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Section 14(e) of the Securities Exchange Act of 1934[1] ('34 Act) prohibits fraud in connection with a tender offer.[2] Securities and Exchange Commission (SEC) rule 14e-3[3] requires any person in possession of material, nonpublic information relating to a tender offer either to disclose the information publicly or to abstain from trading in the securities involved in the tender offer.[4] A duty to disclose inside information or abstain from trading has traditionally applied only to a corporate insider.[5] Rule 14e-3 requires careful examination because the rule imposes a duty to disclose material nonpublic information upon a person who is not a corporate insider.[6]

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[1] 15 U.S.C. §§ 78(a)-(lll) (1976).

[2] *See generally* HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, INVESTOR PROTECTION IN CORPORATE TAKEOVERS, H.R. Rep. No. 91-1655, 91st Cong., 2d Sess. (1970) [hereinafter cited as 1970 House Rep.]; SENATE COMM. ON BANKING AND CURRENCY, ADDITIONAL CONSUMER PROTECTION IN CORPORATE EQUITY OWNERSHIP, S. Rep. No. 1125, 91st Cong., 2d Sess. (1970) [hereinafter cited as 1970 Senate Rep.]; *An Act to Amend Sections 13(d), 13(c), 14(d) and 14(e) of the Securities Exchange Act of 1934 In order to Provide Additional Consumer Protection for Investors*: Hearings on S. 3431 *Before the Subcom. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 2d Sess. (1970) [hereinafter cited as 1970 House Hearings]; *A Bill to Extend the Coverage of Sections 13(d), 14(d), and 14(e) of the Securities Exchange Act of 1934 in Order to Provide Additional Protection for Investors: Hearing on S. 3431 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 91st Cong. 2d Sess. (1970) [hereinafter cited as 1970 Senate Hearings]; HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, H.R. Rep. No. 1711, 90th Cong. 2d Sess. (1968) [hereinafter cited as 1968 House Rep.]; SENATE COMM. ON BANKING AND CURRENCY, FULL DISCLOSURE OF CORPORATE EQUITY OWNERSHIP AND IN CORPORATE TAKEOVER BIDS, S. Rep. No. 550, 90th Cong., 2d Sess. (1967) [hereinafter cited as 1967 Senate Rep.]; *Bills Providing for Full Disclosure of Corporate Equity Ownership of Securities Under the Securities Exchange Act of 1934: Hearings on H.R. 14475 and S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. (1967) [hereinafter cited as 1967 Senate Hearings].

A tender offer is a method of corporate takeover in which a bidder offers to purchase shares of a target corporation at a premium price provided the target's shareholders sell a specified number of shares. 1968 House Hearings, *supra* note 2, at 11 (statement of Manuel F. Cohen, Chairman, Securities and Exchange Commission). Target shareholders wishing to sell shares to a bidder making a tender offer tender their shares to an agent specified by the bidder. *Id.* The bidder sets a time period within which target shareholders must tender their shares. *Id.* If sufficient shares are tendered, the bidder must purchase the shares at the tender offer price. *Id.*; 17 C.F.R. § 240.14d-1(c)(3) (1981). If insufficient shares are tendered, the bidder must either extend the tender offer period or return the shares to their owners. 1968 House Hearings, *supra* note 2, at 11; 17 C.F.R. § 240.14d-1(c)(3) (1981).

[3] 17 C.F.R. 240.14e-3 (1981).

[4] *Id.*; 45 Fed. Reg. 60,410, 60,413 (1981).

[5] Walton v. Morgan Stanley & Co., Inc., 623 F.2d 796, 798 (2d Cir. 1980); Feldman v. Simkins Indus., Inc., 492 F. Supp. 839, 844-45 (N.D. Ca. 1980); *see* text accompanying notes 17-20 *infra*.

[6] *See* 45 Fed. Reg. 60,410, 60,413 (1980) (rule 14e-3 applicable to any person). Rule

Rule 14e-3 contains four parts. First, rule 14e-3(a) requires any person in possession of material nonpublic information concerning a tender offer to disclose the information or to abstain from trading in the securities involved in the tender offer.[7] Second, rule 14e-3(b) provides an exception to rule 14e-3(a) for multi-service financial institutions.[8] Third,

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14e-3(a) has several elements. First, a bidder must commence or take substantial steps to commence a tender offer. 17 C.F.R. § 240.14e-3(a) (1981); *see* 45 Fed. Reg. 60,410, 60,413 (1980). A bidder commences a tender offer when he first communicates the tender offer to the target shareholders. 17 C.F.R. § 240.14d-2 (1981); *see* SEC Rel. No. 34-16623 (March 5, 1980). A bidder takes a substantial step to commence a tender offer when he forms a plan to make a tender offer, prepares tender offer materials, or takes any other significant action toward commencing a tender offer. 45 Fed. Reg. at 60,413 n.33; 44 Fed. Reg. 70,349, 70,353 n.33 (1979). The second element of rule 14e-3(a) is that a person other than the bidder acquire material information concerning a tender offer. 17 C.F.R. § 240.14e-3(a) (1981); *see* 45 Fed. Reg. at 60,413. Material information concerning a tender offer includes, but is not limited to, a bidder's intent to make or withdraw from a tender offer or to increase the consideration for tendered shares. 45 Fed. Reg. at 70,413 n.35. Rule 14e-3(a) also requires that the person in possession of material information regarding a tender offer know or have reason to know that the information is nonpublic. 17 C.F.R. § 240.14e-3(a); *see* 45 Fed. Reg. at 60,413 & n.36. The final element of rule 14e-3(a) is that the person in possession of material nonpublic information relating to a tender offer know or have reason to know that he acquired the information either directly or indirectly from the bidder or target. 17 C.F.R. § 240.14e-3(a); *see* 45 Fed. Reg. at 60,413 n.37. Thus, rule 14e-3(a) prohibits a person from trading in securities involved in a tender offer based upon material nonpublic information obtained through misappropriation or from conversations with a bidder, target, or agent of a bidder or target. 45 Fed. Reg. at 60,413 n.37. Rule 14e-3(a) does not prohibit trading pursuant to market rumors concerning a tender offer. *Id.*; *see* 44 Fed. Reg. at 70,353 (commentators fear that rule 14e-3(a) prohibits trading on market rumor information). Rule 14e-3(a) applies both before and after commencement of a tender offer until the tender offer expires or disclosure is properly made. 45 Fed. Reg. at 60,413 n.33, 60,414.

[7] 17 C.F.R. § 240.14e-3(a) (1981). The disclosure requirement of rule 14e-3(a) has two elements. *See* 17 C.F.R. § 240.14e-3(a). First, a person coming within the scope of rule 14e-3(a) must disclose his material nonpublic information within a reasonable time before trading in the securities involved in the tender offer. 45 Fed. Reg. at 60,414. Second, the disclosure must include the source of the information and be made by press release or other appropriate method. *Id.* A person in possession of material nonpublic information relating to a tender offer is relieved of the duty to disclose if another person discloses the information in conformity with rule 14e-3(a). *Id.*

[8] 17 C.F.R. § 240.14e-3(b) (1981). Rule 14e-3(a) applies to "any person." 17 C.F.R. § 240.14e-3(a) (1981). A multi-service financial institution is a legal person other than a natural person that provides many financial services. *Id.*; *see* 15 U.S.C. § 78(c)(9) (definition of "person" under '34 Act); 45 Fed. Reg. 60,410, 60,415 (1980). Absent rule 14e-3(b) a multi-service financial institution would violate rule 14e-3(a) if one department of the institution possessed material nonpublic information concerning a tender offer, while another department traded in the target securities without knowing the information. 45 Fed. Reg. at 60,414 (1980). Thus, rule 14e-3(b) limits the liability of a multi-service financial institution under rule 14e-3(a) to situations involving actual misuse of information. 45 Fed. Reg. at 60,414.

