Proposed SEC Regulation of Market Sweeps: Should Market Sweeps Be Governed by the Williams Act?

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INTRODUCTION

Mergers and acquisitions continue to dominate the dynamic "big-bucks" transactions on Wall Street and throughout corporate America. Financial analysts have advanced numerous theories to explain why mergers and acquisitions have increased in number and frequency, including reduced antitrust enforcement, growth of the junk bond market, and deregulation of the securities industry.

Acquisition of a controlling interest in a company may be accomplished through a variety of methods, including proxy contests, tender offers, and market sweeps. Proxy contests and tender offers currently

1. An acquisition is a "union of two businesses into one corporate structure." See A. Frey, J. Choper, N. Leech & C. Morris, Cases and Materials on Corporations 1281 (2d ed. 1977). A merger is considered a type of acquisition involving the "union of [two] corporate entities" into one corporate structure. Id. at 1281-82.

2. Merger and acquisition activity has risen dramatically throughout the 1980's. In 1980, 1,565 transactions were conducted, totalling approximately $33 billion. See 1986 Profile, Mergers & Acquisitions, May/June 1987, at 57. By 1986, the total number of merger transactions had risen to 4,024, totalling over $190 billion. Id.

3. See Greenfield & Weininger, Regulators Widen Options In Weighing Mergers, Mergers & Acquisitions, Spring 1985, at 55. "In 1982, under an administration avowedly more sympathetic to mergers than its predecessors, the Justice Department finally buried the 1968 guidelines and issued a new set that more accurately reflected the department's actual enforcement stance." Id.; see also Rhoades, The Decline and Possible Resurrection of Antitrust Policy Toward Mergers, 17 Antitrust L. & Econ. Rev. 49, 49-50 (1985) (listing five major reasons for the rise of the promerger view and the accompanying decline of the proantitrust position).


Merger activity should continue, even after the October 1987 stock market crash, because of lower stock prices and increased foreign buying of United States' companies, spurred by the weak dollar. See The Hunt for M&A Bargains, Mergers & Acquisitions, Jan./Feb. 1988, at 9-10.

6. See, e.g., Dynamics Corp. of Am. v. CTS Corp., 637 F. Supp. 406, 407 (N.D. Ill.), aff'd, 794 F.2d 250 (7th Cir. 1986), rev'd, 107 S. Ct. 1637 (1987). In a proxy contest, the acquiring entity tries "to persuade the shareholders of the TARGET COMPANY that the present management of the firm should be ousted in favor of a slate of directors favorable to the acquirer." J. Downes & J. Goodman, supra note 4, at 313. If the shareholders vote in favor of the candidates of the acquiring entity, it gains control of the company without purchasing shares. See id.

7. See, e.g., Edelman v. Fruehauf Corp., 798 F.2d 882, 884-85 (6th Cir. 1986); see also infra text accompanying notes 12-17 (defining tender offer).

8. A market sweep entails large block purchases of stock through open-market or privately negotiated transactions. See Blanc, Commission Proposes to Outlaw Market
are regulated by federal law.\textsuperscript{9}

The Securities Exchange Act of 1934 ("1934 Act")\textsuperscript{10} protects shareholders by requiring companies engaged in a proxy contest—the traditional takeover technique prior to the advent of tender offers—to give shareholders information about their plans for the acquired company.\textsuperscript{11} In the 1960's, bidders began to use tender offers to gain controlling interests in corporations. A cash tender offer, now considered a conventional method of carrying out a corporate takeover battle,\textsuperscript{12} typically entails a bid by a person\textsuperscript{13} to buy shares of a company, usually at a premium price.\textsuperscript{14} Those persons accepting the offer tender their stock for purchase.\textsuperscript{15} If the conditions specified at the outset by the bidder are met,\textsuperscript{16} he must buy all the tendered shares he obligated himself to purchase.\textsuperscript{17}


\textsuperscript{12} See L. Loss, supra note 4, at 497-98; see, e.g., Maynard Oil Co. v. Deltec Panamerica S.A., 630 F. Supp. 502, 503 (S.D.N.Y. 1985) (Avalon Corporation made a tender offer of $6.00 per share for all outstanding Maynard shares); Corchado, Neoax to Buy IU International for $671 Million, Wall St. J., March 7, 1988, at 6, col. 1 (Neoax made a tender offer of $17.50 a share and later increased the bid to $22.25, eventually gaining control of the company); Freedman & Johnson, E-II Holdings to be Acquired for $1.1 Billion, Wall St. J., Feb. 1, 1988, at 3, col. 1 (to defeat E-II Holdings' tender offer, American Brands made a counter offer of $17.05 for E-II Holding shares—a "Pac-Man" defense).

\textsuperscript{13} Section 13(d)(3) of the Williams Act defines "person" as including "two or more persons [who] act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer." 15 U.S.C. § 78n(d)(2) (1982).


\textsuperscript{15} See sources cited supra note 14.

\textsuperscript{16} See W. Cary & M. Eisenberg, supra note 14, at 1562; see, e.g., Maynard Oil Co. v. Deltec Panamerica S.A., 630 F. Supp. 502, 503 (S.D.N.Y. 1985) (tender offer for Maynard shares conditioned on tender of a minimum number of shares, at a specific price, and by an expiration date); N.Y. Times, Sept. 8, 1987, at D13, col. 4 (in tender offer announcement, Ivanhoe Partners conditioned the offer on receiving sufficient financing and a minimum of 28 million shares tendered); Wall St. J., May 26, 1987, at 45, col. 4 (in tender offer announcement, Morgan Stanley conditioned the offer on actually receiving a majority of the outstanding shares tendered and the purchaser entering into certain financing agreements).

\textsuperscript{17} See W. Cary & M. Eisenberg, supra note 14, at 1562 (bidder need not purchase shares exceeding the number specified in the offer); see also sources cited supra note 14.
This increased use of cash tender offers placed a substantial number of corporate control battles beyond the reach of the disclosure requirements of the 1934 Act. In 1968, Congress passed the Williams Act to provide consistent disclosure under the 1934 Act to shareholders facing tender offers, whether exchange or cash, that involve securities subject to registration under the 1934 Act. The Williams Act also includes a provision regulating significant accumulations of shares through open-market purchases.

Although the Williams Act regulates to varying degrees both open-market purchases and tender offers, the Act does not effectively regulate market sweeps. Market sweeps—purchases of large blocks of stock in either the open market or through privately negotiated transactions in a relatively short period of time—may be used to acquire or retain a controlling interest in a company engaged in a takeover battle. Because the Williams Act fails to regulate market sweeps effectively, shareholders lack the protections the Act guarantees in the case of tender offers.

In an effort to provide the shareholder protections intended by the Williams Act, the Securities and Exchange Commission ("SEC") has proposed Rules 13e-2, 14d-11(a), and 14d-11(b) under the 1934 Act to regulate market sweeps. The proposed rules require all purchases, of-

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20. Williams Act, § 12(1), 15 U.S.C. § 78m(a),(b),(g) (1982); see H.R. Rep. No. 1711, supra note 11, at 2812-13 (bill seeks to help maintain honest securities markets and to ensure that public investors have truthful information on which to make investment decisions). For relevant statutory language, see infra notes 53-76.

21. See Williams Act, § 13(d), 15 U.S.C. § 78m(d) (1982); L. Loss, supra note 4, 514-15 (discussing § 13(d)(1)(A)-(E) and 13(d)(2)). For the statutory language, see infra note 71.

22. See infra notes 91-100 and accompanying text.

23. See Blanc, supra note 8, at 29, col. 1.


25. See SEC Release, supra note 24, at 37,475.

26. See id. at 37,474. At an open meeting on September 16, 1987, the SEC, by a four-to-one vote, approved the recommendation of the SEC's Divisions of Corporation and Finance Market Regulation, in which the Enforcement Division and the General Counsel's Office concurred, to issue a release proposing Rules 13e-2 and 14d-11 under the Securities Exchange Act of 1934 and soliciting comment on them. The SEC requested that all comments be delivered by December 7, 1987. The Division of Corporate Finance
fers, arrangements or understandings to purchase, and all solicitations of offers to sell securities undertaken during or shortly after a tender offer to comply with the statutory provisions and rules applicable to tender offers if the purchases would increase any person's ownership of a class of securities subject to the tender offer by ten percent or more of that class.

This Note examines whether the class of transactions known as market sweeps needs to be regulated, and, if so, whether the SEC's proposed rules would effectively regulate such transactions. Part I discusses the harms caused by unregulated tender offers and the elimination of such harms through passage of the Williams Act. Part II explains how market sweeps have evaded the protections of the Williams Act and demonstrates the need to adopt remedial provisions, drawing an analogy between the damage caused by unregulated tender offers prior to passage of the Williams Act and that inflicted by market sweeps. Part III introduces the SEC's proposed regulation of market sweeps and analyzes its benefits and shortcomings. This Note concludes that promulgation of the SEC proposal, with some modifications, is necessary to prevent investors from using market sweeps to circumvent the laudable intentions of the Williams Act.

