

"ACQUISITIONS" AND "GROUPS" UNDER SECTION 13(d) OF THE SECURITIES EXCHANGE ACT OF 1934

The beginning of wisdom is the definition of terms—

Socrates

The Williams Amendments of 1968 augmented the Securities Exchange Act of 1934¹ by requiring disclosure of persons or groups seeking corporate control through the use of a cash tender offer.² In addition, subsection (d) was added to Section 13 of the Act. It provides, in part, that:

(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security . . . is directly or indirectly the beneficial owner of more than [ten] per centum of such class shall, within ten days after such acquisition . . . [file certain specified information.]³

...
(3) 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 this subsection.⁴

The purpose of section 13(d) is to enable investors to make in-

¹ 15 U.S.C. §§ 78a-hh (1970).

² 15 U.S.C. §§ 78n(d)-(f) (Supp. V, 1970), as amended, 15 U.S.C. §§ 78n(d)-(f) (1970).

³ Section 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970), requires that the following information be filed:

(A) the background and identity of all persons by whom or on whose behalf the purchases have been or are to be effected;

(B) the source and amount of the funds or other consideration used or to be used in making the purchases . . . ;

(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals . . . to make any . . . major change in its business or corporate structure;

(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the name and address of each such associate; and

(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer

In addition, all information which the Commission by its rules and regulations prescribes as necessary for the protection of investors must be filed. The information to be filed is embodied in Schedule 13 D, 17 C.F.R. § 240.13d-101 (1971).

⁴ 15 U.S.C. § 78m(d) (Supp. V, 1970), as amended 15 U.S.C. § 78m(d) (1970). The 1970 Amendment changed the point at which disclosure is required from beneficial ownership of 10 percent of an issuer's securities to 5 percent. However, since the cases discussed in this comment arose when the 10 percent requirement was in effect, all references in the article are to the ten percent requirement; otherwise, references are to the statute as amended.

telligent investment decisions by providing them with information concerning shifts in corporate ownership which portend a change in control.⁵ To achieve this objective the statute requires disclosure of pertinent information upon the existence of two facts. The first is the beneficial ownership of ten percent of the outstanding securities of an issuer.⁶ More descriptively, a ten percent interest may be considered a power base from which the policies of a corporation can be influenced or controlled.⁷ The second is a two percent or greater acquisition of beneficial ownership in a particular class of an issuer's equity securities within a twelve month period.⁸ Conceptually, a two percent acquisition is an objective index of an intent to change management or otherwise influence corporate policy.⁹

The Courts applying these standards have reached conflicting conclusions as to the meaning of "acquisition" in paragraph (1) of the subsection and have also encountered difficulty in ascertaining the scope of the paragraph (3) definition of "person." Acquisition has been inconsistently defined as (1) a market purchase of securities,¹⁰

⁵ See pp. 163-66 *infra*.

⁶ 15 U.S.C. § 78m(d)(1) (Supp. V, 1970), as amended, 15 U.S.C. § 78m(d)(1) (1970).

⁷ According to one authority:

The ten percent figure is commonly used as the size shareholding that gives control of publicly held corporations. Although it may be too low for that purpose, it seems much higher than the minimum size shareholding which would give rise to an interest in structural decisions. At least in the publicly held corporation, a figure of one percent would see more appropriate. . . .

Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 Calif. L. Rev. 1, 43 (1969).

The ten percent figure was reduced to five percent by Pub. L. 91-567, 84 Stat. 1497 (1970), amending the Williams Act, 82 Stat. 454 (1968), codified as 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1970).

⁸ "The purpose of § 13(d) is to require disclosure of information by persons who have acquired a substantial interest, or increased their interest in the equity securities of a company by a substantial amount, within a relatively short period of time." H.R. Rep. No. 1711, 90th Cong., 2d Sess., reported in U.S. Code Cong. & Ad. News 2811, 2818 (1968) (emphasis added).

A substantial increase is defined as two percent of the issuer's outstanding securities: The provisions of this subsection shall not apply to

(b) any acquisition of the beneficial ownership of a security which, together with all other acquisitions by the same person of securities of the same class during the preceding twelve months, does not exceed 2 per centum of that class.

15 U.S.C. § 78m(d)(6)(B) (1970).

⁹ The desire of Congress to separate acquisitions made for investment purposes from those which require disclosure is evident in the statute. Section 13(d)(6)(D) provides that the subsection shall not apply to "any acquisition . . . which the Commission . . . shall exempt . . . as not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer." 15 U.S.C. § 78m(d)(6)(D) (1970). See also 113 Cong. Rec. 24, 665 (1967) (exchange between Senators Javits and Williams).

¹⁰ *GAF Corp. v. Milstein*, 324 F. Supp. 1062, 1070 (S.D.N.Y. 1971); *Ozark Airlines, Inc. v. Cox*, 326 F. Supp. 1113, 1117-18 (E.D. Mo. 1971). See discussion at pp. 155-59 *infra*.

(2) an acquisition of a beneficial interest in securities by any means,¹¹ and (3) a purposeful acquisition of a beneficial interest in securities.¹² The disparity lies not only in the meaning of the term acquisition, but also in the specification of that which must be acquired—a beneficial interest in the security vs. the security itself. The problem of defining person has essentially been one of determining the characteristics of a "group acting to acquire, hold or dispose of securities." The only decision to consider carefully this question concluded that several defendants constitute a group when, and only when, they act in concert to *acquire* securities of an issuer.¹³ Thus, groups acting to *hold* or *dispose* of securities were effectively eliminated from the paragraph (3) definition.¹⁴

This comment examines the legal foundation of the recent decisions. Upon analysis, the legislative history of the Williams Amendments and the statutory language of section 13(d) suggest that principles underlying the concept of "beneficial ownership," which have evolved under Section 16 of the Exchange Act, define acquisition and set the parameters of a paragraph (3) "group." The comment concludes that (1) any acquisition of beneficial ownership is a reportable event under section 13(d) if the acquisition and resultant interest in the issuer's securities are of sufficient magnitude; and (2) individuals acting jointly to acquire, hold or dispose of securities constitute a section 13(d)(3) group if, by concerted action, the individuals have acquired a beneficial interest in each other's securities.

I. "ACQUISITIONS" UNDER SECTION 13(d)

Determining the acquisitions which precipitate the section 13(d) disclosure requirements presents two discrete problems. The first is defining the term "acquisition." The difficulty is not so much a matter of finding an acceptable meaning for the term as it is establishing criteria by which to judge whether transactions fall within the ambit of the subsection. The problem is similar to that arising under Section 16(b) of the Exchange Act.¹⁵ Section 16(b) provides that profits realized by corporate "insiders" from purchases and sales of an issuer's equity security made within a six month period shall inure to the issuer.¹⁶ The problem lies in determining what trans-

¹¹ *Sisak v. Wings and Wheels Express, Inc.*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991 at 90,668 (S.D.N.Y. 1970). See discussion at pp. 159-61 *infra*.

¹² *Bath Indus., Inc v. Blot*, 427 F.2d 97, 109 (7th Cir. 1970), discussed at pp. 153-55 *infra*.

¹³ *Id.*

¹⁴ The group purposes of acquiring, holding or disposing of securities are analogous to purchasing, voting and selling securities. Since purchases of securities are not usually necessary to groups acting to vote or sell securities, it is unlikely that these groups would undertake any acquisition which might require them to register under § 13(d).

¹⁵ 15 U.S.C. § 78p(b) (1970).

¹⁶ *Id.*

actions constitute either a "purchase" or a "sale."¹⁷ Because certain of the decisions to be discussed use the term purchase to define acquisition, it may be helpful to note that a purchase of securities is not limited to the typical market transaction; a purchase has been broadly described as *any* transaction which creates the potential for abuse which the statute was designed to prevent.¹⁸

The second problem presented is that of determining the meaning of "beneficial ownership of securities" for the purposes of the subsection. The same problem arises under Section 16(a) of the Exchange Act, which requires corporate insiders to report changes in beneficial ownership.¹⁹ While the interpretation given this section by the Securities and Exchange Commission (SEC) clearly indicates that beneficial ownership does not refer to ownership as of record,²⁰ the discernible trend in the decisions interpreting section 13(d) is to equate the two.²¹ In order to understand the distinction between beneficial and legal ownership, it may be helpful to view the latter as the bundle of rights, privileges, powers and immunities which ordinarily attaches to legal title.²² Beneficial ownership, on the other hand, refers to control or enjoyment of the beneficial incidents of ownership by one who may or may not possess legal title.²³ The beneficial incidents which attach to security ownership are those which are intrinsic to the security, such as the rights to vote in corporate affairs and to collect interest or dividends, and those which arise from dealing and speculating in the security, such as the power to buy and sell the security.²⁴

¹⁷ See *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.), cert. denied, 348 U.S. 827 (1954), for discussion of these problems.

¹⁸ *Newmark v. RKO General, Inc.* 425 F.2d 348, 351 (2d Cir.), cert. denied, 400 U.S. 854 (1970).