The exception to rule 14e-3(a) provided in rule 14e-3(b) has two requirements. First, an institution must prove that the individual who traded in securities involved in a tender offer did not have possession of material nonpublic information concerning the tender offer. *Id.* at 60,415; *see* 17 C.F.R. § 240.14e-3(b)(1). Second, the institution must prove the existence of reasonable internal procedures to ensure that persons making investment decisions within the institution could not violate rule 14e-3(a). 45 Fed. Reg. at 60,415; *see* 17 C.F.R. §

rule 14e-3(c) allows exceptions to rule 14e-3(a) for persons acting on behalf of a bidder, and for persons selling securities to a bidder.[9] Finally, rule 14e-3(d) prohibits the communication of material nonpublic information relating to a tender offer when violation of rule 14e-3(a) is foreseeable.[10] The SEC considers such communications as constituting misuse of material nonpublic information.[11] Thus, rule 14e-3(a) contains the central disclosure requirement of rule 14e-3, while subsections (b), (c) and (d) provide exceptions designed to ensure that rule 14e-3 regulates only actual misuse of material nonpublic information concerning a tender offer.[12]

Section 14(e) of the '34 Act applies solely to fraud in the sale of securities involved in a tender offer.[13] Before promulgation of rule 14e-3,

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240.14e-3(b)(2). Reasonable procedures include, but are not limited to, Chinese walls and restricted lists. 45 Fed. Reg. at 60,415; *see* 17 C.F.R. §§ 240.14e-3(b)(2)(i) & (ii). A Chinese wall is a procedure that prohibits the flow of confidential information between departments in a multi-departmental business. 45 Fed. Reg. at 60,451; *cf. The Future of the Chinese Wall Defense to Vicarious Disqualification of a Former Government Attorney's Law Firm*, 38 WASH. & LEE L. REV. 151 (1981). A restricted list is a list of corporations that have given material, nonpublic information to an institution. *Id.* An institution can prevent misuse of the information by prohibiting employees from either rendering services relating to the securities or trading in securities of corporations on the list. *Id.*

[9] *See* 17 C.F.R. § 240.14e-3(c) (1981). Rule 14e-3(c)(1) permits a broker or agent of a bidder to trade in target securities on behalf of the bidder. *Id.* Rule 14e-3(c)(1) is necessary because absent the exception, rule 14e-3(a) would preclude a bidder's broker or agent from trading in target securities if the bidder revealed to his broker or agent an intent to make a tender offer. 45 Fed. Reg. 60,410, 60,416 (1980). Although rule 14e-3(c)(1) allows a bidder's broker or agent to purchase target securities for the bidder, a bidder's broker or agent would violate rule 14e-3(a) if he traded in the target securities for personal benefit. *Id.*; *see* 17 C.F.R. § 240.14e-3(c)(1).

Rule 14e-3(c)(2) places persons selling target securites to the bidder outside the scope of rule 14e-3(a). 17 C.F.R. § 240.14e-3(2). The rule 14e-3(c)(2) exception allows a target security holder who has material nonpublic information relating to a tender offer to sell the target securities to the bidder before the bidder commences the tender offer. 45 Fed. Reg. at 60,416; *see* text accompanying note 11 *supra*.

[10] 17 C.F.R. § 240.14e-3(d) (1981). Rule 14e-3(d) applies to two groups of persons. *See id.*; 45 Fed. Reg. 60,410, 60,417 (1980). The first group consists of bidders, targets, or persons acting on behalf of bidders or targets. 17 C.F.R. § 240.14e-3(d)(2)(i)-(iii). The second group consists of persons who receive information from the first group. 17 C.F.R. § 240.14e-3(d)(2)(iv). Members of either group violate rule 14e-3 if they communicate material nonpublic information relating to a tender offer to another person when violation of rule 14e-3(a) is reasonably foreseeable. 17 C.F.R. § 240.14e-3(d)(1).

Subsections (i)-(iii) of rule 14e-3(d)(1) provide an exception to rule 14e-3(d) for good faith communications to persons involved in planning, financing, preparing, or executing a tender offer, or to any person communicating information concerning a tender offer pursuant to law. *Id.* A person who communicates material nonpublic information relating to a tender offer does not communicate in good faith if he knows or has reason to know that the communication will result in violation of rule 14e-3. 45 Fed. Reg. at 60,417. The exception does not affect the potential rule 14e-3 liability of the recipient of the information. *Id.*

[11] *See* 45 Fed. Reg. 60,410, 60,417 (1980).

[12] *See* 17 C.F.R. § 240.14e-3 (1981); 45 Fed. Reg. 60,410, 60,414 (1980).

[13] *See* 15 U.S.C. § 78(n) (1976).

the SEC regulated insider trading through section 10(b) of the '34 Act[14] and rule 10b-5.[15] Section 10(b) and rule 10b-5 prohibit fraudulent, manipulative, or deceptive acts in connection with the sale of any security.[16] Under section 10(b) and rule 10b-5, a corporate insider owes a fiduciary duty to both buyers and sellers of his corporation's securities.[17] The duty arises from a corporate insider's obligation to conduct the business affairs of his corporation for the benefit of all shareholders.[18] Section 10(b) and rule 10b-5 prohibit a corporate insider from taking advantage of access to confidential corporate information for personal gain at the shareholders' expense.[19] Thus, a corporate insider is guilty of fraud under section 10(b) and rule 10b-5 if he purchases or sells shares of his corporation based on inside information that the shares' value will soon increase or decrease.[20]

In *Chiarella v. United States*,[21] the Supreme Court considered whether section 10(b) and rule 10b-5 prohibit a person who is not a corporate insider from trading in securities involved in a tender offer without first publicly disclosing his material nonpublic information concerning the tender offer.[22] Chiarella, an employee of a financial printer, discovered the identity of several tender offer targets.[23] Chiarella traded

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[14] 15 U.S.C. § 78j(b) (1976); *see* text accompanying note 21 *infra*.

[15] *See* 17 C.F.R. § 240.10b-5 (1980); text accompanying note 21 *infra*.

[16] Section 10(b) of the Securities Exchange Act of 1934 ('34 Act) prohibits any person from employing any manipulative or deceptive device in connection with the purchase or sale of any security. 15 U.S.C § 78j(b) (1976). Rule 10b-5 prohibits in connection with the purchase or sale of a security any device, scheme, or artifice to defraud, or any act, practice, or course of business which would defraud any person. 17 C.F.R. § 240.10b-5 (1980). Rule 10b-5 also prohibits any person from making, in connection with the sale or purchase of any security, an untrue statement of material fact, or from omitting a material fact necessary to make statements made not misleading. *Id.*

[17] *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 883, 849 (2d Cir. 1968).

[18] *Id.*

[19] SEC v. Murphy, 626 F.2d 633, 652 n.23 (9th Cir. 1980); Walton v. Morgan Stanley & Co., Inc., 623 F.2d 796, 798 (2d Cir. 1980); SEC v. Miller, 495 F. Supp. 465, 482 (S.D.N.Y. 1980); American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 742 n.45 (E.D. Va. 1980); Feldman v. Simkins Indus., Inc., 492 F. Supp. 839, 844-45 (N.D. Ca. 1980).

[20] *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854 (2d Cir. 1968); Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951); *In re* Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961).

[21] 445 U.S. 222 (1980).

[22] *See id.* at 224-26.

[23] *Id.* at 224. Chiarella was an employee of Pandick Press, a New York based financial printing company. *Id.* Through his position, Chiarella learned the identities of four tender offer targets and one merger candidate. *Id.* at n.1. Without disclosing his knowledge of the forthcoming takeovers, Chiarella purchased securities in the target companies. *Id.* at 224. After the bidders publicly announced the takeover attempts, Chiarella sold his interests in the targets and realized a $30,000 profit. *Id.* The SEC investigated Chiarella's trading and in May 1977, Chiarella entered into a consent decree with the SEC which required Chiarella to return the profits from his transactions. *Id.* In January of 1978, Chiarella was indicted on 17 counts of violating § 10(b) and rule 10b-5. *Id.* He was convicted on all counts. 450 F. Supp. 95 (S.D.N.Y. 1978), *aff'd* 558 F.2d 1358 (2d Cir. 1978).

profitably in the target securities without disclosing his knowledge of the pending takeovers.[24] Following an SEC investigation into Chiarella's trading activities, Chiarella was indicted for violations of section 10(b) and rule 10b-5.[25] The Supreme Court held that section 10(b) and rule 10b-5 require only a corporate insider to disclose his material nonpublic information concerning a tender offer before trading in target securities.[26] The Court found that Chiarella was not a corporate insider because Chiarella was not in a relationship of trust toward the parties to his market transactions.[27] Therefore, the Court held that Chiarella did not violate section 10(b) or rule 10b-5.[28]

Before the Supreme Court's decision in *Chiarella*, the SEC proposed rule 14e-3 to require a person who is not a corporate insider to disclose his material, nonpublic information concerning a tender offer before trading in the target securities.[29] The SEC understood that the Supreme Court's decision in *Chiarella* could affect the validity of rule 14e-3.[30] The Commission recognized that rule 14e-3 would be superfluous if the Court held that section 10(b) and rule 10b-5 required Chiarella to disclose his nonpublic information despite the absence of a fiduciary duty.[31] Such a holding in *Chiarella* would have established a disclosure duty under section 10(b) and rule 10b-5 applicable to all tender offer transactions within the scope of rule 14e-3.[32] The SEC also recognized that if *Chiarella* re-

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[24] 445 U.S. 222, 224 (1980).