I. THE WILLIAMS ACT

Prior to amendment by the Williams Act, the Securities Exchange Act of 1934 did not regulate cash tender offers in a way "remotely comparable" to proxy regulation. During this period, a person or a corporation desiring to purchase a number of shares of stock of a particular company offered shareholders a set price, typically at a premium, for their shares through a tender offer. The offeror, who could remain anonymous, then purchased the shares on a first-come, first-served basis, terminating the offer after purchasing the desired number of shares.

will review the solicited comments and submit a final proposal to the Commission, which will conduct an open meeting to consider the final proposal.

27. See SEC Release, supra note 24, at 37,473; For relevant proposed language, see infra notes 149-50, 157.
28. See SEC Release, supra note 24, at 37,473 & n.4.
31. See L. Loss, supra note 4, at 498; H.R. Rep. No. 1711, supra note 11, at 2812. The only regulations of cash tender offers prior to 1968 were the fraud provision of § 10b-5 and the insider trading provision of § 16. L. Loss, supra note 4, at 498.
33. See H.R. Rep. No. 1711, supra note 11, at 2812; 113 Cong. Rec. 855 (1967) (statement of Sen. Williams). In addition, an unregulated tender offer permitted any person who made a tender offer to keep any plans to gain corporate control and future management plans from the shareholders of the corporation. Id.; see also L. Loss, supra note 4, at 498.
34. See sources cited supra note 32.
Use of a tender offer enabled the purchaser to gain a controlling interest in the company without first notifying shareholders. During the 1960's, the growth of cash tender offers as a method of gaining corporate control led to recognition of the harms caused by such unregulated transactions and to passage of the Williams Act to eliminate these harms.

A. Harms Of Unregulated Tender Offers

Unregulated tender offers inflicted various harms on shareholders and target companies. The absence of regulation permitted bidders to conduct tender offers covertly, a practice that contradicted the open nature of American securities markets established by the Securities Exchange Acts of 1933 and 1934. These covert corporate acquisition attempts unfairly blinded target companies and shareholders, depriving them of the ability to protect their interests properly.

The 1934 Act did not require a person seeking corporate control through a tender offer to disclose any information about his background, motives, or plans. This lack of information handicapped target company shareholders in making decisions whether to tender their shares because, without the information, they could not evaluate the competence or sincerity of the bidding party. Furthermore, the first-come, first-served purchase policy pressured shareholders into making quick decisions to sell because they faced the risk that the offeror would terminate the offer before they could tender their shares. At the same time, however, the possibility that the bidder might raise the offered price pressured shareholders to delay tendering their shares. Moreover, the first-come, first-served policy treated shareholders unequally because those who tendered quickly could sell all their shares, while other shareholders could not.

37. See H.R. Rep. No. 1711, supra note 11, at 2812-14; infra notes 38-77 and accompanying text.
38. See 113 Cong. Rec. 855 (1967) ("persons seeking control in these ways are able to operate in almost complete secrecy concerning their intentions, their commitments and even their identities") (statement of Sen. Williams).
42. See H.R. Rep. No. 1711, supra note 11, at 2812; Wellman, 475 F. Supp. at 822.
43. See H.R. Rep. No. 1711, supra note 11, at 2812.
44. See id.
might not be able to tender any.\textsuperscript{45} Last, the lack of disclosure requirements gave the bidder an advantage over the target company, which had no data or information with which to evaluate the offer and react accordingly.\textsuperscript{46}

### B. Tender Offer Provisions of the Williams Act

In reaction to the harms implicit in unregulated tender offers, Congress amended the Securities Exchange Act of 1934 through passage of the Williams Act.\textsuperscript{47} Section 14(d) of the Williams Act deals specifically with tender offers,\textsuperscript{48} while section 13(d) establishes posttransaction reporting requirements for open-market purchases in which investors acquire more than five percent of a company's outstanding shares.\textsuperscript{49} Congress, by separating sections 14(d) and 13(d), distinguished between purchases for corporate control made through tender offers and large stock accumulations made through open-market purchases.\textsuperscript{50}

The Williams Act resolves most of the problems generated by an unregulated tender offer,\textsuperscript{51} thus closing a gap in federal securities regulation.\textsuperscript{52} Section 14(d)(1) of the Williams Act\textsuperscript{53} removes the information

\textsuperscript{45} See id. ("if [the shareholder] tenders late, he runs the risk that none of his shares will be taken").

\textsuperscript{46} See 113 Cong. Rec. 854-55 (1967) (statement of Sen. Williams); see also Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 48 (1967) (statement of Mr. Kahler, secretary and general counsel of the International Silver Co.) (explaining that some tender offers or covert purchases may be used to destroy a target company).


\textsuperscript{52} See H.R. Rep. No. 1711, supra note 11, at 2814.

\textsuperscript{53} Section 14(d)(1) provides in pertinent part:

It shall be unlawful for any person, directly or indirectly, . . . to make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursuant to section 78l of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 78l(g)(2)(G) of this title, or any equity security issued by a a [sic] closed-end investment company registered under the Investment Company Act of 1940 . . . if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or given to security holders such person has filed with the Commission a statement containing such of this information . . .
MARKET SWEEPS


59. Rule 14e-1 provides in pertinent part that "no person who makes a tender offer shall ... [h]old such tender offer open for less than twenty business days from the date such tender offer is first published or sent or given to security holders." 17 C.F.R. § 240.14e-1 (1987).

their shares to withdraw them during the first seven days of the tender offer or at any time after sixty days from the commencement of the offer, provided the offeror has not yet purchased the shares. This provision allows shareholders the opportunity to change their decision to tender if presented with a more attractive option. Section 14(d)(6) prevents the first-come, first-served policy by requiring the bidder to purchase tendered shares on a pro rata basis if the initial tender offer is for less than all outstanding shares. This eliminates the risk that some shareholders will be closed out before they can tender their shares. Last, section 14(d)(7) mandates that all tendering shareholders receive the same price for their shares, even if the offeror later increases the offering price, guaranteeing all shareholders the highest price offered.

No. 15, at 3031-32 (Jan. 23, 1986); see also Tyson, The Williams Act After Hanson Trust PLC v. SCM Corporation: Post-Tender Offer Purchases by the Tender Offeror, 61 Tul. L. Rev. 1, 5 (1986) (Congress' goals included providing "sufficient time to evaluate [relevant] information so that [a shareholder] would be in a position to respond adequately to an offer.").

61. Section 14(d)(5) provides:

Securities deposited pursuant to a tender offer or request or invitation for tenders may be withdrawn by or on behalf of the depositor at any time until the expiration of seven days after the time definitive copies of the offer or request or invitation are first published or sent or given to security holders, and at any time after sixty days from the date of the original tender offer or request or invitation, except as the Commission may otherwise prescribe by rules, regulations, or order as necessary or appropriate in the public interest or for the protection of investors.


62. Shareholders may be presented with tender offers from competing bidders. See, e.g., Sease, Industrials Ease as Profit-Taking and Program Trading Brake Rally, Wall St. J., Mar. 10, 1988, at 51, col. 2 (R.H. Macy Co. and Campeau Corp. launch competing tender offers for Federated Dep't Stores). The shareholders' ability to revoke their tenders leaves shareholders with the chance to respond to a move by the target company to retain control. For example, the target company may provide a dividend as part of a restructuring program used to compete against a hostile tender offer. See, e.g., Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1339-40 (Del.), aff'g, 533 A.2d 585 (Del. Ch. 1987).

63. Section 14(d)(6) provides in pertinent part:

Where any person makes a tender offer, or request or invitation for tenders, for less than all the outstanding equity securities of a class, and where a greater number of securities is deposited pursuant thereto within ten days after copies of the offer or request or invitation are first published or sent or given to security holders than such person is bound or willing to take up and pay for, the securities taken up shall be taken up as nearly as may be pro rata, disregarding fractions, according to the number of securities deposited by each depositor.


64. Section 14(d)(7) provides in pertinent part:

Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder whose securities are taken up and paid for pursuant to the tender offer or request or invitation for tenders whether or not such securities have been taken up by such person before the variation of the tender offer or request or invitation.
Thus, the Williams Act ensures equal and fair treatment of the target company's shareholders. By guaranteeing all shareholders the rights to withdraw, to have their shares purchased on a pro rata basis, and to receive the highest price offered, sections 14(d)(5) through 14(d)(7) ensure that no shareholder receives a better offer than any other shareholder, regardless of when they tender their shares.

In addition to regulating tender offers, the Williams Act contains provisions applicable to open-market purchases. Section 13(d) of the Act establishes a posttransaction filing requirement that guarantees the dissemination of relevant information with respect to any large accumulation of stock without substantially disrupting the buying and selling of such securities on the open market.

In enacting sections 14(d) and 13(d) to protect shareholders, Congress guarded against "tipping the balance" of regulation either in favor of incumbent management or in favor of the party making the takeover bid. Congress sought to ensure a takeover environment that would be fair to all parties. In addition to the filing requirements section 14(d)(1)

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65. See Pin v. Texaco, Inc., 793 F.2d 1448, 1453 (5th Cir. 1986).
71. Section 13(d) provides in pertinent part:
Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class . . . 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 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 investors . . . .
Id. For the specific information required to be filed, see supra note 53.


