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Securities Regulation: Section 13(d) From Blot to GAF

The Williams Act was passed by Congress in 1968 in order to regulate corporate take-over attempts, principally those in the form of tender offers. Since the enactment of this amendment to the Securities Exchange Act of 1934, however, section 13(d) of the Act, which drew little attention as a companion to the much publicized section 14(d), has proved vexatious in application and has resulted in clear conflicts in interpretation between several federal district courts and at least two courts of appeals. This note will examine the statute as interpreted by the two principal cases decided under it and discuss the weight which should be given those decisions in future applications of the law.

Section 13(d) of the Act provides that upon acquisition of more

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4 Id. § 78m(d).
5 The corporate tender offer is directly regulated by § 14(d). Id. § 78n(d).
6 These conflicts will be discussed infra in the context of the cases in which they arose.

(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 78f 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 closed-end investment company registered under the Investment Company Act of 1940, 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—

... . . .

(3) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection.

... . . .
than five percent\(^8\) of a class of the securities of a corporation the person or group acquiring such securities must file a Schedule 13D with the Securities Exchange commission. This statement discloses the number of shares the person owns or controls; the sources of funds for any purchases; any prospective additional purchases intended; the background and identity of all persons on whose behalf the purchases were effected; any arrangements with others concerning loans, options, and proxies; whether control of the issuer is sought; and any major plans such person has for the issuer if control is obtained.\(^9\)

In the first case to consider whether the requirement for filing had been "triggered,"\(^{10}\) Bath Industries, Inc. v. Blot,\(^{11}\) the plaintiff corporation sought a preliminary injunction to prevent Blot and his associates from voting stock they had allegedly acquired without making the disclosure required by section 13(d). The defendants, who owned more than ten percent of Bath's outstanding shares of common stock, "undertook

\(^5\) The Commission, by rule or regulation or by order, may permit any person to file in lieu of the statement required by paragraph (1) of this subsection or the rules and regulations thereunder, a notice stating the name of such person, the number of shares of any equity securities subject to paragraph (1) which are owned by him, the date of their acquisition and such other information as the Commission may specify, if it appears to the Commission that such securities were acquired by such person in the ordinary course of his business and were not acquired for the purpose of and do not have the effect of changing or influencing the control of the issuer nor in connection with or as a participant in any transaction having such purpose or effect.

\(^6\) The provisions of this subsection shall not apply to—

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

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

\(^8\) Pub. L. No. 91-567, § 1, 84 Stat. 1497 (1970), amending Securities Exchange Act § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1970), reduced the level of equity ownership triggering the disclosure requirement from 10% to 5%. At all relevant times for the cases discussed in this Note the level was 10%. This change does not affect the principles involved.


\(^10\) Susquehanna Corp. v. Pan Am. Sulfur Co., 423 F.2d 1075 (5th Cir. 1970), considered the sufficiency of a § 13(d) filing, but the question of whether a filing was required was not at issue.

a deliberate, conscious plan to pool their voting interests in Bath stock and to acquire additional shares of Bath stock, and to obtain the support and votes of other large stockholders . . . to the end that they could force the resignation of [the president of Bath] . . . .” Pursuant to this “plan,” several of the defendants increased their holdings substantially and began preparing for a proxy contest.

In granting Bath’s request for an injunction, the district court found that the defendants did constitute a “group” as defined by section 13(d)(3) and therefore were required to file a 13D disclosure. The court of appeals, in affirming, rejected Bath’s contention that the Blot group would have to comply with the Act within ten days of the time they agreed to act in concert whether or not any members of the group had purchased additional stock in furtherance of their plan. The court found, rather, that “the Act should be interpreted to require compliance with its disclosure provisions when, but only when, any group of stockholders owning more than 10% of the outstanding shares of the corporation agree to act in concert to acquire additional shares.” The court further stated that the Act “does [not] proscribe legitimate cooperation among existing shareholders to assert their determination to take over control of management, absent an intention to acquire additional shares for the furtherance of such purpose.”

