁶ that *GAF* did settle the issue of whether subsequent purchases are necessary to trigger section 13(d)'s filing requirement, like *Bath Industries* it failed to resolve the question of what constitutes a group. This difficult problem was avoided by remanding⁴⁷ to the district court for a

"acquisition," it was clear from the language of the statutes that an actual purchase was contemplated. Believing the language of the statute to be clear, Judge Pollack disregarded legislative history to the contrary and stated that "the words of the enactment control over the inconsistent explanation of those who described the statute." 324 F. Supp. at 1067. The Second Circuit sharply criticized this reasoning. In a note to its opinion it stated: "The meaning of 'acquiring' hardly could be considered plain when two district court judges recently failed to agree on whether an inheritance of stock was an 'acquisition.'" 453 F.2d at 716 n.14.

The two cases referred to were *Sisak v. Wings & Wheels Express, Inc.*, [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991, at 90665 (S.D.N.Y. 1970), and *Ozark Air Lines, Inc. v. Cox*, 326 F. Supp. 1113 (E.D. Mo. 1971). The former had given the word "acquisition" a broad, unqualified interpretation by holding that the "passage" of securities from an estate to the legatees under a will was an acquisition. [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991, at 90668. *Ozark Air Lines*, on the other hand, held, under similar circumstances and just as unqualifiedly, that § 13(d) was designed to reach only "purposeful" acquisition. 326 F. Supp. at 1117. In neither case was there an issue of group formation.

⁴⁴ See 453 F.2d at 717.

⁴⁵ See *id.* at 717-18.

⁴⁶ See text at notes 85-88 *infra*.

⁴⁷ See 453 F.2d at 718, 722. Since the case was before the Second Circuit on the district court's dismissal pursuant to Fed. R. Civ. P. 12(b)(6), the question was easily avoided. The complaint alleged the formation of a group. It was the failure to allege subsequent purchases that caused its earlier dismissal. 324 F. Supp. at 1064, 1071, 1073.

The Second Circuit's decision in *GAF* gave passing consideration to the question of whether management groups whose members collectively own more than the threshold percentage will be required to file. Judge Kaufman deemed the argument that such management groups would be required to file "totally without substance," since "management groups *per se* are not customarily formed for the purpose of 'acquiring, holding, or disposing of securities of [the] issuer' and would not be required to file unless the members conspired to pool their securities (sic) interests for one of the stated purposes." 453 F.2d at 719. He noted:

The more difficult question, and a question we need not decide on this appeal, is whether management groups which expressly agree to pool their interests to fight a potential takeover are subject to section 13(d). Nor do we intimate any view on whether an insurgent group which has filed under 13(d) and subsequently is successful in its takeover bid remains subject to the section. In any event, as we have already indicated, the Commission can forestall any untoward effects under the exemptive power conferred upon it by section 13(d)(6)(D).

Id. at 719 n.20. Two years later, the Second Circuit resolved this question somewhat perfunctorily in *Corenco Corp. v. Schiavone & Sons, Inc.*, 488 F.2d 207 (2d Cir. 1973). In

determination as to whether the individuals involved indeed constituted a section 13(d)(3) group. District Judge Pollack was given a difficult task; he had held that filing should be required only after the members of a group unite in common purpose *and* acquire more shares precisely because of his fear that "[t]he inherent difficulty of ascertaining when a group was formed is akin to an attempt to grasp quicksilver."⁴⁸

IV. FORMATION OF THE STATUTORY GROUP: THE CONTRIBUTION OF SEC STAFF OPINIONS

On two occasions prior to *GAF* and once subsequently, the SEC's Division of Corporate Finance has received inquiries⁴⁹ seeking advice regarding the staff's position on when section 13(d)(3) groups are formed. Although each case lacks specific criteria, together they shed some light on this complex problem.

In April 1971, the staff of the SEC refused to take a no-action position in *Budd Co.*,⁵⁰ a situation in which twelve institutional lenders received warrants to purchase about fourteen percent of the issuer's common stock. Arguing in the letter of inquiry that the only link of any one lender to any of the other lenders was the similarity of the written agreements and the concurrent timing of the closing for each loan, counsel claimed the absence of any "concerted action" among the lenders.⁵¹ The staff replied that it was unable to agree with counsel's conclusion that the transaction involved in the placement did not require the group to file a Schedule 13D.⁵² Since the staff did not delineate reasons for its decision, one can only

that case the court held that, because § 14(d)(4) of the Act required disclosure of a target company's affairs whenever the target's management advised its shareholders not to tender, § 13(d)(3) disclosure would be superfluous. *Id.* at 218. *Accord*, *Scott v. Multi-Amp Corp.*, 386 F. Supp. 44, 61-63 (D.N.J. 1974) (management group formed to further control).

⁴⁸ 324 F. Supp. at 1068.

⁴⁹ The securities bar attributes great significance to these published inquiries and staff responses. However, Lowenfels, *SEC No-Action Letters: Conflicts with Existing Statutes, Cases, and Commission Releases*, 59 Va. L. Rev. 303 (1973), suggests that by bureaucratic fiat, the SEC staff is creating substantive securities law inconsistent with relevant statutes, case law, and formal administrative decisions. *Id.* at 319. Although the concept is a valuable innovation, the SEC staff no-action letter has been widely abused and, consequently, the regulatory scheme has suffered. Lowenfels suggests that the SEC should be bound to adhere to existing precedents in certain areas such as § 13(d). *Id.* at 321.

⁵⁰ [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,115, at 80414 (SEC Div. Corp. Fin. Apr. 8, 1971).

⁵¹ *Id.* at 80415. Counsel for the Budd Company also argued that, since the loan was made in the ordinary course of all the parties' business and did not have as one of its purposes the alteration of the issuer's control pattern, the entire transaction was outside the scope of § 13(d). *Id.* at 80416. Management was not only aware of the identity of the parties and the source of their funds, but had also solicited their participation. It should be noted that the Second Circuit decision in *GAF* had not been handed down at the time the letter of inquiry was submitted to the staff.

⁵² *Id.* at 80414.

speculate as to the significance of the ruling. The refusal to take a no-action position may have resulted from a conclusion that the transactions involved the possibility that lender influence would be brought to bear on the Budd management. The large amount of money involved (\$30,000,000), the substantial equity relinquished through the issuance of warrants (14%), and the fact that the lenders conditioned the accomplishment of the transaction upon the aggregate amount borrowed by the company equaling \$30,000,000⁵³ may have indicated to the staff that the transaction involved the possibility of a shift in Budd's control pattern rather than mere incurrence of long-term debt.⁵⁴ The staff apparently concluded that the investing public should know of the strong possibility of lender influence on the company's management.