74. 113 Cong. Rec. 856 (1967) ("With this legislation, all will stand on an equal foot-
imposes upon the tender offeror, section 14(d)(4) of the Williams Act requires the target company to file with the SEC and submit to the bidder any recommendations it plans to make to its shareholders with respect to the offer. By requiring both the tender offeror and the target company to provide each other with information regarding their positions, these provisions place both parties in comparable situations, thus removing any advantage enjoyed by the offeror.

II. MARKET SWEEPS: A TAKEOVER TACTIC THAT REMAINS UNREGULATED

Market sweeps recently have been used in corporate takeover battles to gain controlling interests in target companies. Any of three parties may employ a market sweep in the context of a takeover battle: the target company, to retain control; the bidder, to acquire control; or a third party, often called a "white knight," acting in conjunction with the target company, to defend the company from the raider's threatened takeover.

Market sweeps particularly are attractive once a tender offer has been commenced, which by definition includes public announcements made pursuant to Rule 14d-2(b) of the Williams Act. Upon public announcement or commencement of a tender offer through a section 14(d)
filing, market professionals begin assembling blocks of stock, which they then market to the bidder, target company, and third parties.\textsuperscript{85} The bidder in a takeover battle may refuse to begin an announced tender offer or may terminate a tender offer already in progress and purchase these blocks of stock at market price through a quick "market sweep," winning the takeover battle by circumventing the tender offer process.\textsuperscript{86} Termination of a tender offer in favor of a market sweep benefits the purchaser by reducing his cost of gaining corporate control\textsuperscript{87} and by giving him the advantage of surprise over other competitors.\textsuperscript{88} Although parties may use either market sweeps or tender offers to achieve the same goal,\textsuperscript{89} neither section 13(d) nor 14(d) of the Williams Act adequately regulates market sweeps.\textsuperscript{90}

A. \textit{Section 13(d) Fails to Regulate Market Sweeps Effectively}

Section 13(d) of the Williams Act regulates open-market purchases, requiring disclosure of pertinent information within ten days of the acquisition of more than five percent of a company's outstanding securities.\textsuperscript{91} Because market sweeps frequently are completed within ten days,\textsuperscript{92} a purchaser may gain a controlling interest in a company before the purchaser must meet the disclosure requirements. Therefore, the postfiling requirements of section 13(d) do not effectively provide shareholders the protections intended by Congress in passing the Williams Act.

\textsuperscript{85} See id. at 37,475.
\textsuperscript{86} See id.; see, e.g., Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 52 (2d Cir. 1985) (Hanson Trust terminated its tender offer for SCM shares on Sept. 11th and performed a market sweep that same afternoon); Bracan Ltd. v. Edper Equities Ltd., 477 F. Supp. 773, 775 (S.D.N.Y. 1979) (Edper abandoned conditional offer to acquire Bracan and purchased 3 million shares of Bracan stock on the open market 10 days later).
\textsuperscript{87} See SEC Release, supra note 24, at 37,474; infra notes 135-36 and accompanying text.
\textsuperscript{88} See Note, \textit{Promoting Shareholder Equality in Stock Accumulation Programs for Corporate Control}, 36 Am. U.L. Rev. 93, 111 (1986); infra note 134 and accompanying text; cf. L. Loss, supra note 4, at 498 (secrecy with which an unregulated tender offer may be executed enables the offeror to surprise management); W. Cary & M. Eisenberg, supra note 14, at 1563 ("the important advantage of surprise is lost by reason of the registration process").
\textsuperscript{90} See infra notes 91-100 and accompanying text.
\textsuperscript{91} See 15 U.S.C. § 78m(d) (1982); supra note 71.
\textsuperscript{92} See, e.g., Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 52 (2d Cir. 1985) (acquired 25% control within two hours); \textit{Gold Fields Increases Its Newmont Stake To Nearly 50%, Appears to Foil Pickens}, Wall St. J., Sept. 23, 1987, at 3, col. 1 (white knight acting in cooperation with the target purchased 21.5% in only one day).
B. Market Sweeps Are Not Covered by Section 14(d) Regulations

Parties involved in corporate control battles have challenged market sweeps performed without prior disclosure to shareholders on the grounds that the purchases were, in effect, tender offers and therefore should be subject to the requirements of section 14(d) of the Williams Act. They based this argument on the absence of a definition of "tender offer" in the Williams Act. In enacting section 14(d), Congress elected not to define the term "tender offer," merely referring to a "tender offer for, or a request or invitation for tenders of [securities]."

This ambiguity, however, left room for arguments that market sweeps might be considered unconventional tender offers.

In response to these challenges, courts have established three different tests to determine whether a market sweep is a tender offer. The first test, recommended by the SEC, considers the existence of eight factors in deciding whether a particular transaction is a tender offer. This test is the broadest, focusing on the various characteristics of a tender offer such as the length and extent of the offer. The second test is a two-pronged test that examines whether there existed a "publicly announced intention" to acquire control of a company and a subsequent, rapid purchase of the target company's stock. The final test examines a par-


96. See Note, supra note 49, at 547; infra notes 97-99 and accompanying text.

97. The eight factors in deciding whether a market sweep is a tender offer are:

1) active and widespread solicitation of public shareholders for the shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm, rather than negotiable; (5) offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased; (6) offer open only a limited period of time; (7) offeree subjected to pressure to sell his stock[...]; and (8) public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of large amounts of the target company's securities.


98. The second test, developed in S-G Secs., Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114 (D. Mass. 1978), classifies a market sweep as a tender offer if, first, there is "a publicly announced intention by the purchaser to acquire a substantial block of the stock
tic transaction's impact on the target company's shareholders.99 A majority of these courts decline to classify market sweeps as tender offers that must comply with SEC tender offer rules.100

C. Harms Caused by Market Sweeps

The courts' narrow interpretation of the definition of tender offer and section 13(d)’s ineffective regulation of market sweeps have left a gap through which acquirers may avoid the Williams Act’s regulations.101 This lack of regulation increases the effectiveness of market sweeps, thereby augmenting their attractiveness as a defensive or offensive tactic in takeover situations.102 Unregulated market sweeps, however, cause harms analogous to those inflicted by unregulated tender offers prior to passage of the Williams Act.103

A purchaser may perform a market sweep without disclosing to shareholders any information about his plans, identity, or financing,104 and he may purchase shares on a first-come, first-served basis,105 potentially excluding smaller shareholders, who may not know of the market sweep, from participating in the transaction.106 Shareholders who do know of

of the target company for purposes of acquiring control thereof,” and second, “a subsequent rapid acquisition by the purchaser of large blocks of stock through open-market and privately negotiated purchases.” Id. at 1126-27.

99. The third test, employed by the court in Pin v. Texaco, Inc., 793 F.2d 1448 (5th Cir. 1986), classifies a market sweep as an unconventional tender offer when the solicitees need the protections of the Williams Act in order to make an informed decision. See id. at 1454; see also Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 57 (2d Cir. 1985) (adopting the test); Smallwood v. Pearl Brewing Co., 489 F.2d 579, 598 (5th Cir.) (same), cert. denied, 419 U.S. 873 (1974). This test is best labelled a “shareholder impact test.” Note, supra note 88, at 102; see also Nachman Corp. v. Halfred, Inc., [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,455, at 95,590 (N.D. Ill. 1973) (definition of tender offer should extend to offers with same impact as conventional tender offer).

100. See SEC Release, supra note 24, at 37,473; see, e.g., Pin v. Texaco, Inc., 793 F.2d 1448, 1454-55 (5th Cir. 1986); Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 57 (2d Cir. 1985); SEC v. Carter Hawley Hale Stores, 760 F.2d 945, 949-50 (9th Cir. 1985). But see S-G Secs., Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114, 1126-27 (D. Mass. 1978) (acquisition of large blocks of stock following an announcement to gain control constituted a tender offer); Cattlemen's Inv. Co. v. Fears, 343 F. Supp. 1248, 1251-52 (W.D. Okla. 1972) (active solicitation or personal contact with shareholders for purpose of purchasing their shares constituted a tender offer).

101. See SEC Release, supra note 24, at 37,476.


103. See SEC Release, supra note 24, at 37,473, 37,476; infra notes 104-36 and accompanying text.

104. See SEC Release, supra note 24, at 37,475; cf. L. Loss, supra note 4, at 498 (bidder may perform unregulated tender offer in secrecy); 113 Cong. Rec. 855 (1967) (statement of Sen. Williams) (bidder in unregulated tender offer need not disclose any information about his background, motives, or plans); supra notes 41-42 and accompanying text (same).

105. See SEC Release, supra note 24, at 37,475; cf. H.R. Rep. No. 1711, supra note 11, at 2812 (bidder in unregulated tender offer may purchase shares on first-come, first-served basis); supra text accompanying note 34 (same).

106. During a market sweep, the purchaser typically buys from market professionals
the market sweep must decide whether to sell or retain their shares without knowing whether the purchaser plans to obtain a controlling interest in the company, and, if so, what, if any, corporate changes he will institute. The lack of sufficient information, combined with the intense, short-term nature of the market sweep, pressures these shareholders into making quick, uninformed decisions.