[25] *Id.*; *see* text accompanying note 23 *supra.*

[26] *Id.* at 232-33. The Supreme Court's decision in *Chiarella* that § 10(b) and rule 10b-5 imposes a duty to disclose material nonpublic information before trading only upon corporate insiders is well founded. In *Frigitemp Corp. v. Financial Dynamics Fund, Inc.*, the Second Circuit held that liability under § 10(b) and rule 10b-5 for failing to disclose material nonpublic information can arise only where a duty to disclose exists. 524 F.2d 275, 282 (2d Cir. 1975). The court held that parties who were not corporate insiders did not violate § 10(b) and rule 10b-5 when they did not disclose lawfully obtained material nonpublic information, because the parties did not have a duty to disclose the information. *Id.* Similarly, the Second Circuit held in *General Time Corp. v. Talley Indus., Inc.*, that a person who is not a corporate insider does not have a duty to disclose material information to a seller before purchasing the seller's shares. 403 F.2d 159, 164 (2d Cir. 1968). Thus, *Frigitemp* and *General Time* indicate that liability under § 10b and rule 10b-5 for failure to disclose material nonpublic information requires a duty to disclose the information. *See* Chiarella v. United States, 445 U.S. 222, 227-29 (1980).

[27] 445 U.S. 222, 231, 235 (1980).

[28] *Id.*

[29] *See* 45 Fed. Reg. 60,410, 60,411 n.2 (1980). The SEC first proposed rule 14e-2(c) to prohibit a person who is not a corporate insider from trading in securities involved in a tender offer without disclosing his material nonpublic information. *See id.*; 44 Fed. Reg. 9956 (1979). Rule 14e-3 evolved from amendments to rule 14e-2(c). 45 Fed. Reg. at 60,411; *see* 44 Fed. Reg. 70,349, 70,352-55 (discussion of amendments to proposed rule 14e-2(c)). The SEC amended and adopted rule 14e-3, on October 14, 1980. 45 Fed. Reg. at 60,410. The Supreme Court decided *Chiarella* on March 18, 1980. 445 U.S. 222, 222 (1980).

[30] *See* 45 Fed. Reg. 60,410, 60,411 (1980).

[31] *See id.*

[32] *See* 45 Fed. Reg. 60,410, 60,413 (1980); 15 U.S.C. § 78j(b) (1976); 17 C.F.R. §§ 240.14e-3, 240.10b-5 (1981).

quired only corporate insiders to disclose material, nonpublic information, doubts concerning the Commission's authority to promulgate rule 14e-3 would arise.[33] Although the *Chiarella* Court held that only a corporate insider has a duty to disclose certain information before trading in securities, the SEC maintains that *Chiarella* does not preclude promulgation of rule 14e-3.[34] The Commission asserts that since *Chiarella* concerned violations of section 10(b) and rule 10b-5, *Chiarella* does not limit SEC rulemaking authority under section 14(e).[35] While the *Chiarella* Court did not expressly limit SEC rulemaking authority under section 14(e), careful examination of the *Chiarella* rationale and the statutory language and legislative history of section 14(e) raises several questions concerning the applicability of rule 14e-3 to a person who is not a corporate insider.[36]

In *Chiarella*, the Supreme Court reasoned that the statutory language and legislative history of section 10(b) demonstrates that Congress did not intend section 10(b) to create a duty requiring a person other than a corporate insider to disclose his material nonpublic information before making a market transaction.[37] The Court held that the SEC could not create such a duty under rule 10b-5 because the rule would exceed the intended scope of section 10(b) of the '34 Act.[38] Sections 10(b) and 14(e) of the '34 Act employ similar terms to prohibit fraudulent securities transactions.[39] Therefore, according to the Court's reasoning in *Chiarella*, the application of rule 14e-3 to a person who is not a corporate insider is valid only if Congress intended section 14(e) to impose a disclosure duty upon persons who are outside a fiduciary relationship.[40]

Examination of the language of section 14(e) is the initial step in determining whether Congress intended section 14(e) to require a person who is not a corporate insider to disclose his material, nonpublic informa-

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[33] *See* 45 Fed. Reg. 60,410, 60,411-13 (1980) (SEC position that *Chiarella* does not preclude promulgation of rule 14e-3).

[34] *See id.* at 60,412.

[35] *See id.*

[36] *See* 45 Fed. Reg. 60,410, 60,411-13 (1980).

[37] 445 U.S. 222, 226, 233 (1980).

[38] *Id.*

[39] *Compare* 15 U.S.C. § 78j(b) (1976) *with* 15 U.S.C. § 78n(e) (1976).

[40] *Cf.* Aaron v. SEC, 446 U.S. 680, 691 (1980). In *Aaron*, the Supreme Court considered the scope of the rulemaking power of the SEC under § 10(b). *Id.* at 690. The *Aaron* Court held that the scope of rule 10b-5 cannot exceed the scope of § 10(b). *Id.* at 691. Thus, the Court ruled that liability under rule 10b-5 requires *scienter* because liability under § 10(b) requires *scienter*. *Id.* In reaching its decision in *Aaron*, the Supreme Court relied upon *Ernst & Ernst v. Hochfelder*. *See id.* at 690-91. The *Hochfelder* Court found that the rulemaking power granted to the SEC is not the power to create law. *Id.* at 213. The Court reasoned that the SEC has rulemaking power only to the extent that the rules give effect to the intent of Congress as expressed by statute. *Id.* at 241; *see* Dixon v. United States, 381 U.S. 68, 74 (1965) (I.R.S. rulemaking authority limited to scope of Internal Revenue Code); Manhattan Gen. Equip. Co. v. Commissioner, 297 U.S. 129, 134 (1936) (regulations exceeding statutory authority are void).

tion before trading in securities involved in a tender offer.[41] The operative language of section 14(e) is nearly identical to the language of section 10(b) and rule 10b-5.[42] Section 14(e) prohibits any person from making misstatements of material fact or engaging in any fraudulent, deceptive, or manipulative act in connection with a tender offer.[43] Alternatively, section 10(b) and rule 10b-5 prohibit any person from employing any manipulative or deceptive device in connection with the sale of a security.[44] Based on the similarity in language of sections 10(b) and 14(e) and rule 10-5, courts have ruled uniformly that the duties imposed under rule 10b-5 and sections 10(b) and 14(e) are identical.[45] In *Chiarella*, the Supreme Court held that the language of section 10(b) does not impose a

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[41] *See* Aaron v. SEC, 446 U.S. 680, 690 (1980) (initial step in determining scope of § 10(b) is examination of § 10(b) statutory language); Chiarella v. United States, 445 U.S. 222, 226 (1980) (statutory language defines scope of § 10(b)); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 212 (1976) (statutory language and legislative history indicate scope of § 10(b)). Although no court has considered whether § 14(e) extends a duty to disclose material nonpublic information to a person who is not a corporate insider, the weight of authority shows that resolution of the issue depends on examination of the statutory language and legislative history of § 14(e). *See, e.g.*, Piper v. Chris-Craft Indus., 430 U.S. 1, 24 (1977) (language and legislative history reveal scope of § 14(e)); Crane v. American Standard, Inc., 603 F.2d 244, 249 (2d Cir. 1979) (statutory language and legislative history indicate § 14(e) does not imply private cause of action); Stargent v. Genesco, Inc., 492 F.2d 705, 769 (5th Cir. 1974) (legislative history shows "security holders" have a private cause of action under § 14(e)); H.K. Porter Co., Inc. v. Nicholson File Co., 482 F.2d 421, 424 (1st Cir. 1973) (statutory scheme and legislative history indicate purpose of § 14(e) is shareholder protection).