In *U.S. Rubber Reclaiming Co.*,⁵⁵ another request for an SEC staff no-action letter, three individuals concededly were accumulating more than the threshold percentage of the issuer's outstanding common stock. Counsel for one of the three purchasers indicated to the SEC staff that the individuals might seek representation on the issuer's board of directors. However, counsel also stated that the three had not entered into a written agreement and that "their intent to hold the stock could change from that of desiring representation to holding it as an investment."⁵⁶ In its reply, the staff simply paraphrased the language of section 13(d)(3),⁵⁷ leaving the unmistakable impression that group filing should occur when the aggregate accumulation exceeded five percent.

In both *Rubber Reclaiming* and *Budd* the staff's position appeared to be based upon an extremely broad interpretation of section 13(d). In *Budd*, the only evidence of concerted action among the lenders was the concurrent timing of the loan closings and the similarity of the agreement forms, both of which were conditions required by the issuer.⁵⁸ In *Rubber Reclaiming*, the absence of a written agreement among the three purchasers was apparently considered insignificant.⁵⁹ Moreover, the staff reply gave no indication that the admitted present intent of the purchasers to gain represen-

⁵³ Id. at 80414-15. Counsel did not actually specify whether any lender could cancel its participation if the total borrowings did not equal \$30,000,000.

⁵⁴ For example, if there were provisions regarding the maintenance of specified amounts of working capital, as is common in many such direct placements, see American Bar Foundation, *Commentaries on Indentures* 452 (1971), the lenders may justifiably have expected to have more than just minimum influence on the company's management.

⁵⁵ [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,585, at 81258 (SEC Div. Corp. Fin. Dec. 15, 1971).

⁵⁶ Id.

⁵⁷ Id.

⁵⁸ [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,115, at 80415.

⁵⁹ [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,585, at 81258.

tation on the board of the issuer was particularly important.⁶⁰ However, it was probably of significance to the staff that two or more individuals had been acting in concert in aggregating more than the threshold percentage of securities.

It should be noted that both of these rulings, although subsequent to the Seventh Circuit's decision in *Bath Industries*,⁶¹ were made prior to the Second Circuit decision in *GAF*. Presumably the Seventh Circuit would have imposed the duty to file in *Budd* only upon a subsequent purchase by at least one of the lenders and in *Rubber Reclaiming*, upon the next purchase after the purchases by the three individuals had brought them to the triggering percentage. However, under the Second Circuit's analysis in *GAF*, the duty to file might never have been triggered in either *Budd* or *Rubber Reclaiming*, since in neither case did the applicable letter of inquiry indicate evidence from which could be drawn the inference that the group possessed the requisite view to control. In this sense, then, the SEC staff's view of section 13(d)(3) was apparently much broader than the judicial views formulated in either *Bath Industries* or *GAF*.

Any uncertainty regarding the staff's view of section 13(d) was dispelled in March 1972. Shortly after the Second Circuit's decision in *GAF*, inquiry was made by counsel for a committee of note holders who were to receive warrants to purchase common stock in a complicated refinancing transaction involving the Great Southwest Corporation.⁶² In the aggregate, these warrants were exercisable for about fifteen percent of the outstanding common stock of the issuer. Counsel argued that the members of his committee as well as the other note holders were, together with numerous other institutions, simply creditors of a corporation in severe need of refinancing.⁶³ The issuer would be unable to borrow the appropriate funds unless each of the creditors simultaneously consented to the terms of the refinancing. According to counsel, since the issuance of the warrants was merely an incidental part of the refinancing, the note holders would not acquire the warrants as a group but as individual creditors of the same class.⁶⁴ The staff in *Great Southwest* ruled that

⁶⁰ Id.

⁶¹ Counsel for Budd Company had cited *Bath Industries* as support for his position that concerted action among the participants was required before group formation could occur. [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,115, at 80415. The staff apparently did not disagree with counsel's theoretical position—only with his assertion that the kinds of activity present in the loan transaction did not rise to the level of "concerted."

⁶² Great Southwest Corp., [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,714, at 81504 (SEC Div. Corp. Fin. Apr. 3, 1972).

⁶³ Id. at 81507.

⁶⁴ Id. Counsel for the note holder-warrant recipients in *Great Southwest* argued, as had counsel for Budd, that this was "not the type of activity which was intended to be regulated

the recipients of the warrants in the proposed refinancing program did constitute a "group" and thus a "person" within the meaning of section 13(d)(3).⁶⁵ Crucial to the staff's ruling was the evidence that acceptance of the plan of refinancing by each individual creditor was conditioned upon its acceptance by all other creditors. From this fact the staff reasoned that the recipients of the warrants were acting in concert for the purposes of the refinancing transaction.⁶⁶ The resultant statutory duty to file as a section 13(d)(3) group was, in the staff's view,⁶⁷ based upon the acquisition of beneficial ownership of more than five percent of the outstanding shares of any outstanding class of the issuer's equity securities.⁶⁸

Despite the staff's *Great Southwest* ruling that the recipients of the warrants would constitute a section 13(d)(3) group, the fact that the creditors received warrants not exercisable for one year resulted in the staff's decision that the initial receipt of these warrants did not involve a present acquisition which would otherwise trigger immediately the section 13(d)(1) filing requirement. The staff ruled that under Rule 13d-3⁶⁹ the common stock underlying the warrants

by the Williams Act." *Id.* Assuming that the overall purpose of that legislation was to regulate the tender offer, counsel was probably correct. Given, however, the more specific statements in the legislative history regarding *potential* alterations in an issuer's control pattern, counsel's view may have been too narrow. See, e.g., the language of H.R. Rep. No. 1711, 90th Cong., 2d Sess. 8-9, reprinted in 1968 U.S. Code Cong. & Ad. News at 2818, to the effect that § 13(d)(3) was designed to obtain full disclosure of the identity of "any . . . group obtaining the benefits of ownership of securities by reason of any contract, understanding, relationship, agreement or other arrangement." [Emphasis added.]

⁶⁵ [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,714, at 81505.

⁶⁶ *Id.*

⁶⁷ *Id.* The staff did not indicate what it meant by a "statutory obligation." The reply does, however, make it quite clear that the fact that control of the issuer was lodged in a parent corporation not a member of the group did not affect such obligation. *Id.* Obviously, the staff is moving toward the position that while concerted action is crucial to group formation, it need not be taken with a view to control in order to trigger the filing requirement.

⁶⁸ Counsel for the note holders advanced another argument, *id.* at 81508, based on § 13(d)(6)(D), 15 U.S.C. § 78m(d)(6)(D) (1970), which exempts:

[A]ny acquisition or proposed acquisition of a security which the Commission, by rules or regulations or by order, shall exempt from the provisions of this subsection [13(d)] as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection.

The Commission has never promulgated a rule pursuant to this authority.