The pressure market sweeps place on shareholders is functionally equivalent to the pressure created by unregulated tender offers. If a shareholder responds quickly to the offer to purchase, he might not gain timely knowledge of the risks of his decision and cannot reverse his decision once his shares are sold. A shareholder who sells his shares in a market sweep may forfeit other options, including the possibility of obtaining a higher price that subsequently might be offered or the chance who hold large blocks of the target company's stock. See Federal Securities & Corporate Developments, Close 10-Day Window to Stop Abuses from Open-Market Purchases, SEC Told, 17 Sec. Reg. & L. Rep. (BNA) No. 37, at 2075 (Nov. 29, 1985) [hereafter Close 10-Day Window]; see, e.g., Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 52 (2d Cir. 1985) (Hanson acquired 25% of SCM's outstanding stock through five privately negotiated cash purchases and one open-market purchase).

107. See SEC Release, supra note 24, at 37,475.

108. See SEC Release, supra note 24, at 37,476; cf. H.R. Rep. No. 1711, supra note 11, at 2812 (discussing the lack of information faced by shareholders during unregulated tender offers); supra notes 41-42 and accompanying text (same).

109. See, e.g., Hanson Trust PLC, 774 F.2d at 52 (Hanson acquired 3.1 million SCM shares in two hours to obtain a 25% interest); Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 385, 398 (Del. Ch.), aff'd, 535 A.2d 1334 (Del. 1987) (Consolidated Gold Fields, a white knight acting in cooperation with the target, purchased 15.8 million Newmont shares in only two days).


Uninformed decisions violate fundamental economic principals of market efficiency. Mendelson, The Economics of Insider Trading Reconsidered, 117 U. Pa. L. Rev. 470, 472 (1969) (use of inside information by small number of investors creates biased decision-making on behalf of other investors and fosters a persistent misallocation of economic resources). Furthermore, creation of a securities market where all investors have an equal opportunity to receive information, will reduce the volatility in market price swings caused by low investor participation in the stock market, and increase allocative efficiency. Seligman, The Reformation of Federal Securities Law Concerning Nonpublic Information, 73 Geo. L.J. 1083, 1117-18 (1985) (prominent reason for investor departure from the market is widely held perception that institutional investors receive "inside information" that small investors did not).

111. Cf. Smallwood v. Pearl Brewing Co., 489 F.2d 579, 597-98 (5th Cir.) (if a shareholder responded to a tender offer prior to the Williams Act, "he might not learn in time the true risks of his decision"), cert. denied, 419 U.S. 873 (1974); H.R. Rep. No. 1711, supra note 11, at 2812 (discussing similar harms inflicted by unregulated tender offers); supra note 45 and accompanying text (same).

112. Often in a takeover battle, a tender offeror may have to raise the price being offered either because another higher offer has been made or the price is not drawing enough tenders. Betting the Store: Campeau at Last Gets Federated—Now Can He Make a Go of It, Wall St. J., Apr. 4, 1988, at 10, col. 2 (R.H. Macy Co. and Campeau Corp. made competing tender offers for Federated Stores which started with a $61 a share offer
to support a new party in the takeover battle who better represents his economic interests. 113 If the shareholder delays, he may foreclose the option of obtaining the going price for his shares 114 because the buyer may purchase the desired number of shares from other shareholders. 115 In addition, shareholders may not be aware of the exact time pressure they are under, because nobody—not even the purchaser—knows how long it will take to obtain the desired number of shares. 116

The first-come, first-served method of purchase used in market sweeps results in the unequal treatment of shareholders as a class, 117 thereby frustrating one of the fundamental principles of the Williams Act. 118 Arbitrageurs benefit most from the first-come, first-served method because their easy access to market information 119 quickly provides them with knowledge of large buy orders. 120 This enables them to sell their large blocks of stock while smaller shareholders, who often do not possess this knowledge, miss the opportunity to sell their shares. 121 The first-come, first-served method of purchase thus places nonprofessional shareholders faced with a market sweep at a distinct disadvantage.

113 A shareholder may prefer to sell to the target company rather than to a raider who wishes to collect greenmail, the premium price paid by a takeover target to a raider for his shares in exchange for his promise not to pursue the takeover battle. When a shareholder sells his shares to the purchaser, there is no opportunity to withdraw as there is in a tender offer, see Williams Act, § 14(d)(5), 15 U.S.C. § 78n(d)(5) (1982). See SEC Release, supra note 24, at 37,475.

114 After a market sweep has been completed, the price of the stock tends to drop. See infra note 133 and accompanying text.

115 Cf. Smallwood v. Pearl Brewing Co., 489 F.2d 579, 598 (5th Cir.) (if a shareholder waited to respond to a tender offer prior to the Williams Act, he risked losing his opportunity to gain a premium price for his securities because others might already have tendered to the offeror the number of shares he required), cert. denied, 419 U.S. 873 (1974); H.R. Rep. No. 1711, supra note 11, at 2812 (discussing similar harms of unregulated tender offers); supra notes 41-45 and accompanying text.

116 See, e.g., SEC v. Carter Hawley Hale Stores, 760 F.2d 945, 947 (9th Cir. 1985) (sweep completed in seven days); Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585, 598 (Del. Ch.), aff'd, 535 A.2d 1334 (Del. 1987) (sweep completed in two days).

117 See Curbing Market Sweeps, supra note 110, at 1385; Blanc, supra note 8, at 29, col. 3; cf. H.R. Rep. No. 1711, supra note 11, at 2812 (first-come, first-served method of purchasing in unregulated tender offers creates unequal treatment of shareholders); supra note 45 and accompanying text (same).

118 See supra notes 65-69 and accompanying text.

119 Arbitrageurs, by monitoring the market through Quotrons and keeping track of orders to buy or sell, are able to recognize a potential takeover battle at its inception. An arbitrageur is a "person who endeavors to profit from offsetting long and short security positions or from a disparity in market prices on different markets." A. Pessin & J. Ross, Words of Wall Street: 2,000 Investment Terms Defined 13 (1983).


121 See SEC Release, supra note 24, at 37,474. But see L. Cohen, supra note 120, at 33, col. 1 (arguing small shareholders may remain unharmed by a market sweep).
Although many smaller shareholders may gain a profit by selling their shares to arbitrageurs, they still are denied the protections sought by the Williams Act. First, many shareholders may sell their shares early in the takeover battle, thereby foregoing larger returns if the bidding war escalates. Second, many shareholders may not be able to participate in the market sweep because they lack the knowledge and time to evaluate all their options.

Market sweeps also disrupt the equal footing between competing parties in a takeover battle\(^{122}\) that Congress found so important in drafting the Williams Act.\(^{123}\) Market sweeps discourage further bidding through tender offers, hurting not only bidders, but shareholders as well.\(^{124}\) Market sweeps "lock out" additional action by bidders already involved in the takeover battle.\(^{125}\) Because a person conducting a market sweep purchases shares at market price,\(^{126}\) parties who have made tender offers terminate the offers rather than increase the premium price offered.\(^{127}\) Moreover, the possibility of being undercut by a "free rider"\(^{128}\) deters bidders from launching tender offers.\(^{129}\) For example, in a defensive market sweep,\(^{130}\) the target company repurchases its own shares on the market, thereby introducing excessive uncertainty with respect to the prospective success of an unsolicited tender offer.\(^{131}\) A defensive market sweep not only ends the bidding by parties already involved in the battle, but also deters other bidders from entering the battle.\(^{132}\) An unsuccessful tender offer is quite costly to the offeror due to the legal, advisory, and

\(^{122}\) See SEC Release, supra note 24, at 37,475.

\(^{123}\) See supra notes 73-77 and accompanying text.

\(^{124}\) See Curbing Market Sweeps, supra note 110, at 1385 (statement of SEC Director, Division of Corporation Finance, Linda Quinn).

\(^{125}\) See id.

\(^{126}\) See supra note 86 and accompanying text.

\(^{127}\) See Curbing Market Sweeps, supra note 110, at 1385 (statement of SEC Director, Division of Corporation Finance, Linda Quinn).

\(^{128}\) A free rider is a third party who takes advantage of the market environment to effect a market sweep. The free rider may be a company that desires to make a bid for a target company engaged in a takeover battle but refrains from making a tender offer and effects the acquisition via a market sweep. The free rider may wait so as to ambush the other bidders and possibly the target company with a quick, rapid accumulation of the target company's stock. By doing this, the free rider may block any response from other parties.


\(^{130}\) A defensive market sweep is performed by a target company to preempt a takeover. See SEC Release, supra note 24, at 37,475.

\(^{131}\) See Note, supra note 49, at 537.

It has been argued that market sweeps serve as a mechanism to entrench management. See id. at 552-53; see, e.g., SEC v. Carter Hawley Hale Stores, 760 F.2d 945, 949 (9th Cir. 1985) (SEC accused Carter Hawley Hale of such tactics); Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585, 600 (Del. Ch.) (Ivanhoe claimed that Newmont, aided and abetted by Consolidated Gold Fields, violated its fiduciary obligation to Newmont shareholders), aff'd, 535 A.2d 1334 (Del. 1987).

