CASE COMMENTS

TENDER OFFER MANIPULATION UNDER SECTION 14(e) OF THE SECURITIES EXCHANGE ACT—BEYOND *SCHREIBER*

Schreiber v. Burlington Northern, Inc.,
105 S. Ct. 2458 (1985)

In *Schreiber v. Burlington Northern, Inc.*[1] the United States Supreme Court further restricted the scope of the federal securities laws by holding that "manipulative" acts under section 14(e) of the Williams Act[2] require misrepresentation or nondisclosure.[3]

In December 1982, Burlington Northern, Inc. (Burlington) undertook a hostile tender offer for El Paso Gas Co. (El Paso) to which a majority[4] of the El Paso shareholders, including the plaintiff Barbara Schreiber, subscribed. Burlington rescinded the initial tender offer, however, after negotiating a friendly takeover agreement with El Paso management.[5] Under the new agreement Burlington agreed to make a second tender offer.[6] The second tender offer was oversubscribed, requiring Burlington to purchase shares from individual shareholders on a pro rata basis.[7] The rescission of the first tender offer therefore caused an economic loss to those shareholders who, like Schreiber, tendered during the first offer.[8]

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1. 105 S. Ct. 2458 (1985).

2. 15 U.S.C. § 78n(e) (1982). Section 14(e) provides:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. . . .

Id.

3. 105 S. Ct. at 2465.

4. *Id.* at 2460.

5. *Id.*

6. *Id.* Burlington also agreed to provide safeguards against a squeeze-out merger of minority shareholders, to recognize "golden parachute" contracts between El Paso and four of its officers, and to purchase over four million shares from El Paso. *Id.*

7. *Id.* Section 14(d)(6) of the Securities Exchange Act, 15 U.S.C. § 78n(d)(6) (1982), requires bidders to purchase tendered shares on a pro rata basis if shareholders offer to sell more shares than the bidder desires to purchase.

8. 105 S. Ct. at 2460-61. Burlington offered to purchase 21 million shares at $24 a share. *Id.* El Paso's shareholders, however, tendered more than 40 million shares. Each shareholder therefore was able to sell only about one-half of the shares he tendered. *Id.* Schreiber claims she lost $24 for each share returned to her because of the proration. *Id.*

Schreiber sued Burlington, El Paso, and El Paso's directors, alleging that the withdrawal of the first tender offer constituted a manipulative act or practice in violation of section 14(e) of the Williams Act.[9] The United States Court of Appeals for the Third Circuit affirmed the district court's dismissal of the complaint.[10] On appeal, the Supreme Court affirmed and *held*: "manipulative" acts under section 14(e) of the Williams Act require misrepresentation or nondisclosure and do not include acts that, although fully disclosed, "artificially" affect the price of the takeover target's stock.[11]

In response to the growing popularity of tender offers as a corporate acquisition technique, Congress enacted the Williams Act in 1968.[12] Congress was particularly concerned with the pressure created by tender offers on shareholders to react quickly, often without adequate information.[13] The primary goal of the Williams Act is to assure full and fair disclosure in connection with tender offers.[14]

In addition to extensive disclosure provisions[15] and limited substantive

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9. *Id.* at 2461.

10. Schreiber v. Burlington N., Inc., 731 F.2d 163 (3rd Cir. 1984), *aff'd*, 105 S. Ct. 2458 (1985).

11. 105 S. Ct. 2458, 2465 (1985).

12. Act of July 29, 1968, Pub. L. No. 90-439, *reprinted in* 1968 U.S. CODE. CONG. & AD. NEWS (82 Stat.) 521.

13. *See* 111 CONG. REC. 28,258 (1965) (statement of Sen. Williams).

14. *See* H.R. REP. NO. 1711, 90th Cong., 2d Sess. 11, *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2811, 2812 [hereinafter "HOUSE REPORT"]; *see also* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 31 (1977).