⁶⁹ Rule 13d-3, 17 C.F.R. § 240.13d-3 (1974), states:

In determining, for the purposes of section 13(d) . . . whether a person is directly or indirectly the beneficial owner of securities of any class, such person shall be deemed to be the beneficial owner of securities of such class which such person has the right to acquire through the exercise of *presently exercisable options, warrants or rights* or through the conversion of presently convertible securities, or otherwise. The securities subject to such options, warrants, rights or conversion privileges held by a person shall be deemed to be outstanding for the purpose of computing the percentage of outstanding securities of the class owned by such person

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need not be considered for the purposes of section 13(d)(1) until the warrants became exercisable, at which time the underlying common stock would be deemed acquired regardless of whether or not the warrants were exercised.⁷⁰

The staff refused to speculate on whether the creditors would be acting as a statutory group at the time the warrants became exercisable. Apparently when the present refinancing plan closed and the warrants were received, the note holder-warrant recipients would no longer exist as a group within the meaning of section 13(d)(3) since the SEC staff understood⁷¹ that the holders were acting in concert solely for the purpose of the refinancing plan. The obligation to file at a time in the future when the warrants became exercisable would not arise merely because the holders had been a group at the time of the initial receipt of the warrants. Filing would be required only if the holders, at that time, constituted a statutory group holding in excess of five percent of the issuer's common stock.⁷²

Consistent with its ruling in *Budd and Rubber Reclaiming*, the staff in *Great Southwest* declined to read a purpose to control test into the acting in concert provision of section 13(d)(3),⁷³ and in so doing again indicated its desire to read section 13(d) expansively. This expansive interpretation could engender a fear that after *Great Southwest*, SEC injunctive proceedings, predicated on a failure to file a Schedule 13D, could be instituted against those shareholders who owned, in the aggregate, more than the threshold five percent and who merely had discussed the performance of the issuer's management. Under the staff's apparent reading of the section, all that would have to be shown would be action in concert and ownership of the threshold percentage.⁷⁴

An analysis of the SEC position in the *Great Southwest* ruling should include a consideration of the Second Circuit's earlier opinion in *GAF*. Even when the Second Circuit's requirement of concerted action with a view to control is applied to the SEC rulings, the fundamental question remains as to what constitutes a "view to

but shall not be deemed to be outstanding for the purpose of computing the percentage of the class owned by any other person.

[Emphasis added.]

⁷⁰ [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,714, at 81505.

⁷¹ Id.

⁷² Id. The position that the requisite beneficial interest does not accrue until the warrants become presently exercisable was recently confirmed. *FAS Int'l, Inc.*, [1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,948, at 84444-45 (SEC Div. Corp. Fin. Aug. 8, 1974).

⁷³ [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,714, at 81505-06.

⁷⁴ To date no SEC injunctive proceedings have been filed. Management attorneys, however, continue to utilize this extraordinarily successful tactical device. E.g., *Cook United, Inc. v. Shulman*, Civ. No. 74-379 (S.D.N.Y. Jan. 1974) (complaint).

control." The staff may have been more likely to infer the existence of a view to control from the circumstances of *Budd* or *Rubber Reclaiming* than from the facts in *Great Southwest*. In the *Great Southwest* ruling the staff did note the fact that the acceptance of the plan by each note holder was dependent upon the acceptance of the plan by all other note holders. The staff conceded, however, that the entire relationship between the note holders existed solely for the purpose of the refinancing transaction. Nevertheless, because the transaction would result in ownership of more than the threshold five percent limit, the participants were within the staff's definition of a section 13(d)(3) group.⁷⁵ There is no evidence that control of the corporation was a factor important to the note holders or considered legally relevant by the staff of the SEC.

The effect of *Great Southwest*, if followed, may be that whenever simultaneous acquisitions, by any means and for any purpose, are made by two or more persons, filing will be required, provided that the resulting aggregation of securities is in excess of the threshold five percent. On the other hand, if no purchases are involved, concerted activity alone may be enough to trigger the filing requirement if the participants already own in the aggregate the threshold percentage of shares. The question of what constitutes concerted activity is still open, but, under the SEC view, the necessary level of participation for purposes of the statute is not particularly high.⁷⁶ The attorney who seeks solace through application for a no-action letter might better utilize his time in compiling the appropriate information to complete his client's Schedule 13D.

V. FORMATION OF THE STATUTORY GROUP: RECENT JUDICIAL INTERPRETATIONS

Three months after the Second Circuit's decision in *GAF*, the United States District Court for the District of Rhode Island decided *Nicholson File Co. v. H. K. Porter Co.*,⁷⁷ which involved an attempt

⁷⁵ [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,714, at 81505.

⁷⁶ This SEC staff position was not unpredictable. The authors of the Griffin & Tucker article, *supra* note 39, were, respectively, the Chief and a member of the staff of the Small Issues Branch of the SEC's Division of Corporation Finance. They give several examples of Schedule 13D filings where group formation occurred without the view to control requirement imposed by *GAF*. Griffin & Tucker, *supra* note 39, at 685-86. However, the level of concerted activity in those examples does appear higher than that of the note holder-warrant recipients in *Great Southwest*.

Shortly before this article went to press, the SEC's Division of Investment Management Regulation, queried about the application of § 13(d)(3) to several investment companies with a common investment advisor, replied that the terms of the statute required a filing without regard to whether the companies were "acting in concert." Stewart Fund Managers Ltd., [1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 80,047, at 84886-87 (SEC Div. Inv. Mgmt. Reg. Aug. 9, 1974).

⁷⁷ 341 F. Supp. 508 (D.R.I. 1972).

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by Thomas M. Evans⁷⁸ to gain control of the Nicholson File Company (Nicholson). Sometime during 1969, Evans, the H. K. Porter Company (Porter), and several nominee companies controlled by Evans, purchased more than five percent of Nicholson's stock.⁷⁹ During the next two years, Evans and several high-ranking employees of Porter approached the management of Nicholson concerning their desire to discuss a merger. On each occasion the Nicholson management rejected Evans' overtures on the ground that such a merger would precipitate a Justice Department inquiry into a possible antitrust violation.⁸⁰ Not until March 1972, more than two years later, did Evans and Porter institute a tender offer for the stock of Nicholson. The cash to pay for the stock to be acquired by the tender offer was raised by spinning off, through a public offering of its securities, the wholly-owned Porter subsidiary, a method of raising capital which could also solve any antitrust problems. Within ten days after the institution of the tender offer, Porter duly filed the Schedule 13D.⁸¹

Nicholson's management contended that Evans, Porter (of which Evans owned fifty-one percent of the stock), Reb & Co. (a wholly-owned subsidiary of Porter), and Evans & Co. (a New York stock brokerage firm) constituted a section 13(d)(3) group.⁸² Conceding that Evans controlled all of the members of the group, plaintiff urged that several legal personalities were involved and that a pooling of interests of those personalities to acquire control of Nicholson had occurred.⁸³ Alternatively, plaintiff argued that even if only one individual were involved, "the intent of that individual, a 5% beneficial owner since December 22, 1970, to acquire control of Nicholson [would trigger the] application of §13(d) without further acquisition of interest in the Nicholson stock."⁸⁴

In rejecting both of plaintiff's contentions, Judge Pettine initially examined the legislative history of the Williams Act.⁸⁵ He concluded that:

The fact that § 13(d) calls for disclosure after acquisition, whether acquisition is by an individual or by the pooling of interests of a group, indicates an intention not to give

⁷⁸ For a synopsis of Evans' takeover activities in years prior to his attempts to alter Nicholson's control pattern, see Barnett, *Tom Evans' Take-Overs Build a Vast Fortune, Stir Hot Controversy*, Wall Street Journal, May 16, 1968, at 1, col. 6.