[42] *Compare* 15 U.S.C. § 78j(b) (1976) *and* 17 C.F.R. § 240.10b-5 (1981) *with* 15 U.S.C. § 78n(e) (1976).

[43] 15 U.S.C. § 78n(e) (1976).

[44] 15 U.S.C. § 78j(b) (1976); 17 C.F.R. § 240.10b-5 (1981).

[45] *See, e.g.*, Crane v. American Standard, Inc., 603 F.2d 244, 249 (2d Cir. 1979); Herbst v. ITT Corp., 495 F.2d 1308, 1313 n.11 (2d Cir. 1974); Smallwood v. Pearl Brewing Co., 489 F.2d 579, 605 (5th Cir. 1974); H.K. Porter Co., Inc. v. Nicholson File Co., 482 F.2d 421, 426 (1st Cir. 1973); Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 361 (2d Cir. 1973); Electronic Speciality Co. v. Int'l Controls Corp., 409 F.2d 937, 940 (2d Cir. 1969). In *Crane*, the Second Circuit compared shareholder rights under rule 10b-5, § 10(b) and § 14(e). *Id.* at 249. Observing that the language of § 14(e) and rule 10b-5 are nearly identical, the Court held that the primary difference in the scope of the sections is that rule 10b-5 applies to any sale or purchase of any security, while § 14(e) applies only to tender offers. *Id.* In *Herbst*, the Second Circuit also ruled that the principles embodied in rule 10b-5 and § 14(e) are identical. 495 F.2d at 1313 n.11. In *Smallwood*, the Fifth Circuit held that Congress intended § 14(e) to create duties identical to those imposed under rule 10b-5. 489 F.2d at 605. The *Smallwood* court held that when Congress drafted § 14(e) with language similar to rule 10b-5, Congress intended the law concerning rule 10b-5 to apply to § 14(e). *Id.* Thus, the Fifth Circuit held that once standing is established in a § 14(e) action, analysis under rule 10b-5 and § 14(e) is identical. *Id.* In *H.K. Porter Co., Inc.*, the First Circuit held that the difference between § 14(e) and rule 10b-5 is that § 14(e) provides broader standing requirements than § 10(b). 482 F.2d at 424. In *Chris-Craft Industries, Inc.* and *Electronic Speciality Co. v. Int'l Controls Corp.*, the Second Circuit held that with the exception of loosening standing requirements, the major impact of § 14(e) was to codify under § 14(e) the law relating to § 10(b). *See* Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341, 361 (2d Cir. 1973); Electronic Specialty Co. v. Int'l Controls Corp., 409 F.2d 937, 940 (2d Cir. 1969).

duty to disclose material, nonpublic information upon persons not in a fiduciary relationship.[46] Therefore, the language of section 14(e) indicates that section 14(e) should apply only to a person in a fiduciary relationship.[47]

Since the statutory language of section 14(e) does not explicitly justify the scope of rule 14e-3, examination of the legislative history of section 14(e) is necessary.[48] Congress enacted section 14(e) in 1968 through the Williams Act, which amended the '34 Act to impose disclosure and antifraud requirements upon a bidder making a tender offer.[49] In 1970, Congress amended the Williams Act to grant the SEC rulemaking authority under section 14(e).[50] Thus, the legislative history to both the Williams Act and the 1970 amendments provide insight concerning whether Congress intended section 14(e) to grant the SEC authority to institute a disclosure duty as broad as the duty that the SEC seeks to impose under rule 14e-3.[51]

The 1967 Senate and 1968 House reports concerning the Williams Act reveal that Congress enacted the Williams Act to prevent fraudulent tender offers through the imposition of disclosure requirements upon bidders.[52] While the 1968 congressional reports emphasize the need for a bidder to disclose to target shareholders material information con-

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[46] 445 U.S. 222, 233 (1980).

[47] *See* text accompanying note 50 *supra*.

[48] *See* Chiarella v. United States, 445 U.S. 222, 226 (1980); text accompanying note 81 *supra*.

[49] *See* 15 U.S.C. § 78(l)-(n) (1934), *as amended by*, Pub. L. No. 91-439, §§ (1)-(2), 84 Stat. 1497 (1970) (current version at 15 U.S.C. § 78(l)-(n) (1976)).

[50] *See* 15 U.S.C. § 78(l)-(n) (1934), *as amended by*, Pub. L. No. 91-567 §§ (1)-(2), 84 Stat. 1497 (1970) (current version at 15 U.S.C. § 78(l)-(n) (1976)).

[51] *See* text accompanying note 41 *supra*.

[52] *See* 1967 Senate Rep., *supra* note 2, at 4; 1968 House Rep., *supra* note 2, at 2-3. Congress enacted the Williams Act because tender offers had become an increasingly common method of corporate takeover. *See* 1967 Senate Rep., *supra* note 2, at 2; 1968 House Rep., *supra* note 2, at 2. Tender offers had become popular because they allowed bidders to engage in corporate takeovers without disclosing to target shareholders any facts relevant to the takeover. *See* 1967 Senate Rep., *supra* note 2, at 2; 1968 House Rep., *supra* note 2, at 2. Thus, Congress enacted the Williams Act to require a bidder making a tender offer to disclose to the target shareholders material information concerning the tender offer. *See* 1967 Senate Rep., *supra* note 2, at 2-3; 1968 House Rep., *supra* note 2, at 2.

The Williams Act requires a bidder making a tender offer to file with the SEC a statement indicating the background and identity of all bidders in the offer. 15 U.S.C. § 78(d)(1) (1934), *as amended by* Pub. L. No. 90-439, § 2, 82 Stat. 454 (1968) (current version at 15 U.S.C. § 78(d)(1) (1976)). Under the Act, a bidder must disclose to the SEC the financing arrangements for the tender offer, the bidder's plans for the target after takeover, and the number of target shares in the bidder's possession. *Id.* A bidder also must disclose any outstanding obligations of the bidder relating to the target shares. *Id.* Since the focus of the Williams Act is on a bidder's duty to target shareholders, the § 14(e) antifraud provision should be considered as referring to a bidder unless the legislative history of § 14(e) indicates an intent to expand the scope of the section to include a person who is not a corporate insider. *See* text accompanying note 41 *supra*.

cerning a tender offer, the reports' commentary on section 14(e) does not mention a duty to disclose material, nonpublic information applicable to persons other than those making or opposing a tender offer.[53] Therefore, the 1967 Senate and 1968 House reports pertaining to the Williams Act do not indicate congressional intent to create a disclosure duty applicable to persons not in a fiduciary relationship.[54]

The 1967 Senate and the 1968 House hearings concerning the Williams Act also indicate that Congress enacted the Williams Act to prohibit bidders, rather than persons outside a fiduciary relationship, from engaging in fraudulent tender offers.[55] The section-by-section analysis of the Williams Act appearing in the 1967 Senate hearings states that section 14(e) prohibits a person making or opposing a tender offer from committing fraudulent acts in connection with the tender offer.[56] Senator Thomas Kuchel, co-sponsor of the Williams Act, reported that the Williams Act was designed to prohibit a bidder from taking control of the target without first disclosing material information concerning the tender offer to the target shareholders.[57] The Chairman of the SEC,[58] the President of the American Stock Exchange,[59] and a Vice President of the New York Stock Exchange[60] agreed with Senator Kuchel. Several legal scholars also expressed the view that the drafters of the Williams Act intended to impose a disclosure duty upon a bidder.[61] Thus, the 1967

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[53] *See* 1967 Senate Rep., *supra* note 2, at 11 (§ 14(e) applies to person making, opposing, or seeking to influence tender offer); 1968 House Rep., *supra* note 2, at 6 (§ 14(e) applies to persons making or opposing tender offer).

[54] *See* text accompanying notes 49-53 *supra.*

[55] *See* 1967 Senate Hearings, *supra* note 2, at 1-3 (statement of Senator Harrison A. Williams) (Williams Act requires bidder to disclose material facts when making tender offer); 1968 House Hearings, *supra* note 2, at 1 (statement of Congressman John E. Moss) (Williams Act requires bidder to disclose material facts connected with tender offer).