¹⁹ 15 U.S.C. § 78p(a) (1970).

²⁰ 11 Fed. Reg. 10967 (1934). 17 C.F.R. § 241.21 (1971). (Although 17 C.F.R. § 241 does not reprint the text of the interpretive releases, it is cited because it provides convenient access to the text printed in the Federal Register and the CCH Fed. Sec. L. Rep.).

²¹ See text at pp. 157-59 *infra*.

²² See generally W. Hohfeld, *Fundamental Legal Conceptions* (1923).

²³ 31 Fed. Reg. 1375, 1376 (1966), 17 C.F.R. § 241.7824 (1971), provides that "[a] person . . . may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership."

While 17 C.F.R. § 241.7824 (1971) discusses beneficial ownership of securities under Section 16(a) of the Securities Exchange Act of 1934, "it should be noted that generally the same principles apply to disclosing beneficial ownership [throughout the law of Securities Regulation]." *Id.*

²⁴ This categorization of beneficial incidents was suggested in Feldman and Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 W. Res. L. Rev. 1054, 1059 (1966).

The thesis of the Feldman-Teberg article is that:

[I]f section 16(a) is to achieve its goals, "beneficial ownership" must be construed "not technically and restrictively, but flexibly to effectuate . . . [its] broad remedial purposes." [Therefore] it is the enjoyment of the benefits of security ownership, rather than the rights to such benefits, which is the appropriate standard for construing the term "beneficial ownership" as used in

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By tradition, a partner is considered the beneficial owner of securities held by the partnership in proportion to his interest in the partnership;²⁵ a husband is considered the beneficial owner of securities held by his wife and minor children;²⁶ and a person who has the authority to vote securities owned by another is considered the beneficial owner of these securities.²⁷ The recurring question in litigation arising under section 13(d) is whether a group, by virtue of its concerted action to acquire, hold or dispose of securities, acquires a beneficial interest in the securities owned by its members and, if so, whether such acquisition is a reportable event under section 13(d).²⁸

While the foregoing discussion should give the reader a basis for understanding the ensuing analysis of decisions interpreting the subsection, none of the courts has distinguished the problem of defining acquisition from that of defining beneficial ownership.²⁹ Nor, in reaching their decisions, have the courts examined the existing law, developed under section 16, which is relevant to the problems arising under section 13.³⁰ However, it is submitted that the present conflict of opinion will eventually be resolved by reference to this law and, therefore, the dichotomy of issues should be kept in mind.

A. Judicial Definitions

The case of *Bath Industries, Inc. v. Blot*³¹ presented the first judicial opportunity to define the meaning of acquisition as used in section 13(d).³² The definition implicit in *Bath* was that acquisition means a *purposeful acquisition of a beneficial interest* in the securities

section 16(a). Accordingly, in computing whether a person is subject to the section as the beneficial owner of more than ten percent of a class of registered equity security, the purposes of section 16(a) require the inclusion of any securities from which he obtains those benefits of ownership which enable him to achieve an inside position. And . . . once a person is subject to it, either by reason of beneficial ownership or position as officer or director, he should also be regarded as beneficially owning any securities from which he obtains benefits of ownership which may provide either the incentive for, or lend themselves to any of the abuses of inside position that the Exchange Act was designed to prevent.

Id. at 1065-66 (footnotes omitted). The author subscribes to this thesis and acknowledges his reliance upon the article's excellent analysis of beneficial ownership under § 16.

²⁵ 11 Fed. Reg. 10970 (1938). 17 C.F.R. § 241.1965 (1971).

²⁶ 31 Fed. Reg. 1005 (1966). 17 C.F.R. § 241.7793 (1971).

²⁷ *Bath Indus., Inc. v. Blot*, 427 F.2d 97, 112 (7th Cir. 1970).

²⁸ Every case in which the issue of determining the scope of § 13(d)(1) has arisen has involved "group" action. See text at pp. 153-61 *infra*.

²⁹ Id.

³⁰ Id.

³¹ 427 F.2d 97 (7th Cir. 1970).

³² Section 13(d) had been considered previously by courts but the issue raised concerned the adequacy rather than the necessity of disclosure. See *Susquehanna Corp. v. Pan Am. Sulfur Co.*, 423 F.2d 1075 (5th Cir. 1970). See also *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969), which discussed the adequacy of a Schedule 13D filed pursuant to §§ 14(d)-(f) of the Williams Amendments. 15 U.S.C. §§ 78n(d)-(f) (1970).

of an issuer.⁸³ The case involved a group of stockholders cooperating in an effort to change Bath's management. The controversy originated when the defendant Blot, a director of the corporation, proposed a change of the chief executive officer to the board of directors. The proposal was rejected, whereupon Blot set out to enlist the support of several substantial shareholders in an effort to effect the change. Approximately one year later, Blot again submitted the proposal, this time with an accompanying list of his alleged supporters. He intimated that unless the proposal were adopted, a special stockholders' meeting would be called, the number of directors increased, and the change thereby effected. Although neither Blot nor any of his supporters owned ten percent of Bath's securities, collectively they either owned or controlled approximately fifty percent of Bath's stock and, during the year, had made purchases totalling substantially more than two percent. The corporation responded to Blot's threat by filing suit and requesting a preliminary injunction to restrain the defendants from taking any of the aforementioned actions, pending trial on the issue of whether the defendants had violated section 13(d).

In support of its request for the injunction, Bath contended that section 13(d) requires disclosure whenever stockholders who beneficially own ten percent or more of a corporation's outstanding shares agree to act in concert.⁸⁴ The defendants, who admittedly had not filed Schedule 13D, contended that the section governs purchases of shares, by cash tender offer or otherwise, but that it is not directed toward the concerted action of existing stockholders.⁸⁵

On appeal from a district court decree granting the injunction, the Court of Appeals for the Seventh Circuit held that compliance with the disclosure provisions of section 13(d) is required when, and only when, any group of stockholders beneficially owning more than ten percent of the securities of a corporation agrees to act in concert *to acquire additional shares*.⁸⁶ The court observed that, although the district court had not examined the contents of the group's agreement, the lower court had made a subsidiary finding that some members of the group had purchased additional Bath securities. In view of this finding, the court held that a rebuttable presumption was raised that the purchases had been made pursuant to a group agreement dated the day of the purchase. The court concluded that the defendants had acted as a group to acquire securities as of that date; since the defendants collectively owned over ten percent of Bath's securities, they were required to have registered within ten days of their agreement. The court therefore sustained the injunction.

The Seventh Circuit considered the primary issue to be whether the defendants had acted as a group; the court failed to confront di-

⁸³ See text at notes 37-41 *infra*.

⁸⁴ 427 F.2d at 108-09.

⁸⁵ *Id.* at 109.

⁸⁶ *Id.*

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rectly the problem of defining "acquisition."³⁷ Yet, a decision requiring the defendants to register pursuant to section 13(d) presupposes the occurrence of the necessary acquisition by the group.³⁸ The implicit premise was that if several defendants aggregately owning ten percent or more of an issuer's securities act as a group, the group acquires a beneficial interest in the securities of its constituents by virtue of the concerted action. Importantly, the court expressly denied that an acquisition of securities—as opposed to an acquisition of beneficial interest in securities—was a prerequisite to the disclosure requirements: "Once the group *agrees* to act in concert to *acquire shares*, its members must comply with the Act's disclosure requirements whether or not any one of them has at that time acquired stock in furtherance of the underlying plan."³⁹

While *Bath* seems to be precedent for an expansive definition of acquisition, the decision does not actually define the term, nor do the facts of the case require the broadest interpretation. The acquisition by the group resulted from a concerted effort to obtain control.⁴⁰ Thus, acquisition may be defined restrictively to mean "that which is obtained purposefully through the efforts of the acquirer." This meaning would effectively eliminate from the scope of the statute acquisitions by operation of law, such as by inheritance or gift.⁴¹

Since the defendants in *Bath* had in fact acquired over two percent of Bath's securities by purchase, prior to court determination that registration was required, it is not surprising that *Bath* was later distinguished on its facts. In *GAF Corporation v. Milstein*,⁴² the court, in a carefully reasoned opinion, did distinguish *Bath*, holding that acquisition means a market purchase of securities.⁴³ The Milstein defendants were related stockholders of GAF Corporation. Collectively they owned approximately 10.25 percent of GAF's convertible preferred stock, which they had acquired as a result of GAF's merger

³⁷ Id. at 108. The court stated that:

Since it is conceded that no individual defendant owns 10% of the outstanding stock of Bath and since the disclosure provisions of the Williams Act come into play only when a person or group beneficially owns more than 10% of the relevant class of a corporation's shares, we must first determine whether. . . the defendants should be treated as a "group" within the meaning of the Act.

Concluding that the defendants were a "group," the court held that "full disclosure for the benefit and protection of other stockholders and investors will be required." Id. at 110-11.

