Washington and Lee Law Review

Volume 44 | Issue 3 Article 12

Summer 6-1-1987

City National Bank V. American Commonwealth Financial Corp: The Application Of Rule 10B-13 Of The Securities Exchange Act Of 1934 To Executory Contracts

CITY NATIONAL BANK v. AMERICAN COMMONWEALTH FINANCIAL CORP: THE APPLICATION OF RULE 10b-13 OF THE SECURITIES EXCHANGE ACT OF 1934 TO EXECUTORY CONTRACTS

Congress enacted the Securities Act of 1933[1] ('33 Act) and Securities Exchange Act of 1934[2] ('34 Act) to provide investors with the information necessary to make informed investment decisions.[3] Congress intended that the '33 and '34 Acts protect investors from fraudulent and deceptive practices in securities transactions by requiring the effective disclosure of material facts pertaining to the sale of securities.[4] More specifically, the '33

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1. Securities Act of 1933, Pub. L. No. 73-291, 48 Stat. 74 § (1933)(codified as amended at 15 U.S.C. §§ 77a-77aa (1986)).

2. Securities Exchange Act of 1934, Pub. L. No. 73-22, 48 Stat. 881 (1934)(codified as amended at 15 U.S.C. §§ 78a-78kk (1986))

3. *See* 1 L. Loss, SECURITIES REGULATIONS 21 (2d ed. 1961)(Congress expressed recurrent theme of disclosure throughout Securities Act of 1933 and Securities Exchange Act of 1934). In enacting the Securities Act of 1933 ('33 Act), Congress attempted to control securities investments in interstate commerce by requiring all issuers of new securities to disclose fully all material information pertaining to the securities issue. *See* H.R. REP. No. 85, 73d Cong., 1st Sess. 89 (1933), *reprinted in* 1 FEDERAL SECURITIES LAWS LEGISLATIVE HISTORY 1933-1982, at 138, 138-39 (disclosure requirements of '33 Act provide investors with adequate information necessary to judge accurately value of securities in initial offering). Congress thus attempted to eliminate the concealment from the investing public of material facts concerning the securities issue. *Id.* While the '33 Act regulates new issues of securities, the Securities Exchange Act of 1934 ('34 Act) regulates publicly traded corporations by requiring the continuous disclosure of material information to the investing public. *See infra* notes 5-6 and accompanying text (discussing scope of regulation of '33 and '34 Acts). In enacting the '34 Act, Congress sought to control problems of secrecy concerning the financial condition of publicly traded corporations. *See* H.R. REP. No. 1383, 73d Cong., 2d Sess. 11 (1934), *reprinted in* 1 FEDERAL SECURITIES LAWS LEGISLATIVE HISTORY 1933-1982, at 794, 804 (continuous disclosure of information that the '34 Act requires provides investors with basis for valuing securities that investors buy and sell); *see also* S. REP. No. 792, 73d Cong., 2d Sess. 10 (1934) [hereinafter 1934 SENATE REPORT], *reprinted in* 1 FEDERAL SECURITIES LAWS LEGISLATIVE HISTORY 1933-1982, at 708, 717 ('34 Act requires corporations that have securities traded on national exchange to file up-to-date information with Securities Exchange Commission).

4. *See* 1934 SENATE REPORT, *supra* note 3, at 7 (Congress specifically prohibited any device that serves no legitimate purpose and that raises or depresses security prices artificially); *see also* United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975)(discussing purpose of Securities Act of 1933 and Securities Exchange Act of 1934). In *United Housing Foundation*, the United States Supreme Court explained that the primary purpose of the Securities Act of 1933 and the Securities Exchange Act of 1934 was to prevent abuses in the securities market. *United Housing Foundation*, 421 U.S. at 849. The Supreme Court explained that in the '33 and '34 Acts Congress focused on the sale of securities to raise capital, on the functioning of the securities exchanges, and on the need to protect investors from fraud. *Id.*; *see* 15 U.S.C. § 77b(1) (1982 & Supp. III 1985)(defining security under '33 Act). Under the '33 Act, the term "security" includes any note, stock, treasury stock, bond, debenture, evidence of indebtedness,

Act regulates the registration, offer, and sale of new issues of securities.[5] Additionally, the '34 Act regulates securities exchanges, companies that have securities traded on national securities exchanges, and the activities of securities brokers, dealers, and underwriters.[6] Prior to 1968, the '33 and

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and any interest or instrument commonly known as a security. 15 U.S.C. § 77b(1) (1982 & Supp. III 1985)(defining security under the '33 Act); 15 U.S.C. § 78c(a)(10) (1982 & Supp. III 1985)(defining security under '34 Act). Under the '34 Act, the term "security" includes any note, stock treasury stock, bond, debenture, or any interest commonly known as a security. 15 U.S.C. § 78c(a)(10) (1982 & Supp. III 1985)(defining security under the '34 Act); *see* H.R. REP. No. 85, 73d Cong., 1st Sess. 11 (1933)[hereinafter 1933 HOUSE REPORT]. Congress defined "security" in broad terms to include many types of instruments that fall within the ordinary concept of a security in the commercial world. 1933 HOUSE REPORT, *supra*, at 11; *see* Vincent v. Moench, 473 F.2d 430, 436 (10th Cir. 1973)(Congress intended definition of security under '34 Act to be broad and to embrace wide variety of investment instruments). In *Vincent v. Moench*, the United States Court of Appeals for the Tenth Circuit defined a security, generally, as any transaction or scheme in which a person invests money in an enterprise to earn profits from the enterprise's business activities. *Vincent*, 473 F.2d at 434; *see* Oxford Fin. Co. v. Harvey, 385 F. Supp. 431, 435 (D. Pa. 1974)(definitions of security under '33 and '34 Acts are virtually identical and, therefore, test of security under '33 and '34 Acts is same); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)(defining material fact). In *TSC Industries, Inc. v. Northway*, the United States Supreme Court explained that an omitted fact is material when, under all the circumstances, a substantial likelihood exists that a reasonable shareholder would have considered the omitted fact important in the shareholder's investment decision. *TSC Industries*, 426 U.S. at 449.

5. *See* 15 U.S.C. §§ 77(c)-(e), 77(e)(b)(23), 77(k), 77(l)(2)(1982 & Supp. III 1985). Sections 77(c)-(e) of the United States Code (Code) provide for the registration of securities and exemptions from registration of securities. *Id.* §§ 77(c)-(e). Section 77(e)(b)(23) of the Code requires the issuer of registered securities to give purchasers of the securities a prospectus that contains the essential information found in the registration statement. *Id.* § 77(e)(b)(23). Sections 77(k) and 77(l) of the Code impose civil liability on individuals for material misrepresentations or omissions in the course of transactions resulting in the acquisition or sale of a security. *Id.* §§ 77(k), 77(l).

6. *See* 15 U.S.C. §§ 78(f), 78(l), 78(j) (1982 & Supp. III 1985). Section 78(f) of the United States Code requires that before the Securities Exchange Commission (SEC) can register an exchange as a national security exchange, the SEC must determine whether the exchange can prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, protect investors and the public interest, and provide fair procedures for the disciplining of exchange members for violation of securities laws. *Id.* §78(f). Section 78(l) prohibits members, brokers, or dealers from effecting transactions in any security on a national security exchange unless the security is properly registered. *Id.* § 78(l). Section 78(j) prohibits a person from employing any manipulative or deceptive device or contrivance in connection with the purchase or sale of any security registered on a national securities exchange. *Id.* § 78(j); *see* 17 C.F.R. § 240.13a-13 (1986)(requiring disclosure of information in annual reports). Corporations registered under § 12 of the Securities Exchange Act of 1934 must file an annual report on Form 10-K. *Id.* Form 10-K annual reports include information concerning the nature of the business, financial data, capital structure, and management structure. 11A pt.1 E. GADSBY, BUSINESS ORGANIZATIONS § 4.02[1] (1986)(discussing information required in Form 10-K); 17 C.F.R. § 249.13a-11 (1986)(requiring disclosure of current information). Issuers that have securities registered under § 12 of the '34 Act must file a current report on Form 8-K. *Id.* Form 8-K current reports include information concerning changes in control, acquisition or disposition of assets, bankruptcy, and change in certified public accountants. *See* G. GADSBY, *supra*, § 4.02[4](discussing information required in Form 8-K).

'34 Acts also required the disclosure of pertinent information that related to exchange offers of stock and proxy solicitations.[7] The '33 and '34 Acts, however, did not require the disclosure of material information in tender offers.[8] In 1968 Congress amended the '34 Act by adopting the Williams Act to require the disclosure of material information in the context of a tender offer.[9] Specifically, section 14(e) of the Williams Act prohibits false

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7. An exchange offer includes a tender offer for any security in exchange for consideration that is not entirely cash. *See* 17 C.F.R. § 240.10b-13(b) (1986)(defining exchange offer); Wellborn, *Rule 10b-13: A Reconsideration*, 26 Sw. L.J. 653, 653 n.2 (1972)(exchange offer describes tender offers for any security in exchange for any consideration other than solely for cash); Lowenfels, *Rule 10b-13, Rule 10b-6 and Purchases of Target Company Securities During an Exchange Offer*, 69 COLUM. L. REV. 1392, 1392 (1969)(exchange offer is offer by corporation of corporation's securities for securities of another corporation); *see also infra* note 8 and accompanying text (distinguishing exchange offer from tender offer).

