A Look Back: Regulation M-A & The "Five-Business Day" Rule

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Looking back some fifteen or twenty years ago when I was working as a young Staff attorney in the SEC's Division of Corporation Finance, things seemed a lot simpler back then. My job was basically to review public company filings, issue comments to counsel around the country who were representing their public company clients, and evaluate the adequacy of their clients' responses and overall compliance with the federal securities laws.

Clearly, I was but one of many hundreds of attorneys, accountants, financial analysts and others working at the SEC who were all acutely focused on protecting investors, keeping order in the securities markets and enforcing the many disclosure requirements on the books. Little did I know that I would get pulled into a rulemaking project that would span three-plus years and would significantly change the manner in which public M&A transactions are structured and carried out today.

At that time, M&A deals seemingly worked just fine. Parties to a business combination would announce their deals. Structuring the transaction as a merger with a vote of security holders would entail the preparation and filing of a preliminary proxy statement that would be reviewed by the Staff in due course, with Staff clearance and mailing of a definitive proxy statement to security holders many months after the merger agreement was first signed.

Structuring the transaction as a tender or exchange offer (without any vote of security holders) required a slightly different protocol. Shortly after the announcement of a cash tender offer, the bidder would need to quickly prepare and file with the SEC a Schedule 14D-1 tender offer statement[1] and commence the offer within *five* business days of the first public announcement of the transaction.[2] Yes, that's right, a hard-and-fast deadline was imposed on the prospective bidder to either "put up" or "shut up." Failure to file and commence was hardly an option as most bidders would not want to risk violating the SEC's tender offer rules and a stern call from Enforcement.

If the tender offer consideration involved securities, generally referred to as a "stock-for-stock" exchange, the parties to the transaction would issue a press release to announce their deal and promptly schedule an investor call within minutes to proudly extol the benefits and synergies associated with their big deal. Interestingly, at the time there was a relatively well-known, but unwritten, rule called the "48-hour rule" under which the SEC Staff would allow the parties to a business combination transaction to communicate freely with investors for up to two days without running afoul of Section 5 despite all the media fanfare.

After the communications bonanza ended, the parties had to go silent in what was known as the "quiet period" during which all public communications about the deal would cease and the advisors would work furiously to pull together a rather lengthy disclosure document (a prospectus) included as part of a registration statement (on Form S-4) that would eventually get filed with the SEC many weeks later.

Once filed, the Staff would generally take up to thirty days to review the registration statement, and after some back-and-forth comments and responses between the Staff and the parties, including their advisors, the disclosure would be finalized, the registration statement would be declared effective, and the exchange offer would then commence. It was not uncommon for the period from first public announcement to commencement to run several months, when security holders would first receive a disclosure document and be given an opportunity to tender their shares, and consummation of the exchange offer and issuance of the consideration offered occurring after one or more months had passed. The drawn out process and timelines were similar to those of mergers that involved a vote of security holders.

To get a better understanding of how this framework came into being, one need only look back to the mid-to-late 1960s when muscle cars such as Mustangs and Camaros were flowing out of Detroit to rule the American roads. In that era the M&A landscape was much different. Mergers and acquisitions had only recently become "daily fare for readers of the financial page,"[3] with the markets experiencing a

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[1] 17 C.F.R. § 240.14d-6 (1998) (current version at 17 C.F.R. § 240.14d-6 (2013)).

[2] 17 C.F.R. § 240.14d-2 (1998) (current version at 17 C.F.R. § 240.14d-2 (2013)).

[3] Note, *Cash Tender Offers*, 83 Harv. L. Rev. 377 (1971).

"phenomenal increase" in activity,[4] prompting cries from various constituencies seeking greater regulation and the need for transparency in such transactions. Those cries for protection were not all that dissimilar from the reactions witnessed after the recent frauds and ensuing market volatilities that ultimately led to the enactment of Sarbanes-Oxley[5] and Dodd-Frank[6].

Back in that era, takeover mechanisms such as proxy contests were subject to much more rigid and fulsome disclosure obligations, whereas tender offers received significantly less regulatory oversight.[7] Specifically, for cash tender offers there was no requirement to disclose an offeror's plans following the purchase or for that matter the offeror's identity. Rather, the offeror could simply disclose the bare basics necessary to entice a sufficient number of security holders to sell their shares: the name of the security sought, the price offered, the deadline to sell, the number of shares sought, the number of shares required to obligate the offeror to purchase, and the name and address of the depository.[8]

This technique was used effectively by hostile bidders to implement change of control transactions in a relatively short period of time. Of course, this approach placed extreme pressure on investors to make a hasty and sometimes ill-informed investment decision given the lack of information regarding the offer and the persons and motives behind the offer.