The Williams Act does not define "tender offer." The SEC has set forth eight factors to help determine whether an acquisition is a tender offer: (1) active and widespread solicitation of public shareholders; (2) solicitation for a substantial percentage of the stock; (3) offer to purchase at a premium; (4) terms of offer are firm; (5) offer is contingent on the tender of a fixed percentage of shares; (6) offer is limited in duration; (7) shareholders are subject to pressure to sell; and (8) public announcements of a purchasing program precede or accompany rapid accumulation of stock. *See* Branson Ltd. v. Edper Equities, Ltd., 477 F. Supp. 773, 791 (S.D.N.Y. 1979).

15. The Williams Act requires disclosure in two types of transactions: substantial stock acquisitions and tender offers. First, a person acquiring 5% or more of a class of any equity security registered under § 12 of the Securities Exchange Act must disclose certain information to the issuer and the SEC pursuant to § 13(d) of the Williams Act. 15 U.S.C. § 78m(d) (1982); *see also* 17 C.F.R. § 240.13d-1(a) (1985). Schedule 13D requires the disclosure statement to contain the identity and background of the person filing the statement, the person's current holdings in the issuer, the source and amount of funds used for the acquisition, and most importantly, the person's purpose underlying the substantial stock acquisition. Second, a person making a tender offer for a class of any registered equity security must file a similar disclosure statement with the SEC prior to purchasing the shares, pursuant to § 14(d) of the Williams Act. 15 U.S.C. § 78n(d) (1982); *see also* 17 C.F.R. § 240.14d-3 (1985).

safeguards,[16] Congress armed the Williams Act with section 14(e), an antifraud provision patterned after section 10(b) of the Securities Exchange Act and rule 10b-5.[17] Section 14(e) makes it unlawful to make a material misrepresentation or to engage in "manipulative acts" in connection with a tender offer.[18] Section 14(e), however, fails to define "manipulative acts," leaving that task to the courts.[19]

Judicial interpretations of section 10(b) have significantly contributed to the analysis of "manipulative acts" under section 14(e). In *Ernst & Ernst v. Hochfelder*,[20] for example, the Supreme Court considered whether an alleged negligent failure of an accounting firm to discover irregular practices during an audit of an investment firm was actionable under rule 10b-5.[21] Relying on the language of section 10(b), the Court held that rule 10b-5 requires "scienter"—an intent to deceive, manipulate, or defraud—or, at least, something more than negligence.[22] In particular, the Court maintained that manipulation connotes willful conduct

16. The Williams Act provides a period during which shareholders may rescind shares tendered. 15 U.S.C. § 78n(d)(5) (1982). The Act also requires bidders to purchase stock on a pro rata basis. 15 U.S.C. § 78n(d)(6) (1982). Finally, the Act compels bidders to apply retroactively variations of the original terms of the offer. 15 U.S.C. § 78n(d)(7) (1982). Because Congress included substantive provisions, some commentators conclude that disclosure constitutes only one means to protect target shareholders during a tender offer. *See, e.g.*, Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228, 240-41 (1984).

17. The similarities among the language of § 14(e), § 10(b) and rule 10b-5 have led some courts and commentators to conclude that Congress merely intended to apply § 10(b) to the tender offer context. *See, e.g.*, Applied Digital Data Sys., Inc. v. Milgo Elec. Corp., 425 F. Supp. 1145, 1157 (S.D.N.Y. 1977); Profusek, *Tender Offer Manipulation: Tactics and Strategies After* Marathon, 36 SW. L.J. 975, 993 (1982). The House Report states that § 14(e) "affirms" the duty of tender offer parties to fully disclose material information. *See* HOUSE REPORT, *supra* note 14, at 2821.

One commentator urges nevertheless that § 14(e) encompasses a broader range of conduct than § 10(b) because Congress added "fraudulent" conduct to § 14(e), a form of conduct not specificially mentioned in § 10(b). *See* Junewicz, *The Appropriate Limits of Section 14(e) of the Securities Exchange Act*, 62 TEX. L. REV. 1171, 1174-75 (1984).