³⁸ Section 13(d) requires registration by "[a]ny person who, *after acquiring* . . . the beneficial ownership of any equity security . . . is the beneficial owner of more than 10 per centum . . ." 15 U.S.C. § 78m(d)(1) (1970) (emphasis added).

³⁹ 427 F.2d at 110.

⁴⁰ Not only is group effort to take control necessary, the group must agree to acquire additional shares to reinforce its position against management before registration is required. Id. at 109-10.

⁴¹ See for example, *Ozark Airlines, Inc. v. Cox*, 326 F. Supp. 1113, 1117-18 (E.D.Mo. 1971) discussed at p. 159 *infra*.

⁴² 324 F. Supp. 1062 (S.D.N.Y. 1971).

⁴³ Id. at 1068, 1070.

with the Ruberoid Company. Prior to the merger, the Milsteins had owned about eight percent of Ruberoid's common stock; GAF owned twenty-six percent. During the merger, GAF's holdings in Ruberoid were cancelled, causing the defendant's interest automatically to increase from eight percent in Ruberoid to 10.25 percent in GAF's convertible preferred. In addition to the preferred shares thus acquired, the Milsteins had purchased 1.6 percent of GAF's common stock.

GAF alleged that the Milsteins had conspired to take over the corporation and that they were thus required by section 13 to file Schedule 13D.⁴⁴ GAF's theory was that when stockholders owning ten percent of a corporation's securities act to obtain control, under paragraph (3) the individual stock ownership is constructively conveyed to the group thus formed. Since the group owned over ten percent of GAF's securities, and had acquired over two percent through constructive conveyance, registration was required. The District Court for the Southern District of New York (Pollack, J.) sustained the defendants' motion to dismiss. The court held that the mere organization of a group of stockholders owning more than ten percent of a class of equity security, with the intention of seeking control is, without more, not a reportable event under the subsection.⁴⁵ The court noted that a group can avoid filing under section 13(d)(1) if it does not acquire a significant number of securities after its formation.⁴⁶

Unlike the *Bath* decision, GAF did not closely consider whether the defendants comprised a "group." Rather, the court apparently assumed that they did and moved directly to the problem of defining "acquisition." After noting that the statute contains no definition of this term, the court concluded that the statutory language clearly compelled "the construction that the reportable event is the acquisition of the requisite amount of shares and not the mere formation of a group. . . ."⁴⁷ The court distinguished *Bath* on its facts noting that, in that

⁴⁴ Id. at 1064, 1066.

⁴⁵ Id. at 1068-70.

⁴⁶ Id. at 1071.

⁴⁷ Id. at 1067. The court's rationale in reaching this conclusion was that the statute on its face did not require disclosure in respect to an individual, absent an acquisition of securities. To require a group of individuals to file where no securities had been acquired would result in disparate treatment of individuals and groups. While granting that certain statutes make group action "more reprehensible" than individual action, e.g., monopolies under the Sherman Act, 15 U.S.C. §§ 1, 2 (1970), the court stated that the number of people involved is unimportant in the context of corporate takeovers. "It is money not numbers that counts here." Id. at 1068.

The problem with this analysis is that the court incorrectly assumed that no disclosure is required of individuals who have not purchased securities. The statute states that any person, whether an individual or a group, must register after acquiring a beneficial interest in securities. 15 U.S.C. § 78m(d)(1) (1970). Thus, if an individual acquires a 10 percent beneficial interest by acquiring a vested beneficial interest in a trust, he should be required to register. See 17 C.F.R. § 240.16a-8 (1971); *Sisak v. Wings & Wheels Express, Inc.* [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991 (S.D.N.Y. 1970). Cf. *Ozark Airlines, Inc. v. Cox*; 326 F. Supp. 1113 (E.D.Mo. 1971). Obviously, there is no disparity in requiring a group also to register, absent a purchase of securities, if it has acquired the requisite beneficial interest through group action.

case, the defendants had purchased over two percent of Bath's securities, whereas the Milstein family had purchased only 1.6 percent of GAF's stock.⁴⁸

The salient aspect of the *GAF* definition of acquisition is the requirement that a corporation's equity securities, not merely a beneficial interest in those securities, must be acquired. This requirement effectively eliminates groups which act to hold or dispose of securities from section 13(d) registration requirements. Since these groups are either voting or selling securities, further acquisitions may not be essential to the group purpose. In most cases, the possibility of being subjected to disclosure requirements of the subsection will suffice to deter purchases which might bring the group within the court's definition of a reportable event.

Perhaps the same criticism could be directed toward the *Bath* decision, which limited paragraph (3) groups to those acting to acquire securities.⁴⁹ However, the court in *Bath* presumably would consider any coalition of stockholders a group if any of the individuals made a purchase, no matter how small.⁵⁰ Thus, even a minimal purchase would transform the group purpose from one of holding or disposing to acquiring, thus bringing the group within the paragraph (3) definition. To the extent that the *GAF* decision requires a purchase of at least two percent, it represents a more severe limitation of the scope of section 13(d), as applied to concerted stockholder action.

A more important difference between the two decisions is that the *Bath* court imposed the "purchase" requirement on the definition of "person" in paragraph (3)⁵¹ while the *GAF* court read the requirement into the definition of "acquisition" in paragraph (1). The result under *Bath* is that any person, whether an individual or a group, is required to register if the specified amount of beneficial interest has been acquired; under *GAF* neither groups nor individuals need make disclosure under section 13(d), regardless of the beneficial interest acquired, if no securities have been purchased. For example, a person who acquires the right to vote securities owned by another, such as by

⁴⁸ 324 F. Supp. at 1071. The court also noted that the securities purchased were common stock and therefore not in the class of convertible preferred, of which the defendants held 10 percent. However, this fact would not be determinative. See 17 C.F.R. § 240.13d-3 (1971), providing that a person shall be deemed the beneficial owner of securities of a class which he has a right to acquire through presently convertible securities. The important question is whether, upon conversion, the defendants would have owned 10 percent of the common stock. Apparently they would not. 324 F. Supp. at 1064.

⁴⁹ 427 F.2d at 109.

⁵⁰ *Id.* at 110. After holding that a group agreeing to acquire additional shares was required to register, the court concluded that "once it is shown that . . . a group has agreed to pursue a common objective, and once it is further shown that a member of the group has thereafter purchased additional shares of the corporation's stock, then a *rebuttable presumption* arises that such purchase was made pursuant to an agreement of the group . . . [and compliance] with the Act's disclosure provisions . . . [is] required within ten days of such purchase." *Id.*

⁵¹ *Id.* at 109.

irrevocable proxy, would be required to register under *Bath*, but according to the *GAF* court, he would not.⁵² However, as pointed out in *Bath*: "[I]n the context of struggles for corporate control . . . voting control of stock is the only relevant element of . . . ownership . . ."⁵³ Thus, the *GAF* decision eliminates many acquisitions particularly significant to the purposes of the subsection.

Another interesting aspect of the *GAF* decision is its narrow definition of acquisition. Although the court speaks alternately in terms of "acquisitions of shares" and "purchases of shares," it appears to limit the application of section 13(d) to market purchases of securities. Responding to the plaintiff's argument that securities owned by individuals are constructively conveyed to the group when it acts to obtain corporate control, the court stated:

[A] constructive "conveyance" from individuals to the group, by aggregating the holdings of a group, by itself does not affect the equilibrium between supply and demand and therefore cannot affect market values. The basic protection of Section 13(d) is to indicate who is behind large holdings that are created or supplemented by market trading . . . and showing the cause of various price movements is not needed when there have been *neither* open market purchases *nor* any tender offer. Requiring a group to file in such a situation, as plaintiff argues . . . is superfluous in the context the Williams Bill's goals if not counter to them altogether.⁵⁴

However, to the extent that the formation of a group represents a new coalition of voting power which may signify a change in corporate policy or management, the supply and demand equilibrium will predictably be affected if this information is disclosed. The trading behavior which the Williams Amendments are designed to affect is that of investors at large who, without disclosure, would rely on inaccurate information regarding the issuer.⁵⁵ On the other hand, information concerning purchases by a group are superfluous to the objectives of the Amendments except to the degree that a new con-

⁵² See *id.* at 112 where the *Bath* court held that since an investment adviser who recommended a stock purchase is usually allowed to vote the stock, the adviser is considered the beneficial owner of the stock.

⁵³ *Id.*

⁵⁴ 324 F. Supp. at 1070.

⁵⁵ The need for disclosure to protect investors when changes in corporate control occur was summarized by former SEC Chairman Manuel Cohen:

A change in control brings with it the possibility of different operating results and different investment results . . . [A change] may be either good or bad depending upon the facts and circumstances involved. But investors and their advisors cannot reach informed conclusions on the possible effects of a change in control until the facts are available to them.

Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 133-34 (1967) [hereinafter cited as *Hearings on S. 510*].

solidation of voting strength has occurred. Since acquisitions are not reportable until after they have been made, it is unlikely that Congress intended the disclosed information to affect any market transactions which may be executed by the group.⁵⁶ The court's elimination of non-market acquisitions from the scope of the subsection thus seems incompatible with the objectives of the Amendments.

Despite the inordinately narrow reading of section 13(d) by the court in *GAF*, the decision appears destined to be influential. In *Ozark Airlines, Inc. v. Cox*,⁵⁷ the court followed the *GAF* interpretation of the subsection, holding that an inheritance of more than ten percent of an issuer's securities by a beneficiary of a trust and the legatee under the residuary clause of a will is not an acquisition which requires registration under section 13(d).⁵⁸ "[The] subsection . . . clearly is designed to regulate filings regarding purposeful acquisitions, holdings, or disposals Indeed, information to be furnished in a 13(d) filing expressly relates to purchases"⁵⁹ The court also held that, although certain of the defendants comprised a group within the meaning of paragraph (3), and owned more than ten percent of a class of the issuer's securities, no registration was required because the defendants had not made purchases exceeding two percent.⁶⁰

A final permutation on the problem of interpreting section 13(d) was stated in *Sisak v. Wings and Wheels Express, Inc.*⁶¹ The District Court for the Southern District of New York (Frankel, J.) held that the acquisition of a ten percent beneficial interest in an issuer's securities, by any means, was sufficient to activate the disclosure requirements of section 13(d).⁶² In *Wings and Wheels*, Edward L. Richter, founder and principal stockholder of Wings, died leaving an estate including over thirty percent of Wings' stock to his widow as principal beneficiary. Eight months later, in July 1969, the estate contracted to sell its Wings stock to Novo Corporation (Novo). Shortly thereafter, Novo proposed a merger with Wings; the offer was rejected. During the following year, Novo actively pursued its desire to merge through various involved maneuverings which included (1) entering into agreements to purchase approximately twenty percent of Wings stock in addition to that held by the Richter estate; and (2) an agreement with Weisner, president of Wings, in which Wings was to acquire Novo Air Freight, a subsidiary of Novo, for a negotiable amount of Wings stock.

Plaintiff Sisak was a stockholder and insurance broker of Wings.

⁵⁶ 15 U.S.C. § 78m(d)(1) (1970).

⁵⁷ 326 F. Supp. 1113 (E.D.Mo. 1971).

⁵⁸ *Id.* at 1117-18. The court expressly recognized that the Cox Medical Center had acquired a beneficial interest exceeding 10 percent of Ozark Airlines' securities but concluded that this was insufficient to invoke the disclosure requirements of § 13(d). *Id.*

⁵⁹ *Id.* (emphasis in original).

⁶⁰ *Id.* at 1118.

⁶¹ [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991 (1970).

⁶² *Id.* at 90,668.

Disapproving of the merger, he formed a voting trust to prevent it and also filed individual, derivative, and class actions, the latter on behalf of all stockholders, alleging violations of the Securities Act of 1933,⁶³ and the Sherman⁶⁴ and Clayton Acts.⁶⁵ In addition, he moved for a preliminary injunction to enjoin all corporate action in furtherance of the merger, alleging a violation of section 13(d). Sisak contended that when the stock had passed to the estate upon Richter's death, the estate, the executor and the beneficiary were all required to file Schedule 13D as beneficial owners of more than ten percent of a class of Wings' securities. Sisak also contended that the defendants had acted as a group for the purpose of (1) transferring securities owned by Wings to Novo and (2) acquiring for Novo the Wings securities from the estate, Wings and two large stockholders.

The court held that an acquisition of ten percent of a class of an issuer's securities, whether by operation of law or by purchase, must be disclosed:

[Section 13(d)] with no pertinent qualification, requires "[a]ny person . . . acquiring" registered securities and becoming by such acquisition [the] beneficial owner of more than 10% of the relevant class of securities to file the prescribed information The statute is not limited to any particular mode of "acquisition," nor has the SEC so limited its operation by any regulation.⁶⁶

The court, however, rejected the argument that the defendants had acted as a group, stating that, in this context, the concept of group action does not encompass both the buyer and seller of securities.⁶⁷ Thus the court granted the injunction against the estate, its executor and its beneficiary but dismissed the motion as to the other defendants.

The *Wings and Wheels* decision is the broadest possible interpretation of section 13(d). Under the definition provided, one may acquire the requisite interest notwithstanding the absence of aggressive action on the part of the recipient. Furthermore, the acquisition of merely a beneficial interest is considered sufficient to activate the disclosure requirements. This result follows from noting that the injunction issued against the executor and beneficiary of the estate, both of whom were only beneficial owners of ten percent of Wings' securities.⁶⁸ It

⁶³ 15 U.S.C. §§ 77a et seq. (1970).

⁶⁴ 15 U.S.C. §§ 1 et seq. (1970).

⁶⁵ 15 U.S.C. §§ 12 et seq. (1970).

⁶⁶ [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. at 90,668.

⁶⁷ Id. at 90,670. However, the court did not discount the possibility that a group with identical aims may be appropriately characterized as a group acting to acquire and dispose of securities or to acquire, hold and dispose of securities. "If the purchase and sale were incident to a general plan to hold securities, a different result might obtain." Id. According to the court, the identity of objectives is a critical factor in determining who would appropriately comprise the group. Id.

⁶⁸ Id. at 90,668. See also 17 C.F.R. § 240.16a-4 (a)(1) (1971), exempting executors

would be anticipated then, that had the court found certain of the defendants to be acting as a group, it would have held that the group had acquired the necessary beneficial interest requiring registration.⁶⁹

Thus, with a touch of irony, the *Wings and Wheels* decision appears to be the perfect complement to the disparate judicial interpretations of section 13(d). Under the *Wings and Wheels* and *GAF* decisions (both from the S.D.N.Y.), acquisition has been interpreted to be antonymous with itself: *Wings and Wheels* holding that a *non-purposeful acquisition of beneficial interest* will satisfy the statutory requirements;⁷⁰ *GAF* holding that a *market purchase of securities* is required.⁷¹ While the existing conflict of views is certain to have a disquieting effect upon persons in situations similar to those of the defendants in the above cases, failure of the courts to provide a theoretical foundation to resolve the issue is even more disturbing. None of the decisions discussed sets forth a tenable rationale for its interpretation of section 13(d).

While the court in *Bath Industries, Inc. v. Blot* did not directly consider the problem of defining acquisition, it assumed that if the defendants were, by reason of their group effort, a "person" as defined by paragraph (3), then the entity acquired a beneficial interest in its members' securities for the purpose of the subsection.⁷² While the assumption may be true, it extends the traditional interpretations of beneficial ownership and requires explanation.⁷³ Furthermore, *Bath* discerned a congressional intent to limit application of the statute to situations involving acquisitions of securities and used this interpretation to define "group action."⁷⁴ Assuming that this reading of the legislative history is correct, the restriction should be equally applicable to situations involving a single defendant. However, achieving such equal application necessitates reading the purchase requirement into

and administrators of an estate of a decedent from §§ 16(a)-(b) of the Exchange Act during the 12 month period following their appointment.

⁶⁹ This analysis presumes that the court would agree with the holding in *Bath* that a group acquires a beneficial interest in the securities owned by its members. 427 F.2d at 109.

The court in *Sisak* did not address itself to the question of whether the two large shareholders, owning together more than 10 percent of *Wings* stock, comprised a group acting to dispose of *Wings* securities when they agreed to sell their holdings to Novo Corporation at a substantial premium. [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. at 90,668. Groups acting to dispose of securities are discussed at pp. 172-73 *infra*.

⁷⁰ [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. at 90, 668.

⁷¹ 324 F. Supp. at 1068, 1070.

⁷² 427 F.2d at 109.

⁷³ For example, a partnership is not usually considered the beneficial owner of the securities held by its members. 11 Fed. Reg. 10970 (1938). 17 C.F.R. § 241.1965 (1971). See the discussion at p. 168 *infra*.

⁷⁴ 427 F.2d at 109. "Our review of the . . . purpose of Congress in enacting this legislation was 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 [control] contest . . ." *Id*.

the definition of acquisition in paragraph (1) of the subsection.⁷⁵ If this were done, the result would alter the court's implied definition from "an acquisition of beneficial ownership" to "a purchase of securities," contradicting both the holding of the case and the statutory language.

In *GAF*, the only other carefully reasoned decision, the court based its interpretation primarily on the statutory language.⁷⁶ A comparison of the statute and the court's rationale is worth noting. The statute provides that registration is required "after acquiring *directly or indirectly the beneficial ownership* of any equity security . . ."⁷⁷ The *GAF* interpretation requires registration "after acquiring . . . ownership of any equity security . . ."⁷⁸ Since substantially different results follow from an interpretation requiring the acquisition of securities rather than the acquisition of beneficial ownership,⁷⁹ the omission in *GAF* severely undercuts the validity of the court's reasoning.