A proxy is an agency relationship that arises when a shareholder permits a proxy holder to vote for the shareholder at a corporate shareholders' meeting. *See* Note, *Proxy Solicitation: The Need for Expanded Disclosure Requirements*, 70 MARQ. L. REV. 1100, 1101 (1977)(defining proxy). A proxy solicitation is a request for a proxy, a request to execute or not to execute a proxy, or the furnishing of a proxy or other communication to security holders calculated to result in the procurement, withholding, or revocation of a proxy. *See* 17 C.F.R. § 240.14a-1(f)(1) (1986)(defining proxy solicitation).

8. *See* 113 CONG. REC. 855 (1967)('33 and '34 Acts regulated only exchange offers and proxy contests prior to 1968). In debating about the lack of regulation concerning tender offers, Senator Williams explained that a gap existed in securities regulation because a tender offeror was not required to disclose any information, while persons involved in exchange offers or proxy contests had to disclose the information necessary for investors to make intelligent investment decisions. *Id.* Senator Williams further noted that the absence of any requirement for a tender offeror to disclose material information was inconsistent with the prevailing disclosure patterns in the securities markets. *Id.*

A tender offer is a public invitation to shareholders to sell all or part of their shares at a premium over the current price. Korval, *Defining Tender Offers: Resolving a Decade of Dilemma*, 13 SEC. L. REV. 549, 549 (1981); *see* Wellman v. Dickinson, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979)(discussing characteristics of tender offer). In *Wellman v. Dickinson*, the United States District Court for the Southern District of New York noted that tender offerors usually engage in active solicitation of public shareholders of an issuer. *Wellman*, 475 F.2d at 823. The district court further noted that tender offerors also solicit a substantial percentage of the issuer's stock, offer to purchase the stock at a premium over the market price, and offer a firm rather than a negotiable price. *Id.* at 823-24. Finally, the district court noted that tender offerors make the offer contingent on a minimum number of shares, make the offer outstanding for a limited amount of time, and subject the offeree to pressure to tender the stock. *Id.* Neither the Securities Exchange Commission nor Congress, however, has defined a tender offer. *See* Smallwood v. Pearl Brewing Co., 489 F.2d 579, 596 (5th Cir.)(noting that Congress and SEC have declined to define term "tender offer"), *cert. denied*, 419 U.S. 873 (1979).

9. Pub. L. No. 439, 82 Stat. 454 (1968)(codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982 & Supp. III 1985)). Congress enacted the Williams Act in response to the significant increase in cash tender offers during the 1960's. *See* H.R. REP. No. 1711, 90th Cong., 2d Sess. 2 (increase in cash tender offers necessitated regulation of cash tender offers) *reprinted in* U.S. CODE CONG. & ADMIN. NEWS 2811, 2812-13. Congress' goal in enacting the Williams Act was to ensure that tender offerors would provide target company shareholders

or misleading statements of material fact, omissions of material fact, and fraudulent, deceptive, or manipulative acts that arise in connection with tender offers.[10]

In addition to adopting section 14(e) of the Williams Act to combat abuses involved in connection with tender offers, Congress enacted section 10(b) of the '34 Act, which grants the Securities and Exchange Commission (SEC) rule making powers to prevent abuses in the securities field that Congress specifically did not prohibit.[11] In 1969, pursuant to sections 10(b),

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with the information necessary to permit the shareholders to make rational decisions concerning the tender offer. *Id.* The Williams Act requires tender offerors to include in proxies detailed information about the financial condition of persons making the tender offer and about the background of directors and executive officers. *See* 17 C.F.R. § 240.14a-3 (discussing material information that tender offeror must disclose in tender offer). The '34 Act also requires a proxy to include information concerning transactions between directors and officers and others that may give rise to a conflict of interest. *Id.* Additionally, the Williams Act requires a proxy to include information about matters in which shareholders must vote. *Id.*

10. 15 U.S.C. § 78n(e) (1982 & Supp. III 1985). Section 14(e) of the Williams Act prohibits a person from using untrue statements of material fact, from omitting statements of material fact, or from engaging in fraudulent, deceptive, or manipulative acts or practices in connection with a tender offer, request or invitation to tender, or any solicitation of security holders in opposition to or in favor of any tender offer. *Id.*; *see* 17 C.F.R. 14a-1(f) (1986)(defining solicitation). The term solicitation includes any request for a proxy, any request to execute, not to execute, or revoke a proxy, and any communication to security holders that a solicitor reasonably calculates will result in the procurement, withholding, or revocation of a proxy. 17 C.F.R. § 240a-1(f) (1986); *see also* Calumet Industries, Inc. v. MacClure, 464 F.Supp. 19, 32 (N.D. Ill., E.D. 1978)(court cannot broaden definition of solicitation beyond definition in regulations); Goolrick, *Purchases on the Market of Target Company Stock*, 26 BUS. LAW. 457, 472-73 (1970)(discussing § 14e of Williams Act as general anti-fraud and anti-manipulation provisions that apply to pre-tender purchases).

11. *See* 15 U.S.C. § 78j(b) (1982 & Supp. III 1985)(prohibiting manipulative and deceptive devices in connection with purchase or sale of securities). Section 10(b) of the Securities Exchange Act of 1934 ('34 Act) prohibits any person from using any means or instrumentality of interstate commerce, the mails, or any facility of a national security exchange to manipulate any rules and regulations that the Securities Exchange Commission proscribes for the protection of investors in connection with the purchase or sale of any security. *Id.*; *see also* 1934 SENATE REPORT, *supra* note 3, at 18 (Congress gave SEC broad rule-making power to prevent mischievous practices). The drafters of § 10(b) of the '34 Act intended that § 10(b) enable the SEC to combat new manipulative and fraudulent practices. *Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934), *reprinted in* 8 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, item 23 (1973). The legislative history of § 10(b) does not demonstrate, however, the scope of the SEC's authority to promulgate rules and regulations under § 10(b). *Id.*

An example of the SEC's authority to promulgate rules to prevent manipulative and fraudulent practices is the SEC's promulgation of Rule 10b-5 of the '34 Act. 17 C.F.R. § 240.10b-5 (1986). Rule 10b-5 prohibits a person from employing any misrepresentative devices, schemes, or other acts that operate as fraud or deceit in connection with the purchase or sale of a security. 17 C.F.R. § 240.10b-5 (1986); *see* Securities Exchange Commission v. M.A. Lundy Assoc., 362 F.Supp. 326, 334 (R.I. 1973)(Rule 10b-5 protects investing public from misleading statements or omissions in connection with purchase or sale of securities); *see also*

13(e), 14(e), and 23(a) of the '34 Act, the SEC promulgated Rule 10b-13.[12] Rule 10b-13 prohibits any person who makes a tender or exchange offer from purchasing or arranging to purchase outside the offer either the securities of the target company or other securities that the person immediately may convert into or exchange for the securities of the target company while the offer is in effect.[13] Rule 10b-13 does not apply to purchases of a target company's securities that are not within the tender or exchange offer period.[14] Until recently, no courts had considered, however, whether a

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H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS 825 (1983)(discussing requirements of Rule 10b-5). Federal courts have allowed individuals an implied right of action against individuals under Rule 10b-5. H. HENN, *supra*, at 825. To establish liability in fraudulent corporate transactions under Rule 10b-5, the plaintiff must offer proof of scienter in connection with the sale or purchase of a security. H. HENN, *supra*, at 828-29. Additionally, plaintiffs must be sellers or purchasers of a security to recover damages in a Rule 10b-5 transaction. *Id.* at 829. To recover damages in situations in which an individual makes an affirmative misrepresentation concerning the sale or purchase of a security, a plaintiff must establish that the plaintiff relied on the misrepresentation. *Id* at 826-27. To recover damages when an individual does not disclose information, however, the plaintiff only must demonstrate the information was material, not that the plaintiff relied on the information. *Id.* Under Rule 10b-5, information is material when the information, if disclosed, would influence a reasonable person to act differently. *See* List v. Fashion Park, Inc., 340 F.2d 457, 463 (2d Cir. 1965)(discussing materiality requirement under Rule 10b-5); *see also* Goolrick, , *supra* note 10, at 472-73 (discussing Rule 10b-5 of '34 Act as general anti-fraud and anti-manipulation provisions that apply to pre-tender purchases).