The Bath court’s interpretation of section 13(d) went unchallenged until recently, when the Court of Appeals for the Second Circuit in GAF Corp. v. Milstein rejected the Bath holding insofar as it would require that the disclosure mechanism be set in motion only by additional acquisitions of stock after a section 13(d)(3) group was formed. In GAF the GAF Corporation alleged that the Milstein family, which had acquired collectively more than ten percent of the preferred shares of GAF, “formed a conspiracy among themselves and other persons to act as a syndicate or group for the purpose of acquiring, holding, or

1305 F. Supp. at 531.
12Id. at 537.
13427 F.2d at 108-09.
14Id. at 109 (emphasis by the court).
15Id. at 110.
17The Milsteins, a father and his three children, obtained 10.25% of the outstanding preferred shares of GAF Corporation when the Rubberoid Company, in which they held 8% of the common stock, was merged with GAF. Since the merger, the Milsteins had acquired no additional preferred shares of GAF. They had purchased 1.6% of GAF common stock. 324 F. Supp. at 1064.
disposing of securities of GAF with the ultimate aim of seizing control of GAF for their own personal and private purposes." \(^{10}\)

The lower court determined that the issue was whether organizing a ten percent group with a view to seeking control of the corporation was, without more, a reportable event under 13(d). \(^{20}\) That court rejected GAF's contention that when a group is formed there is a constructive conveyance of the stock from the individual members to the group and thus an "acquisition" by the group. Instead, in granting the Milsteins' motion for dismissal, the court said that "the specific statutory language is clear and compels the construction that the reportable event is the acquisition . . . and not the mere formation of a group with a view to control." \(^{21}\)

On appeal, the Court of Appeals for the Second Circuit reversed in part and found that the Milsteins were a "group" and thus a "person" as defined by section 13(d)(3). The controlling question was whether the group had acquired the stock owned by its members. \(^{22}\) The court answered that question affirmatively, saying that "manifestly, according to the complaint, the group when formed acquired a beneficial interest in the individual holdings of its members." \(^{23}\) Thus the Milsteins, employing that "legitimate cooperation among existing shareholders" to which the Bath court had referred with approval, \(^{24}\) were found to have subjected themselves to the disclosure requirement of section 13(d).

There is clearly a conflict as to when the formation of a group triggers the filing requirement. The Seventh Circuit would require not only that the group be formed for the stated purposes, but also that the group then agree to acquire additional shares. In GAF, the Second Circuit found that the formation of the group in itself constituted the qualifying acquisition. In light of these decisions a court must answer several question in interpreting section 13(d). It must decide when a "group" is formed, and after its formation, when it becomes a "person." The statute provides that "[w]hen . . . persons act as a . . . group for the purpose of acquiring, holding, or disposing of securities . . . such . . . group shall be deemed a 'person' for the purposes of this subsec-

\(^{10}\) 453 F.2d at 713.
\(^{20}\) 324 F. Supp. at 1064.
\(^{21}\) Id. at 1067.
\(^{22}\) 453 F.2d at 715.
\(^{23}\) Id. at 716.
\(^{24}\) 427 F.2d at 110.
tion."\(^2\) As the court in *GAF* points out, an interpretation requiring that the group agree to acquire additional shares ignores the words "holding" and "disposing."\(^2\) The *Bath* court had been persuaded by the repeated reference in the legislative history of the Act to "purchase" and "acquisition"\(^2\) that the Act was intended to protect investors only when the group made acquisitions after its formation. Such an inference might be valid were it not for the considerable evidence that the Act was intended to provide disclosure when stock is rapidly accumulated, however that accumulation is accomplished. The Committee Reports on the Williams Act stated that:

[Section 13(d)(3)] would prevent a group of persons who seek to pool their voting or other interests in the securities of an issuer from evading the provisions of the statute because no one individual owns more than 10 percent of the securities. The group would be deemed to have become the beneficial owner, directly or indirectly, of more than 10 percent of a class of securities at the time they agreed to act in concert. Consequently, the group would be required to file the information called for in section 13(d)(1) within ten days after they agree to act together, whether or not the group had acquired any securities at that time. This provision is designed to obtain full disclosure of the identity of any person or group obtaining the benefits of ownership of securities by reason of any contract, understanding, relationship, agreement or other arrangement.\(^2\)

This statement goes directly to the point of the *Bath* and *GAF* cases, and legislative history should be given considerable weight where, as in the case of section 13(d), conflicting interpretations are possible.\(^2\) The court in *Bath* acknowledged the difficulty of proving a group's agreement to acquire securities and concluded that when a group agrees to act in concert and some members of that group subsequently acquire additional securities, there is a rebuttable presumption that the acquisition was made pursuant to an agreement.\(^3\) At the time of the subsequent acquisition the group would be subject to the disclosure requirements of section 13(d). This "presumption" would frustrate the purpose

\(^{2}\)453 F.2d at 718 n.18.
\(^{2}\)See, e.g., 113 Cong. Rec. 24646-65 (1967).
\(^{2}\)427 F.2d at 110.
of the statute since disclosure would, in effect, be required only after the group had actually acquired additional securities, with the result that information would not be available to the shareholder until well after the need for it had arisen. In light of the purposes of the Act, the more reasonable interpretation would seem to be that of the Second Circuit: that persons acting in concert are a group; that a group formed for the purposes stated in the Act is to be treated as a person; and that such a "person" who owns more than five per cent of a class of the securities of an issuer must meet the disclosure requirement.

When a five per cent group is formed for one of the purposes set out in the statute, it is subject to the requirements of section 13(d)(1). In addition, however, the courts must determine whether, under that section, an acquisition triggers the filing requirement. Sections 13(d)(5) and 13(d)(6)(D) provide for lesser filing requirements or in some cases for exemptions from filing. Under these two sections the Commission may modify the disclosure requirement if neither the purpose nor the effect of the acquisition was to change or influence the control of the issuer. Congress by these provisions clearly contemplated acquisitions with respect to which no protective disclosure would be necessary.

The courts are in conflict, however, as to the relevance of the purpose of an acquisition when there has been no ruling by the Commission under 13(d)(5) or 13(d)(6)(D). Neither Bath nor GAF directly considered this question, although the GAF court did indicate that not all formations, even though acquisitions of the required percentage of stock, would trigger the filing requirement.

The problem is clearly delineated by two district court cases in which groups were not involved. Those cases, Ozark Air Lines, Inc. v. Cox and Sisak v. Wings & Wheels Express, Inc., both involved the inheritance of securities. In Ozark the court held that inheritance was not a reportable acquisition, saying that the "subsection . . . clearly is

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32Id. § 78m(d)(5), (6)(D), set out note 7 supra.
33The statute indicates that Congress expected the Securities Exchange Commission to promulgate objective standards for the exemptions provided. Id. Research has disclosed no such promulgation as of the date of this writing.
34Rejecting the Milsteins' argument that the GAF decision would "catch too many fish," the court said, that "management groups per se, are not customarily formed for the purposes of the statute. Therefore, the court avoided the question of whether management groups which pool their interests to fight a takeover are subject to section 13(d). 453 F.2d at 719.
designed to regulate filings regarding purposeful acquisitions, holdings or disposals” which change or influence the control of the issuer or affect the market.\textsuperscript{37} The court in \textit{Sisak}, on the other hand, held that the beneficiary and the executor of an estate which included thirty-one percent of the shares of a corporation were required to file. The court explained that section 13(d) “is not tied to proxy contests . . . [and] is not limited to any particular mode of ‘acquisition.’”\textsuperscript{38}