Given the relatively loose regulatory framework, cash tender offers were an appealing takeover mechanism for a would-be acquiror. With little to no mandated disclosure or procedures, offerors could secretly accumulate shares of an issuer preceding a planned tender offer.[9] In some cases, offerors would execute what was referred to as a 'Saturday Night Special' where the offeror would make a sudden public tender offer announcement, typically over the weekend, in an effort to surprise the target company and reduce its ability to respond effectively.[10] Offerors could also tip off a few friends to the impending tender offer, enabling them to purchase shares prior to the tender offer only to reap significant profits upon tendering their shares.[11]

The passage of the Williams Act[12] in 1968 led to the SEC's promulgation of the first generation of tender offer rules, mandating minimum tender offer periods, affording investors withdrawal rights (opportunities to change their minds) during certain time periods, and the "five-business" day rule, all of which were designed to address the growing public outcry regarding the many deceptive practices surrounding tender offers.[13] The five-business day rule, previously Rule 14d-2(b)(2), required an offeror to withdraw its offer or provide shareholders with the means to tender their shares within five business days of first *announcing* a cash tender offer.[14]

The rule hinged on whether there was a public announcement containing certain specified information including: (1) the bidder's identity, (2) the identity of the target company, (3) the amount and class of securities sought and (4) the price offered for the securities sought.[15] Accordingly, any offeror planning to make a tender offer had to be in a position to file a full-blown tender offer statement including not only the identities of the bidder and the subject company, the amount and class of securities being sought, the scheduled expiration date of the tender offer, but also a plethora of other detailed disclosure items

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[4] Patrick J. Griffin, Jr. & J. Richard Tucker, *The Williams Act, Public Law 90-439-Growing Pains? Some Interpretations with Respect to the Williams Act*, 16 How. L.J. 655 (1971).

[5] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (H.R. 3763) (July 30, 2002).

[6] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (H.R. 4173) (July 21, 2010).

[7] 83 Harv. L. Rev. at 379.

[8] 16 How L.J. at 659.

[9] 16 How L.J. at 658.

[10] David W. Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. Rev. 153, 158 n.18 (1986).

[11] 16 How L.J. at 658. Today, Rule 14e-3 protects investors against insider abuses like these. *See* 17 C.F.R. § 240.14e-3 (2013).

[12] The Act was named for Senator Harrison Williams of New Jersey. 83 Harv. L. Rev. at 381.

[13] One peripheral aspect of the new rules was the federal government's desire to preempt state laws seeking to regulate tender offers. *See* W. Brewster Lee, III, *SEC Tender Offer Timing Rules: Upsetting A Congressionally Selected Balance*, 68 Cornell L. Rev. 914, 915 (1983).

[14] *See supra* note 1.

[15] 17 C.F.R. § 240.14d-2(c) (1998). The old rules permitted, without filing with the SEC, communications that identified the bidder and the subject company and included a statement that the bidder intends to make a tender offer but did not specify how many shares were sought or for how much consideration. 17 C.F.R. § 240.14d-2(d) (1998).

on a Schedule 14D-1 that would be disseminated to security holders.[16] In addition, the offer had to be held open for a minimum period of time giving security holders an opportunity to consider the offer and its terms before having to make an investment decision.

The five-business day rule forced offerors contemplating a cash tender offer to stay quiet until they had most of their offer details, including any financing and other terms, worked out. By contrast, the more burdensome Section 5 registration requirements served as the basis to give bidders engaging in stock exchange offers significantly more latitude with respect to the timing of commencement. Clearly the regulatory framework requiring cash tender offers to commence much sooner than exchange offers was designed to protect security holders from many of the abuses detailed above,[17] but at the same time it restricted communications with the marketplace and mandated fixed timetables on parties to a business combination.

Thirty years later, during my tenure at the Commission, I had the pleasure of working with many other SEC Staff members including Brian Lane (then Division Director), Mauri Osheroff (Senior Associate Director), Dennis Garris (then Chief of the Office of Mergers & Acquisitions), Laurie Green (who at the time was working on amending the SEC's Cross Border rules) and P.J. Himelfarb (another Special Counsel working in OM&A with me at the time) in implementing the reforms that have shaped today's regulatory framework for business combinations. During the rulemaking process there were many debates internally as to how the tender offer rules could best be updated and there was no shortage of commentary from outside the Commission as to how the M&A rules could be improved. After all, many of the rules governing tender offers and business combination transactions were almost thirty years old when we first began working on what is now known as Regulation M-A.