12. 17 C.F.R. § 240.10b-13 (1986); *see* 15 U.S.C. §§ 78j(b), 78m(e), 78n(e), 78w(a) (1982 & Supp. III 1985). Section 78j(b) of the Securities Exchange Act of 1934 authorizes the SEC to promulgate rules and regulations that modify the '34 Act. 15 U.S.C. § 78j(b) (1982 & Supp. III 1985). Section 78m(e) of the '34 Act authorizes the SEC to define acts that are fraudulent, manipulative, or deceptive and to proscribe means to prohibit such acts. *Id.* § 78m(e). Section 78n(e) of the '34 Act authorizes the SEC to promulgate rules and regulations that are necessary to prevent fraud, manipulation, and deception in a tender offer. *Id.* § 78n(e). Section 78w(a) of the '34 Act authorizes the SEC to promulgate rules and regulations necessary and appropriate to implement the rules that the SEC must enforce. *Id.* § 78w(a).

13. 17 C.F.R. § 240.10b-13(a) (1986); *see* Levmore, *Interstate Exploitation and Judicial Intervention*, 69 VA. L. REV. 563, 621 n.235 (1983)(discussing various statutory definitions of target company). State corporation statutes, rather than federal securities laws, provide a definition of target company. *See e.g.*, MASS. GEN. LAWS ANN. ch. 110, § 1 (West 1981)(defining target company as company incorporated or having principal place of business in state and company's securities are subject to takeover bid); Pa. Stat. Ann. tit. 70, § 73 (Purdon 1983)(same); VA. CODE ANN. § 53-13 (1986)(defining target company as company incorporated in state and company's securities are involved in takeover effort).

14. Exchange Act Release No. 8712 [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) § 77,745 at 83,708 (Oct. 8, 1969). Purchases of securities made prior to a tender offer period (pre-tender purchases), although not subject to Rule 10b-13 of the Securities Exchange Act of 1934 ('34 Act), are subject to the general anti-fraud and anti-manipulation provisions that could apply to pre-tender purchases. *Id.*; *see* Sunshine Mining Co. v. Great W. United Corp., [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) § 96,049 at 91,715 (D. Idaho 1977)(holding that Rule 10b-13 does not apply to pre-tender private purchases); *see also supra* notes 10-11 (discussing examples general anti-fraud and anti-manipulation provisions that apply to pre-tender purchases of a target company's stock).

tender offeror's status as a party to a contract to purchase stock in the future that was executory at the commencement of a tender offer immunized the tender offeror from the application of Rule 10b-13 to purchases pursuant to the executory contract.[15] In *City National Bank v. American Commonwealth Financial Corp.*,[16] the United States Court of Appeals for the Fourth Circuit considered whether Rule 10b-13, which regulates securities purchases during a tender offer period, regulates a pre-tender agreement that binds a tender offeror to purchase the target company's securities when the parties to the pre-tender purchase agreement did not execute fully the agreement before the commencement of the tender offer period.[17]

In *City National Bank*, the plaintiffs were minority shareholders of All American Assurance Company (All American).[18] In January, 1979, the defendant, American Commonwealth Financial Corporation (American Commonwealth) acquired 67% of All American's stock from American Bank and Trust Company.[19] American Commonwealth subsequently transferred its interest in All American's stock to a wholly-owned subsidiary of American Commonwealth, Great Commonwealth Life Insurance Company (Great Commonwealth).[20] At the time of American Commonwealth's acquisition of All American's shares and the subsequent transfer of the shares to Great Commonwealth, Robert Shaw was the president of American Commonwealth and a director of Great Commonwealth.[21] Additionally, after Great Commonwealth acquired All American's shares from American Commonwealth, Robert Shaw became president of All American.[22]

On December 11, 1979, Great Commonwealth agreed to purchase 57,782 shares of All American's stock at $5 per share.[23] The terms of the stock purchase agreement required Great Commonwealth to pay five percent of

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15. *See supra* notes 13-14 and accompanying text (discussing Rule 10b-13); *infra* notes 52-62 and accompanying text (discussing Fourth Circuit's holding in *City National Bank* concerning application of Rule 10b-13 to pre-tender stock purchase agreements of target company's stock that parties to agreement fail to execute by commencement of tender offer period).

16. 801 F.2d 714 (4th Cir. 1986).

17. *See* City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 716-18 (4th Cir. 1986)(considering whether Rule 10b-13 applies to contracts to purchase stock that are executory at commencement of tender offer).

18. *Id.* at 715.

19. *Id.* at 716. In *City National Bank*, American Commonwealth Financial Corporation (American Commonwealth) acquired All American Assurance Company's (All American) stock for $10.28 per share. *Id.* at 718.

20. *Id* at 716.

21. *Id.*

22. *Id.* In *City National Bank*, as a result of Great Commonwealth Life Insurance Company's (Great Commonwealth) acquisition of American Commonwealth Financial Corporation's interest in All American Assurance Company's stock, Robert Shaw simultaneously held the positions of president of American Commonwealth and All American, and director in Great Commonwealth. *Id.*

23. *Id.*

the purchase price on December 12, 1979 and the balance due on the purchase price on January 2, 1980.[24] The stock purchase agreement included 18,500 shares of the Post family trust's interest in All American's shares.[25] On December 14, 1979, Great Commonwealth made a tender offer for 175,000 shares of All American's stock at $5 per share.[26] Great Commonwealth's tender offer expired January 4, 1980.[27] The tender offer enabled Great Commonwealth to increase its interest in All American's stock to 80% of All American's outstanding shares.[28] The tender offer disclosed fully Great Commonwealth's private purchases of the Post family's interest in All American's stock.[29] Pursuant to the tender offer, the plaintiffs sold their minority interest in All American to Great Commonwealth at the tender offer price.[30]

In August, 1982, the plaintiffs brought suit in the United States District Court for the Western District of North Carolina.[31] The plaintiffs alleged that the defendant violated Rule 10b-13 of the '34 Act because the defendant did not make the initial five percent payment on the stock purchase agreement due on December 12, 1979 until December 17, 1979, which was during the tender offer period.[32] Additionally, the plaintiffs alleged that the defendant violated Rule 10b-5 of the '34 Act because the defendant made material misrepresentations and omissions in the tender offer concerning the defendant's purchase of the Post family's interest in All American's stock.[33] The plaintiffs further alleged that the defendant committed common law fraud and breached the defendant's fiduciary duties to the minority

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24. *Id.*

25. *Id.* In *City National Bank*, the 18,500 shares of All American Assurance Company's stock that the Post family trust owned were the only shares of the purchase agreement in dispute. *Id.* The Post family had a substantial interest in the stock of I.C.H. Corporation (I.C.H.). *Id.* at 717. I.C.H. owned Ozark National Life Insurance, which in turn had substantial holdings in American Commonwealth Financial Corporation. *Id.*; *see supra* notes 20 & 23 and accompanying text (American Commonwealth was parent corporation of Great Commonwealth Life Insurance Company, which was party to purchase agreement for All American's stock).

26. *City National Bank*, 801 F.2d at 716; *see supra* note 10 and accompanying text (defining tender offer as public invitation to shareholders to sell all or part of their shares at premium over current market price).

27. *City National Bank*, 801 F.2d at 716.

28. *Id.*

29. *Id.*

30. *Id.* In November, 1982, after the plaintiffs in *City National Bank* sold their minority interest in All American Assurance Company to Great Commonwealth Life Insurance Company, All American merged with I.C.H. Corporation. *Id.*

31. City Nat'l Bank v. American Commonwealth Fin. Corp., 608 F. Supp. 941, 942 (W.D.N.C. 1985).

32. City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 716 (4th Cir. 1986).

33. *Id.*; *see supra* note 11 and accompanying text (discussing Rule 10b-5 of Securities Exchange Act of 1934).

shareholders of All American.[34] The defendant argued that the evidence did not support the plaintiffs' claims.[35] More specifically, the defendant in *City National Bank* claimed that the defendant did not violate Rule 10b-13 because the evidence established that the defendant completed the purchase of the Post family's interest in All American's shares by receiving the stock certificates to All American prior to the commencement of the tender offer.[36] The defendant alternatively claimed that even if the defendant did not complete the purchase of the Post family's interest in All American's stock before the commencement of the tender offer, the defendant did not violate Rule 10b-13 because the defendant became the beneficial owner of