The absence of a persuasive rationale supporting a particular interpretation of the statute is probably the best explanation for the wide divergence of opinion. More difficult to explain is the failure of the courts to look to the decisions interpreting Section 16 of the Exchange Act for guiding principles.⁸⁰ The similarity between the interpretive problems of section 13(d) and section 16(a) and (b) has already been pointed out.⁸¹ This similarity and the almost identical statutory phrasing of these sections would seem to demand that an *a priori* inquiry into the correct interpretation of section 13(d) begin with the principles and law developed under section 16.⁸² That none of the above discussed cases used this approach is probably due to the fact that, in the early cases applying section 13(d), the courts were confronted with the primary issue of whether stockholders cooperating in an effort to obtain corporate control were required to register.⁸³

⁷⁵ Section 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970), the general disclosure requirement, applies to all persons, individuals or groups. The *Bath* court, however, used its interpretation of the legislative history to construe the § 13(d)(3); definition of "person"; this definition applies only to the joint action of two or more persons. 427 F.2d at 109.

⁷⁶ 324 F. Supp. at 1067.

⁷⁷ 15 U.S.C. § 78m(d)(1) (1970) (emphasis added).

⁷⁸ 324 F. Supp. at 1066.

⁷⁹ See pp. 157-58 *supra*.

⁸⁰ 15 U.S.C. § 78(p) (1970).

⁸¹ See pp. 151-52 *supra*.

⁸² Section 13(d)(1) provides: "Any person who, after acquiring directly or indirectly the beneficial ownership of more than 5 per centum of such class. . . ." 15 U.S.C. § 78m(d)(1) (1970). Section 16(a) provides: "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of equity security. . . ." 15 U.S.C. § 78p(a) (1970).

⁸³ All the cases previously discussed involved "group" action. See pp. 153-61 *supra*. Other cases interpreting the Williams Amendments involved purchases of securities which unquestionably were within the scope of the Amendment. Thus the definition of "acquisition" was not at issue. See *Susquehanna Corp. v. Pan Am. Sulfur Co.*, 423 F.2d 1075 (5th Cir. 1970); *Electronics Specialty Co. v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969).

For different reasons, the courts in *Bath* and *GAF*, which set the tone of the decisions in this area of law, felt that mere cooperative efforts to obtain control, without more, need not be disclosed. To this end, the *Bath* court read into the paragraph (3) definition of "person" a requirement that a group must act to purchase securities, and the *GAF* court defined "acquisition of beneficial ownership" as a purchase of securities. While one might agree that some cooperative efforts of stockholders should be excluded from the statute, it is submitted that *Bath's* interpretation of the congressional intent is not supported by the legislative history of the subsection, and that *GAF's* reading of the statute contradicts the statutory language which should be interpreted in accordance with the law developed under Section 16 of the Exchange Act.

B. The Legislative History

Perhaps the most remarkable aspect of the legislative history of the Williams Amendments, insofar as it relates to section 13(d), is the paucity of literature concerning either the scope or the implications of the subsection. The discussion in the hearings and in the Congressional Record focuses upon the regulation of the cash tender offer and contains what may be described as incidental remarks concerning section 13(d):

S. 510 . . . amends the Securities Exchange Act of 1934 by requiring the disclosure of pertinent information . . . (1) when a person or group of persons seek to acquire a substantial block of equity securities of a corporation by a cash tender offer . . . or through *open market or privately negotiated purchases*, or (2) when a corporation *repurchases* its own equity securities.⁸⁴

While this language and the primary objective of Congress to regulate purchases by cash tender offer tend to support the argument that the Amendment is limited to purchases of securities, the House Report, in the section-by-section summary, indicates that a broader interpretation is warranted:

[Paragraph (3) of subsection (d)] would prevent a group of persons who seek to pool their voting or other interests . . . 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 . . . 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

⁸⁴ H. R. Rep. No. 1711, 90th Cong., 2d Sess. (1968), reported in U.S. Code Cong. & Ad. News 2811 (1968) (emphasis added) [hereinafter cited as H. R. Rep.]. To the same effect see 113 Cong. Rec. 24,664 (1967) and Hearings on S. 510, *supra* note 55, at 133-34.

13(d)(1) within 10 days after they agreed to act together, whether or not any member of the group had acquired any securities at that time.⁸⁵

Unfortunately, this description seems to be inconsistent with other statements in the Report and is not supported by anything in the previously mentioned discussions. Professor Louis Loss has remarked in connection with another of the Amendments that the Report "bears the earmarks of a bit of manufactured legislative history."⁸⁶ Presumably, this remark, if it is also applicable to the summary of subsection 13(d)—and it is submitted that it is—does not mean that the summary is incorrect but rather that it cannot be taken at face value. Thus, the legislative history is ambiguous, at best, and inconsistent, at worst, and its relevance to the statute must be gleaned inferentially.

Senate Bill 2731, the predecessor of S. 510, which was later enacted into law as the Williams Amendments, was the congressional response to pleas from the management sector for protection from so-called "corporate raiders."⁸⁷ Allegedly, these outsiders were effectively using the cash tender offer to acquire corporate control, liquidate assets and thereby realize a quick profit.⁸⁸ The basic thrust of the bill was to require disclosure prior to the making of the cash tender offer so that management could marshal its defenses to thwart the takeover bid.⁸⁹ Because the tender offer was often preceded by, and in some cases dependent upon, substantial acquisitions of securities through open market or privately negotiated purchases, disclosure of these acquisitions was also required.⁹⁰ This provision, the direct antecedent of section 13(d), was an integral part of the legislative scheme to regulate cash tender offers and it served as an additional warning to management of potential threats.⁹¹ That the provision was framed as an amendment to Section 10 of the Exchange Act⁹² and required preacquisition disclosure⁹³ indicates that Congress may have intended that

⁸⁵ H. R. Rep., *supra* note 84, at 2818.

⁸⁶ 6 L. Loss, *Securities Regulation* 3661 (Supp. 1969), commenting on § 14(e) of the Williams Amendments, 15 U.S.C. § 78n(e) (1970).

⁸⁷ 111 Cong. Rec. 28,257 (1965).

⁸⁸ "In recent years we have seen proud old companies reduced to corporate shells after white-collar pirates have seized control with funds from sources . . . unknown in many cases, then sold or traded away the best assets, later to split up the loot among themselves." *Id.* (remarks of Senator Williams).

⁸⁹ *Id.* at 28,259.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² 15 U.S.C. § 78j(b) (1970) prohibits the use of any manipulative or deceptive device or contrivance in connection with the purchase or sale of any security.

⁹³ 111 Cong. Rec. 28,259 (1965). Disclosure was required twenty days prior to the acquisition. The preacquisition disclosure requirement of S. 2731 seems clearly incompatible with the argument that a "group" acquires a beneficial interest when its members agree to act in concert. Where mere concurrence is the event requiring registration, there is nothing to report before the agreement, but when an agreement is made, registration is already twenty days late.

it should serve to equalize the relative bargaining positions of buyers and sellers in prospective market transactions and to reduce the possibility of fraud. Thus, the over-all design of Congress at this point in the legislative history would seem to be compatible with the interpretation that the scope of what was to become section 13(d) was limited to situations in which purchases of securities were contemplated.

However, S. 2731 died in committee. When it was reintroduced as S. 510, the provisions relating to more general acquisitions of beneficial ownership were severed from those pertaining to cash tender offers and were offered as an amendment to section 13; in addition, disclosure was not to be required until after the acquisitions had been made.⁹⁴ While these changes were probably formulated to avoid favoring either management or stockholders in a struggle for control,⁹⁵ it is clear that section 13(d) no longer has a role to play in the specific purchases contemplated by persons required to register under the subsection. More importantly, the underlying purpose of the Amendment was changed from protection of management to disclosure of shifts in ownership indicating a possible change in control.⁹⁶ The evil to be eliminated was not the covert purchases by an individual or a group, but rather, the undesirability of permitting a situation in which investors make investment decisions without adequate information.⁹⁷ Whether a position of power is obtained through a purchase of securities or through a coalition of existing stockholders should be immaterial to the goals of the statute if the implied result is a shift in control.

This reading of the legislative history is clearly incompatible with the idea that a purchase of securities is a prerequisite to disclosure. Group efforts to vote or sell securities may have a significant effect upon corporate policy and are therefore important to investors.⁹⁸ However, by requiring a purchase of securities prior to disclosure, these groups have been exempted from the disclosure requirement and the effectiveness of the Amendment has thus been limited. Similarly, individual acquisitions of a ten percent beneficial interest in an issuer's securities by gift or devise under a will would escape disclosure.⁹⁹ However, since the Amendment is designed to require disclosure only of those acquisitions entered into for the purpose of, or having the effect of, changing or influencing control, this result might initially

⁹⁴ 113 Cong. Rec. 856 (1967).