It was clear then that the time had come to update the rules. But where to begin? How about that "five-business day" rule which required all bidders to formally commence their cash tender offers by a strictly imposed deadline following the public disclosure of a few basic terms. After all, why did a bidder making a cash tender offer have to commence within five business days while the same bidder making a registered exchange offer received all the flexibility and time in the world to commence? Would the markets fall to their knees if a cash offer commenced six business days after first announcement? And what's wrong with announcing one's plans or intentions to make a tender offer without immediately commencing the offer? Perhaps nothing at all, but at the time there were a few current and former senior Staffers with significantly more familiarity with the rules and experience working on numerous prior rulemakings over the past three decades who were much less optimistic, warning of the inherent dangers that loom large with such rule changes.

Despite the naysayers' concerns, we proceeded to draft proposed rule amendments that incorporated outlandish concepts at the time, concepts such as "early commencement" for exchange offers (permitting exchange offers to commence *before* there is an effective registration statement on file), "subsequent offering periods" (similar to the what the Brits had readily allowed in U.K. deals) and not the least of which was a proposal to eliminate the five-business day rule. To address some of the critics' concerns, the SEC also promulgated Rule 14e-8, which generally prohibits, as deceptive acts, cases where the offeror: (1) makes a tender offer announcement without the intention to commence the offer within a reasonable time, (2) makes the announcement with the intention to manipulate the target company's stock price or (3) does not have a reasonable belief that he or she will have the means to complete the offer.[18]

When Regulation M-A went into effect in early 2000 (almost three years after the rulemaking had first begun), tender offers quickly changed and they would never be the same again. The reforms updated the rules governing cash and stock tender offers and significantly deregulated communications in business combination transactions. This came as a rude awakening for some of the '33 Act purists at the time. Along with the changes, the five-business day rule was eliminated, permitting offerors to freely communicate their intentions to the public without having to be ready to launch a tender offer on an accelerated timetable. As a quid pro quo, all written communications relating to potential tender offers had to contain appropriate legends and such communications had to be filed with the SEC on the date

[16] 17 C.F.R. § 240.14d-6 (1998) (current version at 17 C.F.R. § 240.14d-6 (2013)).

[17] 16 How L.J. at 658—60.

[18] 14 C.F.R. § 240.14e-8 (2013).

of their first use.[19] Since that time cash tender offers have become increasingly more common, viewed as the takeover mechanism of choice by many acquirors. Of course, other advances in the law, such as the recently enacted amendments to DGCL § 251(h)[20] have only provided bidders with additional reasons to favor cash tender offers over mergers.

While no parade of horribles has ensued since the five-business day rule was eliminated, the SEC has since had the opportunity to use Rule 14e-8 in a handful of instances to combat fraudulent offers, such as:[21]

- In 2003, Ade Ogunjobi, through his company Toks offered unregistered promissory note securities with the purpose of raising at least one billion dollars to finance tender offer deals for the stock of at least fifteen of the world's largest corporations, a set of transactions claimed to require at least five trillion dollars in stock. Subsequently, when the defendants attempted to launch multiple exchange offers, the SEC alleged several violations of the Exchange Act as well as a violation of Exchange Act Rule 14e-8, arguing that Toks and Ogunjobi had no reasonable belief they had the means necessary to complete the tender offers they had announced through their offering materials.[22] Toks and Ogunjobi were permanently enjoined by default in March of 2004.[23]
- More recently, in 2011, Allen Weintraub, a convicted felon who was previously barred from serving as an officer or director of a public issuer[24] and owed the SEC a $1.05 million judgment for past tender offer violations, emailed letters to the boards of Eastman Kodak and AMR Corporation, the parent of American Airlines, announcing his intention to make tender offers to purchase all outstanding securities of both companies,[25] at near 50% premiums over their then-current trading prices. In connection with these offers, Mr. Weintraub emailed an announcement to various reporters and later claimed that "several large institutions" backed his plans, although he never secured a single financing agreement or letter of credit. In the litigation that followed, the SEC alleged, among other things, a violation of Rule 14e-8, successfully winning summary judgment on the facts.[26]

In retrospect, I think it is safe to say that the Regulation M-A amendments adopted by the Commission in late 1999 and implemented the next year accomplished their intended goals—specifically to free up communications, place stock and cash tender offers on a more equal playing field, facilitate the delivery

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[19] 17 C.F.R. § 240.14d-2(b) (2013).

[20] 79 Del. Laws Ch. 72 (2013).