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34. *City National Bank*, 801 F.2d at 716; *see* Ragsdale v. Kennedy, 286 N.C. 130, 138, 209 S.E.2d 494, 500-01 (1974)(discussing common law fraud in securities context). In *Ragsdale v. Kennedy*, the Supreme Court of North Carolina found that the essential elements of fraud are false representations or concealment of material facts that a person reasonably calculates and intends will deceive another person. *Ragsdale*, 209 S.E.2d at 500. Additionally, the party committing the fraud actually must deceive and damage the injured party. *Id.* The *Ragsdale* court explained that the definition of fraud is sufficiently flexible to prevent persons that essentially commit a fraudulent act from escaping liability based on a mere technical avoidance the definition. *Id.*; *see* King Mfg. Co. v. Clay, 216 Ga. 581, 585, 118 S.E.2d 581, 584-85 (1961)(discussing fiduciary duties at common law of directors and officers to disclose fully to shareholders all material facts relative to value of corporation upon purchase by director of shareholder's interest in corporation); Fulton v. Talbert, 255 N.C. 183, 185, 120 S.E.2d 410, 411-12 (1961)(discussing common law duties of directors and officers as fiduciaries). *See generally* H. HENN, *supra* note 11, at 525-28 (discussing fiduciary duties of directors and officers). Directors and officers are agents of a corporation and, therefore, are subject to the fiduciary rules of agency. *Fulton*, 120 S.E.2d at 411; *see King Mfg.*, 118 S.E.2d at 584 (directors and officers are fiduciaries). Directors and officers owe fiduciary duties to a corporation and to the shareholders of the corporation. *Fulton*, 120 S.E.2d at 411; *see King Mfg.*, 118 S.E.2d at 584 (directors and officers owe fiduciary duty to corporation and shareholders). As fiduciaries, directors and officers should discharge their duties in good faith and with the diligence and care that prudent persons would exercise under similar circumstances in like positions. *Fulton*, 120 S.E.2d at 411. Some states statutorily provide that directors and officers owe fiduciary duties to a corporation and to the shareholders of the corporation. *See* N.C. GEN. STAT. § 55-35 (1986)(providing that directors and officers owe fiduciary duty to corporation and shareholders to discharge duties in good faith and with diligence and care that ordinary prudent persons would exercise under similar circumstances in like position); S.C. CODE ANN. § 33-13-150 (Law. Co-op. 1983) (same).

35. *City National Bank*, 801 F.2d at 716.

36. *Id.* at 716-17. In support of the defendant's contention in *City National Bank* that the defendant did not violate Rule 10b-13 of the Securities Exchange Act of 1934 because the defendant had completed the purchase of the Post family's in All American Assurance Company before the tender offer period, the defendant explained that the December 11, 1979 stock purchase agreement required Great Commonwealth Life Insurance Company to pay five percent of the purchase price on the closing date, December 12, 1979. *Id.* A defendant's witness then testified that the Post family delivered the stock certificates to the defendant on December 12, 1979. *Id.* at 717. The defendant next noted that the tender offer period did not commence until the public announcement of the tender offer, December 14, 1979. *Id.* Accordingly, the defendant argued that defendant did not violate Rule 10b-13 because the evidence established, as a matter of law, that the defendant acquired ownership of the Post family stock two days before the tender offer period. *Id.*

the Post family's interest in All American's stock when Great Commonwealth and Post entered into the stock purchase agreement.[37] The defendant claimed that the defendant became a beneficial owner of the Post family's interest in All American Assurance Company's stock on December 11, 1979 under Rule 13d of the Securities Exchange Act of 1934.[38] The defendant, therefore, asserted that the Post family and Great Commonwealth Life Insurance Company executed the pre-tender stock purchase before commencement of the tender offer.[39] Accordingly, the defendant argued that the defendant did not violate Rule 10b-13.[40]

Upon presentation of the evidence, the jury found that Great Commonwealth's purchase of the Post family's interest in All American's stock violated Rule 10b-13 and that Great Commonwealth made the purchase with the intent to deceive, manipulate, or defraud the plaintiffs.[41] Additionally, the jury found that the defendant committed common law fraud and breached the defendant's fiduciary duties to the minority shareholders of All American.[42] The jury in *City National Bank* found, however, that the defendant did not violate rule 10b-5 because any omissions in the tender offer would not have affected the investment decision of a reasonable shareholder.[43] The jury awarded the plaintiffs $5.28 per share plus nine percent interest from January 4, 1980 until settlement.[44]

The defendant subsequently filed a motion for a judgment notwithstanding the verdict in the United States District Court for the Western District of North Carolina.[45] The district court denied the defendant's motion.[46] The

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37. *Id.* at 717; *see supra* note 14 and accompanying text (discussing Rule 13d of '34 Act).

38. *City National Bank*, 801 F.2d at 716.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*; *see supra* note 34 (discussing common law fraud and breach of fiduciary duty).

43. *City National Bank*, 801 F.2d at 716; *see supra* note 11 (Rule 10b-5 of the Securities Exchange Act of 1934 requires that omission from tender offer would have influenced investment decision of reasonable shareholder).

44. City Nat'l Bank v. American Commonwealth Fin. Corp., 608 F. Supp. 941, 942 (W.D.N.C. 1985). The jury in *City National Bank* found that at the time of the tender offer, All American Assurance Company's stock had a value of $10.28 per share. *Id.* Because the plaintiffs tendered their minority shares at $5.00 per share, the jury awarded the plaintiffs $5.28 per share in damages. *Id.*

45. *Id.*

46. *Id.* at 945. In considering the defendant's motion for a judgment notwithstanding the verdict in *City National Bank*, the United States District Court for the Western District of North Carolina required both the plaintiffs and the defendant to file responses with the district court concerning the jury's award of prejudgment interest to the plaintiffs on the plaintiffs' federal 10b-13 claim and the state common law fraud and breach of fiduciary duty claims. *Id.* at 942. The plaintiffs claimed that both federal securities law and state law permitted a jury to include prejudgment interest in an award. *Id.* The defendant conceded that a jury could award prejudgment interest on a Rule 10b-13 claim. *Id.* The defendant, however,

defendant subsequently appealed the district court's decision denying the defendant's motion for a judgment notwithstanding the verdict to the United States Court of Appeals for the Fourth Circuit.[47] On appeal the defendant again argued that the evidence did not support the jury's finding that the defendant's purchase of the Post family's interest in All American's stock violated Rule 10b-13 of the '34 Act.[48] The defendant argued alternatively that the defendant did not violate Rule 10b-13 because the defendant became the beneficial owner of the Post family's interest in All American's stock

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contested the plaintiffs' assertion that state law allowed a jury to award prejudgment interest on a state securities law claim. *Id.*

In examining the award of prejudgment interest on the plaintiffs' Rule 10b-13 claim, the district court determined that federal common law controls an award of prejudgment interest. *Id.* The district court further determined that whether an award of prejudgment interest is appropriate in a securities fraud case is a question of fairness that lies within a district court's sound discretion. *Id.* The district court then explained that a finding of a defendant's personal wrongdoing can tip the balance of the fundamental fairness of a prejudgment interest award in favor of a plaintiff. *Id.* at 943. The district court recognized that the award of prejudgment interest often occurs in cases that involve breach of fiduciary duty. *Id.* The district court in *City National Bank* noted that the jury found that a relationship of trust and confidence existed between the plaintiffs and the defendant. *Id.* The district court further noted that the jury found that the defendants violated Rule 10b-13 with the intent to deceive, manipulate, or defraud the plaintiffs. *Id.* The *City National Bank* court explained, therefore, that the court attributed particular significance to the defendant's wrongdoing because the defendant's wrongdoing amounted to calculated fraud. *Id.*

In weighing the factors of fundamental fairness of the prejudgment interest award, the district court also considered whether the award of prejudgment interest was compensatory in nature and whether the delay between the act complained of and the date of trial was substantially the responsibility of the plaintiff. *Id.* Upon concluding that the prejudgment interest was compensatory in nature, that the plaintiff was not responsible for the delay between the act complained of and the date of trial, and that the defendant's wrongdoing deserved added significance, the district court upheld the jury's award of prejudgment interest on the Rule 10b-13 claim. *Id.* at 944; *see* Muscat v. Norte & Co., 397 U.S. 989, 997 (1970)(defendant's personal wrongdoing is factor to consider in weighing fundamental fairness of prejudgment interest award); Blau v. Lehmen, 368 U.S. 403, 410 (1962)(in federal securities cases, court awards interest based on considerations of fairness).

In examining the award of prejudgment interest on the plaintiffs' common law fraud and breach of fiduciary duty claims, the *City National Bank* court determined that North Carolina state law controls an award of prejudgment interest. *City National Bank*, 608 F. Supp. at 944. The district court explained that North Carolina law prohibits an award for prejudgment interest when damages are not liquidated or readily ascertainable. *Id.* The district court then determined that under North Carolina law, monetary damages awarded for the fraudulent sale of stock are not liquidated or readily ascertainable. *Id.* Accordingly, the district court in *City National Bank* reversed the jury's award of prejudgment interest on the plaintiffs' common law fraud and breach of fiduciary claims. *Id.*; *see* Lazenby v. Godwin, 60 N.C. App. 504, 509, 299 S.E.2d 288, 291 (1983)(prohibiting award of prejudgment interest in tort action in which defendants used fiduciary relationship with plaintiff to fraudulently procure sale of plaintiff's stock).