⁷⁹ All purchases were made prior to December 22, 1970, the date when the lower (5 percent) triggering percentage became effective. 341 F. Supp. at 518.

⁸⁰ Id. at 515.

⁸¹ Id. at 512.

⁸² Id. at 517.

⁸³ Id.

⁸⁴ Id.

⁸⁵ Id.

information by way of disclosure useful to block acquisition but rather an intention to divulge information of the potential effects such acquisition will have in the investment.⁸⁶

Relying on *GAF*, Judge Pettine reasoned that an actual intent on the part of a group to acquire more shares in or to acquire control of the issuer is irrelevant to the purpose of section 13(d) and that, to the contrary, the filing requirement is triggered simply by "the formation of the group in common purpose."⁸⁷

The court's reliance on *GAF* for this conclusion may be misplaced. If the *Nicholson* court meant that group formation occurred when there was a coming together for *any* common purpose related to the issuer, then its position is closer to that of the SEC staff in *Great Southwest* than to that of the Second Circuit in *GAF*. The decision in *GAF* was rendered upon a fact situation in which there was a group intent to gain, or at least a view toward gaining, control of the issuer.⁸⁸ The question upon which the court in *GAF* focused was whether the mere formation of the group constituted a statutory "acquisition" sufficient to impose the filing requirement.

On further analysis, *Nicholson's* contention that the formation of an intent to acquire more shares in or an intent to acquire control of an issuer triggers the statutory duty to file appears to be merely a logical extension of the SEC staff position in *Great Southwest*. As information used in an investor's valuation of the issuer's stock, knowledge that an individual who already owns in excess of the threshold percentage has made a decision to attempt to alter the control pattern of the issuer would seem as important as knowledge that there has been a recent accumulation in excess of that percentage, whether or not there is an intent to acquire more shares. Holding that, regardless of whether a group or an individual controlled the shares, no accumulation above the applicable threshold had occurred after December 22, 1970, the court found no violation.⁸⁹ Even if a "group" had been involved, the court further reasoned, such a group would not be one "formed to 'acquire, hold, or dispose' " of the issuer's shares.⁹⁰ Relying upon the rationale of *GAF*, the court concluded that the defendants had incurred no duty to file and indicated its belief that slowly acquired blocks of se-

⁸⁶ Id. at 517-18.

⁸⁷ Id. at 518.

⁸⁸ 453 F.2d 709, 717-18 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972). See text at notes 43-45 *supra*.

⁸⁹ 341 F. Supp. at 518. The court had earlier pointed out that no retroactive filing requirement was incurred by the Evans group simply because the threshold percentage was reduced by Congress on December 22, 1970, from 10 to 5 percent. Id. at 517.

⁹⁰ Id. at 518.

curities do not represent the kind of potential alterations of an issuer's control pattern toward which Congress directed the disclosure requirements of the Williams Act.⁹¹

In what may be the significant portion of the court's opinion, Judge Pettine explored the motives of the Evans group. Although it had ruled that section 13(d)(1) was not applicable to the defendants, the court assumed, *arguendo*, that it was applicable, and then further assumed any intent of the defendant to acquire control of Nicholson had been formed prior to January 1972, and, in fact, as far back as 1969.⁹² However, in the court's view such intent was qualified and was not sufficiently definite. Moreover, even if there was an agreement to acquire Nicholson, it was "necessarily dependent on the meeting of several prior substantial conditions,"⁹³ the most important of which were: (1) the success of a public offering of a subsidiary of one of the defendants; and (2) the subsequent divestiture of the subsidiary so as to avoid a possible violation of section 7 of the Clayton Act.⁹⁴ In other words, the defendant Porter was seen as in no position to "agree" to acquire.⁹⁵

The issuer argued that Porter should have filed before or soon after divestiture proceedings began on January 1, 1972, but that filing did not occur until after a meeting of the defendants in late February.⁹⁶ At that meeting, alternate uses of the proceeds of the sale of the subsidiary were discussed, but not until March 3 was the decision made to use the proceeds for a tender offer to Nicholson's shareholders.⁹⁷ The court held that if filing had occurred within ten days after the January 1 meeting, the filing would have been "premature, . . . vague, and indefinite," since the divestiture of the Porter subsidiary might not have been successful, and consequently the tender offer might never have been made.⁹⁸ It then stated that Nicholson was incorrect in suggesting that Congress had intended to require a five percent shareholder to file upon each of several possible plans before he reasonably could have chosen among alternative plans.⁹⁹ The court warned of the danger of filing at a time when the

⁹¹ Id.

⁹² Id. at 518-19.

⁹³ Id. at 519.

⁹⁴ 15 U.S.C. § 18 (1970).

⁹⁵ 341 F. Supp. at 519.

⁹⁶ Id. at 518-19.

⁹⁷ Id. at 519. The court did not comment on what its holding would have been had members of the post-March 3 group made individual purchases prior to that date. It is relevant that no purchases of Nicholson stock were made by any member of the Evans faction subsequent to December 22, 1970, when in the aggregate they already held in excess of 5 percent. Id.

⁹⁸ Id.

⁹⁹ Id.

disclosed information would be open to challenge as being inadequate or inaccurate due to overstatement or understatement.¹⁰⁰ In other words, at the points in time at issue, when plans were necessarily contingent, filing would not serve the legislative purpose of protecting the investor and should not be required.¹⁰¹

The guideline suggested by the *Nicholson* decision is that a close examination of circumstantial evidence is essential to a determination of group formation and common purpose. The analytic emphasis should not be on the question of whether the group has formulated common intent to gain or to alter control of the issuer. It should not matter that some members of the group are selling their shares (or granting voting proxies) to other members. Instead, the emphasis should be on the question of whether the group has been formed with a common purpose relevant to the acquisition, holding, or disposal of the issuer's shares, regardless of its control motive. It is at that point in time that the filing requirement will be triggered, if the members of that group own in the aggregate the threshold percentage of shares.