\(^{132}\) See Curbing Market Sweeps, supra note 110, at 1386 (statement of SEC Commissioner Joseph Grundfest).
printing expenses associated with launching a takeover bid. Furthermore, by blocking out other bidders, market sweeps deprive shareholders of the possibility of obtaining the higher price other bidders might have offered for their shares.133

Purchasers employing market sweeps enjoy additional advantages that disrupt the balance between competing parties in a takeover battle. A purchaser usually uses a market sweep to realize an element of surprise against the target company and other bidders.134 Without notice, other parties to the battle cannot undertake appropriate defensive measures. The purchaser also maintains the advantage of incurring lower costs in a market sweep than he would have incurred in a tender offer, which typically entails greater attorneys' fees due to the required filings, greater overhead costs,135 and payment of a premium price for the shares.136

While Congress primarily intended to protect shareholders in passing the Williams Act, it also sought to ensure that the Act would not discourage legitimate corporate takeover activity.137 Congress believed that corporations, shareholders, and employees could benefit highly from economically sound mergers and acquisitions and therefore constructed the Williams Act to further such beneficial activity.138

Market sweeps impose harms on parties in a takeover battle analogous to those imposed on parties affected by unregulated tender offers.139 Although section 14(d) of the Williams Act eliminated the harms caused by unregulated tender offers,140 the current use of market sweeps enables parties to bypass section 14(d)’s regulations.141 Indeed, court decisions refusing to impose the regulating scheme of section 14(d) on market

133. See id. at 1385 (statement of SEC Director, Division of Corporation Finance, Linda Quinn). The SEC found that investors often received between one and two dollars per share less when selling their shares after a completed market sweep. See id. Exemplifying this, Consolidated Gold’s market sweep locked out Ivanhoe’s tender offer for $105 per share by purchasing shares at prices between $95 and $99 per share, preventing shareholders from getting the highest price possible. See Gold Fields Increases Its Newmont Stake To Nearly 50%, Appears to Foil Pickens, Wall St. J., Sept. 23, 1987, at 3, 17, col. 1. Only three months later, the stock was trading in the mid-thirties after a $33 dividend, giving the stock an adjusted value in the mid-sixties. See Compuserve Inc., Database (March 5, 1988).

134. See Note, supra note 88, at 111; cf. L. Loss, supra note 4, at 498 (in an unregulated tender offer, “secrecy enable[s] [the offeror] to catch the management by surprise”).

135. Overhead costs include printer’s fees, overtime pay, and postal charges.

136. See SEC Release, supra note 24, at 37,474; Curbing Market Sweeps, supra note 110, at 1385. The party performing a market sweep need not pay as high a premium because the seller in the market sweep receives cash up front, whereas a person who tenders may receive a combination of cash and securities and must wait until at least after the minimum tender offer period has elapsed.


138. See id.

139. Compare supra notes 104-36 and accompanying text (harms inflicted by market sweeps) with supra notes 38-46 and accompanying text (harms inflicted by unregulated tender offers).

140. See supra notes 51-69 and accompanying text.

141. See SEC Release, supra note 24, at 37,475.
sweeps provide examples, which if followed, set precedents that endanger those goals established by the Williams Act. Parties wishing to gain a controlling interest in a company will employ market sweeps almost exclusively, leaving the tender offer regulations useless, just as tender offers became a popular way to avoid proxy regulations during the 1960's. Market sweeps, therefore, must be regulated. Because courts are unwilling to apply section 14(d) of the Williams Act to market sweeps, "remedial administrative or legislative action [is] necessary."

III. REGULATION OF MARKET SWEEPS

A. Recent SEC Proposal

The SEC has decided that the time to allow the courts to deal with the growing problems caused by today's frequent and high-priced merger battles has passed. Therefore, the SEC has proposed Rules 13e-2, 14d-11(a), and 14d-11(b) to regulate market sweeps by applying the tender offer provisions of the Williams Act to them. These proposed rules

142. See supra note 100 and accompanying text.
143. See supra notes 47-77 and accompanying text.
144. See Tyson, supra note 60, at 40.
145. See SEC Release, supra note 24, at 37,474.
146. See id.

On several previous occasions, the SEC and Congress have attempted to solve the problems created by market sweeps. All such attempts, however, have failed. In 1979, the SEC proposed Rules 14d-1(b)(1) and 14e-5, see Exchange Act, Release No. 34-16,385, 44 Fed. Reg. 70,349-57 (1979), to bring certain market sweeps within the classification of tender offers. Proposed Rule 14d-1(b)(1) defined a tender offer as either (1) one or more offers to purchase or solicitations of offers to purchase the same class of securities during a 45-day period directed to more than 5% of the class of securities, or (2) wide dissemination of offers to purchase or solicitations of offers to sell at a premium price when there is no possible opportunity to negotiate the terms of the offer. See id. at 70,350-51. Proposed Rule 14e-5 permitted a tender offeror to purchase the target company's securities only by means of the tender offer. This restriction remained in effect through the tenth business day after the offer's termination. See id. at 70,357. The SEC chose not to adopt either of these proposed rules.

In 1980, an SEC report submitted to Congress suggested changes in the Williams Act, including a modification of § 13(d) to require persons acquiring 5% ownership of a class of securities to announce publicly, within one business day, their identity, percentage of ownership, and other relevant information. See Securities and Exchange Commission Report on Tender Offer Laws, Printed for the Use of the Senate Comm. on Banking, Housing, and Urban Affairs 84-85 (Comm. Print 1980); Note, supra note 88, at 119 & n.157. Congress declined to enact these changes.

In a final report issued on July 8, 1983, the SEC Advisory Committee on Tender Offers recommended that any accumulation of greater than 20% of an issuer's voting securities be made pursuant to a tender offer to all shareholders, unless purchased directly from the issuer. See Securities & Exchange Commission Advisory Comm. on Tender Offers, Report of Recommendations 21-23 (1983); Note, supra note 88, at 121-22. The SEC also recommended that a prospective purchaser be required to disclose its ownership and intentions at least 48 hours prior to acquiring greater than 5% of a company's outstanding shares. See Securities and Exchange Commission Advisory Comm. on Tender Offers, Report of Recommendations 21-23 (1983); Note, supra note 88, at 121 & n.166. Once again Congress declined to follow the Commission's suggestions.

In addition, Congress considered two bills designed to eliminate abuses associated with
will prevent the harms caused by market sweeps by giving shareholders needed protections and restoring a balance between the parties in a take-over battle.

Proposed Rules 14d-11(a) and 14d-11(b) apply to any person wishing to acquire shares for which a tender offer has been commenced or announced publicly, whereas Rule 13e-2 applies specifically to issuers. Together, proposed Rules 13e-2 and 14d-11(a) require, with certain large, open-market and privately negotiated purchases, including market sweeps. See The Tender Offer Reform Act of 1984, Memorandum of the Securities and Exchange Commission Regarding H.R. 5693, As Amended and Ordered Reported by the House Comm. on Energy and Commerce, reprinted in H.R. Rep. 1028, 98th Cong., 2d Sess. 34 (1984); S. 1907, 99th Cong., 1st Sess., 131 Cong. Rec. S17098 (daily ed. Dec. 6, 1985). The 1984 bill, proposed by Representative Wirth of Colorado, required that a disclosure document be filed within 24 hours of the acquisition of over 5% of an issuer's outstanding voting securities and prohibited additional purchases until 48 hours had elapsed after the filing of the document. See H.R. 5693, 98th Cong., 2d Sess. § 202, reprinted in H.R. Rep. 1028, 98th Cong., 2d Sess. 2-4 (1984); Note, supra note 88, at 121-22; see also L. Loss, supra note 4, at 540 (discussing the 1984 bill). In September 1984, the Commission opposed the bill but encouraged further work on this type of bill. See Memorandum of the Securities and Exchange Commission Regarding H.R. 5693, As Amended and Ordered Reported by the House Comm. on Energy and Commerce, reprinted in H.R. Rep. 1028, 98th Cong., 2d Sess. 34 (1984); Note, supra note 88, at 121-22.

In 1985, Congress considered the Tender Offer Reform Act of 1985, proposed by Senator D'Amato of New York, S. 1907, 99th Cong., 1st Sess., 131 Cong. Rec. S17098 (daily ed. Dec. 6, 1985), which required a person acquiring more than 5% of a class of stock to announce that fact and to file a Schedule 13(D) within a 24 hour period of the purchase and prohibited the purchaser from acquiring additional shares of that class for the 48 hours following the "triggering purchase." See id.; Note, supra note 88, at 123. The bill also would have regulated many currently unregulated acquisition programs, subjecting them to the Williams Act's tender offer provisions. See S. 1907, 99th Cong., 1st Sess., 131 Cong. Rec. S17098 (daily ed. Dec. 6, 1985); Note, supra note 88, at 124-25. The bill, however, did not pass.