47. City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 715 (4th Cir. 1986).

48. *Id.* at 716; *see supra* notes 35-40 and accompanying text (discussing defendant's arguments at trial court level).

on December 11, 1979.[49] The defendant also reasserted its argument that the evidence did not support the jury's finding that the defendant committed common law fraud and breached the defendant's fiduciary duty to the plaintiffs.[50] Additionally, the defendant argued that the jury improperly included a control premium in the award of damages of $5.28 per share.[51]

In examining the defendant's assertion that the defendant did not violate Rule 10b-13 because the evidence established that the defendant completed the purchase of the Post family's interest in All American's shares prior to the commencement of the tender offer, the Fourth Circuit recognized that the plaintiffs presented evidence that Great Commonwealth and Post did not execute the pre-tender stock purchase agreement according to the terms of agreement and did not execute the agreement prior to the tender offer.[52] The Fourth Circuit found, therefore, that the district court properly submitted the issue concerning the execution of the pre-tender purchase agreement to the jury.[53] The Fourth Circuit also explained that from the evidence, the jury could infer that Great Commonwealth and Post did not execute the pre-tender stock purchase agreement prior to the tender offer.[54] The Fourth Circuit noted that despite the defendant's witness who testified that Post delivered the securities to Great Commonwealth on December 12, 1979, evidence existed that demonstrated that Great Commonwealth did not pay Post until after December 17, 1979.[55] In support of the jury's finding that the defendant violated Rule 10b-13 with the intent to deceive, defraud, or manipulate the plaintiffs, the Fourth Circuit explained that the relationship between Post and Shaw conceivably could have induced the plaintiffs into selling the plaintiffs' minority interest in All American at a price below the actual value of the plaintiff's interest.[56] Accordingly, the Fourth Circuit affirmed the district court's holding that the evidence supported the jury's finding that the defendant violated Rule 10b-13 because the defendant did not complete the purchase of the Post family's interest in All American's stock before the commencement of the tender offer.[57]

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49. *City National Bank*, 801 F.2d at 717.

50. *Id.* at 716; *see supra* notes 48-50 and accompanying text (discussing defendant's arguments at trial court level).

51. *City National Bank*, 801 F.2d at 718; *see* Alma Capital Ass'n v. Wagner, 758 F.2d 562, 566 (11th Cir. 1985)(defining control premium). The *Alma Capital Association* court defined control premium as the enhanced value of stock on a per share basis due to a shareholder's controlling position in a corporation, as opposed to a non-controlling position. *Alma Capital Ass'n*, 758 F.2d at 566.

52. *City National Bank*, 801 F.2d at 717.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*; *see supra* notes 22-25 and accompanying text (discussing relationship between Post family and Shaw).

57. *City National Bank*, 801 F.2d at 717.

In addition to considering the defendant's argument that the defendant did not violate Rule 10b-13 because he had completed the private stock purchase agreement prior to the tender offer period, the Fourth Circuit considered the defendant's alternative Rule 10b-13 argument that the defendant did not violate Rule 10b-13 because the he became the beneficial owner of the Post family's interest in All American's stock when Great Commonwealth and Post entered into the stock purchase agreement on December 11, 1979.[58] The *City National Bank* court explained that Rule 10b-13 regulates the purchase of stock and not the claim to beneficial ownership of the stock.[59] Furthermore, the Fourth Circuit recognized that the pre-tender purchase agreement, nonetheless, did not purport to convey the Post family's interest in All American's stock to Great Commonwealth at the time the parties entered into the agreement.[60] The *City National Bank* court, therefore, rejected the defendant's claim that the defendant did not violate Rule 10b-13 because the defendant became the beneficial owner of the Post family's interest in All American's stock on December 11, 1979.[61] Accordingly, the Fourth Circuit held that Rule 10b-13 is applicable to contracts for the private purchase of stock that are executory at the time of a tender offer.[62]

In addition to considering the defendant's Rule 10b-13 arguments, the Fourth Circuit considered the defendant's contention that the evidence did not support the jury's finding that the defendant had committed common law fraud and had breached the defendant's fiduciary duty to the plaintiffs.[63] The defendant argued that an inconsistency existed in finding that the defendant committed common law fraud and had breached fiduciary duties but did not violate Rule 10b-5.[64] The *City National Bank* court explained, however, that a distinction exists between a common law act of commission of fraud and deceit and a Rule 10b-5 omission.[65] Accordingly, the Fourth Circuit upheld the district court's holding that the defendant had committed common law fraud and had breached the defendant's fiduciary duty to the plaintiffs.[66]

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58. *Id.*

59. *Id.*

60. *Id.* In *City National Bank* the Fourth Circuit noted that the pre-tender purchase agreement did not convey beneficial ownership to the defendant, but instead provided for delivery of the Post family's interest in All American Assurance Company's stock to Great Commonwealth Life Insurance Company at closing upon payment of five percent of the purchase price. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 718.

64. *Id.*; *see supra* notes 11 & 34 and accompanying text (discussing elements of Rule 10b-5 and common law fraud).

65. *City National Bank*, 801 F.2d at 718. *Compare supra* note 11 (violation of Rule 10b-5 of Securities Exchange Act of 1934 can be act of omission) *with supra* note 34 (violation of common law fraud is act of commission).

66. *City National Bank*, 801 F.2d at 718.

After denying the defendant's claims concerning Rule 10b-13 and common law fraud, the Fourth Circuit considered the defendant's assertion that the jury's award of $5.28 per share in damages improperly included a control premium.[67] In examining the defendant's contention, the *City National Bank* court found that from the evidence, the jury could infer that the award did not include a control premium.[68] The Fourth Circuit noted that American Commonwealth acquired a controlling block of All American stock in January, 1979 for $10.28 per share.[69] The Fourth Circuit further noted that Robert Shaw, president of American Commonwealth and All American and a director of Great Commonwealth, testified that $10.28 per share for All American's stock was a bargain purchase and that Shaw would have paid more for All American's stock.[70] The Fourth Circuit also noted that the plaintiff's expert witness testified that All American's shares were worth $14.63 per share in December, 1979.[71] Accordingly, the *City National Bank* court found that the jury's award of $5.28 per share did not include a control premium.[72]

The Fourth Circuit in *City National Bank* correctly held that Rule 10b-13 applied to the pre-tender purchase agreements that the parties to the agreement consummated during the tender offer period.[73] Because other courts have not considered explicitly whether Rule 10b-13 applies to pre-tender purchase agreements that the parties do not execute fully until the tender offer period, courts should turn for guidance to SEC pronouncements concerning Rule 10b-13 and the statutory language of Rule 10b-13.[74] For example, in a letter from the SEC to Radiation Dynamics, Inc. (RDI letter), the SEC considered whether Rule 10b-13 applied to an executory pre-tender stock purchase agreement that the parties to the agreement were to execute after the completion of a tender offer.[75] In the RDI letter, Radiation

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67. *Id.*; *see supra* note 44 and accompanying text (discussing jury's award of damages); *supra* note 51 and accompanying text (defining control premium).

68. *City National Bank*, 801 F.2d at 718.

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *See infra* notes 54-129 and accompanying text (demonstrating that Rule 10b-13 applies to pre-tender stock purchase agreements that the parties consummate during the tender offer period).

74. *See, e.g.*, R.J. Reynolds Indus., Inc., SEC No-Action Letter (Aug. 30, 1982)(discussing application of Rule 10b-13 to executory pre-tender purchase agreement in connection with tender offer and merger proposal); Morton-Norwich Prods., Inc., SEC No-Action Letter (Aug. 20, 1982)(same); Radiation Dynamics, Inc., SEC No-Action Letter (Jan. 4, 1974)(discussing application of Rule 10b-13 to pre-tender purchase agreement that the parties had not consummated fully at commencement of tender offer); *see also infra* notes 75-107 and accompanying text (discussing Securities Exchange Commission pronouncements concerning Rule 10b-13); *infra* note 124 and accompanying text (discussing purpose of Rule 10b-13).

75. Radiation Dynamics, Inc., SEC No-Action Letter (Jan. 4, 1974)(discussing application of Rule 10b-13 to executory pre-tender purchase agreement in connection with tender offer).