An examination of such circumstantial evidence may show, however, that while there are a number of plans each one of which has as its ultimate purpose a control alteration of the issuer, those plans are, in fact, a series of indefinite, possibly vague, alternatives. If these "plans" represent no more than options to the individuals discussing them, there will be no group formation and thus no triggering of the filing requirement. However, at the time the individual members choose one of the alternatives there will then exist among them a common purpose and they will be considered members of a section 13(d)(3) group which must file the appropriate Schedule 13D

¹⁰⁰ *Id.*

¹⁰¹ The *Nicholson* court took its cue on this question of premature disclosure from two circuit court opinions in the tender offer area. In *Susquehanna Corp. v. Pan Am. Sulphur Co.*, 423 F.2d 1075 (5th Cir. 1970), the Fifth Circuit stated, in the context of a genuine cash tender offer:

The person or corporation filing a Schedule 13D statement . . . must . . . be precise and forthright in making full and fair disclosure as to all material facts called for by the various items of the schedule. At the same time he must be careful not to delineate extravagantly or to enlarge beyond reasonable bounds. The securities market is delicately arranged and needs only slight impetus to upset it.

Id. at 1085. Earlier, in *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969), Judge Friendly indicated that "[i]t would be as serious an infringement of these [SEC] regulations to overstate the definiteness of the plans as to understate them." *Id.* at 948. See also Note, *The Courts and the Williams Act: Try a Little Tenderness*, 48 N.Y.U.L. Rev. 991, 1001-02 (1973). Obviously, the *Nicholson* court was concerned with the burden placed on the group, its members, and on counsel if they were required to describe a series of alternatives together with the probability of each one's occurrence. For an excellent discussion of the method by which an investor should calculate such probabilities, see generally C. J. Grayson, *The Use of Statistical Techniques in Capital Budgeting*, in *Financial Research and Management Decisions* 98-107 (A. Robichek ed. 1967).

within ten days. Viewed in this perspective, the *Nicholson* decision makes good sense. Unfortunately, other recent decisions have not further explicated its solid rationale.

In contrast to the logical reasoning of the court in *Nicholson* is the decision of the court in *Water & Wall Associates, Inc. v. American Consumer Industries, Inc. (ACI)*.¹⁰² That case involved ACI's attempt to enjoin an insurgent solicitation of proxies for its annual meeting scheduled for April 24, 1973. Water & Wall had been incorporated on December 20, 1972 for the purpose of acquiring ACI shares. Its four officers, who owned nearly all of Water & Wall's outstanding shares, were also officers and directors of Merchants Investors Corporation (MIC), a broker-dealer which was a signatory of a December 20, 1972 agreement (part of which was the incorporation of Water & Wall) to gain control of ACI.¹⁰³ MIC later assigned the agreement to Water & Wall. Defendants conceded that a group had been formed as a result of the signing of the incorporation agreement on December 20, 1972. Filing occurred on January 2, 1973. Plaintiff contended that group formation had occurred much earlier—during the fall of 1972—and, hence, that the requested injunctive relief against the proxy solicitation was appropriate.¹⁰⁴

Plaintiff relied on a series of meetings which had taken place between the various principals of Water & Wall and several other shareholders of ACI prior to the December 20 memorialization of the agreement.¹⁰⁵ Lendman, one of the principals of Water & Wall acting for MIC at the time, met with one Appel, a three percent shareholder of ACI "sometime prior to November 16, 1972,"¹⁰⁶ and discussed the possibility of a proxy contest against ACI's management. After considering the matter, and discussing it with several other shareholders, Appel wrote a letter, dated November 16, 1972, stating that he was prepared to participate in the plan which Lendman had outlined. On December 6, Appel spoke with one Alexander, who owned or controlled approximately 22,500 ACI shares.¹⁰⁷ Alexander later met with MIC's counsel and agreed that he and Appel "would join MIC in some type of joint voting arrangement."¹⁰⁸ By this time, several other shareholders had been contacted and had indicated their willingness to join a plan once it was

¹⁰² [1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,943, at 93752 (D.N.J. 1973).

¹⁰³ *Id.* at 93753.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 93755.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 93756. Since the number of shares outstanding at the time was 580,000, approximately 29,000 were required to trigger the filing requirement. *Id.* at 93756 n.3.

¹⁰⁸ *Id.* at 93755.

put together. On December 13, 1972, Alexander received a draft of a shareholder agreement in substantially the same form as the one ultimately executed on December 20. The December 20th agreement provided that no later than forty-eight hours after the purchase of 50,000 shares of ACI by MIC, Appel and Alexander would deliver irrevocable proxies for not less than 42,964 shares of ACI. On the same date, December 20, MIC fulfilled its promise and purchased over 50,000 shares of ACI.¹⁰⁹

Defendants asserted that there was no agreement to work in concert until December 20. Citing *Nicholson* as support for their contention,¹¹⁰ they argued that until the agreement was signed on December 20, there were substantial barriers to any agreement. In addition, defendants claimed that the agreement could not go into effect until MIC met the condition subsequent of purchasing the 50,000 shares. Underlying the defendants' arguments seemed to be the implicit contention that until all parties to the agreement committed themselves to its precise terms, there was no coming together in common purpose and thus no group formation necessary to trigger the filing requirement.¹¹¹ The court rejected the defendant's reliance on *Nicholson*, and held that the conditions claimed by the defendants to exist in this case did not approach "the substantialness of the conditions in *Nicholson* and actually amount[ed] to nothing more than consideration—the delivery of proxies for the guarantee that they would be joining a persuasive force."¹¹² The promise to deliver shares was not sufficiently conditioned on the assent of another group member so as to postpone the defendants' obligation to file.

Despite the court's refusal to find no group formation under the *Nicholson* rationale in this situation, *Water & Wall* may be consistent with the *Nicholson* decision. The prior conditions in *Nicholson*, though not independent of the plan, were indeed less likely to occur. The success of Porter's plan in *Nicholson* depended upon the taking of certain specific action by parties outside the membership of the group.¹¹³ It was necessary that an investment banking firm agree to underwrite the issue of the Porter subsidiary, that a registration statement be prepared and filed, that the SEC effectuate the registration statement, and that the Justice Department's Antitrust Division approve the divestiture. On the other hand, the conditions in *Water & Wall* were almost certain to materialize. The purchase of

¹⁰⁹ Id.

¹¹⁰ Id. at 93756.

¹¹¹ See id.

¹¹² Id.

¹¹³ See text at notes 93-94 supra.