[21] Several other instances of SEC complaints alleging Rule 14e-8 violations can be found. *See, e.g.*, SEC Sues Global Airlines Corporation and Its Chief Executive Officer Emil Bernard for Securities Fraud, Litig. Release No. 18055, 79 S.E.C. Docket 2862, 2003 WL 1633001 (Mar. 31, 2003) (alleging violations of Rule 14e-8 in connection with tender offer announcements to purchase Trans World Airlines, Inc. and US Airways Group Inc.), *available at* http://www.sec.gov/litigation/litreleases/lr18055.htm; SEC Sues Richard M. Ryan for Fraudulent Tender Offer for Enron Corporation, Litig. Release No. 18124, 80 S.E.C. Docket 449, 2003 WL 21025843 (May 7, 2003) (alleging Rule 14e-8 violations in connection with a tender offer for Enron Corporation), *available at* http://www.sec.gov/litigation/litreleases/lr18124.htm; SEC Charges Treyton L. Thomas and Pembridge Group, Ltd. With Securities Fraud and Stock Manipulation, Litig. Release No. 18957, 84 S.E.C. Docket 263, 2004 WL 2480713 (Nov. 3, 2004) (alleging Rule 14e-8 violations in connection with a tender offer purportedly intended to manipulate the price of Imagis Technologies, Inc. stock), *available at* http://www.sec.gov/litigation/litreleases/lr18957.htm.

[22] Complaint, *Sec. & Exch. Comm'n v. Toks, Inc.*, No. 03-Civ. 01787, (D.D.C. Aug. 25, 2003), *available at* https://www.sec.gov/litigation/complaints/comp18309.htm.

[23] SEC Obtains Permanent Injunction Against Toks, Inc. and Its Chief Executive Officer Ade O. Ogunjobi, Litig. Release No. 18710, 82 S.E.C. Docket 3042, 2004 WL 1091103 (May 13, 2004), *available at* http://www.sec.gov/litigation/litreleases/lr18710.htm. In 2001, Ogunjobi had registered securities as part of a very similar plan, and the SB-2 registration statement was suspended in an earlier Initial Decision on January 8, 2002. *In re* Toks Inc., S.E.C. Release No. 198, 2002 WL 21693 (ALJ Jan. 8, 2002), *available at* http://www.sec.gov/litigation/aljdec/id198bpm.htm. The original SB-2 filed by Toks, Inc. and Ogunjobi is available on the SEC website at https://www.sec.gov/Archives/edgar/data/1158135/000115813501500006/tok3.txt. The Rule 425 free writing prospectuses are also available on the SEC website. The Rule 425 prospectus for AT&T Wireless can be found at https://www.sec.gov/Archives/edgar/data/1138234/000111055001500072/wireless.txt.

[24] SEC Obtains Officer and Director Bar Against Allen Weintraub and Obtains Injunctions Against Florida Stock Transfer, Inc., Vector Holdings Corp. and Allen E. Weintraub, Litig. Release No. 18021, 79 S.E.C. Docket 2333, 2003 WL 896205 (Mar. 7, 2003), *available at* https://www.sec.gov/litigation/litreleases/lr18021.htm.

[25] Weintraub's letters were sent to the board of directors at each of Kodak and AMR, with copies sent to their largest shareholders. *Sec. & Exch. Comm'n v. Weintraub*, No. 11-Civ-21549-CIV, 2011 WL 6935280 at *1 (S.D. Fla. Dec. 30, 2011). Weintraub went so far as to call the press and grant telephone interviews in which he admitted making a tender offer for both AMR and Kodak. *See* Terry Maxon, *We talk about AMR deal with hopeful buyer*, Dallas Morning News (Mar. 29, 2011, 6:42 PM), http://aviationblog.dallasnews.com/2011/03/we-talk-about-amr-deal-with-ho.html/?nclick_check=1.

[26] *Sec. & Exch. Comm'n v. Weintraub*, No. 11-Civ-21549-CIV, 2011 WL 6935280 at *1—*2, *5, *7, *10 (S.D. Fla. Dec. 30, 2011).

of more information to investors and provide bidders and target companies alike with the necessary flexibility to structure their deals and commence their offers in a manner and on a timetable that makes the most sense given the particular circumstances.

While the elimination of the five-business day rule was but one small aspect of the regulatory over-haul, it was nevertheless an important change that many newer lawyers and bankers to the profession may fail to fully appreciate today. And those fears expressed early on that there would be a tidal wave of bogus tender offers along with numerous attempts by state regulators to encroach into this area have all proved to be unfounded. Lucky for us!

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