147. See SEC Release, supra note 24, at 37,482.

148. See id. at 37,481.

149. Proposed Rule 13e-2(a) provides in pertinent part:

Upon commencement of an issuer tender offer pursuant to Rule 13e-4(a)(4) . . . until the expiration of ten business days after the scheduled expiration date of such tender offer, including any extensions thereof, the issuer shall not, directly or indirectly, purchase, offer to purchase, make any arrangement or understanding to purchase, or solicit any offer to sell either an aggregate of ten percent or more of securities of a class that is or was subject to such tender offer or securities of a class which are convertible into, exchangeable for, or otherwise
exceptions, that after commencement of a tender offer, all purchases of ten percent or more of the securities of a particular corporation by any person during the offer and for the ten business days immediately following its termination, shall be made in compliance with the the tender offer requirements.151

The SEC chose a ten-day cooling-off period because it believed such a time period sufficient to allow the "market dynamics"152 of a takeover battle to settle.153 The ten percent threshold attempts to protect against the accumulation of a target company’s stock during a takeover situation154, while minimizing the regulations’ effect on normal arbitrage activity.155 The SEC concluded that regulation at a lower threshold might interfere with such free market activity.156

Proposed Rule 14d-11(b)157 requires a bidder who publicly announces

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give any right or privilege to, an aggregate of ten percent or more of securities of a class that is or was subject to such tender offer unless the purchase, offer to purchase, arrangement or understanding to purchase or solicitation of any offer to sell is made pursuant to Rule 13e-4 . . . .

SEC Release, supra note 24, at 37,481.

Section 13e-2(b) provides similar regulation of acquisitions and related activities by any affiliate of the issuer after commencement of a tender offer. See id. Section 13e-2(c) outlines purchases not subject to these provisions. See SEC Release, supra note 24, at 37,481-82; infra notes 164-73 and accompanying text.

150. Proposed Rule 14d-11(a) provides in pertinent part:

Upon commencement of an issuer tender offer pursuant to Rule 13e-4(a)(4) . . . . until the expiration of ten business days after the scheduled expiration date of such tender offer, including any extension thereof, no person shall, directly or indirectly, purchase, offer to purchase, make any arrangement or understanding to purchase, or solicit any offer to sell any security that would increase any person’s beneficial ownership of securities of a class that is or was subject to the tender offer by an aggregate of ten percent or more of that class, unless the purchase, offer to purchase, arrangement or understanding to purchase or solicitation of any offer to sell is made pursuant to section 14(d) of the Act and the rules promulgated thereunder.

SEC Release, supra note 24, at 37,482.

151. See id. at 37,473; Blanc, supra note 8, at 28.

152. See supra notes 85-86 and accompanying text.

153. See SEC Release, supra note 24, at 37,477.

154. See id.

155. Most arbitrageurs do not purchase more than 10% of a target company's stock. See id.

156. See id.

157. Proposed Rule 14d-11(b) provides in pertinent part:

Upon commencement of a tender offer by public announcement pursuant to Rule 14d-2(b) . . . . and until either—

(1) The bidder commences the tender offer by means other than such public announcement or

(2) The expiration of 30 business days after the date that the bidder makes a public announcement pursuant to Rule 14d-2(b)(1) . . . . that it will not continue with such tender offer, whichever occurs first, the bidder shall not, directly or indirectly, purchase, offer to purchase, make any arrangement or understanding to purchase, or solicit any offer to sell any security that would increase any person’s beneficial ownership of securities of a class that is or was subject to the tender offer by an aggregate of ten percent or more of that class, unless the
plans to commence a tender offer to comply with the tender offer regulations set forth by the Williams Act for thirty business days after termination of the offer once that bidder purchases more than ten percent of the outstanding securities of the target company. Proposal of this section is based on the SEC’s belief that public announcements of tender offers have the same effect on the market for the subject securities as do commencements of tender offers. Under proposed Rule 14d-11(b), if a bidder announces a tender offer and thereafter decides not to commence it, he still remains subject to the twenty-day minimum offering period applicable to tender offers and the ten-day “cooling-off” period established by proposed Rules 14d-11(a) and 13e-2. Proposed Rules 13e-2, 14d-11(a), and 14d-11(b) thus prevent any party involved in a takeover battle from taking advantage of the market dynamics caused by a public announcement or commencement of a tender offer by performing a market sweep and bypassing the Williams Act’s regulations.

The proposed rules, however, exclude from the ten percent limit shares purchased through any of five specified arrangements. The proposal exempts purchases that include blocks of more than five percent of a company’s outstanding securities where the beneficial ownership of the securities had been reported for at least one year. Because the beneficial owner did not assemble the block in reaction to, or in anticipation of, a tender offer, the transaction does not pose the same risk to shareholders that a market sweep does.

The proposal also excludes from regulation “purchases pursuant to a binding contract between the purchaser and owner of the securities entered into prior to the announcement of a tender offer.” Requiring the seller to own the securities at the time of the contract and requiring the contract terms to be fixed eliminates any risk to shareholders confronting a market sweep.

The third and fourth exceptions encompass situations in which share-

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_id_ at 37,482. Section 14d-11(c) enumerates purchases not subject to section 14d-11 regulation. See id.; infra notes 164-73 and accompanying text.

158. See SEC Release, _supra_ note 24, at 37,478.
159. See id. at 37,476; see also _supra_ notes 85-86 and accompanying text.
160. 17 C.F.R. § 240.14e-1(a) (1987); see _supra_ note 59.
161. See SEC Release, _supra_ note 24, at 37,478.
162. See _supra_ notes 85-86, 119-21 and accompanying text.
163. See SEC Release, _supra_ note 24, at 37,476.
164. _Id._ at 37,478.
165. The SEC believes that unless the purchases are in reaction to a tender offer, shareholders suffer no disadvantage. See _id._
166. _Id._
167. _See id._
168. _See id._
holder approval is necessary before the transaction occurs. The proposed rules exclude purchases by issuers pursuant to securityholder approval, including repurchase plans, reorganizations, and recapitalizations that do not constitute a tender offer. The proposed rules also exclude purchases in connection with a merger or consolidation of the issuer that require prior shareholder approval.

The final exception excludes purchases from an issuer because these purchases do not affect the market or securityholders in the same detrimental manner as market sweeps do.

B. Arguments In Favor of the Proposal

The strong analogy between the harms wrought by market sweeps and those caused by unregulated tender offers prior to enactment of the Williams Act supports the application of section 14(d) of the Act to market sweeps. Proposed Rules 13e-2, 14d-11(a), and 14d-11(b) subject market sweeps to the tender offer provisions of the Williams Act, thereby eliminating the time pressure on, and lack of information faced by, shareholders. Application of section 14(d) of the Williams Act will provide shareholders with adequate time and the information necessary to make a rational decision whether to sell their shares in a market sweep. In addition, the proposed rules prevent unequal treatment of shareholders by requiring the purchase of shares to be prorated and

169. The SEC believes, in these cases, that shareholder protection is provided even in the absence of the proposed rules. See id.
170. See id.
171. See id.
172. See id. The issuer in a takeover battle is the target company.
173. See id.
174. Compare supra notes 104-36 and accompanying text (harms of market sweeps) with supra notes 38-46 and accompanying text (harms of tender offers).
175. See SEC Release, supra note 24, at 37,475.
176. See supra notes 146-63 and accompanying text.
177. Cf. H.R. Rep. No. 1711, supra note 11, at 2813-15 (stating that application of §§ 14(d)(1) and 14(d)(5) through 14(d)(7) to tender offers provide the information needed by shareholders); 17 C.F.R. § 240.14e-1 (1987) (requiring a tender offer remain open for 20 business days); supra notes 51-63 and accompanying text (noting that tender offer provisions reduce time pressure and lack of information faced by shareholders).
179. Cf supra notes 53-63 and accompanying text (§ 14(d) provides shareholders adequate time and sufficient information necessary to make a rational decision whether to tender their shares in a tender offer). In the absence of the proposed rules, Consolidated Gold Fields purchased an additional 23.5% of Newmont’s outstanding stock during Ivanhoe’s tender offer in only two days. Gold Fields Wins Approval to Keep Stake in Newmont, Wall St. J., Nov. 19, 1987, at 43, col. 1. Under the proposed rules, this would not have been possible. The filing requirement would have compelled Consolidated Gold Fields to provide the shareholders with adequate information, which takes time and removes the advantage of surprise, thereby eliminating the possibility of a two-day market sweep.
180. Cf. supra notes 65-69 and accompanying text (§ 14(d) ensures equal treatment of shareholders in a tender offer).
181. The proposed rules subject market sweeps to § 14(d)(6) of the Williams Act,
the price received by each shareholder participating in the market sweep to be the same.\textsuperscript{182}

In addition to eliminating harms similar to those inflicted by unregulated tender offers, the proposed rules provide a solution for problems unique to market sweeps. By placing management in the same position as tender offerors and requiring them to meet section 14(d) requirements,\textsuperscript{183} the proposal would reduce management’s use of market sweeps to entrench itself, an act that reduces shareholder value.\textsuperscript{184} Furthermore, by ensuring that all parties comply with existing tender offer regulations,\textsuperscript{185} the proposal maintains the equal balance intended by the Williams Act among target companies, raiders, and third parties.\textsuperscript{186} By maintaining this equal balance, the proposal encourages auctioning of companies because it prevents the “locking out” of potential bidders through quick, preemptive market sweeps.\textsuperscript{187}

C. Arguments Against the Proposal

One argument favoring nonregulation of market sweeps is based, in part, on the assumption that regulation of market sweeps will tamper with the free market.\textsuperscript{188} This free market argument asserts that open-market transactions involve willing buyers and sellers who should be free from any governmental interference.\textsuperscript{189} This view, however, fails to appreciate that the proposal effectively remedies the harms of market sweeps without overregulating open-market and privately negotiated


\textsuperscript{183} See 15 U.S.C. § 78n(d)(7) (1982). See SEC Release, supra note 24, at 37,474. If the SEC proposal had predated the battle for Newmont, see Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585 (Del. Ch.), aff’d, 535 A.2d 1334 (Del. 1987), investors, small and large alike, would have had the opportunity to participate in the market sweep, receiving the same price as the “large block” holders (most likely arbitrageurs), without being closed out merely because the purchaser could obtain the desired number of shares more quickly and easily from these “large block” holders.