[56] 1967 Senate Hearings, *supra* note 2, at 14.

[57] 1967 Senate Hearings, *supra* note 2, at 16 (statement of Senator Thomas H. Kuchel).

[58] 1967 Senate Hearings, *supra* note 2, at 16 (statement of Manuel F. Cohen). The SEC Chairman stated that imposing disclosure requirements upon a bidder allows target shareholders to make an informed judgment regarding the effects of a change in the target's management. 1967 Senate Hearings, *supra* note 2, at 18 (statement of Manuel F. Cohen). One advantage resulting from bidder disclosure is protection of target shareholders from making a hasty decision to sell when bidder disclosure might reveal the possibility of a better offer. 1967 Senate Hearings, *supra* note 2, at 17 (statement of Manuel F. Cohen).

[59] 1967 Senate Hearings, *supra* note 2, at 96 (statement of Ralph S. Saul).

[60] 1967 Senate Hearings, *supra* note 2 at 70 (statement of Donald L. Calvin).

[61] *See* 1967 Senate Hearings, *supra* note 2, at 129 (statement of Arthur Fleischer, Jr.) (proposed Williams Act applies to bidders, but requires excessive bidder disclosure); 1967 Senate Hearings, *supra* note 2, at 136 (statement of Stanley A. Kaplan) (proposed Williams Act requires unnecessary bidder disclosure); 1967 Senate Hearings, *supra* note 2, at 139 (statement of William H. Painter). Painter testified that the broad issue concerning the proposed Williams Act was determining when a bidder has a duty to disclose inside information. 1967 Senate Hearings, *supra* note 2, at 143 (statement of William H. Painter). Painter stated that § 10(b) and § 14(e) have similar language and that the proposed Williams Act did not indicate a difference in the application of the two sections. 1967 Senate Hearings, *supra*

Senate and 1968 House hearings indicate that the primary thrust of the Williams Act is the prevention of fraud by a bidder making a tender offer.[62]

Although the Senate and House hearings demonstrate that the Williams Act regulates bidders, the hearings also contain evidence that Congress intended section 14(e) to require any person in possession of material nonpublic information concerning a tender offer to disclose the information before trading in target securities.[63] Congressman John Moss stated that the purpose of the Williams Act is to provide shareholders with the information necessary to make an informed investment decision regarding a tender offer.[64] A Vice President of the New York Stock Exchange testified that a primary concern of the Williams Act is elimination of adverse market effects resulting from trading in securities without disclosing material nonpublic information.[65] The Chairman of the SEC testified that a major misconception concerning the Williams Act was that the sole purpose of the Act is the prevention of fraud by parties making or opposing a tender offer.[66] If the scope of the Williams Act is not limited to preventing fraud by persons making or opposing a tender offer, then section 14(e) might justify a rule requiring a person who is not in a fiduciary relationship to disclose his material nonpublic information concerning a tender offer before trading in target securities.[67] The Senate and House hearings, however, do not explicitly reveal congressional intent that section 14(e) broaden the duty to disclose under the '34 Act beyond the duty imposed under section 10(b).[68]

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note 2, at 140 (statement of William H. Painter). Painter concluded that if Congress desired to create special protections for target shareholders, the protection should be implemented by amending § 10(b), not § 14(e). 1967 Senate Hearings, *supra* note 2, at 142 (statement of William H. Painter).

[62] *See* text accompanying notes 55-61 *supra*.

[63] *See* text accompanying notes 64-68 *infra*.

[64] 1968 House Hearings, *supra* note 3, at 1 (statement of John E. Moss).

[65] 1968 House Hearings, *supra* note 2, at 43 (statement of Donald L. Calvin). Calvin attacked a section of the proposed Williams Act that would have required a bidder to file with the SEC a statement of intention to make a tender offer five days before commencing the tender offer. *Id.* Calvin opposed the rule because the rule would promote leaks of material, nonpublic information concerning a tender offer. *Id.* at 44. Calvin testified that when material, nonpublic information relating to a bidder's intent to commence a tender offer leaks into the securities market, the market price of the target securities increases to the tender offer price. *Id.* When the market price reaches the tender offer price, bidders may be forced to abandon their tender offers, thus harming target shareholders who would have tendered their shares. *Id.* Since Calvin directed his remarks toward the market effects of trading absent public disclosure of material nonpublic information, Calvin implicitly supported requiring a person who is not a corporate insider to abstain from trading in securities without first disclosing the material nonpublic information. *See id.* Calvin gave similar testimony in the 1967 Senate Hearings. *See* 1967 Senate Hearings, *supra* note 2, at 69-76 (statement of Donald L. Calvin).

[66] 1967 Senate Hearings, *supra* note 2, at 205 (statement of Manuel F. Cohen).

[67] *See* text accompanying note 41 *supra*.

[68] *See* text accompanying notes 52-67 *supra*.

The legislative history of the 1970 amendment to rule 14(e) contains little evidence that Congress intended to grant the SEC the power to regulate the disclosure duty of a person not in a fiduciary relationship.[69] The Senate and House reports concerning the amendment to section 14(e) indicate instead that Congress intended to grant the SEC rulemaking power to regulate sophisticated schemes and devices used by bidders and targets in a tender offer.[70] The reports do not mention an intent to regulate trading upon material, nonpublic information.[71] The 1970 Senate and House hearings also indicate that Congress granted the SEC rulemaking power under section 14(e) to regulate bidder and target fraud.[72] Thus, the legislative history emphasizes that Congress intended the 1970 amendment to section 14(e) to allow regulation of bidders and targets, not corporate outsiders.[73]

The 1970 Senate hearings, however, do provide some evidence that Congress amended section 14(e) to allow the SEC to prohibit all trading in securities involved in a tender offer absent disclosure of material nonpublic information.[74] During the hearings, Senator Williams asked the SEC Chairman for examples of practices that rules promulgated under section 14(e) would prohibit.[75] The Chairman responded that the rules would prohibit a person aware of a pending tender offer from trading in the target securities without first publicly disclosing that the target was a tender offer candidate.[76] The SEC Chairman did not indicate whether the rule would apply to all persons gaining possession of material, nonpublic information relating to a tender offer or whether the rule would

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[69] *See* text accompanying notes 70-73 *infra*; text accompanying note 45 *supra*. *But see* text accompanying notes 74-78 *infra*.

[70] *See* 1970 Senate Hearings, *supra* note 2, at 36 (statement of SEC Chairman Hamer H. Budge); 1970 House Hearings, *supra* note 2, at 21 (statement of SEC Chairman Hamer H. Budge); 1970 Senate Hearings, *supra* note 2, at 2 (statement of Harrison A. Williams). The 1967 Senate hearings provide examples of fraudulent practices that targets employ in contested tender offers. Professor Stanley A. Kaplan testified that target managements will often issue a public statement that the tender offer price is too low, and then propose a dividend increase. *See* 1967 Senate Hearings, *supra* note 2, at 125 (statement of Stanley A. Kaplan). Target managements also often attempt to defeat a tender offer through the institution of litigation based upon questionable claims against the bidder. *See id.* In response to Professor Kaplan's remarks, Professor Robert H. Mundheim remarked that § 14(e) would prohibit such practices. 1967 Senate Hearings, *supra* note 2, at 125 (statement of Robert H. Mundheim).

[71] *See* 1970 Senate Rep., *supra* note 2, at 6; 1970 House Report, *supra* note 2, at 21.

[72] *See* 1970 Senate Hearings, *supra* note 2, at 36 (statement of SEC Chairman Hamer H. Budge); 1970 House Hearings, *supra* note 2 at 21 (statement of SEC Chairman Hamer H. Budge).

[73] *See* text accompanying notes 69-72 *supra*.

[74] *See* text accompanying notes 75-78 *infra*.

[75] 1970 Senate Hearings, *supra* note 2, at 11 (statement of Senator Harrison A. Williams).