Dynamics, Incorporated (RDI) represented that Firestone Tire and Rubber Company (Firestone) owned 66% of the common stock of RDI.[76] Firestone agreed to sell the 66% interest in RDI to Oppenheimer & Company (Oppenheimer).[77] Within five days of the execution of the agreement between Firestone and Oppenheimer, RDI intended to make a tender offer for the remaining outstanding shares of RDI's common stock.[78] The tender offer price was to be the same as the price that Oppenheimer paid for Firestone's interest in RDI's common stock.[79] Oppenheimer's actual purchase of Firestone's interest in RDI's stock, however, would not occur until after the tender offer.[80] In addition, Firestone and Oppenheimer did not condition the purchase agreement on the success of RDI's tender offer.[81] RDI also intended to give RDI's shareholders an opportunity to withdraw previously tendered shares if Oppenheimer failed to purchase Firestone's interest in RDI's stock.[82] Furthermore, RDI intended to disclose fully the entire transaction to RDI's shareholders in the public tender offer.[83] In examining the representations in the RDI letter, the SEC concluded that it would not take

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76. *Id.* In the no-action letter from the Securities Exchange Commission to Radiation Dynamics, Inc.(RDI), RDI represented that RDI registered its common stock under § 12(g) of the Securities Exchange Act of 1934 and traded the common stock over-the-counter. *Id.*

77. *Id.* In the no-action letter from the Securities Exchange Commission to Radiation Dynamics, Inc.(RDI), RDI represented that Oppenheimer & Co. (Oppenheimer) agreed to purchase Firestone Tire & Rubber Co.'s (Firestone) interest in RDI for $4,000,000. *Id.* The purchase price represented 1,304,250 shares of Firestone's interest in RDI's stock at approximately $3.07 per share. *Id.*

78. *Id.* In the no-action letter from the Securities Exchange Commission to Radiation Dynamics, Inc. (RDI), RDI intended to redeem all of RDI's outstanding common stock except the RDI common stock that Firestone Tire and Rubber Company (Firestone) and the officers and directors of RDI owned. *Id.* The total amount of RDI's common stock that Firestone and the directors of RDI did not own was 636,283 shares. *Id.* RDI and Firestone entered into a pre-tender agreement, however, that required Firestone to sell to RDI any difference between the actual number of shares tendered and 636,283 shares at $3.07 per share. *Id.* RDI and Firestone agreed that any sale from Firestone to RDI would not occur until after the tender offer period. *Id.* Accordingly, any sale from Firestone to RDI would reduce the number of shares that Firestone agreed to sell to Oppenheimer & Company by an amount equal to the number of shares that Firestone sold to RDI. *Id.* RDI and Firestone also agreed that if Firestone and Oppenheimer cancelled the agreement for Oppenheimer to purchase Firestone's interest in RDI's stock, Firestone would not have to sell Firestone's interest in RDI's stock to RDI. *Id.*

79. *Id.* In the letter from the Securities Exchange Commission to Radiation Dynamics, Inc., RDI offered to pay $3.07 for each share of RDI stock tendered by outstanding shareholders of RDI other than Firestone Tire and Rubber Company and the officers and directors of RDI. *Id.*

80. *Id.*

81. *Id.* In the letter from the Securities Exchange Commission to Radiation Dynamics, Inc., Oppenheimer & Co.'s purchase of Firestone Tire and Rubber Co.'s interest in RDI's common stock was to occur whether RDI proceeded with the tender offer or cancelled the tender offer before the conclusion of the tender offer. *Id.*

82. *Id.*

83. *Id.*

action against RDI for violating Rule 10b-13 in the transaction described in the letter.[84]

The SEC correctly did not take action against RDI for violating Rule 10b-13 because the transaction did not deceive the shareholders of RDI concerning the true nature of the transaction.[85] The transaction described in the RDI letter did not deceive RDI's shareholders because the tender offer disclosed fully the pre-tender stock purchase agreement and Firestone and Oppenheimer did not execute the agreement until after the tender offer period.[86] Additionally, the tender offer price equaled the stock purchase agreement price and the tender offer gave tendering shareholders an opportunity to withdraw previously tendered shares if Firestone and Oppenheimer did not execute the agreement.[87] Accordingly, the SEC found that a tender offeror can enter an executory pre-tender stock purchase agreement without violating Rule 10b-13 when the parties do not consummate the agreement during the tender offer period and the agreement does not deceive shareholders.[88]

A letter from the SEC to R.J. Reynolds Industries, Incorporated (R.J. Reynolds letter) also demonstrates that Rule 10b-13 should not apply to pre-tender stock purchase agreements when the agreements do not deceive shareholders.[89] In the R.J. Reynolds letter, the SEC considered whether Rule 10b-13 applied to an executory pre-tender stock purchase agreement that the parties to the agreement were to execute after the completion of a

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84. *Id.* The Securities Exchange Commission concluded that the transactions in the letter from the SEC to Radiation Dynamics, Inc. (RDI) would not violate Rule 10b-13 only if RDI, Firestone Tire and Rubber Co., and Oppenheimer & Co. acted in accordance with the representations of RDI in the letter. *Id.*

85. *See infra* notes 84-86 and accompanying text (transaction described in letter from Securities Exchange Commission to Radiation Dynamics, Inc. (RDI) did not deceive RDI's shareholders).

86. *See* Wellborn, *supra* note 7, at 661 (purchases of target company's stock during tender offer period is deceiving whether or not purchase is made with intent to influence shareholder behavior). *Compare* Radiation Dynamics, Inc., SEC No-Action Letter (Jan. 4, 1974)(manipulation of shareholders by pre-tender stock purchase agreement did not exist because parties fully disclosed agreement and parties did not execute agreement during tender offer period) *with* City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 716-17 (4th Cir. 1986)(although parties disclosed fully pre-tender stock purchase agreement, manipulation of target company's shareholder existed because agreement executed during tender offer period).

87. *See* Radiation Dynamics, Inc., SEC No-Action Letter (Jan. 4, 1974)(shareholder manipulation prevented because tender offer price equaled stock purchase agreement price). *But cf.* Wellborn, *supra* note 7, at 660 (market activity in security by person engaged in purchase of security can induce others persons to purchase security).

88. *See supra* notes 75-88 and accompanying text (discussing Securities Exchange Commission finding concerning application of Rule 10b-13 to pre-tender purchase agreement in letter from SEC to Radiation Dynamics, Inc.).

89. *See* R.J. Reynolds Indus., Inc., SEC No-Action Letter (Aug. 30, 1983)(permitting non-manipulative pre-tender stock purchase agreement).

tender offer.[90] In the R.J. Reynolds letter, R.J. Reynolds Industries, Incorporated (R.J. Reynolds) represented that R.J. Reynolds and Heublein, Incorporated (Heublein) agreed that Heublein would merge into a wholly-owned subsidiary of R.J. Reynolds (Subsidiary).[91] Additionally, R.J. Reynolds and Heublein also agreed that R.J. Reynolds would purchase privately shares of Heublein's outstanding common stock for $63 per share.[92] Furthermore, the Subsidiary was to make a cash tender offer to purchase up to 51% of Heublein's common stock for $63 per share.[93] R.J. Reynolds and Heublein, however, conditioned R.J. Reynolds' private purchase of Heublein's outstanding common stock on the completion of the tender offer.[94]

In examining the representations in the R.J. Reynolds letter, the SEC correctly concluded that the SEC should not take action against R.J. Reynolds for violating Rule 10b-13 in the transaction described in the letter.[95] The SEC explained that it would not take action against R.J. Reynolds if R.J. Reynolds' private purchase of Heublein's outstanding common stock did not occur either during the tender offer or did not occur less than ten days after the tender offer period.[96] Additionally, the pre-tender stock purchase agreement price equaled the tender offer price.[97] The SEC, therefore, found that Rule 10b-13 would not apply to an executory pre-tender stock purchase agreement that the parties to the agreement were to execute after the completion of a tender offer.[98] Like the RDI letter, the

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90. *Id.*

91. *Id.* In the letter from the Securities Exchange Commission to R.J. Reynolds Industries, Inc. (R.J. Reynolds), R.J. Reynolds and Heublein, Inc. (Heublein) conditioned the merger upon approval of the merger by the shareholders of both R.J. Reynolds and Heublein. *Id.* Upon approval of the merger by the shareholders of both entities, each share of Heublein common stock was to be converted into the number of shares of R.J. Reynolds Industries common stock divided by 31.83 and one share of R.J. Reynolds Industries authorized but unissued series B cumulative preferred stock valued at $25 per share. *Id.*

92. *Id.* In the letter from the Securities Exchange Commission to R.J. Reynolds Industries, Inc., R.J. Reynolds represented that in connection with the merger between the wholly-owned subsidiary of R.J. Reynolds and Heublein, Inc., R.J. Reynolds agreed to purchase 18.4% of Heublein's outstanding common stock as of June 30, 1982. *Id.*

93. *Id.* In the letter from the Securities Exchange Commission to R.J. Reynolds Industries Inc., R.J. Reynolds asserted that its wholly-owned subsidiary was to complete the cash tender offer for Heublein Inc.'s (Heublein) outstanding shares before the merger of Heublein into the subsidiary. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*.

97. R.J. Reynolds Indus., Inc., SEC No-Action Letter (Aug. 30, 1982); *see infra* notes 126-30 and accompanying text (although pre-tender stock purchase agreement price equals tender offer price, manipulation may exist).