\textsuperscript{184} See supra notes 130-33 and accompanying text (discussing management entrenchment as a harm caused by market sweeps).

\textsuperscript{185} See Blanc, supra note 8, at 29, col. 3.

\textsuperscript{186} See supra notes 73-77 and accompanying text (discussing Congress’ desire, when drafting the Williams Act, not to tip the balance between the tender offeror and the target company).

\textsuperscript{187} See supra notes 125-33 and accompanying text.

\textsuperscript{188} See SEC v. Carter Hawley Hale Stores, 760 F.2d 945, 948 (9th Cir. 1985).

\textsuperscript{189} See Close 10-Day Window, supra note 106, at 2073-76 (statement of Arthur Fleischer of Fried, Frank, Harris, Shriver & Jacobson).
purchases.\textsuperscript{190} Proponents of this argument rigidly insist on applying old law to a new environment. Extension of Williams Act provisions to market sweeps would not interfere with the open market. Congress intended by passing the Williams Act to regulate substantial purchases of stock that pressured shareholders.\textsuperscript{191} In doing so, Congress differentiated between tender offers, which are regulated by 14(d), and open-market and privately negotiated transactions, which are regulated by 13(d).\textsuperscript{192} At the time of enactment, market sweeps rarely were practiced and therefore Congress did not consider this type of transaction when drafting the Act's provisions. Today, however, the availability of large amounts of capital through junk bond financing\textsuperscript{193} makes market sweeps a viable method for acquiring controlling blocks of stock.\textsuperscript{194} The proposed rules, by regulating market sweeps, would be doing, in effect, no more than the Williams Act sought to do. The proposed rules would not interfere with the open-market transactions Congress chose not to regulate, but would regulate only transactions often used as substitutes for tender offers.

Market sweeps obstruct the free market by forcing uninformed investors either to sell at an early stage or to risk lower profits or even loss when a bidder is scared off or prevented from continuing his bid for a company. Thus, by regulating market sweeps, the SEC's proposed rules actually would preserve the free market.\textsuperscript{195} A free market—an environment in which buyers and sellers make consumption decisions based upon perfect information\textsuperscript{196}—cannot exist when participating parties are uninformed.

The proposed rules do not prohibit all open-market purchases; they only regulate those large-block purchases undertaken after a tender offer has been commenced by a party in a takeover battle and after ten percent of the securities of the target company have been acquired.\textsuperscript{197} Furthermore, the rules do not prevent acquisition of stock; they merely guaran-

\textsuperscript{190} The SEC, when writing the proposed rules, guarded against overregulating by setting the 10% threshold, establishing the 10 day "cooling-off" period, and providing 5 exceptions to the rules. See generally SEC Release, supra note 24, at 37,476-78.

\textsuperscript{191} See supra notes 51-72 and accompanying text.


\textsuperscript{193} Junk bonds, see supra note 4, often are issued to raise money needed to finance takeover battles, including market sweeps. See J. Downes & J. Goodman, Dictionary of Finance and Investment Terms 199 (2d ed. 1987).


\textsuperscript{195} See Curbing Market Sweeps, supra note 110, at 1385; see also supra notes 117-33 and accompanying text.


\textsuperscript{197} See SEC Release, supra note 24, at 37,474.
tee that in a hostile takeover context, acquisitions will be made in compliance with the Williams Act. Finally, the proposal only delays block purchases; no significant interference with securities transactions occurs.

A second argument against the SEC proposal challenges the effectiveness of the rules in promoting the interest of the target company's shareholders. SEC Chief Economist Kenneth Lehn claims that a "cooling-off" period of ten days may only delay, not prevent, a market sweep. Mr. Lehn's argument, although true, loses sight of the proposed rules' purpose. That purpose is not to prevent market sweeps, but rather to protect shareholders by providing them with the time and information necessary to react to a large offer to purchase shares of a target company by a party seeking corporate control. Furthermore, the delay, while protecting shareholders, minimizes the resulting interference with the free market.

Mr. Lehn also suggests that market sweeps occur so rarely that a case-by-case analysis of each transaction provides a superior approach. Market sweeps in fact are prevalent and are likely to increase if they remain uncontrolled. A uniform regulation applicable to all market sweeps would lend predictability to the requirements and thereby guide the manner in which large, open-market purchases are made. A case-by-case approach, therefore, would not provide adequate regulation. Preemptive, rather than remedial, regulation is necessary because once a market sweep occurs, the damage is irreparable.

Another argument denying the need for regulation is that market sweeps typically involve professional market arbitrageurs who do not need protection because they are sophisticated, informed investors. This argument fails for two reasons. First, it ignores the harm done to smaller investors left out of market sweeps altogether. Second, shareholders who participate in market sweeps, as well as those who do not,

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198. See id. at 37,473-74.
199. See id. at 37,475.
201. See id. at 1384.
202. See SEC Release, supra note 24, at 37,474; supra notes 51-72 and accompanying text.
203. See SEC Release, supra note 24, at 37,474; supra notes 152-56 and accompanying text.
204. See Curbing Market Sweeps, supra note 110, at 1385.
205. See Close 10-Day Window, supra note 106, at 2075 (citing Martin Lipton of Wachtell, Lipton, Rosen & Katz).
206. See, e.g., Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585, 600, 610 (Del. Ch.) (the court and Newmont agreed that the harms caused by the Consolidated Gold street sweep were irreparable), aff'd, 535 A.2d 1334 (Del. 1987).
207. See Close 10-Day Window, supra note 106, at 2075; see, e.g., Hanson Trust PLC v. SCM Corp., 774 F.2d 47, 57 (2d Cir. 1985).
208. Market sweeps involve purchases from a small number of shareholders. See SEC Release, supra note 24, at 37,474.
need the protections provided by the SEC's proposed rules because the rules provide shareholders with the time and information necessary to make a proper decision whether even to participate in the sweep.\textsuperscript{209} Even arbitrageurs need information and time to apply their skills.\textsuperscript{210} The proposed rules guarantee that both arbitrageurs and smaller investors are provided with the information necessary to make an intelligent decision by requiring the purchaser using a market sweep to meet the disclosure provisions of section 14(d)(1).\textsuperscript{211}

A final argument can be made that the SEC would exceed its rule-making authority by adopting the proposed rules. Such a view rests on two premises. First, as a matter of law, if market sweeps are not tender offers,\textsuperscript{212} as many courts have held,\textsuperscript{213} then the SEC has no authority to regulate such transactions under section 14(d) of the Williams Act. Second, Congress left open-market purchases unregulated because it believed such action to be unnecessarily intrusive into the securities market.\textsuperscript{214} Thus, regulating market sweeps would run directly contrary to Congress' intent.

Although such an objection ultimately is a matter for the courts, many sound reasons support the view that the SEC's rule-making authority should include market sweeps. First, the SEC has authority to "define technical, trade, accounting or other terms used in [the Securities Exchange Act] consistently with the provisions and purposes of this chapter."\textsuperscript{215} In proposing rules to regulate market sweeps, the SEC is in effect using its authority to define the meaning of the term "tender offer,"\textsuperscript{216} purposely left undefined in the Williams Act.\textsuperscript{217} The SEC has taken the position that market sweeps conducted during or soon after a tender offer create "the same pressures on, and unfair treatment of, shareholders that the Williams Act" intended to alleviate and, therefore, should be considered unconventional tender offers.\textsuperscript{218} In the SEC's view, a market sweep and a conventional tender offer differ only in the procedures undertaken to implement each takeover method, but are the same in their purpose and effect.\textsuperscript{219} Therefore, the SEC is proposing rules that would in effect

\textsuperscript{209} See supra note 179.
\textsuperscript{211} See SEC Release, supra note 24, at 37,476; cf. 15 U.S.C. § 78n(d)(1) (1982) (disclosure requirements for tender offers provide the information for all interested stockholders).
\textsuperscript{212} For a discussion of whether market sweeps are tender offers, see generally Jupiter, An Analysis of Efforts to Avoid Williams Act Requirements, 9 Sec. Reg. L.J. 259 (1981); Tyson, The Williams Act After Hanson Trust v. SCM Corporation: Post-Tender Offer Purchases by the Tender Offeror, 61 Tul. L. Rev. 1 (1986); Note, supra note 49.
\textsuperscript{213} See supra sources at note 100.
\textsuperscript{214} See supra notes 188-92 and accompanying text.
\textsuperscript{216} See SEC Release, supra note 24, at 37,481.
\textsuperscript{217} See supra note 94 and accompanying text.
\textsuperscript{218} SEC Release, supra note 24, at 37,475.
\textsuperscript{219} See id.
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categorize market sweeps under tender offer provisions.