18. 15 U.S.C. § 78n(e) (1982) (reprinted at *supra* note 2).

19. Congress amended § 14(e) in 1970 to empower the SEC to "define, and prescribe means reasonably designed to prevent" fraudulent, deceptive, or manipulative acts or practices. Act of Dec. 22, 1970, Pub. L. No. 91-567 § 5, 84 Stat. 1497-98. The SEC has not yet attempted to define these terms.

20. 425 U.S. 185 (1976).

21. *Id.* at 188-90.

22. *Id.* at 193. The Court maintained that the terms "deceptive," "contrivance," and "manipulative" indicate an unmistakable intent to proscribe conduct more culpable than negligence. *Id.* at 197-99. Moreover, the Court held that § 10(b) limits the scope of rule 10b-5; therefore, rule 10b-5 must include an element of scienter. *Id.* at 200-01.

designed to deceive investors by artificially affecting securities prices.[23]

In *Santa Fe Industries, Inc. v. Green*,[24] the Supreme Court once again relied on the language of section 10(b), particularly the term "manipulative," to deny a cause of action under rule 10b-5 to minority shareholders dissatisfied with a short-form merger.[25] In part IV of the *Sante Fe* decision, a majority of the Court also pointed to the purpose of full disclosure and principles of federalism to define the scope of section 10(b) and rule 10b-5. According to the Court, the "fundamental purpose" of the Exchange Act was to implement a "philosophy of full disclosure."[26] Rule 10b-5 therefore protects investors by ensuring full disclosure. The Exchange Act does not attempt to regulate the substantive fairness of a transaction. Rather, state fiduciary law provides a remedy to shareholders for unfair treatment caused by corporate mismanagement.[27] The Court considered the substantive regulation of fundamental corporate reorganizations, such as a short-form merger or a tender offer, to be outside the sphere of federal law.[28]

Several courts specifically addressed the scope of manipulative acts under section 14(e) of the Williams Act. The result was a sharp split of authority among the circuits.

In *Mobil Corp. v. Marathon Oil Co.*,[29] the United States Court of Ap-

23. The Court based its decision on the language of § 10(b), considering the term "manipulative" particularly significant. *Id.* at 199.

24. 430 U.S. 462 (1977).

25. *Id.* at 465-68. Plaintiffs claimed that because Santa Fe allegedly acted with the sole purpose of eliminating minority shareholders and without prior notice to those shareholders, the merger lacked a justifiable business purpose and thus violated rule 10b-5. *Id.* at 468.

The Court stated that manipulation "refers generally to practices, such as wash sales, matched orders, or rigged prices, . . . intended to mislead investors by artificially affecting market activity." *Id.* at 476. The Court maintained that this technical definition comports with the purpose of the Exchange Act, *i.e.* replacing the philosophy of *caveat emptor* with that of full disclosure. *Id.* at 476-77. Moreover, the Court opined that a manipulative scheme usually requires nondisclosure. *Id.*

26. *Id.* at 477-78.

27. *Id.* at 478-79. The Court feared that finding a rule 10b-5 action for breach of fiduciary duty "would overlap and quite possibly interfere with state corporate law." *Id.* at 479. Absent a clear indication of congressional intent, the Court refused to federalize substantive corporate law. *Id.*

28. *Id.* at 478.

