Federal Regulation of Tender Offers: Does It Depend Upon Nondisclosure?

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ISSUE
The issue in Schreiber v. Burlington Northern is whether conduct which is not deceptive may nevertheless violate the Williams Act—the federal law regulating tender offers which is part of the Securities Exchange Act of 1934. Section 14(e) of the Exchange Act prohibits any "fraudulent, deceptive or manipulative acts or practices, in connection with any tender offer." In this case, the meaning of "fraudulent, deceptive or manipulative" is disputed. The Supreme Court is being asked to decide whether deception or misrepresentation (i.e., the lack of full disclosure) is a necessary element of any act that comes within the section 14(e) prohibition, or, on the other hand, whether an act may be fraudulent, deceptive or manipulative in the context of a tender offer even though there has been full disclosure to all of the interested parties.

FACTS
Burlington Northern, Inc. is a transportation and natural resources company. On December 21, 1982, it made a tender offer for 25.1 million shares of common stock of El Paso Company, an energy company, at an offering price of $24 per share. By this offer, Burlington Northern hoped to acquire control of El Paso.

El Paso's management initially opposed Burlington Northern's tender offer on the grounds that $24 per share was an inadequate price for El Paso. In fact, El Paso's management took several steps to try to defeat the tender offer—including advising its shareholders not to tender their shares and filing a lawsuit to enjoin the offer. In spite of these efforts, by December 30, 1982, 25.1 million shares of El Paso common stock had been tendered to Burlington Northern.

At that point, the management of El Paso relented and initiated negotiations with Burlington Northern.

These negotiations resulted in an agreement for Burlington Northern to acquire El Paso on slightly different terms than the December 21 tender offer. Burlington Northern withdrew the December 21 tender offer and released the tendered shares. The offer had not run to the established expiration date (January 19, 1983) and, as a result, Burlington Northern had not then purchased the tendered shares. The December 21 offer stated that it could be withdrawn should certain conditions occur. At least some of these conditions had taken place, and Burlington Northern justified withdrawing the December 21 offer on the basis of these events. After withdrawal of the initial tender offer, Burlington Northern announced its intention to immediately make a new tender offer for 21 million shares of El Paso common stock, at the same price of $24 per share. The revised tender offer was for 4.1 million fewer shares than the initial offer since El Paso had agreed to sell some stock directly to Burlington Northern and also granted Burlington Northern an option for additional shares. The price of the stock to be acquired from El Paso and the option price were also $24 per share. This arrangement was beneficial to Burlington Northern when compared to the original offer, since the money paid to El Paso for the stock would ultimately accrue to the benefit of Burlington Northern when the acquisition was completed. The revised tender offer also benefited the management of El Paso because they could tender their El Paso shares, which they had not tendered in the initial offer.

The revised tender offer was oversubscribed, so Burlington Northern purchased a pro rata portion of the shares tendered by each shareholder including that of El Paso management. The revised offer was successful and Burlington Northern acquired control of El Paso. Subsequently, Burlington Northern acquired all of the remaining outstanding shares of El Paso for the tender offer price of $24 per share.

Barbara Schreiber was a shareholder in El Paso when Burlington Northern made its tender offers. She brought suit on behalf of herself and all other similarly situated El Paso shareholders who had tendered in the initial tender offer, claiming, among other things, that the withdrawal of the December 21 offer by Burlington Northern was a violation of section 14(e), as a manipulative act or practice in connection with a tender offer. Schreiber claimed that she was injured by the withdrawal of the December 21 offer and the making of the revised offer because she could not sell as many shares as she had tendered in the initial offer.

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in the revised offer as she could have sold in the original tender offer. Her claim is based on two differences between the first and second tender offers: the lower number of shares sought by Burlington Northern in the revised offer and the fact that the revised offer was oversubscribed. In the initial tender offer, more of Schreiber's shares would have been purchased because Burlington Northern sought to acquire a greater total number of shares and management of El Paso was not among the group of initially tendering shareholders, so fewer shares were tendered.