[76] 1970 Senate Hearings, *supra* note 2, at 12 (statement of SEC Chairman Hamer H. Budge).

be limited to persons involved in making or opposing the tender offer.[77] Nonetheless, the Chairman's testimony in the 1970 Senate hearings is the best indication that the applicability of rule 14e-3 to a person who is not a corporate insider is within the scope of section 14(e).[78]

Even if rule 14e-3 as interpreted by the SEC is within the scope of section 14(e), the potential impact of rule 14e-3 is difficult to assess. Federal courts have not decided any cases involving alleged violation of rule 14e-3. In *Feldman v. Simkins Industries, Inc.*,[79] and *Walton v. Morgan Stanley & Co., Inc.*,[80] however, two federal courts considered the effect of *Chiarella* upon the issue whether a person who is not a corporate insider has a duty to disclose material nonpublic information concerning a tender offer before trading in target securities.[81] Although the courts decided the cases before promulgation of rule 14e-3,[82] analysis of *Feldman* and *Morgan Stanley* provides insight into the possible impact of rule 14e-3.[83]

In *Feldman*, Louisiana-Pacific Corporation made a tender offer for shares of Fibreboard Corporation.[84] One of the conditions of the tender

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[77] *See id.* Chairman Budge responded by memorandum to Senator Williams' request for examples of the activities that the SEC would prohibit through rules promulgated under § 14(e). *See* MEMORANDUM PREPARED BY DIVISION OF CORPORATE FINANCE, *reprinted in* 1970 Senate Hearings, *supra* note 2, at 12 [hereinafter cited as SEC Memorandum]. The memorandum cited seven fraudulent acts that rules promulgated under § 14(e) would prohibit. *See* SEC Memorandum, *reprinted in* 1970 Senate Hearings, *supra* note 2, at 12. Of the seven fraudulent acts cited, six specifically involved actions by bidders and targets. *See id.* The only act cited that did not apply to a bidder or target applied to "[t]he person who has become aware that a tender bid is to be made." *Id.* Although the plain meaning of the quoted language indicates applicability to any person, the language arguably applies only to agents of a bidder or target. *See* text accompanying notes 69-73 *supra.*

[78] *See* text accompanying note 76 *supra.*

[79] 492 F. Supp. 839 (N.D. Ca. 1980).

[80] 623 F.2d 796 (2d Cir. 1980).

[81] *See* Walton v. Morgan Stanley & Co., Inc., 623 F.2d 796, 799 n.6 (2d Cir. 1980) (under *Chiarella*, duty to disclose or abstain from trading requires fiduciary relationship); Feldman v. Simkins Indus., Inc., 492 F. Supp. 839, 844 (N.D. Ca. 1980) (under *Chiarella*, insiders are officers, directors, majority shareholders, or persons in relationship of trust).

[82] *See* Walton v. Morgan Stanley & Co., Inc., 623 F.2d 796, 799 (2d Cir., June 4, 1980) (breach of fiduciary duty requires fiduciary relationship); Feldman v. Simkins Indus., Inc., 492 F. Supp. 839, 845 (N.D. Ca., June 19, 1980) (duty to disclose material nonpublic information requires fiduciary relationship).

[83] *See* text accompanying notes 84-128 *infra.*

[84] 492 F. Supp. at 842. The *Feldman* court referred to Louisiana-Pacific's takeover attempt to Fibreboard as a cash sale merger offer. *Id.* The cash sale merger offer appears to have been a tender offer. Although the Williams Act requires a bidder to disclose to the SEC certain information relating to a tender offer, the Act does not define tender offer. *See* 15 U.S.C. § 78(l)-(n) (1976). The SEC, however, has proposed a rule defining tender offer. *See* 44 Fed. Reg. 70,349, 70,349-52 (1979). Under the proposed rule, an offer to purchase securities is a tender offer if either of two tests are met. *Id.* The first test has four elements. First, there must be one or more offers to purchase shares of one class. *Id.* Second, the offers must be within a 45 day period. *Id.* Third, the offer must be directed toward more than 10 persons. *Id.* Fourth, the bidder must be seeking more than 5% of the class of securities. *Id.*

The second test of the proposed rule defining tender offer has three elements. *supra*

offer was that Leon Simkins and two other major Fibreboard shareholders tender their shares to Louisiana-Pacific for $15 per share.[85] Although Simkins made repeated public announcements that he would not sell his Fibreboard shares for $15 per share, Simkins sold his shares for an average price of more than $16 per share without making a public announcement of the sale.[86] Feldman, a former Fibreboard shareholder, charged that Simkins' sale of Fibreboard securities violated section 10(b) of the '34 Act and rule 10b-5.[87] Feldman alleged that Simkins' sale of Fibreboard securities constituted material nonpublic information concerning a tender offer,[88] and that Simkins was a corporate insider having duty to disclose publicly his intention to sell his Fibreboard shares before selling them.[89] Alternatively, Feldman charged that Simkins had a duty to disclose his intention to sell his interest in Fibreboard even if Simkins was not a corporate insider.[90]

Based upon the Supreme Court's decision in *Chiarella*, the Northern District of California determined that Simkins was not a corporate insider because Simkins was not an officer, director, controlling shareholder, or person in a relationship of trust or confidence with Fibreboard shareholders.[91] The *Feldman* court ruled that even if Simkins' intention to sell Fibreboard shares constituted material nonpublic information, Simkins had no duty to disclose his intention to sell his interest in Fibreboard.[92] The court found that under the *Chiarella* rationale, a duty

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70,351. First, the offer must be made in a widespread manner. *Id.* Second, the offer price must exceed either 5% of the market price, or exceed the market price by $2 per share. Finally, the offers cannot allow an opportunity to negotiate the offered price. *Id.*

The cash sale merger offer in *Feldman* meets the first test of the proposed SEC definition of tender offer. Louisiana-Pacific made an offer to purchase shares of common stock of Fibreboard. Feldman v. Simkins Indus., 492 F. Supp. 839, 842 (N.D. Ca. 1980). Since Louisiana-Pacific made only one offer involving Simkins' Fibreboard shares, the requirement that the offers be within a 45 day period was irrelevant. *See* 44 Fed. Reg. at 70,350 n.10. The three major shareholders of Fibreboard owned 1,037,200 shares, which constituted only 31% of the outstanding Fibreboard shares. 492 F. Supp. at 842. Thus, although not stated in the decision, the Louisiana-Pacific offer apparently extended to more than 10 Fibreboard shareholders. *See id.* Finally, Louisiana-Pacific sought more than 5% of the Fibreboard shares by requiring the three major Fibreboard shareholders to sell their interests in Fibreboard. *Id.* The Louisiana-Pacific offer would not have met the second of the proposed definitions of tender offer because Louisiana-Pacific negotiated the price of the offer with the Fibreboard management. *See id.*; 44 Fed. Reg. at 70,351.

[85] Feldman v. Simkins Indus., Inc., 492 F. Supp. 839, 842 (1980).

[86] *Id.* at 843.

[87] *Id.* at 844.

[88] *Id.*

[89] *Id.*

[90] *Id.*

[91] *Id.*

[92] *Id.* at 844-45. In *Feldman*, the plaintiff argued that if investors had known that Simkins was selling 400,000 shares of Fibreboard, that knowledge might have influenced their investment decisions. *Id.* at 844 n.3. The plaintiff argued further that the sale of large blocks of Fibreboard shares could have affected prospective shareholders' opinions concerning whether Fibreboard would merge with Louisiana-Pacific. *Id.* at 844. For purposes of its

to disclose material nonpublic information before trading applies only to a corporate insider.[93]

Applying rule 14e-3 to the facts in *Feldman* would not have imposed a duty upon Simkins to disclose or abstain from trading.[94] Rule 14e-3 imposes that duty upon a person who is not a corporate insider only when the person acquires material, nonpublic information concerning a tender offer from a bidder, target, or agent of a bidder or target.[95] Simkins' material, nonpublic information was the personal knowledge that he was selling his interest in Fibreboard.[96] Since Simkins did not acquire that information from bidder Louisiana-Pacific, target Fibreboard or from an agent of the bidder or target, rule 14e-3 would not have required Simkins to disclose his intention to sell his interest in Fibreboard before selling his shares.[97] Thus, applying rule 14e-3 to the *Feldman* facts indicates that rule 14e-3 preserves a shareholder's ability to trade securities upon nonpublic information concerning his personal market transactions.[98]

Although rule 14e-3 would not have altered the result in *Feldman*, rule 14e-3 might have changed the outcome in *Walton v. Morgan Stanley & Co., Inc.*[99] In *Morgan Stanley*, Kennecott Corporation hired Morgan Stanley & Co., Inc. to find a company that Kennecott could acquire.[100] Morgan Stanley, a multi-service financial institution specializing in investment advice,[101] suggested Olinkraft as a merger candidate for Kennecott.[102] Olinkraft favored a merger with Kennecott[103] and gave Morgan Stanley's Mergers and Acquisitions Department material, nonpublic information pertaining to projected Olinkraft earnings.[104] Olinkraft warned Morgan Stanley's Mergers and Acquisitions Department that the information was to be used only for securing a Kennecott bid for Olinkraft securities.[105] Although Kennecott decided not to bid for Olinkraft, Texas

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decision, the district court assumed without deciding that Simkins' sale of large blocks of Fibreboard shares constituted material nonpublic information. *Id.* at 844 & n.3, 845.