29. 669 F.2d 366, 374 (6th Cir. 1981), *cert. denied*, 455 U.S. 982 (1982). The *Marathon Oil* court was perhaps the first circuit court of appeals to address manipulation under § 14(e). Several district courts previously found that a target's defensive measures violated § 14(e) if the target's actions lacked a justifiable business purpose. *See, e.g.*, Whittaker Corp. v. Edgar, 535 F. Supp. 933 (N.D. Ill. 1982); Applied Digital Data Sys., Inc. v. Milgo Elec. Corp., 425 F. Supp. 1145 (S.D.N.Y. 1977); Royal Indus., Inc. v. Monogram Indus., Inc., [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) 95,863 (C.D. Cal. Nov. 29, 1976).

peals for the Sixth Circuit broadly defined manipulative conduct as any conduct that artificially affects securities prices.[30] The court argued that a "lock-up" agreement[31] employed as a defensive takeover tactic created an artificial price barrier on tender offer prices.[32] The court also asserted that lock-up arrangements contravene the purposes underlying section 14(e) by preventing bidders from competing equally with target management.[33] Accordingly, the court concluded that the lock-up agreement constituted a "manipulative act" within the meaning of section 14(e).[34] *Marathon Oil* made section 14(e) a formidable weapon in the hands of shareholders against corporate management who employed defensive tactics to defeat a potentially favorable tender offer.

Most courts considering the type of conduct within the prohibition of section 14(e) criticized *Marathon Oil* as an unwarranted expansion of the scope of section 14(e).[35] In *Buffalo Forge Co. v. Ogden Corp.*,[36] the United States Court of Appeals for the Second Circuit argued that Congress was primarily concerned with the procedural aspects of tender offers. *Marathon Oil*, the court reasoned, went well beyond the policy of full disclosure.[37] "Manipulative acts" under section 14(e) therefore encompass only certain disclosure violations such as misrepresentation or

30. 669 F.2d at 374. The court urged a flexible interpretation of "manipulative" because Congress intended to reach "the full range of ingenious devices used to manipulate securities prices." *Id.* (quoting *Santa Fe*, 430 U.S. at 477).

31. A "lock-up" agreement constitutes an arrangement between the target corporation and a bidder that gives the bidder an advantage over other potential bidders. *See* A. FLEISCHER, TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING 323 (1983). In this case, Marathon Oil arranged a competing tender offer by U.S. Steel. As part of the agreement, U.S. Steel acquired an option, exercisable only if its tender offer failed, to purchase Marathon Oil's interest in a highly lucrative oil field, plus a stock option. 669 F.2d at 367-68. Any successful bidder other than U.S. Steel would therefore receive a company of significantly less value because U.S. Steel would exercise its option to buy the field. Moreover, exercise of the stock option would increase the number of outstanding Marathon Oil shares, and increase the price that a successful tender offeror would have to pay to gain full control. Thus, the option to U.S. Steel effectively precluded competing offers.

32. 669 F.2d at 375. The court concluded that lock-up options "not only artificially affect, but for all practical purposes completely block, normal market activity and in fact could be construed as expressly designed for that purpose." *Id.* at 374.

33. *Id.* at 376. *Cf.* Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 58 (1975) (by requiring bidders to disclose to target management, Congress "intended to do no more than give target management an opportunity to express and explain its position.").

34. 669 F.2d at 377.

35. *See, e.g.*, Feldbaum v. Avon Prods., Inc., 741 F.2d 234 (8th Cir. 1984); Data Probe Acquisition Corp. v. Datatab, Inc., 722 F.2d 1 (2nd Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984); Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757 (2nd Cir.), *cert. denied*, 464 U.S. 1018 (1983).

36. 717 F.2d 757, 760 (2nd Cir.), *cert. denied*, 464 U.S. 1018 (1983).

37. *Id.* at 760.

nondisclosure.[38]

In *Schreiber v. Burlington Northern, Inc.*,[39] the Supreme Court considered the meaning of "manipulative acts or practices" in section 14(e) of the Williams Act. The Court firmly rejected *Marathon Oil*, holding that "manipulative" as used in section 14(e) requires misrepresentation or nondisclosure.[40] As in *Santa Fe* and *Ernst & Ernst*, the Court relied primarily on the statutory language, particularly the term "manipulative" in section 14(e).[41] The Court refused to attach a different meaning to "manipulative" in section 14(e) than it had previously attached to the same term in section 10(b).[42] Therefore, section 14(e) does not regulate the substantive fairness of tender offers.