98. R.J. Reynolds Indus., Inc., SEC No-Action Letter (Aug. 30, 1982). In addition to requiring R.J. Reynolds Industries, Inc. to execute the pre-tender stock purchase agreement after the tender offer and requiring the tender offer price to equal the agreement price, the

R.J. Reynolds letter expresses the notion that the prevention of shareholder manipulation is the primary purpose of Rule 10b-13.[99]

In addition to SEC no-action letters, the statutory language of Rule 10b-13 aids in determining whether parties to a pre-tender stock purchase agreement may execute the agreement after the commencement of the tender offer.[100] The express language of Rule 10b-13 prohibits a person making a tender offer from purchasing or arranging to purchase any security unless the purchase is pursuant to the tender offer during the tender offer period.[101] The SEC has commented on arrangements, made during the tender offer period, to purchase shares of a target company's stock after the expiration of the tender offer period.[102] In the initial release adopting Rule 10b-13, the SEC explained that Rule 10b-13 prohibits agreements between parties, which the parties make during the tender offer period, to purchase shares of a target company's stock after the tender offer period.[103] Although the SEC has not issued a release that specifically comments on pre-tender arrangements to purchase shares of a target company's stock that the parties make before and execute during the tender offer period, Rule 10b-13 likewise should prohibit these pre-tender arrangements, even when full disclosure of the arrangements is present.[104] The SEC recognized that arrangements to purchase shares of a target company's stock that the parties consummate

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Securities Exchange Commission specifically expressed no position concerning the adequacy of disclosure that R.J. Reynolds would need to make in the tender offer. *Id.* The SEC did not express a position concerning the adequacy of disclosure because R.J. Reynolds never described the disclosure of the pre-tender stock purchase agreement. *Id.*; *see infra* notes 126-30 and accompanying text (although tender offer discloses pre-tender stock purchase agreement, shareholder manipulation may exist).

99. *See supra* notes 75-88 and accompanying text (discussing letter form Securities Exchange Commission to Radiation Dynamics, Inc.); *supra* note 124 and accompanying text (prevention of shareholder manipulation is primary purpose of Rule 10b-13).

100. *See infra* notes 101-07 and accompanying text (discussing whether pre-tender stock purchase agreement that parties to agreement do not consummate prior to tender offer violates express language of Rule 10b-13).

101. 17 C.F.R. § 240.10b-13(a) (1986); *see supra* note 13 and accompanying text (discussing provisions of Rule 10b-13).

102. *See* Exchange Act Release No. 8712, [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) § 77,745 at 83,708 (Oct. 8, 1969)(discussing Rule 10b-13 provision concerning arrangements for private purchases of stock of target company).

103. *Id.* In the release adopting Rule 10b-13, the Securities Exchange Commission explained Rule 10b-13 prohibits stock purchase agreements made during the tender offer period that the parties do not execute until after the tender offer period, whether or not the parties have agreed on the terms of the purchase. *Id.* Additionally, parties cannot agree during the tender offer period to negotiate a stock purchase agreement after the tender offer period. *Id.*

104. *See* 17 C.F.R. § 240.10b-13(a) (1986)(discussing provisions of Rule 10b-13); *see also supra* notes 75-99 and accompanying text (discussing Securities Exchange Commission position in no-action letters prohibiting parties to pre-tender agreement to purchase target company's stock from executing agreement during tender offer period); *infra* notes 106-07 and accompanying text (Rule 10b-13 should prohibit pre-tender agreements to purchase target company's stock that parties to agreement execute during tender offer period);

during a tender offer period artificially can increase or decrease demand for the stock.[105] The artificial shift in demand for a target company's stock can influence shareholder behavior because tender offerors can mislead shareholders into tendering or refraining from tendering shares of the target company's stock depending on the demand for the stock.[106] Accordingly, Rule 10b-13 should prohibit pre-tender arrangements to purchase a target company's stock that the parties fully execute during a tender offer because the arrangements can manipulate shareholder behavior.[107]

In addition to the express statutory language of Rule 10b-13 concerning arrangements to purchase, the interpretation of the statutory language concerning purchase is essential to the proper interpretation of Rule 10b-13.[108] The SEC designed Rule 10b-13 to prohibit pre-tender stock purchase agreements to purchase shares of a target company's stock that the parties to the agreements consummate during the tender offer period to prevent manipulation of shareholder behavior.[109] Parties to pre-tender stock purchase agreements, however, should not be able to circumvent the purpose of Rule 10b-13 by claiming that the purchase of the stock is complete upon transfer of the beneficial ownership of the stock prior to the tender offer period.[110] A purchase of a security includes contracts to purchase or to acquire for value a security or interest in a security.[111] A beneficial owner of a security includes any person who has voting or investment power over the security or the right to acquire voting or investment power over a security.[112] Section

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105. *See* Exchange Act Release No. 8712, [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) § 77,745 at 83,708 (Oct. 8, 1969)(parties to private stock purchase agreement can manipulate demand for target company's stock by consummating agreement during tender offer period).

106. *See* Wellborn, *supra* note 7, at 661 (private stock purchases that occur during tender offer period may induce shareholders to tender shares of target company stock). One commentator notes that private stock purchases that occur during a tender offer period can mislead shareholders into believing that demand for the target company's shares has shifted and, therefore may influence shareholder behavior. *Id.*

107. *See supra* notes 100-06 and accompanying text (discussing application of Rule 10b-13 to pre-tender stock purchase agreements).

108. *See infra* notes 109-22 and accompanying text (discussing meaning of "purchase" under Rule 10b-13).

109. *See* Exchange Act Release No. 8595, [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) § 77,706 at 83,616-18 (May 5, 1969)(SEC promulgated Rule 10b-13 to prevent shareholder manipulation).

110. *See infra* notes 111-22 and accompanying text (discussing whether Rule 10b-13 applies to persons acquiring beneficial ownership in pre-tender stock purchase agreement).

111. 15 U.S.C. § 78c(14) (1982 & Supp. III 1985)(defining purchase under Securities Exchange Act of 1934); *see* Commerce Reporting Co. v. Puretec, Inc. 290 F.Supp. 715, 719 (S.D.N.Y. 1968)(discussing interpretation of purchase under Securities Exchange Act of 1934). The term purchase includes every contract to buy, purchase or otherwise acquire a security. *Commerce Reporting Co.*, 290 F.Supp. at 719.

112. *See* 17 C.F.R. § 240.13d-3(a),(d) (1986)(defining beneficial ownership); *see also* Wellman v. Dickinson, 682 F.2d 355, 365-66 (2d Cir. 1982)(beneficial ownership includes any

13(d) of the '34 Act requires that any person who becomes the beneficial owner of greater than five percent of one class of a security must file with the SEC a statement concerning the acquisition of the security.[113] The Congress employed the concept of beneficial ownership under Sections 13(d) and 13(g) to provide investors in securities with full disclosure of the identity of any person or group of persons amassing large blocks of stock.[114] The information concerning large accumulations of a security alerts shareholders to potential changes in corporate control and thus provides shareholders with a means to value the security.[115] The SEC, however, interpreted Congress' intent as limiting the application of beneficial ownership to Sections 13(d) and 13(g) of the '34 Act.[116] Congress did not intend that investors use Section 13(d) as a weapon to obtain stock at artificially depressed prices.[117] Investors potentially would be able to obtain stock at

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person with voting power or right to acquire voting power over a security); K-N Energy, Inc. v. Gulf Interstate Co., 607 F. Supp. 756, 762 (D. Colo. 1983)(beneficial owner includes persons with voting power or investment power over security); *supra* notes 37-40 and accompanying text (defendant in *City National Bank* argued that defendant did not violate Rule 10b-13 because defendant became beneficial owner under Rule 13d before commencement of tender offer).

113. *See* 15 U.S.C. § 78m(d)(1) (1982 & Supp. III 1985); *see also* 17 C.F.R. §§ 240.13d-1(a), 240.13d-101 (1986)(requiring persons to file information statement with Securities Exchange Commission upon acquiring five percent or more of a company's stock).

114. *See* 15 U.S.C. § 78m(d)(1) (1982 & Supp. III 1985); *see also* H. REP. No. 1711, 90th Cong., 2d Sess. 8-9 (§ 13(d) of '34 Act provides investors with information concerning large stock accumulations for valuation purposes), *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2811, 2818; Wellman v. Dickinson, 682 F.2d 355, 366 (2d Cir. 1982)(purpose of § 13(d) is to provide investors in securities with adequate information concerning persons acquiring large amounts of stock); K-N Energy, Inc. v. Gulf Interstate Co., 607 F. Supp. 756, 762 (D. Colo. 1983)(§ 13(d) provides investors with information for valuation purposes); 17 C.F.R. §§ 240.13d (Rule 13d provides for disclosure of information to investors concerning person or group of persons acquiring more than five percent of outstanding shares of company).

115. *See* Wellman v. Dickinson, 682 F.2d 355, 365 (2d Cir. 1982)(§ 13d of '34 Act informs shareholders of potential changes in corporate control, permitting shareholders to act on informed basis); GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971)(§ 13d provides information that allows investors to value security); K-N Energy, Inc. v. Gulf Interstate Co., 607 F. Supp. 756, 762 (D. Colo. 1983)(same).