[93] *Id.* at 845.

[94] *See* text accompanying notes 95-98 *infra.*

[95] *See* 17 C.F.R. § 240.14e-3(a) (1981).

[96] *See* Feldman v. Simkins Indus., Inc., 492 F. Supp. 859, 844 & n.3 (N.D. Ca. 1980); text accompanying note 91 *supra.*

[97] *See* Feldman v. Simkins Indus., Inc., 492 F. Supp. 839, 843-44 (N.D. Ca. 1980) (Simkins created material nonpublic information); 45 Fed. Reg. 60,410, 60,410 (1980); 17 C.F.R. § 240.14e-3 (1981); text accompanying note 6 *supra* (rule 14e-3 requires acquisition of material nonpublic information from bidder, target, or agent of bidder or target).

[98] *See* text accompanying notes 94-98 *supra.*

[99] 623 F.2d 796 (2d Cir. 1980); *see* text accompanying notes 100-103 *infra.*

[100] 623 F.2d at 797.

[101] *See id.*; text accompanying note 8 *supra* (definition of multi-service financial institution).

[102] *See* Walton v. Morgan Stanley & Co., Inc., 623 F.2d 796, 797 (2d Cir. 1980).

[103] *Id.*

[104] *Id.*

[105] *Id.*

Eastern Corporation made a tender offer to purchase Olinkraft shares for $51 per share.[106] After announcement of the Texas Eastern tender offer, Morgan Stanley's Arbitrage Department purchased 149,200 shares of Olinkraft for Morgan Stanley's benefit upon the belief that an offer for Olinkraft at greater than $51 per share would be forthcoming.[107] Although the Mergers and Acquisitions Department knew of the Arbitrage Department's Olinkraft purchases, the Mergers and Acquisitions Department disclosed the confidential Olinkraft earnings projections to Johns-Manville to convince Johns-Manville to make a tender offer for Olinkraft.[108] Johns-Manville and Texas Eastern entered into a bidding war for Olinkraft, and Johns-Manville ultimately purchased Olinkraft for $65 per share.[109] Walton, a former Olinkraft shareholder, brought suit to require Morgan Stanley to account for profits made from purchases of Olinkraft stock.[110] The Second Circuit reasoned that Morgan Stanley owed no fiduciary duty to Olinkraft because Olinkraft and Morgan Stanley had negotiated at arm's length.[111] Thus, since Morgan Stanley had no fiduciary relationship with Olinkraft shareholders, the court held that Morgan Stanley did not have a duty to disclose its confidential information regarding Olinkraft's projected earnings.[112]

Although the Second Circuit held that Morgan Stanley owed no duty to Olinkraft, Morgan Stanley might have been guilty of fraud under rule

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[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *Id.* at 798.

[110] *Id.* The *Morgan Stanley* decision does not indicate the precise point at which Morgan Stanley purchased Olinkraft shares. *See id.* at 797. When Texas Eastern bid $51 for Olinkraft shares, Olinkraft shares had been selling for between $31 and $39. *Id.* Johns-Manville eventually bid $65. *Id.* Since the Johns-Manville bid was nearly double the pre-Texas Eastern bid price, Morgan Stanley's profits appear to have been substantial. *See id.* at 797-98.

[111] *Id.* at 798. The *Morgan Stanley* court found that Morgan Stanley and Olinkraft had separate duties at all times during their negotiations. *Id.* Olinkraft owed a duty to Olinkraft shareholders, while Morgan Stanley owed a duty only to Kennecott. *Id.* The Second Circuit rejected plaintiff's argument that Morgan Stanley became a fiduciary of Olinkraft upon receipt of Olinkraft's material nonpublic information. *Id.* at 799. While the Second Circuit's holding is consistent with the Supreme Court's decision in *Chiarella* that the mere possession of material, nonpublic information does not give rise to a duty to disclose or abstain from trading, *Chiarella* and *Morgan Stanley* are distinguishable. *See* Chiarella v. United States, 455 U.S. 222, 233 (1980) (duty to disclose does not arise upon mere possession of material, nonpublic information).

Chiarella involved a financial printer's employee who never had prior dealings with the parties with whom he traded. 445 U.S. at 231. Morgan Stanley did have dealings with Olinkraft before trading in Olinkraft securities. *See* Walton v. Morgan Stanley & Co., Inc., 623 F.2d 696, 697 (2d Cir. 1980). When Morgan Stanley accepted Olinkraft's material, nonpublic information with a condition upon the use of the information, Morgan Stanley arguably placed itself in a position of trust and confidence with Olinkraft. *See id.* at 803 (Oakes, J., dissenting). Thus, the *Morgan Stanley* court could have ruled that Morgan Stanley owed a duty to Olinkraft shareholders to abstain from trading in Olinkraft. *See id.*

[112] *See* 623 F.2d at 799.

14e-3.[113] Rule 14e-3 prohibits a person from causing the sale or purchase of securities involved in a tender offer without disclosing his material nonpublic information "relating to" the tender offer if the person knows that he acquired the information from the bidder or target.[114] Causing a sale or purchase includes a recommendation to a person that results in a sale or purchase of a security.[115] At the time Texas Eastern made its tender offer, Morgan Stanley possessed material information concerning the value of Olinkraft securities.[116] Morgan Stanley knew the information was nonpublic, and that it had acquired the information from the target of a tender offer.[117] Thus, if the confidential Olinkraft earnings projections "related to" the Texas Eastern tender offer, Morgan Stanley violated rule 14e-3 by purchasing and by advising Johns-Manville to purchase Olinkraft securities.[118]

Since rule 14e-3 does not define information that relates to a tender offer, not all material, nonpublic information concerning a bidder or target necessarily relates to a tender offer.[119] A bidder's intent to make or target's intent to oppose a tender offer are examples of information that clearly relate to a tender offer.[120] A target's projected earnings

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[113] *See* text accompanying notes 114-128 *infra*.

[114] *See* 17 C.F.R. § 240.14e-3(a) (1981); text accompanying note 6 *supra*.

[115] 45 Fed. Reg. 60,410, 60,413 n.38 (1980).

[116] *See* 623 F.2d at 797. The facts in *Morgan Stanley* do not indicate conclusively that the case involved a tender offer within the meaning of rule 14e-3. *See id.* at 797-98. The facts reveal, however, that Texas Eastern made a public announcement of an offer to purchase Olinkraft shares at a price substantially higher than market price. *Id.* at 797. Johns-Manville also made a public offer to purchase Olinkraft shares. *Id.* at 798. The court described the Texas Eastern and Johns-Manville offers as bids. *Id.* at 797-98. Texas Eastern and Johns-Manville made public offers for enough shares to acquire a controlling interest in Olinkraft to more than 10 persons. *See id.* Therefore, the Texas Eastern and Johns-Manville bids appear to have been tender offers as defined in proposed SEC rule 14d-1(b)(1). *See* 44 Fed. Reg. 70,349, 70,349-52 (1979) (proposed SEC rule defining tender offer); text accompanying note 84 *supra*.

[117] *See* 623 F.2d at 797; text accompanying note 6 *supra*.

[118] *See* 17 C.F.R. § 240.14e-3 (1981); 45 Fed. Reg. 60,410, 60,413 n.35 (1980).