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shares and the delivery of irrevocable proxies were foregone conclusions by the time the agreement was memorialized in a writing on December 20. Thus, the theory of substantial prior conditions espoused in *Nicholson* does not appear applicable to the facts in *Water & Wall*. Both *Nicholson* and *Water & Wall*, then, have moved the impact zone of section 13(d)(3) beyond the position of the Second Circuit in *GAF* and toward the SEC staff position announced in *Great Southwest*.

The difficulties that courts have with the concept of concerted activity under section 13(d)(3) is further illustrated by the case of *Mosinee Paper Corp. v. Rondeau*,¹¹⁴ which will be reviewed by the Supreme Court this year. Although both the district court and Seventh Circuit opinions focused on the proper relief to be afforded plaintiff, the case is instructive on the extent to which courts will inquire into the quality of the activity involved before concluding that the purchases have caused a section 13(d)(3) group to form.

In *Mosinee*, nine defendants conceded that the obligation to file had been triggered in May 1971, but argued successfully in the district court that because a subsequent, albeit untimely, filing was made, and because there was an absence of any covert conduct on their part against the issuer or its management, injunctive relief was not warranted.¹¹⁵ The acquisition of plaintiff's shares was spearheaded by Francis Rondeau, whose periodic purchases, on his own and through the vehicle of several corporations he controlled reached the threshold of five percent in May 1971. In April of that year Mosinee's president became aware that Rondeau recently had made several substantial purchases of Mosinee stock. Although the number of shares purchased had not reached the triggering percentage, the president, who was aware of the "associational identity" of the purchasers,¹¹⁶ inquired as to Rondeau's reasons for the purchases. Rondeau stated somewhat disingenuously that he believed the stock to be underpriced and a good investment, that he intended to continue purchases until he held about 40,000 shares, and further, that he was "perfectly happy" with the management and operation of Mosinee in general.¹¹⁷ Rondeau apparently was not aware of the five percent filing threshold although there was evi-

¹¹⁴ 354 F. Supp. 686 (W.D. Wis. 1973), rev'd and remanded, 500 F.2d 1011 (7th Cir. 1974), cert. granted, 95 S. Ct. 653 (1974).

¹¹⁵ 354 F. Supp. at 693-96. Mosinee had sought, *inter alia*, an injunction restraining the defendants: (1) from voting any Mosinee common stock held or acquired in violation of the Exchange Act; (2) from using such stock as collateral to secure funds for the purpose of acquiring control of Mosinee; and (3) from acquiring additional Mosinee common stock "until the effects of [the Exchange Act] violations [had] been fully dissipated." *Id.* at 688.

¹¹⁶ 500 F.2d at 1019 (Pell, J., dissenting).

¹¹⁷ 354 F. Supp. at 689.

dence presented that he was aware of the old ten percent threshold.¹¹⁸ Subsequent to the aforementioned conversation, Mosinee's management continued to monitor Rondeau's purchases and, in July 1971, when those purchases reached approximately 60,000 shares, sent him a letter stating that his activity in Mosinee stock may have created problems under the federal securities laws. No further purchases were accomplished after July 30, the date when Rondeau, shortly after receiving Mosinee's letter, consulted an attorney. Filing occurred on August 25, 1971, approximately three months after the defendants admitted it should have occurred.¹¹⁹ Shortly thereafter, Mosinee instituted its action, requesting among other things, injunctive relief against further stock purchases by the defendants.¹²⁰

Notwithstanding the defendants' admission that their discharge of the duty to file was tardy, the district court held that it would be inappropriate to award the relief sought by Mosinee.¹²¹ In granting the defendants' motion for summary judgment, the district court stated that Mosinee had not documented facts sufficient to show irreparable injury to the corporation.¹²² The court then noted that, even without concluding that irreparable harm is a prerequisite to injunctive relief, the situation in *Mosinee* provided "a particularly inappropriate occasion [for] equitable relief."¹²³ First, the only "harm" Mosinee documented was the "anxiety" which could be expected to accompany any change in management, a predictable consequence of shareholder democracy.¹²⁴ Secondly, there was ample evidence that defendants' purchases were open and notorious and were not the kinds of secret accumulations to which section 13(d) was addressed.¹²⁵ Finally, the court noted that all of the information necessary to dissipate the effect of any purchases in violation of section 13(d) had been available since late September

¹¹⁸ Id. at 690.

¹¹⁹ Id. at 690, 693.

¹²⁰ Id. at 693-96.

¹²¹ Id. at 696.

¹²² Id. at 693.

¹²³ Id. at 694.

¹²⁴ Id. This position taken by the district court in *Mosinee* should be contrasted with that of the district court in *Bath Industries*, 305 F. Supp. 526 (E.D. Wis. 1969), aff'd, 427 F.2d 97 (7th Cir. 1970), where the main reason given for enjoining the Blot group from engaging in a proxy contest was the fear that such a struggle would "chill" the company's chances for securing a lucrative government shipbuilding contract. 305 F. Supp. at 538. See text at note 28 supra. The *Mosinee* court distinguished *Bath*, noting that in that case "irreparable injury to the corporation, as distinguished from its present management, flowed from the covert conduct of the defendants" 354 F. Supp. at 695.

¹²⁵ 354 F. Supp. at 694-95.

1971, and was available at the time the motion for summary judgment was brought.¹²⁶

On appeal the Seventh Circuit reversed,¹²⁷ thus extinguishing any remaining vitality of its *Bath Industries*¹²⁸ decision. The court noted its agreement with the Second Circuit's analysis in *GAF*, and indicated approval of *GAF*'s interpretation of section 13(d) as being intended "to alert the marketplace of every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control."¹²⁹ Since this language in *GAF* was central to the distinction drawn by the *GAF* court between its analysis of section 13(d) and that of the Seventh Circuit in *Bath Industries*, the Seventh Circuit appears to have overruled its *Bath Industries* holding that the section 13(d) filing requirement is not triggered without an agreement to act in concert to acquire additional shares.¹³⁰

Had the Seventh Circuit stopped there, the decision would have provided increased uniformity among the circuits but little real enlightenment. However, in reversing the district court and directing that an injunction be entered against Rondeau and his associates,¹³¹ the court of appeals went much further. While *GAF* had focused on equity accumulations of more than five percent acquired with a view to control, the Seventh Circuit went well beyond that barrier and placed within the statute any accumulation in excess of five percent where "the purchaser portends the *potential* to effectuate a change in control."¹³² The court gave two reasons for its broad construction. First, Congress had deemed it necessary that both management and the general investing public should be able, when such potential arises, to assess the impact of the possible control alteration in valuing the issuer's securities. Second, management must be allowed an opportunity to respond appropriately to the newly-existing potential for a shift in control.¹³³

Whether the Seventh Circuit's language in *Mosinee* will reduce the factual analysis necessary to find a section 13(d) violation to a mere mathematical calculation,¹³⁴ without inquiry into the

¹²⁶ *Id.* at 695.