⁹⁵ *Id.* at 854. "[E]xtreme care [was taken] . . . to balance the scales equally to protect the legitimate interests of the corporation, management, and shareholders without unduly impeding cash takeover bids. Every effort has been made to avoid tipping the balance of regulatory burden in favor of management or . . . the offeror. *Id.* (remarks of Senator Williams).

⁹⁶ *Id.* at 855.

⁹⁷ *Id.*

⁹⁸ See pp. 171-73 *infra*.

⁹⁹ See e.g., *Ozark Airlines, Inc. v. Cox*, 326 F. Supp. 113 (E.D.Mo. 1971) discussed at p. 159 *supra*.

appear to be compatible with the aims of the statute.¹⁰⁰ Nevertheless, such an acquisition may very well influence the control of a corporation.¹⁰¹ The only accurate statement that can be made in this situation is that, while the acquisition does not manifest an intent to obtain or influence control, it harbors the possibility of significant influence by one whose propensities are not yet reflected in corporate policy through past voting activities. If this type of acquisition is to be exempt from the disclosure requirement, the exemption should be made upon due consideration by the Securities and Exchange Commission and not by the courts.¹⁰² Furthermore, definition of "acquisition of beneficial interest" as a purchase of securities would not require disclosure by an individual acquiring irrevocable proxies. This too seems clearly inconsistent with the overall objectives of the Act.

Ultimately, any interpretation of section 13(d) which relies totally upon the legislative history will be unpersuasive, for there is no indication that this Amendment received congressional scrutiny. However, the statutory language seems to indicate clearly that Congress did not intend to limit the applicability of the subsection to situations involving only purchases of securities.

C. *The Statutory Language*

Section 13(d) is phrased in terms of the acquisition, direct or indirect, of beneficial ownership in securities. As traditionally understood in the law of securities regulation, a beneficial owner is one who by reason of any contract, understanding, relationship, agreement or other arrangement possesses benefits substantially equivalent to those of ownership.¹⁰³ The Securities and Exchange Commission has applied this "benefits test" to the family context.¹⁰⁴ It has been persuasively argued that this test is also applicable to any situation in which a person enjoys the benefits of ownership pertinent to the disclosure provisions of the Exchange Act.¹⁰⁵ More importantly, there is significant evidence

¹⁰⁰ 15 U.S.C. § 78m(d)(6) (1970) provides that:
The provisions of this subsection shall not apply to—

...

(D) any acquisition or proposed acquisition of a security which the Commission, by rules or regulation or by order, shall exempt from the provisions of this subsection 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 section.

¹⁰¹ It seems highly unlikely that a person acquiring a "controlling" interest in a company by inheritance or other nonpurposeful acquisition would not at some time take steps influencing the management of a company even if he, at the time of acquisition, had no intent to do so. See e.g., *Ozark Airlines, Inc. v. Cox*, 326 F. Supp. 1113 (E.D. Mo. 1971); *Sisak v. Wings & Wheels Express, Inc.* [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991 (S.D.N.Y. 1970).

¹⁰² See note 100 *supra*.

¹⁰³ 31 Fed. Reg. 1005 (1966). 17 C.F.R. 241.7793 (1971).

¹⁰⁴ *Id.*

¹⁰⁵ *Feldman and Teberg, Beneficial Ownership Under Section 16 of the Securities*

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that the paragraph (3) definition of "person" is a legislative formulation of the benefits test, to be applied in determining who must register under section 13(d).

The section-by-section summary of the House Report on the Williams Amendments provides that:

[The paragraph (3) subsection (d) definition of "person"] 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 agree to act in concert *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.*¹⁰⁶

Clearly, if the above language were taken at face value, the conflict in the decisions which now exists would not have developed. But at least one court has taken the position, at the instance of Professor Loss, that the legislative reports "do not appropriately reflect the law as enacted."¹⁰⁷ However, while the reports are at times ambiguous, it is submitted that the above excerpt from the reports is the correct interpretation of paragraph (3) because it is the only cogent explanation for including the paragraph in the Amendments.

During the period in which the Williams Amendments were under consideration, former SEC Chairman Cohen suggested, *inter alia*, that the paragraph (3) definition be deleted since, in his opinion, it was within the definition of section 3(a)(9), the general definition of "person" in the 1934 Act.¹⁰⁸ While most of his suggestions were accepted, this one was not. The retention of the amendment necessarily implies that it serves a function. If the sole function of the paragraph were to expand the existing definition of person, it is likely that Con-

Exchange Act of 1934, 17 W. Res. L. Rev. 1054 (1966) [hereinafter cited as Feldman and Teberg].

¹⁰⁶ H. R. Rep. supra note 84, at 2818 (emphasis added).

¹⁰⁷ GAF Corp. v. Milstein, 324 F. Supp. 1062, 1067 (S.D.N.Y. 1971). Apparently Professor Loss' original position was in accord with the House Report quoted:

So far as both new filing provisions—§§ 13(d) and 14(d)—are concerned, . . . [a]ny . . . group [acting to acquire, hold or dispose of an issuer's securities] is considered to become the beneficial owner of more than 10 percent at the time its members agree to act in concert. Consequently, the group must file . . . within ten days after its members agree to act together, whether or not any member has acquired any security at that time.

¹⁰⁸ 6 L. Loss, Securities Regulation 3664 (Supp. 1969).

¹⁰⁹ 15 U.S.C. § 78c(a)(9) (1970), defines "person" as an "individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization." Specifically, Chairman Cohen thought that "syndicate or other group," as

gress would have left this task to the SEC. A more substantial justification for its retention is that it is the practice of the SEC to treat beneficial ownership of section 3(a)(9) entities separately.¹⁰⁹ For example, a partnership under the section 3(a)(9) definition does not ordinarily acquire a beneficial interest in the securities owned by the individual partners.¹¹⁰ Therefore, under this definition, a group of individuals acting as a partnership could acquire a controlling interest in a corporation without making disclosure if each partner owned less than ten percent of the corporation's securities. This is exactly the result which Congress intended to avoid by enacting section 13(d)(3). The expressed purpose of paragraph (3) is to require disclosure in this and similar situations where individuals seek to circumvent the requirements of the subsection by pooling their interests.¹¹¹

It is therefore suggested that section 13(d)(3) manifests a congressional intent to apply principles of beneficial ownership developed under section 16(a) of the Exchange Act to the problems arising under section 13(d). It is further suggested that Congress intended to extend these principles to include those persons acting in concert to acquire, hold or dispose of securities. The primary function of paragraph (3), then, is to designate the type of agreement under which the group formed will be considered to be the beneficial owner of the securities held by its constituents; such an agreement gives rise to an acquisition sufficient to trigger the disclosure requirement of the subsection.

It follows that the *purchase* definition of "acquisition" in paragraph (1) should be discarded and that a fair reading of the Amendment must give full meaning to the statutory language. It is therefore submitted that an acquisition of beneficial ownership is a reportable event. Since even a nonpurposeful acquisition, such as by operation of law, may give rise to a change in corporate policy or direction, *any* acquisition should be reported. If upon further consideration the SEC should determine that a particular type of acquisition does not have the effect of changing or influencing the control of an issuer, it has the express power to exempt that transaction from the filing requirements.

stated in § 13(d)(3), could be interpreted by the SEC as being included within the meaning of "unincorporated organization." 112 Cong. Rec. 19,004 (1966).

The SEC had previously proposed to change its rules by including within the § 3(a)(9) definition persons acting as a group for the purpose of acquiring, holding, disposing or voting securities. Sec. Ex. Act Rel. No. 6435, Dec. 12, 1960, [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 76,730. However, this proposal was not adopted. Sec. Ex. Act Rel. No. 6487, Mar. 9, 1961 [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 76,752.

¹⁰⁹ Feldman and Teberg, *supra* note 105, at 1077.

¹¹⁰ 17 C.F.R. § 241.1965 (1971).

¹¹¹ H. R. Rep. *supra* note 84, at 2818; 113 Cong. Rec. 856 (1967). According to Senator Williams, the purpose of § 13(d)(3) is to "successfully close the loophole that now exists which allows a syndicate, where no member owns more than 10 percent, to escape the reporting requirements of the . . . Act. *Id.*

"ACQUISITIONS" AND "GROUPS" UNDER THE 1934 ACT

II. "GROUPS" UNDER SECTION 13(d)

A. General Considerations

Paragraph (3) of subsection (d) provides that a partnership or other group which acts to acquire, hold or dispose of securities shall be considered a "person" for purposes of the subsection.¹¹² The single judicial precedent for determining the scope of paragraph (3) is *Bath Industries, Inc. v. Blot*, where the court limited the definition to stockholders acting to acquire an issuer's securities.¹¹³ The purpose of this limitation was to avoid the undesirable implications suggested by the district court decision in *Bath* which, arguably, held that whenever stockholders owning over ten percent of an issuer's securities agree to vote together in a corporate matter, they comprise a group required to register.¹¹⁴

The unlimited reach of the district court decision is well illustrated by the situation of Clark Estates, Inc. (Clark), one of the *Bath* defendants. Clark was the beneficial owner of Bath securities by virtue of its ability to determine the voting of shares owned by a number of accounts for which it provided investment advice. During the relevant time period, Clark communicated with the defendant Merkle, a key figure in the controversy, at the latter's request. Clark indicated to Merkle dissatisfaction with the executive officer and a willingness to support a move to replace him. On this basis, Clark was considered to be a member of a group acting to hold Bath securities and subject to the disclosure requirements.¹¹⁵ On review, the circuit court observed that this decision would virtually destroy the right of stockholders to discuss the performance of management and to cooperate in an effort to replace officers when necessary. Weighing this consideration against the need of investors to obtain pertinent information, the court concluded that such action, standing alone, should be excluded from the statute since, absent a decision to purchase additional shares to reinforce its position, a stockholders' agreement would not be of critical importance to the investor.¹¹⁶

The necessity of finding some limitation to the broad language of paragraph (3) cannot be overemphasized. A liberal interpretation of the language, such as that provided by the district court in *Bath*,

¹¹² 15 U.S.C. § 78m(d)(3) (1970).