[119] *See* 17 C.F.R. § 240.14e-3 (1981). The language of rule 14e-3 applies expressly to material nonpublic information relating to a tender offer. *Id.* If the SEC had intended rule 14e-3 to apply to information relating to a bidder or target, but not relating to a tender offer itself, the SEC could have drafted rule 14e-3 expressly to prohibit trading upon nonpublic information relating to corporations involved in a tender offer. The SEC has published examples of information that relates to a tender offer. *See* 45 Fed. Reg. 60,410, 60,413 n.35 (1980); 44 Fed. Reg. 70, 349, 70,353 (1979). All of the examples involve information that a tender offer will be either made, withdrawn, or altered. *See* 45 Fed. Reg. at 60,413 n.35; 44 Fed. Reg. at 70,353; text accompanying note 120 *infra*. *But see* text accompanying notes 124-26 *infra*. The SEC's published examples of information that relates to a tender offer are distinguishable from Olinkraft's earnings projections because the earnings projections do not bear directly upon the tender offer. *See* 45 Fed. Reg. at 60,413 n.35; 44 Fed. Reg. at 70,353. Since the Olinkraft earnings projections had only an indirect relation to the Texas Eastern tender offer, the information arguably did not relate to the tender offer within the meaning of rule 14e-3. *But see* text accompanying notes 124-26.

[120] *See* 45 Fed. Reg. 60,410, 60,413 n.35 (1980); 44 Fed. Reg. 70,349, 70,353 (1979).

arguably relate only to the target, and do not relate to the tender offer.[121] Thus, the Olinkraft earnings projections could have constituted material, nonpublic information without relating to the Texas Eastern tender offer within the meaning of rule 14e-3.[122] The ambiguity of the requirement that material information relate to a tender offer, however, does not preclude an interpretation of rule 14e-3 requiring a person in possession of material nonpublic information concerning simply a bidder or target to disclose his information before trading in bidder or target securities.[123]

The SEC has implied that any material information concerning a bidder or target relates to a tender offer under rule 14e-3.[124] The Commission maintains that information relating to a tender offer is not limited to a bidder's intent to make or withdraw a tender offer, or to a bidder's intent to increase the consideration for tendered shares.[125] Further, the SEC has stated that information material to investors concerning an ongoing tender offer may relate to the tender offer.[126] Since knowledge of Olinkraft's earnings projections would have been material to investors contemplating the Texas Eastern tender offer, the information related to the tender offer under the SEC's interpretation of rule 14e-3.[127] Therefore, Morgan Stanley would have violated rule 14e-3 because Morgan Stanley failed to disclose its material, nonpublic information relating to the Texas Eastern tender offer before purchasing and inducing Johns-Manville to purchase target securities of that tender offer. The exception to rule 14e-3(a) for multi-service financial institutions would not have saved Morgan Stanley from liability because the Mergers and Acquisitions Department did not disclose its knowledge of Olinkraft's projected earnings before advising Johns-Manville to purchase Olinkraft securities.[128]

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[121] *See id.*; text accompanying note 118 *supra.*

[122] *Id.*

[123] *See* text accompanying notes 124-26 *infra.*

[124] *See* 44 Fed. Reg. 70,349, 70,353 (1979).

[125] *See* 45 Fed. Reg. 60,410, 60,413 n.35 (1980); 44 Fed. Reg. 70,349, 70,353 (1979).

[126] 44 Fed. Reg. 70,349, 70,353 (1979).

[127] *See* text accompanying notes 124-26 *supra.*

[128] *See* Walton v. Morgan Stanley & Co., 623 F.2d 796, 797-98 (2d Cir. 1980); text accompanying notes 113-27 *supra.* The exception to rule 14e-3(a) for multi-service financial institutions would not have saved Morgan Stanley from liability because the Mergers and Acquisitions Department did not disclose publicly its knowledge of Olinkraft's projected earnings before advising Johns-Manville to purchase Olinkraft securities. *See* 17 C.F.R. § 240.14e-3(a), (b) (1981); text accompanying notes 8 & 13-14 *supra.* Had the Mergers and Acquisitions Department not advised Johns-Manville to buy Olinkraft, the exception might have saved Morgan Stanley from liability under rule 14e-3(a). *See* 17 C.F.R. § 240.14e-3(b) (1981); note 8 *supra.* The exception would have required Morgan Stanley to prove that its Arbitrage Department, the actual purchaser of Olinkraft stock, did not possess the material nonpublic information that Olinkraft provided to the Mergers and Acquisitions Department. *See* 17 C.F.R. § 240.14e-3(b) (1981); note 8 *supra.* The exception would also have required Morgan Stanley to prove that it had established procedures reasonably designed to prevent

Rule 14e-3 imposes upon a person who is not a corporate insider a duty either to disclose his material, nonpublic information regarding a tender offer or abstain from trading.[129] The rule prohibits persons such as Chiarella and Morgan Stanley from taking advantage of their nonpublic market information to the disadvantage of uninformed traders.[130] The rule, however, does not affect the ability of a shareholder like Simkins to trade in securities without disclosing information concerning his personal market transactions.[131] Although rule 14e-3 accomplishes the goal of the SEC to prohibit persons who are not corporate insiders from trading in securities involved in a tender offer pursuant to material nonpublic information,[132] the SEC's interpretation of the scope of rule 14e-3 is questionable.[133] Neither the statutory language[134] or the legislative history[135] of section 14(e) encourages a finding that Congress intended section 14(e) to create a disclosure duty broader than the duty imposed under section 10(b). Federal circuit and district courts have held uniformly that the duties imposed under section 14(e) do not exceed the duties imposed under section 10(b).[136] Since *Chiarella* held that section 10(b) requires only a corporate insider to disclose material, nonpublic in-

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interdepartmental communication of material nonpublic information. *See* 17 C.F.R. § 240.14e-3(b); note 8 *supra*.

In addition to violating rule 14e-3(a), Morgan Stanley's communication of Olinkraft's earnings projections to Johns-Manville violated rule 14e-3(d). Rule 14e-3(d) prohibits the communication of material nonpublic information relating to a tender offer when violation of rule 14e-3(a) is reasonably foreseeable. *See* 17 C.F.R. § 240.14e-3(d) (1981); text accompanying note 10 *supra* (discussion of rule 14e-3(d)). When Morgan Stanley disclosed the Olinkraft earnings projections to Johns-Manville, the information constituted material nonpublic information relating to the Texas Eastern tender offer. *See* Walton v. Morgan Stanley & Co., Inc., 623 F.2d 796, 797-98 (2d Cir. 1980); text accompanying notes 120-126 *supra*. Furthermore, since Morgan Stanley induced Johns-Manville to bid for Olinkraft shares, Morgan Stanley knew that the communication of Olinkraft's confidential earnings projections likely would result in Johns-Manville's trading pursuant to the information. *See* 623 F.2d at 797-98. The exception to rule 14e-3(d) allowing good faith communications to a bidder of material nonpublic information relating to a tender offer would not have absolved Morgan Stanley from liability. *See* 17 C.F.R. § 240.14e-3(d)(1)(i) (1981). Morgan Stanley's disclosure of Olinkraft's earnings projections was not made in good faith because Morgan Stanley had reason to know that Johns-Manville would purchase Olinkraft shares without disclosing the information. *See id.*, 45 Fed. Reg., 60,410, 60,417 (1980) (rule 14e-3(d) exception does not apply if person knows or has reason to know that communication of information will result in violation of rule 14e-3). Moreover, when Morgan Stanley communicated the information to Johns-Manville, Johns-Manville was not a bidder. *See* 623 F.2d at 797.

[129] *See* 17 C.F.R. § 240.14e-3 (1981).

[130] *See* text accompanying notes 113-128 *supra*.

[131] *See* text accompanying notes 94-98 *supra*.

[132] *See* text accompanying notes 113-128 *supra*.

[133] *See* text accompanying notes 52-78 *supra*.

[134] *See* text accompanying notes 52-77 *supra*.

[135] *See* text accompanying notes 41-47 *supra*.

[136] *See* text accompanying note 45 *supra*.

formation before trading in target securities, rule 14e-3 appears to be an invalid attempt of the SEC to extend the disclosure duty under section 14(e) beyond statutory limits.[137]

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[137] *See* Olden, *SEC Rule On Tender Offer Nips Back On 'Chiarella,'* Vol. 3 No. 20 LEGAL TIMES OF WASHINGTON 19, Oct. 20, 1980 at 19 (rule 14e-3 promulgated to circumvent *Chiarella*).