¹²⁷ 500 F.2d at 1017.

¹²⁸ *Bath Industries, Inc. v. Blot*, 427 F.2d 97 (7th Cir. 1970). See text at notes 27-34 *supra*.

¹²⁹ 500 F.2d at 1016, quoting *GAF Corp. v. Milstein*, 453 F.2d 709, 717 (2d Cir. 1971).

¹³⁰ See text at notes 30-33 *supra*.

¹³¹ 500 F.2d at 1017.

¹³² *Id.* at 1016.

¹³³ *Id.*

¹³⁴ In other words, if $N = .05(S)$ where N = number of shares acquired and S = the number of shares of the class outstanding, then the filing provision has been triggered.

purchaser's possible intent to alter the corporation's pattern of control, is difficult to determine. The use of the word "portend" together with the concept of shift in issuer control indicates that the accumulating process engaged in prior to the triggering acquisition must be carried on in a way foretelling an attempt to alter the issuer's control pattern. On the other hand, the court stated that: "It is clear from the language of the Act that Congress intended to include within the scope of the reporting requirements those transactions entered into for investment purposes and not control."¹³⁵ This language seems to indicate that, in the view of the Seventh Circuit, failure to file would be a per se violation. If, on the other hand, the court's prior reference to corporate control,¹³⁶ is accepted as definitive, then the view to control condition to imposition of the statutory duty, required by the *GAF* court, is at least partially retained.

The effect that the Seventh Circuit's analysis will have on the problem of group formation is also somewhat uncertain. Neither the majority nor the dissenting opinion in *Mosinee* cited section 13(d)(3) or discussed the statutory problem of group formation.¹³⁷ Both opinions apparently assumed that Rondeau alone had been responsible for the entire accumulation.¹³⁸ The failure of the court to discuss this issue is unfortunate since the contrast with the analysis of the Williams Act's purpose would have been worthwhile. It is one thing to state that, *if* an accumulation has occurred, regardless of motive, filing must follow. It is an entirely different matter to state that several persons, none of whom have purchased an additional share, have engaged in concerted activity with respect to the issuer such that a statutory accumulation has resulted. Nevertheless, with some interpolation, the group formation problem can be analyzed in the context of the facts of *Mosinee*.

There is nothing in the district court's opinion in *Mosinee* to indicate that the "crystallization" of plans, prior to the consultation with the attorney, had hinged on substantial prior conditions or that the crystallization had been the result of a selection process which contemplated a choice from several vague options. The *Mosinee*

¹³⁵ 500 F.2d at 1016 n.4.

¹³⁶ See text at note 132 supra.

¹³⁷ The district court opinion, however, set out in detail that Rondeau was not the only purchaser, and that he did not personally purchase in excess of the triggering percentage. 354 F. Supp. at 691. But since the defendants had earlier conceded that a violation of § 13(d)'s filing requirement had occurred, such discussion, except as it related to the remedy, was unnecessary.

¹³⁸ See 500 F.2d at 1014-15 (majority opinion); id. at 1019-20 (dissenting opinion).

defendants, unlike the *Nicholson* defendants,¹³⁹ seem to have been waiting for the right moment at which to strike.¹⁴⁰ Furthermore, Judge Doyle's opinion passed over Rondeau's less than candid response to the inquiry of Mosinee's president as to the reason for the stock purchases,¹⁴¹ and the fact that after receiving the warning letter, Rondeau himself placed no more purchase orders, though other defendants did. When Rondeau was first queried as to his purpose, approximately 18,000 shares had been purchased; when the issuer's warning letter was received, the group had accumulated just over the threshold percentage. Yet by the time the late filing occurred, the defendants had accumulated close to an eight percent equity interest.¹⁴² Such deliberate deception in the light of subsequent events should have been sufficient to show the defendants' "covert conduct," or, in Second Circuit's language, "view to control," or, in *Nicholson*'s language, "common purpose."

As has been demonstrated earlier, a section 13(d)(3) group's duty to file is the result, not only of group holdings in excess of the threshold percentage, but also of a group attitude, whether judicially termed a "view to control," a "firm agreement," or a "common purpose." Thus, the *Mosinee* issuer should have been entitled to relief on the basis of the defendants' admission (showing the requisite attitude as of May 17) and the covert accumulations to try to obtain control (evidenced by Rondeau's less than candid reaction to the issuer's inquiry as to his intent and by a late filing motivated only by fear of litigation for failure to file). Had the district court

¹³⁹ See text at notes 92-95 *supra*.

¹⁴⁰ At the time of the district court decision in *Mosinee*, Judge Doyle had only the conduct of the defendants in *Bath* as a basis of comparison in determining whether covert, conspiratorial conduct had occurred. The issues of group formation and duty to file could, however, have been readily resolved by using the *Nicholson* concept of prior substantial conditions. Under that theory the court might easily have inferred that the defendants were pursuing their course of accumulation until the right moment. Given the record of accumulation by the defendants and the poor earnings record of the issuer (which had recently reduced its dividend), 354 F. Supp. at 688, the trial court could have further inferred high shareholder receptivity to a tender offer. Certainly this receptiveness was indicated by a market rise in the stock from thirteen to twenty-one dollars per share a few days after the late filing. More importantly, an examination by the court of the Schedule 13D would have shown that the defendants were considering borrowing 3.6 million dollars for the purchase of an additional thirty percent equity interest in Mosinee. These circumstances should have indicated that the defendants had, on May 17, agreed to try to obtain control, and were simply biding their time until the right moment to make the tender offer. If the financing referred to was a substantial condition to the formulation of a common purpose, under the rationale of *Nicholson* the court could have tolled the filing period until the financing became a virtual certainty. On the other hand, if obtaining the financing seemed a foregone conclusion, then the district court should have allowed the issuer equitable relief.

¹⁴¹ See text at note 117 *supra*.

¹⁴² 354 F. Supp. at 690-91.

decision been affirmed, it would have created a strained and unnecessary distinction between the duty to file because of concerted activity and the duty to file because of covert, conspiratorial action to obtain control.

The date of group formation was crucial in *Texasgulf, Inc. v. Canada Development Corp.*,¹⁴³ a decision rendered by the United States District Court for the Southern District of Texas. Late in the afternoon of July 24, 1973, the Canada Development Corporation (CDC) gave notice to the management of Texasgulf that it was about to announce a tender offer for the stock of Texasgulf, which, if successful, would result in CDC control of that world-wide, publicly-owned mining and chemical company. Texasgulf quickly sought an injunction restraining CDC from proceeding with its tender offer, alleging, *inter alia*, securities and antitrust violations, conspiracy, and possible conflict of interest.¹⁴⁴ Although the section 13(d) issue was clearly a subsidiary one, the *Texasgulf* court's treatment of that issue is instructive. It illustrates the fact that the federal district courts are heavily influenced by the *GAF* rationale.