The Court buttressed its holding by referring to the purpose and legislative history of section 14(e).[43] The Court could not find in the legislative history the "slightest suggestion that [section] 14(e) serves any purpose other than disclosure."[44] Section 14(e) therefore merely supple-

38. *Id.*

39. 105 S. Ct. 2458 (1985) (Burger, C.J.) (7-0). Justices Powell and O'Connor took no part in the consideration of the case.

40. *Id.* at 2465.

41. *Id.* at 2461-62. Schreiber argued that "fraudulent, deceptive or manipulative acts or practices" should encompass even fully disclosed acts that artificially affect the target's stock price. *Id.* at 2461. The Sixth Circuit in *Mobil* gave "manipulative" precisely the same interpretation. *See supra* notes 29-34 and accompanying text. The Court criticized that interpretation as conflicting with the normal meaning of "manipulative." 105 S. Ct. at 2461-62. Moreover, the Court criticized Schreiber's interpretation inasmuch as it relied on a congressional purpose broader than full and accurate disclosure. *Id.* at 2461.

42. Schreiber asserted that because § 14(e) prohibits "fraudulent, deceptive *or* manipulative" conduct, manipulative conduct need not involve fraud or deception. *Id.* The Court responded that § 10(b) similarly used the disjunctive. *Id.*

The Court found no suggestion that use of "manipulative" by Congress represented a departure from § 14(e)'s and the Exchange Act's "facial and primary concern with disclosure." *Id.* at 2462-63. Moreover, the Court noted that Congress grouped together the terms "fraudulent," "deceptive," and "manipulative" and directed each to nondisclosure. *Id.* Therefore, the Court should give a related rather than a different meaning to each word. The Court claimed to apply "a familiar principle of statutory interpretation that words grouped in a list should be given related meaning." *Id.*

43. *Id.* at 2463-65.

44. *Id.* at 2464. The Court found no evidence that § 14(e) "serves any purpose other than disclosure or that the term 'manipulative' should be read as an invitation to the courts to oversee the substantive fairness of tender offers; the quality of any offer is a matter for the marketplace." *Id.*

The Court reasoned that permitting judges to read into "manipulative" their own sense of what constitutes "unfair" or "artificial" conduct would create uncertainty until after the tender offer closed. The Court thought that such uncertainty would undercut Congress' intent to provide investors with full information. *Id.* at 2465. Moreover, the Court noted that Congress intended that the bidder and target corporations address target shareholders directly. *Id.* The Court thus found that judicial oversight of the fairness of tender offers contradicts Congress' emphasis on shareholder

ments the disclosure provisions throughout the Williams Act.[45]

Finally, the Court affirmed the district court's finding that Burlington's conduct was not manipulative.[46] The Court emphasized that all activity that might have affected the price of El Paso's shares was done openly and with full disclosure.[47]

The Supreme Court's interpretation of "manipulative" represents a reasoned limitation on the application of section 14(e). A broader interpretation of "manipulative," allowing federal courts to determine substantive fairness or to develop federal fiduciary duties would conflict with state fiduciary law. Case-by-case development of federal fiduciary law would create substantial uncertainty in the acquisition market, stifling legitimate offensive and defensive tactics.

The Supreme Court in *Schreiber* provided some certainty with respect to the proper scope of section 14(e) by precisely defining the meaning of "manipulative." The Court avoided the federalism issue, however, that was discussed in part IV of *Sante Fe*. As a result, the Court leaves unresolved the proper roles of federal and state law in the regulation of tender offers.

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choice. *Id.* Therefore, the Court refused to read a single word so expansively in an otherwise disclosure-oriented statute. *Id.*

45. *Id.* at 2646.

46. *Id.* at 2465.

47. *Id.*