116. *See* 17 C.F.R. § 240.13d-3 (1986)(SEC interpreted Congressional intent to limit application of beneficial ownership to § 13d of '34 Act); *see* Exchange Act Release No. 15,348, [1978-1979 Transfer Binder] FED. SEC. L. REP. (CCH) § 91,838 at 92,765 (Nov. 22, 1978)(explaining that § 13d does not concern manipulation but provides investors information concerning rapid accumulations of stock).

117. *See* K-N Energy, Inc. v. Gulf Interstate Co., 607 F. Supp, 756, 762 (D. Colo. 1983)(§ 13(d) of '34 Act does not provide investors with method to obtain stock). In *K-N Energy*, the United States District Court for the District of Colorado explained that Congress designed § 13(d) of the Securities Exchange Act of 1934 to provide investors with the information necessary to value securities. *Id.* The district court further explained that in addition to the notion that § 13(d) does not permit investors to obtain stock at artificially depressed prices, § 13(d) does not permit corporate management to use § 13(d) to avoid takeover attempts. *Id.*; *see infra* notes 111-23 and accompanying text (describing method by which investors could avoid application of Section 10b-13 if term purchase in Section 10b-13 included investors with beneficial ownership claim to target company stock).

artificially depressed prices because investors could create a manipulative pre-tender stock purchase agreement that conveys beneficial ownership of a target company's stock to the purchaser at the time of the agreement.[118] The parties to the agreement, however, would not execute the agreement until the tender offer period, thus misleading shareholders about the demand for and value of the stock.[119] Consequently, allowing purchases to encompass beneficial ownership of a target company's stock under Rule 10b-13 would permit, to the detriment of shareholders, the manipulation of a tender offer that Rule 10b-13 attempts to prohibit.[120] To allow purchases to include beneficial ownership under Rule 10b-13, therefore, would be inconsistent with the purposes of the '33 and '34 Acts.[121] Congress enacted the '33 and '34 Acts and corresponding rules to protect investors from abuses in the securities market, not to enhance the potential for abuses in the securities market through manipulation of the sections under the '33 and '34 Acts.[122]

In addition to the interpretation of the express statutory language of Rule 10b-13 concerning arrangements to purchase and purchases, the purpose underlying the promulgation of Rule 10b-13 provides insight concerning purchases outside the terms of the formal tender offer.[123] The purpose of preventing purchases of or arrangements to purchase stock that are not pursuant to a tender offer is to safeguard the interests of persons who have tendered stock under the terms of the tender offer.[124] More specifically, various courts have stated that the SEC designed Rule 10b-13 to prevent outside purchases of stock at a price different than the price stated in the tender offer.[125] Rule 10b-13, however, should also apply to cases when the

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118. *See* City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 717 (4th Cir. 1986)(applying beneficial ownership to Rule 10b-13 makes Rule 10b-13 inapplicable because parties would have executed transaction before commencement of tender offer period).

119. *Id.; see supra* notes 58-62 and accompanying text (discussing Fourth Circuit's holding in *City National Bank* concerning application of beneficial ownership to Rule 10b-13).

120. *See infra* note 124 and accompanying text (discussing purpose of Rule 10b-13 of '34 Act).

121. *See supra* notes 4-6 and accompanying text (discussing purposes of Securities Act of 1933 and Securities Exchange Act of 1934).

122. *Id.*

123. *See supra* notes 100-22 and accompanying text (discussing interpretation of language of Rule 10b-13 concerning purchases outside terms of tender offer); *see also infra* note 124 and accompanying text (discussing purpose of Rule 10b-13).

124. *See* Exchange Act Release No. 8595, [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) § 77,706 at 83,616-18 (May 5, 1969)(Rule 10b-13 protects shareholders by preventing tender offerors from offering to purchase stock from shareholders at various prices).

125. *See* Pryor v. United States Steel Corp., 591 F. Supp. 942, 960 (S.D.N.Y. 1984)(Rule 10b-13 prevents tender offerors from offering to purchase stock from shareholders at a price different from purchase outside tender offer); Wellman v. Dickinson, 475 F. Supp. 783, 833 (S.D.N.Y. 1979)(Rule 10b-13 prevents tender offeror from making private purchases of stock at price different from tender offer stock price); Heine v. Signal Cos., [1976-1977 Transfer Binder] FED. SEC. L. REP. (CCH) § 95,898 at 91,319 (S.D.N.Y. 1977)(same). In *Wellman v. Dickinson* the United States District Court for the Southern District of New York considered

price per share of a target company's stock in a tender offer is the same as the price per share of a target company's stock in purchases outside the tender offer.[126] Although the price per share of a target company's stock in a tender offer equals the price per share of a target company's stock in purchases outside the tender offer, manipulation, nonetheless, may be present.[127] When the tender offer price equals the private stock purchase agreement price, the identical prices may mislead shareholders because the price of the tender offer actually may be less than the true value of the target company's stock.[128] Accordingly, Rule 10b-13 should apply to situations when the tender offer price and the private stock purchase agreement prices are equal to prevent the manipulation of a target company's shareholders.[129]

In *City National Bank v. American Commonwealth Financial Corp.*, the Fourth Circuit held that Rule 10b-13 applied to pre-tender stock purchase agreements that the parties to the agreement did not execute until the tender offer period.[130] The *City National Bank* court's decision protects a target company's shareholders from manipulation by applying Rule 10b-13 to pre-tender stock purchase agreements when the parties to the agreement consummate the agreement during the tender offer period.[131] The purpose of

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whether the defendant violated Rule 10b-13. *Wellman*, 475 F. Supp. at 791-93. In *Wellman*, a corporation, purchased from the defendant, pursuant to a tender offer, shares of stock on terms different from terms applicable to other tender offerees. *Id.* at 833. In examining the plaintiff's 10b-13 claim, the district court explained that Rule 10b-13 protects shareholders who have tendered shares under a tender offer by prohibiting purchases outside the tender offer that have terms different from the terms of the tender offer. *Id.* The district court further explained that the payment to the defendant under the tender offer provided the defendant with a tax benefit that other tender offerees did not receive. *Id.* at 834. Accordingly, because the terms of the tender offer differed and thus provided the defendant with a benefit that other tender offerees did not receive, the district court found that the defendant violated Rule 10b-13. *Id.*

126. *See infra* notes 127-29 and accompanying text (discussing application of Rule 10b-13 to situations when price of shares in tender offer is same as price of shares in privately negotiated sales); *see also supra* notes 23, 26 and accompanying text (in *City National Bank*, prices of shares in tender offer was same as price of shares in privately negotiated pre-tender stock purchase agreement).

127. *See infra* notes 128-29 and accompanying text (manipulation of shareholders may exist in tender offer when tender offer price per share is same as privately negotiated price per share).

128. *See* Exchange Act Release No. 8712, [1969-1970 Transfer Binder] FED. SEC. L. REP. (CCH) § 77,745 at 83,708 (Oct. 8, 1969)(private stock purchase agreements that parties execute during tender offer period can manipulate target company's shareholders irrespective of price per share in tender offer and price per share in agreement).

129. *See supra* notes - and accompanying text (Rule 10b-13 applies when tender offer price for stock is same as privately negotiated price for stock).

130. City Nat'l Bank v. American Commonwealth Fin. Corp., 801 F.2d 714, 718 (4th Cir. 1986); *see supra* notes 47-72 and accompanying text (discussing Fourth Circuit's holding in *City National Bank*).

131. *See supra* notes 73-129 and accompanying text (Fourth Circuit's holding in *City National Bank* prevents shareholder manipulation).

Rule 10b-13, which is to prevent shareholder manipulation, mandates that parties should not be able to execute pre-tender stock purchase agreements during a tender offer period due to potential stockholder manipulation.[132] Even when a tender offer discloses a pre-tender stock purchase agreement, courts should not allow the parties to the agreement to execute the agreement during the tender offer period because the potential for shareholder manipulation, nonetheless, exists.[133] The mere satisfaction of the disclosure requirements of the Williams Act should not serve to validate pre-tender stock purchase agreements that permit tender offerors to mislead shareholders regarding the value of a security solely due to the timing of the agreement's execution.[134] Courts, therefore, should examine the substantive nature of pre-tender stock purchase agreements and apply Rule 10b-13 to pre-tender purchase agreement situations when the potential for shareholder manipulation exists.[135]

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132. *See supra* notes 100-29 and accompanying text (pre-tender stock purchase agreements that parties execute during tender offer period potentially can manipulate shareholders).

133. *See supra* notes 75-129 and accompanying text (even when tender offer discloses pre-tender stock purchase agreement, shareholder manipulation potentially can occur).

134. *See* Wellborn, *supra* note 7, at 663 (noting that Rule 10b-13 should prevent, during tender offer period, arbitrageurs' private purchases in open market that cause market price distortions that are impervious to disclosure requirements).

135. *See supra* notes 75-134 and accompanying text (Rule 10b-13 applies to pre-tender stock purchase agreements when parties execute agreement during tender offer period).