Plaintiff's attempt to show group formation was ingenious. CDC, the principal defendant, had carefully limited its open market purchases so as not to exceed, together with the purchase of another company with whom it hoped to conduct the tender offer as a joint venture, the five percent triggering percentage. Thus, Texasgulf alleged that Louis R. Desmarais, a vice chairman and director of CDC who was also the president of a large Canadian utility which, in turn, held a controlling interest in two companies possessing substantial shareholdings in Texasgulf,¹⁴⁵ was a participant and that the shares of the two companies should be attributed to the group making the tender offer. The *Texasgulf* court, accepting the Second Circuit's *GAF* guidelines as to when a group becomes obligated to file a Schedule 13D,¹⁴⁶ rejected plaintiff's proposition:

It takes more than the arithmetic of adding up shares to determine that a statutory group exists and that a filing

¹⁴³ 366 F. Supp. 374 (S.D. Tex. 1973).

¹⁴⁴ *Id.* at 391. The opinion is a textbook in defense tactics for counsel for the issuer and its management. See, e.g., *id.* at 380 n.2 (closing argument of counsel for Texasgulf, Inc.). For other well-informed discussions of tender offer defense tactics, see generally Cary, Corporate Devices Used to Insulate Management from Attack, 25 Bus. Law. 839 (1970); O'Boyle, Changing Tactics in Tender Offers, 25 Bus. Law. 863 (1970); Schmults & Kelly, Cash Take-Over Bids—Defense Tactics, 23 Bus. Law. 115 (1967). Perhaps the best known and best conducted defense against an exchange offer was that of B.F. Goodrich Company against Northwest Industries in 1969. See J. Brooks, The Go-Go Years 176-77 (1973).

¹⁴⁵ 366 F. Supp. at 403-04.

¹⁴⁶ *Id.* at 403. See *GAF Corp. v. Milstein*, 453 F.2d 709, 718 (2d Cir. 1971).

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must be made. Two criteria must be met: (1) The members must agree to act together for the purpose of acquiring, holding, or disposing of securities; and (2) once the members agree to act, they must own beneficially or acquire beneficially in excess of 5% of a class of equity security. *Mere relationship, among persons or entities, whether family, personal or business, is insufficient to create a group which is deemed to be a statutory person.* There must be agreement to act in concert.¹⁴⁷

One further point can be gleaned from the *Texasgulf* opinion. It was quite clear that CDC had a carefully planned purchase program beginning in March 1973. As stated, the purchases were designed to cease prior to the two companies reaching in the aggregate ownership of the threshold percentage of shares. The court agreed that the CDC decision not to make further purchases was merely a business judgment based upon a desire to avoid the section 13(d) filing requirement and to allow the price of the target company's stock to settle in the market until July, when the decision whether to proceed with the tender offer was to be made. Relying on the legislative history of the 1970 amendment to the Williams Act,¹⁴⁸ the court held that a conscious avoidance of the five percent triggering percentage did not constitute a violation of law.¹⁴⁹

The *Texasgulf* decision adds one more category to the growing decisional literature surrounding section 13(d). Defendants may now protest that their dealings together did not rise to the level of acting in concert but were merely the product of a relationship outside the scope of section 13(d)(3). Whether such a relationship may be maintained even if there are no "prior substantial conditions" to agreement or if some, but not all, of the members of the group possess the requisite view to control, must await further judicial analysis.

VI. CONCLUSION

To some extent, the problem of when a section 13(d)(3) group forms remains unresolved. However, certain areas have stabilized in the course of judicial and administrative interpretation of the section's language. For example, counsel can no longer, in the face of the decisions and rulings previously discussed, rely in good faith on the Seventh Circuit's holding in *Bath Industries*¹⁵⁰ that section

¹⁴⁷ 366 F. Supp. at 403 (emphasis added).

¹⁴⁸ See notes 1-18 *supra* and accompanying text.

¹⁴⁹ 366 F. Supp. at 404.

¹⁵⁰ *Bath Industries, Inc. v. Blot*, 427 F.2d 97 (7th Cir. 1970).

13(d)(3) group formation can occur only when an intent to acquire more shares is formulated.

Other areas are less susceptible to solution. It is apparent that concerted action among the group membership is necessary, but it is difficult to ascertain the level to which these concerted activities must rise to impose the statutory requirements. Probably the SEC staff's broad view¹⁵¹ as to what constitutes "acting in concert" goes beyond what Congress intended. But it is difficult to state with any degree of assurance that such a view will not be accepted by the courts should the Commission decide to press the issue.

The importance of judicial and administrative precedents in the area of section 13(d) group formation, as elsewhere, lies ultimately in the lawyer's ability to draw guidance from them in formulating advice for a client. More often than not, counsel will be approached by a group which clearly contemplates an attempt to alter the control pattern of the issuer. On these occasions he must urge an immediate filing much the same as the attorney advised Francis Rondeau in the *Mosinee* case. Usually management will by that time be aware of the facts relevant to the intended takeover bid and, therefore, as a tactical matter, disclosure will in large measure be irrelevant. If, however, the pre-filing accumulation process depends on counsel's advice, he must tread a narrower line. Counsel does not serve his client's interest by engaging in an excess of caution. Often disclosure at an early juncture in the accumulation process may serve to terminate the plan, especially if money suppliers become nervous at the prospect of publicity and a long and bitter public relations battle. On the other hand, if counsel waits too long his client may find himself enjoined not only from purchasing more stock, but even from voting that which he already owns, at least until the "effects" of the failure to file have worn off. It is a difficult problem to resolve, and the consequences of an erroneous decision may have substantial impact.

Fortunately the courts are creating a reasonable degree of certainty in this troublesome area. The analyses contained in such cases as *Nicholson* and *Texasgulf*, while quite broad, should not hamper insurgents to the extent feared as a result of the *GAF* decision. In particular, the *Nicholson* decision provides support for those attorneys who would advise that mere discussions regarding the management of the issuer, taking place among persons who in the aggregate own more than the threshold percentage, does not trigger the filing requirement. The problem for the future lies in the need to find flexible and workable remedies when the filing deadline has

¹⁵¹ See text at notes 49-76 supra.

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passed.¹⁵² Where he is retained in time, however, counsel has ample decisional guidance as to when a section 13(d)(3) group is born.

¹⁵² Judge Pell provides exemplary articulation of this point in his dissent to the Seventh Circuit's opinion in *Mosinee*. His specific objection is to the gamesmanship he sees "becoming the order of the day in the area of acquisition-for-control." 500 F.2d at 1022 (dissenting opinion), citing *Missouri Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851 (2d Cir.) (Friendly, J.), cert. denied, 419 U.S. 883 (1974).

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