The District Court for the District of Delaware rejected Schreiber's claim. It ruled that a "manipulative" act requires an act or practice that artificially affects the market price in a misleading manner. The court found that withdrawing the initial tender offer did not affect the market price of El Paso stock in any manner that was not fully disclosed to the shareholders. Because there had been full disclosure, the court found that there had been no violation of the Williams Act.

The Third Circuit Court of Appeals affirmed (731 F.2d 163 (1984)), agreeing with the district court that some element of deception is necessary to make out a claim that the withdrawal of the tender offer by Burlington Northern constituted a manipulative act or practice.

The United States Supreme Court granted Schreiber's petition for a writ of certiorari.

BACKGROUND AND SIGNIFICANCE

The issue involved here has caused a split in the circuits, and that is undoubtedly one reason why the Supreme Court agreed to hear this case. The Sixth Circuit has held that deception is not always required in a case alleging manipulation in connection with a tender offer under section 14(e); the other circuits that have considered the issue have denied recovery absent a showing of deception.

The real significance of this case, however, is much broader than a conflict between the circuits. In the late 1970s, the Supreme Court considered substantially the same issue in the context of section 10(b) and Rule 10b-5, the general antifraud provisions of the federal securities laws. In Santa Fe Industries v. Green (430 U.S. 462 (1977)), the Court considered whether a breach of fiduciary duty that induced a sale of securities was actionable where the breach of duty had been fully disclosed to the sellers, and held that deception was a necessary element in a 10b-5 claim. The Court interpreted the word "manipulation," as used in 10b-5, to require misrepresentation or deceit. The Santa Fe decision was consistent with the Court's unarticulated goal of limiting the availability of a federal forum under the federal securities laws and relegating complaints of substantive fairness in securities transactions to state law.

It would be consistent with the Santa Fe decision and the trend of restricting the scope of the federal securities laws for the Court to uphold the Third Circuit's decision in this case. Although there is some difference in the language of sections 10(b) and 14(e) to support a distinction in the interpretation and scope of the two statutes, the difference is irrelevant to Schreiber's claim. Section 14(e) prohibits "fraudulent" acts or practices in addition to the manipulative or deceptive acts or practices prohibited by section 10(b). This language distinction is not of much help to Schreiber, who relies upon the term "manipulation" to fit her claim within the ambit of section 14(e). "Manipulation" is the same term that the Court interpreted in Santa Fe and other cases as requiring an element of deception. If the Court reversed the Third Circuit, it would have to distinguish tender offers from all other cases of securities transactions to justify a definition of "manipulation" in section 14(e) that is different from the definition under section 10(b). Moreover, a body of federal law regarding the substantive fairness of tender offers would need to be developed to regulate the conduct that would then violate section 14(e).

Whatever decision the Supreme Court renders in this case will be significant because of the ever-increasing use of tender offers as a method of acquiring control of corporations. Tender offers have been characterized by the use of creative and somewhat questionable practices by all interested parties—the tender offeror, the target company's management, and, many times, a third party intervenor. These tactics must be capable of being challenged in some forum, and the Court's decision in Schreiber will determine whether the federal courts will hear many of these complaints. If the Court decides that, absent nondisclosure, such practices as engaged in by Burlington Northern must be challenged in state court, then either Congress will act to require the federal courts to provide a forum for such controversies by broadening the statutory framework for the regulation of tender offers or the matter will be left to the states to resolve.

ARGUMENTS

For Schreiber (Counsel of Record, Irving Bizar, 1370 Avenue of the Americas, New York, NY 10019; telephone (212) 489-5222)

1. Section 14(e) of the Securities Exchange Act of 1934 prohibits manipulative or fraudulent acts without a showing of disclosure—and the withdrawal of the initial tender offer by Burlington Northern constituted a manipulative act.

For Burlington Northern (Counsel of Record, Marc P. Cherno, One New York Plaza, New York, NY 10004; telephone (212) 820-8000)

1. Section 14(e) is not violated absent a showing of nondisclosure, and Burlington Northern fully disclosed its withdrawal of the initial tender offer and the terms of its revised offer.