¹¹⁴ *Bath Indus., Inc. v. Blot*, 305 F. Supp. 526, 537-38 (E.D. Wis. 1969). The SEC interpretation of section 13(d)(3) appears to be as liberal as that in *Bath*. See e.g., SEC v. Madison Square Garden Corp., [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,649 (S.D.N.Y. 1970) and *The Budd Company*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,115 (1970) where, against arguments that there was no "pooling of interests" or "concerted action," the SEC ruled that twelve lenders, who received warrants to purchase an aggregate of 14% of an issuer's shares in connection with loans, were a group required to file Schedule 13D. The only apparent linkage between the lenders was the similarity of the forms of the agreements and the concurrent timing of each loan.

¹¹⁵ 305 F. Supp. at 533-34, 539.

¹¹⁶ 427 F.2d at 109-10.

would adversely affect investors generally and the stockholders of a particular corporation specifically. The basic premise of federal securities legislation is to compel disclosure of relevant information about an issuer, its business and its management in a reasonably timely fashion in order that investors may intelligently decide to buy or sell securities.¹¹⁷ Since disclosure is designed to affect market values and decisions, however, care must be taken to establish disclosure requirements which will not overwhelm the investor with information concerning tentative agreements, or with facts of only marginal importance. Such information would probably impair, rather than facilitate, the making of investment decisions.¹¹⁸

Furthermore, as the circuit court in *Bath* pointed out, an unrestricted interpretation of paragraph (3) precludes any degree of latitude in stockholder action vis-à-vis management before disclosure is required.¹¹⁹ Such an interpretation is also certain to disturb stockholders who wish to cooperate in order to play a more effective role in influencing corporate policy. An unwary stockholder may be subject to judicial sanctions, and to the expense of litigation, because he, at one time, expressed his agreement with another stockholder on a particular issue. A broad interpretation of paragraph (3) also increases the possibility that management will successfully resort to litigation as a delaying tactic whenever its position is threatened by a coalition of stockholders.¹²⁰ Finally, as the situation of Clark Estates, Inc. illustrates,¹²¹ the necessity of requiring registration only upon the occurrence of a specific and ascertainable event is absolutely vital to a fair application of the statute. Unless stockholders or their advisers know when registration is required, the effects of the Amendment are more likely to be deleterious than ameliorative.

Notwithstanding the merit of the circuit court's analysis of the problem in *Bath*, its solution was incorrect. As noted above, the con-

¹¹⁷ See the statement of former SEC Chairman Cohen, note 55 supra.

¹¹⁸ Hearings on S. 510, supra note 55, at 130 (statement of Arthur Fleisher, Jr.); see also, Fleisher, Corporate Disclosure/Insider Trading, 45 Harv. Bus. Rev. 129, 133 (Jan.-Feb. 1967).

Referring to the information to be disclosed under § 13(d)(1)(E), 15 U.S.C. § 78m(d)(1)(E) (1970), which requires disclosure of contracts, arrangements or understandings with respect to securities of an issuer including transfer or joint ventures, one court indicated that only "concrete understandings" need be disclosed. *Electronics Specialty Co. v. International Controls Corp.*, 295 F. Supp. 1063, 1080 (S.D.N.Y. 1968). From this premise, the court concluded that there was no need to disclose unsolicited promises by brokers to tender large blocks of an issuer's securities if a tender offer were made.

¹¹⁹ 427 F.2d at 109-10.

¹²⁰ Hamilton, Some Reflections on Cash Tender Offer Legislation, 15 N.Y.L.F. 269, 297 n.104 (1969). See generally Schmults and Kelly, Cash Take-Over Bids—Defensive Tactics, 23 Bus. Law. 115 (1967).

In *Electronics Specialty Co. v. International Controls Corp.* 409 F.2d 937 (2d Cir. 1969), Judge Friendly, speaking for the court, cautioned district judges to "be vigilant against resort to the courts on trumped-up or trivial grounds as a means of delaying and thereby defeating legitimate tender offers." *Id.* at 947.

¹²¹ See text accompanying note 115 supra.

clusion that Congress intended the subsection to apply 'only when securities are purchased is inconsistent with the statutory language.¹²² Fortunately, the concept of beneficial interest, which rejects the court's solution, suggests another. Having previously concluded that the traditional principles of beneficial ownership should be used to define acquisition,¹²³ it follows that the same precept must be used to determine when a group should be considered a beneficial owner of securities held by its constituents.¹²⁴ Since the subsection was designed to reveal shifts in ownership which affect corporate control, the pertinent benefits of ownership are those having control implications: those which confer (a) the ability to exercise controlling influence over the purchase or sale and (b) the ability to determine the voting of securities. These generally correspond to the "acquiring, holding or disposing" language of paragraph (3). Thus, a number of defendants should be considered a "group" only if a factual inquiry into their situation indicates that they enjoy incidents of ownership which will enable them to benefit from those activities that the Williams Amendments were designed to disclose.

B. *Acting to "Acquire, Hold and Dispose" of Securities*

The decision of the district court in *Bath* provides an appropriate example for the application of the foregoing suggestions. Apparently, the court determined that every group of stockholders, the members of which agree to vote their securities in concert, comes within the scope of the Amendment. While the court did not express its rationale, it seems to have equated persons "pooling their interests" with persons acting as a group for the purpose of acquiring, holding or disposing of securities. Determining that by the agreement to vote in concert the defendants had pooled their interests, the court then concluded that they came within the meaning of a group "acting to hold securities" and were required to register. However, a close examination of this reasoning reveals that the court has not resolved the definitional problems of the paragraph (3) language but has merely substituted the nebulous term "pool" for the broad but descriptive terms "acquire, hold and dispose." Even if this substitution were acceptable, the court's reasoning that stockholder concurrence in voting constitutes a pooling arrangement exceeds traditional limits.

Various forms of pooling arrangements—such as the voting trust, the voting pool and the irrevocable proxy—have long been recognized as legitimate means through which individuals in a minority can obtain

¹²² See pp. 166-68 *supra*.

¹²³ See p. 168 *supra*.

¹²⁴ The argument is that § 13(d)(3), 15 U.S.C. 78 m(d)(3) (1970), evidences a legislative determination that the principles of beneficial ownership developed under § 16(a), 15 U.S.C. § 78 p(a) (1970), are extended to include joint ventures for purposes of § 13(d) disclosure requirements. This is not a novel idea. It was suggested in Feldman and Teberg, *supra* note 105, at 1076-77 and was previously proposed by the SEC; see note 108 *supra*.

corporate control. As a rule, these agreements must be in writing and, in many states, must be filed with the corporation. Undoubtedly, all persons so acting come within the ambit of the Amendment as constituting a group acting to hold the securities of an issuer. However, for obvious reasons, the concept of pooling as a means of obtaining corporate control has never embraced the mere concurrence of several stockholders to vote in concert on a particular issue at a particular time.¹²⁵ Of course, a group of stockholders might well control the course of corporate behavior by their concurrence in voting, even over a number of years. But it is not the concurrence in itself which is important, for this is a possibility which is inherent in the right to vote. Rather, it is that the vote is a result of the independent exercise of judgment by each stockholder. If this be the case, then there has been no firm commitment until the vote is cast. The information which the investor can realistically expect to obtain, and which is sufficiently firm to serve as a basis for investment decisions, is the vote itself and not the tentative judgment of the stockholders. Furthermore, the broad characterization of the defendants' action as a "pool" contradicts even the *Bath* court's definition of "beneficial interest." According to the court, a beneficial interest is the ability to determine how securities are voted.¹²⁶ The defendants, either as a group or as individuals, did not have that ability in *Bath*. It is therefore submitted that section 13(d)(3) applies to voting pools only where the individual members have made a firm commitment and the group has the ability to determine how the securities are to be voted.