Both the history and the language of the Act seem to support the reasoning in \textit{Sisak}. It seems clear that Congress saw the need for investor protection in situations in which neither tender offers nor proxy fights were contemplated at the time of acquisition.\textsuperscript{39} A contrary interpretation would require the courts to speculate about motive rather than focus on the ability to influence the control of the issuer.\textsuperscript{40}

Finally, the requirements of section 14(d)(1)\textsuperscript{41} should be compared with those of section 13(d). Section 14(d)(1) makes it unlawful for a person to make a tender offer for any class of the securities of an issuer if after the offer is consummated such person would own more than five percent of that class, unless at the time the offer is made a disclosure—Schedule 13D—is filed with the Commission by the person making the offer. Section 14(d) is much narrower in scope than section 13(d) since the latter will require disclosure in many cases in which no tender offer is made. Section 14(d), however, would seem to require disclosure in situations in which section 13(d) does not operate only if a person who owns less than five percent makes a tender offer for more than that

\textsuperscript{37}326 F. Supp. at 1117.
\textsuperscript{38}[1970-71 Transfer Binder] CCH \textsc{Fed. Sec. L. Rep.} ¶ 92,991, at 90,668.
\textsuperscript{39}The Exchange Act provides for disclosure in proxy fight and tender offer situations. Securities Exchange Act § 14, 15 U.S.C. § 78n (1970). The practical difficulty of proving intent when the initial acquisitions are made, however, requires an objective standard for triggering § 13(d).
\textsuperscript{40}These considerations were also factors in the decision to lower the percentage of shares which triggers 13(d) to 5%. See \textit{Hearings on Problems in the Securities Industry Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency}, 91st Cong., 1st Sess. 15 (1969) (remarks of Mr. Budge).
\textsuperscript{41}Congress sought to protect investors by requiring disclosure when a “person” has the \textit{ability to influence control} of a corporation. Recent Developments, \textit{An Informal Shareholder Group Must Meet Williams Act Disclosure Requirements within Ten Days after the Group Has Decided to Acquire Additional Shares in Furtherance of a Plan to Seek Corporate Control}, 71 \textsc{Colum. L. Rev.} 466, 469-70 (1971); Note, 24 Sw. L.J., \textit{supra} note 2, at 550; Comment, \textit{Section 13(d) And Disclosure of Corporate Equity Ownership}, 119 \textsc{U. Pa. L. Rev.} 853, 856 (1971). See also 6 \textsc{L. Loss, Securities Regulation} 3664 (Supp. 1969); 113 \textsc{Cong. Rec.} 856 (1967).
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amount and fails to acquire at least five percent. Viewed together, the sections point to the conclusion that while Congress specifically provided for disclosure in tender offer situations, they also saw the need for disclosure with respect to aggregations of securities prior to or in the complete absence of a tender offer.42

The conflicting interpretations of section 13(d) thus remain unresolved. The recent amendments to that section,43 which provide for more stringent disclosure requirements, are a strong indication that Congress saw the need for disclosure in every case in which the control of a corporation might be affected. At the same time, foreseeing that disclosure may in some cases be unnecessary or unduly burdensome, Congress has given the Commission broad discretion to temper the effect of the statute.

Section 13(d) should be interpreted to require disclosure, in the absence of intervention by the Commission, whenever a five percent “group” is formed for the purposes set out in the statute and when a person acquires five percent of a class of shares, whatever the purpose or mode of that acquisition. If this interpretation is followed the influence of section 13(d) in the field of securities regulation will probably be much greater than that of section 14(d), and 13(d) should, in the future, be recognized as the real “meat” of the Williams Act.

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[42] It has been argued that incumbent management’s benefit from this “early tipoff” (proxy and tender offer regulations need not be in effect when § 13(d) is triggered) is much greater than that contemplated when Congress voiced its intention not to tip the scales in favor of either party. See, e.g., Note, 71 Colum. L. Rev., supra note 40.