Second, the 1934 Act gives the SEC general rule-making authority to adopt "rules and regulations as may be necessary or appropriate to implement the provisions of [the Act]."220 The Supreme Court, in Mourn- ing v. Family Publications Service,221 held that a rule enacted pursuant to a general rule-making authority need only be "reasonably related to the purposes of the enabling legislation" in order to be sustained.222 In proposing the rules regulating market sweeps, the SEC is attempting to advance the goals of the Williams Act, which include providing shareholders with proper information, sufficient time, and equal opportunity to make important investment decisions.223 Not only are the aims of the proposal reasonably related to those of the Williams Act; they are, in fact, identical.224

The third justification for SEC action is found in the Williams Act. In passing the Williams Act, Congress granted the SEC broad powers to regulate disclosure with respect to large-scale accumulations of stock,225 third party tender offers,226 and issuer purchases.227 Congress provided that the SEC may act when it is "necessary or appropriate in the public interest or for the protection of investors."228 The SEC is proposing the market sweep rules because shareholders are being denied the protections afforded by the Williams Act.

Although Congress, in passing the Williams Act, distinguished between tender offers and open-market purchases,229 it is not clear that it intended to leave market sweeps conducted during or immediately after a tender offer, which adversely affect target company shareholders, unregulated.230 The broad argument against the SEC's rule-making authority is weakened to the extent that the SEC is not proposing to regulate all open-market purchases, nor is it promulgating general corporate law

222. Id. at 369 (quoting Thorpe v. Housing Auth. of Durham, 393 U.S. 268, 280-81 (1969)).
223. See supra notes 47-77 and accompanying text.
224. Compare supra notes 47-77 and accompanying text with supra notes 174-87 and accompanying text.

The SEC previously has used this broad authority to modify significantly the reach of the Williams Act. The SEC promulgated Rule 13e-4 that, in effect, applies the Williams Act's requirements to issuer tender offers. Compare 17 C.F.R. § 240.13e-4 (1987) with 15 U.S.C. § 78n(d) (1982). This regulation survives today even though § 14(d)(8)(B) of the Williams Act exempts "any offer for, or request or invitation for tenders of, any security . . . by the issuer of such security." 15 U.S.C. § 78n(d)(8)(B) (1982). The SEC's market sweep proposal is not as bold an amendment to the Williams Act as Rule 13e-4 was.

229. See supra note 192 and accompanying text.
230. See supra notes 101-44 and accompanying text.
governing corporate takeover practices. The focus of the current SEC market sweep proposal is limited to takeover situations involving unconventional tender offer techniques\(^{231}\) and is therefore a legitimate application of the reach and goals of the Williams Act.

**D. Suggested Modifications of the Recent SEC Proposal**

The SEC's proposed rules allow a beneficial owner to sell his shares if they were reported as beneficially owned one year prior to announcement or commencement of a tender offer.\(^{232}\) Under this exception, a third party who beneficially owns a large block of stock may, during a takeover battle, sell his shares to any party involved, potentially giving the purchaser a controlling interest in the target company.\(^{233}\) Such a transaction would upset the balance among all parties involved in a takeover battle, frustrating the intentions of the Williams Act.

Effective market sweep regulation should not allow a beneficial owner to sell his block of stock to the issuer or to any party involved in a takeover battle unless the purchaser meets the tender offer requirements of the Williams Act or a majority of the shareholders approve the transaction. One of the primary dangers created by market sweeps is that smaller shareholders do not have the same opportunity to participate in a market sweep as an arbitrageur or some other larger shareholder has.\(^{234}\) Large blocks of stock are more attractive to a bidder because he can purchase a substantial portion of a target company's stock in relatively few transactions. Thus, the SEC proposal seeks to regulate market sweeps so as to provide equal treatment of shareholders.\(^{235}\) To allow a large beneficial shareholder to sell his block to a third party bidder or to the issuer would hinder accomplishment of the proposal's goals because smaller shareholders will be at a relative disadvantage with respect to the beneficial shareholder during the course of the takeover.

Furthermore, the proposal's exception excluding from regulation purchases from an issuer\(^{236}\) hinders achievement of the proposed rules' goals.\(^{237}\) Under this exception, a purchaser buying a block of securities

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\(^{231}\) See SEC Release, * supra* note 24, at 37,481-82.

\(^{232}\) See * supra* notes 164-65 and accompanying text.

\(^{233}\) For example, in *Ivanhoe Partners v. Newmont Mining Corp.*, 533 A.2d 585 (Del. Ch.), aff'd, 535 A.2d 1334 (Del. 1987), Consolidated Gold, as beneficial owner of shares during the takeover battle, could have sold its shares to Newmont Mining in order to defeat Ivanhoe.

\(^{234}\) See * supra* notes 117-21 and accompanying text.

\(^{235}\) See * supra* notes 180-82 and accompanying text.

\(^{236}\) See SEC Release, * supra* note 24, at 37,481-82; * supra* note 172-73 and accompanying text.

\(^{237}\) See SEC Release, * supra* note 24, at 37,474. Three of the four bills currently pending before the House and the Senate, * supra* note 146, forbid any kind of security issuance through which the purchaser gains an interest greater than 10% in the target company. See S. 1324, 100th Cong., 1st Sess. § 9(a)(3)(B) (1987) (a 10% interest); H.R. 2668, 100th Cong., 1st Sess. § 103(2)(A)-(B) (1987) (a 5% interest as provided in § 101(a)); H.R. 2172, 100th Cong., 1st Sess. § 14(i)(2)(A) (1987) (a 5% interest as pro-
from an issuer escapes the requirements of proposed Rule 14d-11 even though a tender offer has been announced publicly or commenced.\textsuperscript{238} An issuer may take advantage of this exception by selling or issuing a large block of common stock or some form of convertible or exchangeable security to a white knight in order to give the white knight a controlling interest in the target company.\textsuperscript{239} This option permits an issuer working with a white knight to defeat a hostile raider.\textsuperscript{240} Although this transaction is not a conventional tender offer, the SEC should restrict it because it has the same adverse impact on shareholders that market sweeps have.

This type of transaction frustrates the purpose of the proposed rules, tipping the balance between the parties in the takeover battle and failing to notify shareholders of the issuer's plan of action. This exception to proposed Rule 14d-11 must be eliminated if the rules are to alleviate the harms generated by market sweeps. Indeed, language specifically including "any purchase, offer to purchase, arrangement or understanding to purchase or solicitation of any offer to sell that relates to a purchase or potential purchase from an issuer" should be added to proposed Rule 14d-11. This additional language would prevent an issuer, after a tender offer is publicly announced or commenced, from performing a defensive sale or issuance of common stock or convertible or exchangeable securities to a white knight in order to defeat a hostile raider. This provision also would further the goals of the proposed rules, providing fair and equal treatment to shareholders and maintaining the balance between competing parties in a takeover battle, without unduly interfering with the free market.

**Conclusion**

Today's volatile environment of mergers and acquisitions has spurred the increasing use of market sweeps to gain control of corporations. Market sweeps create harms analogous to the harms generated by unregulated tender offers prevalent in the 1960's, prior to enactment of the

\textsuperscript{238} See SEC Release, supra note 24, at 37,478, 37,482.

\textsuperscript{239} See SEC v. Carter Hawley Hale Stores, 760 F.2d 945, 946 (9th Cir. 1985) (Carter Hawley Hale sold 1 million shares of convertible preferred stock, composing 22% of the total voting power, to General Cinema for $300 million); Gearhart Indus. v. Smith Int'l, Inc., 741 F.2d 707, 724 (5th Cir. 1984) (upholding authorization of subordinated debentures and accompanying warrants to purchase Gearhart shares designed to be exercisable by the debenture holders at a lower price in the event a change of control occurred); Gelco Corp. v. Coniston Partners, 652 F. Supp. 829, 850 (D. Minn. 1986) (upholding Gelco's defensive sale of a block of 3 million preferred shares to Merrill Lynch).

Williams Act. Because the SEC's proposed Rules 13e-2, 14d-11(a), and 14d-11(b) eliminate the harms caused by market sweeps in the same manner that the Williams Act eliminates the harms caused by unregulated tender offers, they should be adopted with some minor alterations. Failure to adopt these proposals will further encourage the use of market sweeps to bypass the requirements of the Williams Act. The proposed rules provide the regulation necessary to create a fair and open marketplace in which the shareholders of corporate America may invest their time and money.

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