Groups acting to dispose of securities are equally important to the broad objectives of the statute. While their activities may seem inconsistent with the acquisition requirement of the statute, such a group will have *acquired* a beneficial interest in the holdings of its constituents by virtue of their concerted effort to sell.¹²⁷ This ostensibly anomalous result is consistent with the aim of the Amendments. Sales of target company securities prior to a cash tender offer may be executed for the purpose of depressing the market price so that the tender offer can be made at a more advantageous price.¹²⁸ In addition, there may be violations of the antifraud provisions and the more specific antimanipulative section of the Exchange Act.¹²⁹ It has been

¹²⁵ See generally 5 Fletcher Cyc. Corp. §§ 2049.1 et seq., §§ 2064 et seq., §§ 2075 et seq. (perm. ed. rev. 1967). Similarly, the SEC would appear to distinguish between groups acting to hold securities and those acting to vote securities. See Sec. Ex. Act Rel. No. 6435 [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 76,730 (1960) where the SEC proposed to redefine person in § 3(a)(9) of the Exchange Act, 15 U.S.C. § 78c(a)(9) (1970), to include persons acting to acquire, hold, dispose or vote the securities of an issuer.

¹²⁶ 305 F. Supp. at 537-38, 427 F.2d at 112.

¹²⁷ See p. 168 *supra*.

¹²⁸ Bromberg, *The Securities Law of Tender Offers*, 15 N.Y.L.F. 459, 518 (1969).

¹²⁹ *Id.* See also *Sisak v. Wings and Wheels Express, Inc.* [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991 at 90,671 (1970); *SEC v. Posner*, [1970-1971 Transfer

suggested that tender offers have been proposed with as much a view to the trading profit if the offer is unsuccessful, as to the possibility of a takeover.¹³⁰ Also, the sale of a controlling interest raises the spectre of liability under section 10-b.¹³¹ Disclosure under section 13(d) may well tend to discourage such activities and provide information relevant to a suit to recover damages for abuses under the sections mentioned. Because speculation in a corporation's equity securities may cause a loss of public confidence in the corporation, and thereby indirectly harm the corporation's financial outlook or reflect adversely upon the management, registration of these activities directly serves the objectives of the Williams Amendments. Thus, groups acting to dispose of securities should be required to make disclosure under section 13(d).

Whether stockholders have acted as a group to dispose of securities is a question of fact.¹³² Proof of the group purpose will consist, at least in part, of evidence of unusual market activity or evidence that the defendants received a premium price for their aggregated securities. While no court has considered this problem, the opportunity was presented in *Sisak v. Wings and Wheels Express, Inc.*, where two stockholders, who collectively owned more than ten percent of Wings stock, agreed to sell their holdings at a substantial premium.¹³³ Although the court found no group action in the case, its conclusion was directed principally at the plaintiff's argument that both the buyers and the sellers constituted a group.¹³⁴

Groups acting to purchase are of the same genre as those acting to dispose of securities. In both situations, the coalition of substantial beneficial ownership enables the individuals to profit from trading abuses.¹³⁵ For this reason, and the obvious intent of Congress to include groups acting to purchase securities within the ambit of the Amendments, these groups should be required to register. However, it seems unwise to characterize, as did the *Bath* court, a group effort as "acquiring securities" within the paragraph (3) definition solely because its members agreed to vote together, and because some of them made purchases.¹³⁶ Where small purchases are involved, the hazards of speculation are minimal. Similarly, the fact that a stockholder is connected with others who are obviously acquiring securities for specu-

Binder] CCH Fed. Sec. L. Rep. ¶ 93,049, 71 Civ. 2256 (S.D.N.Y. 1971), summary of complaint alleging a violation of § 10b-5 for failing to report a purchase of securities resulting in more than a 10% beneficial ownership.

¹³⁰ Hamilton, *Some Reflections on Cash Tender Offer Legislation*, 15 N.Y.L.F. 269, 300-01 (1969).

¹³¹ Schwartz, *The Sale of Control and the 1934 Act: New Directions for Federal Corporation Law*, 15 N.Y.L.F. 674 (1969).

¹³² Whether a person is a beneficial owner for the purposes of a particular subsection is also essentially a factual question. 11 Fed. Reg. 10970 (1938). 17 C.F.R. § 241.1965 (1971).

¹³³ [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,991 at 90,668 (1970).

¹³⁴ *Id.* at 90,669-70.

¹³⁵ Feldman and Teberg, *supra* note 105, at 1058-59.

¹³⁶ 427 F.2d at 110.

lation purposes does not justify including him within the group unless other evidence indicates that the profits of speculation accrue to him, directly or indirectly. As an evidentiary standard, a two percent acquisition by various members of the group would seem to comport with the aims of Congress. This suggestion is derived from sections 13(d)(6)(B) and (D) which indicate a congressional effort to exclude acquisitions made for investment purposes from the reporting requirements. To this end, the point of discrimination was set at two percent.¹³⁷

It should be noted that less severe standards are suggested for groups acting to hold securities than those acting to acquire or dispose; that is, a more formal agreement must exist before a group voting securities is required to register. The reason for the difference is that voting, as a beneficial incident, is intrinsic to security ownership.¹³⁸ The voting of securities is not only a legitimate activity, it is to be encouraged. Similarly, cooperative voting efforts inevitably result from an interested body of stockholders and they provide a desirable prophylaxis to incompetent or unprogressive management. On the other hand, the ability to purchase and sell securities is a speculative incident of ownership.¹³⁹ Speculation lends itself to abuse and the danger is magnified where large stockholders act concurrently.¹⁴⁰ Since persons engaging in speculative abuses are bound by an untainted desire for profit, and since the abuse can occur within a relatively short period of time, mere concurrence of action is usually sufficient to enable the participants to reap the benefits of consolidated ownership.

By way of summary, it was suggested that joint stockholder action is not a reportable event unless it is determined that the "group" has acquired a beneficial interest in the securities held by its members. Whether the group has become the beneficial owner of the securities should be determined in accordance with the principles of beneficial ownership which have developed under Section 16 of the Exchange Act. A group acts (a) to hold securities where its constituents have made a firm commitment and the group has the ability to determine how the securities are voted; or (b) to purchase or dispose of securities where it is demonstrated that the members of the group have received the benefits of stock speculation. Different standards were suggested for the two categories of beneficial ownership in order to achieve an

¹³⁷ Section 13(d)(6)(B), 15 U.S.C. § 78m(d)(6)(B) (1970), excludes from the filing requirement all acquisitions which, together with all other acquisitions by the same person, do not exceed 2 percent of the class. Presumably, this is not net of any sales during the twelve month period. 6 L. Loss, Securities Regulation 3664 (Supp. 1969). Section 13(d)(6)(D), 15 U.S.C. § 78m(d)(6)(D) (1970), excludes acquisitions which in the determination of the SEC are not entered into for the purpose of, nor have the effect of, influencing the control of the issuer or otherwise as not comprehended within the purposes of the subsection.

¹³⁸ Feldman and Teberg, *supra* note 105, at 1059.

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 1059-60.

optimum balance between the need of investors for disclosure and the desirability of encouraging certain stockholder behavior.

CONCLUSION

One of the primary objectives of the Securities Exchange Act of 1934 was to insure the maintenance of fair and honest markets.¹⁴¹ To a great extent, Congress has relied upon a philosophy of full disclosure to achieve this objective. Clearly, the disclosure requirements of the Act will be ineffective unless they reach everyone engaging in the practices which the statute was designed to prevent or reveal. To avoid circumvention, the statute is phrased in broad language and requires both legal and beneficial owners to comply with the registration requirements.¹⁴²

Section 13(d) was enacted for the purpose of making public any changes in corporate ownership. On its face, the provision requires the disclosure of acquisitions of "beneficial ownership of any equity security . . ."—language theoretically designed to encompass all relevant changes in ownership. However, recent judicial interpretations have tended to limit the application of this subsection to situations in which a person has *purchased* securities. It was suggested that these decisions substantially reduce the effectiveness of section 13(d) as a source of investor information. Furthermore, it was submitted that the decisions are not supported by the provision's legislative history and that they are in conflict with the fundamental and salutary disclosure philosophy of the Exchange Act.

Nonetheless, some restriction must be imposed on the broad language of paragraph (3) which, arguably, has been interpreted to mean that all cooperative stockholder efforts come within the scope of the subsection. The solution to this problem, it is concluded, lies in the application of the principles of beneficial ownership to group efforts, and not in the arbitrary conclusion that a purchase of securities is a prerequisite to disclosure.

BRADFORD J. POWELL

¹⁴¹ 15 U.S.C. § 78b (1970).

¹⁴² During the hearings on the Exchange Act, Senator Carey asked, "Is 'beneficial owner' the proper term there?" Mr. Corcoran, one of the drafters of the Act answered, "It is the broadest term you can have." Hearings Before the Senate Comm. on Banking and Currency, 73d Cong., 2d Sess., at 6556 (1934). See Feldman and Teberg, *supra* note 105, at 1058 n.22.