CHAPTER VII.

BUSINESS COMBINATIONS

A. Introduction

B. Application of ’33 Act requirements to offers of securities made in connection with business combinations involves both uncertainty and inconsistency. A solution is needed which would reduce the area of uncertainty and eliminate substantial distinctions from a ’33 Act standpoint between different types of business combinations.

1. The protean history of the “no sale” concept as applied to business combinations.

    (a) The early position of the Federal Trade Commission.

    (b) The Merck decision.

    (c) The Note to Rule 5 of Form E-1.

    (d) The Leland Stanford case and its aftermath.

    (e) Rule 133.

    (f) When does Rule 133 apply?

2. Problems and inconsistencies created by Rule 133.

3. What is needed.

4. The alternative solutions.

C. Rule 133 should be replaced by application of the fundamental principal of the '33 Act (disclosure appropriate under the circumstances) if practical problems inherent in the application of that principle to business combinations can be solved. The Study believes that this is possible.

1. What sort of a registration statement would be filed?

2. What would the prospectus consist of?

3. How would the registration statement be processed by the Commission's staff and when would it be made effective?

4. When does the public offering of securities take place.

5. What restrictions would apply to the offering of securities?

6. How would the prospectus delivery requirements of Section 5(b)(2) be met?

7. What post-effective prospectus deliveries would be required?

8. Who are "underwriters" under the '33 Act?

9. How can registration be accomplished in a consolidation?

10. When would registration be required in connection with reclassifications of securities?

11. What sale-of-assets transactions would not require registration?

D. A more definite guideline would be useful to assist the acquiring company in determining when an acquisition transaction does not involve a public offering.

E. A rule should be adopted governing the resale of shares issued to a non-public group of shareholders of an acquired company which would give recognition to the special characteristics of business combinations.

CHAPTER VII

BUSINESS COMBINATIONS

A. Introduction

Business combinations in which payment by the acquiring corporation is made in its own securities are effected in three standard ways: (1) a voluntary exchange of securities, (2) a statutory merger or consolidation, and (3) a sale of the assets of the acquired company in exchange for securities of the acquiring company, which are thereupon transferred to the seller's shareholders on its dissolution.

Where method (1) is used, an offer of securities of the acquiring corporation is made directly to the shareholders of the acquired corporation. In methods (2) and (3), the shareholders of the corporation to be acquired are asked to cast their individual votes for or against approval of the acquisition, or, in realistic terms, for or against a legal procedure by which their present shareholdings are exchanged for shares in another company.

Employment of method (1) subjects the transaction to the disclosure requirements of the '33 Act. Employment of methods (2) and (3) does not. The reason for this lies in the existence of a long-standing Commission rule (Rule 133) under which the submission of the acquisition transactions to the vote of shareholders is not deemed to involve a "sale" or "offer to sell" the shares of the acquiring company so far as those shareholders are concerned.

Rule 133 has led a controversial life.[1/] It seems clear to the Study that its theoretical basis—the notion that the change in the stockholdings of the acquired corporation occurs exclusively through "corporate action"—is, in the words of Professor Loss, "unforgivably formalistic."[2/]

1/ The following are some of the more significant commentaries on Rule 133, both pro and con:

Sargent, A Review of the "No-Sale" Theory of Rule 133, 13 Bus. Law. 78 (1957); Orrick, Some Interpretative Problems Respecting the Registration Requirements Under the Securities Act, 13 Bus. Law. 377 (1958); Throop, In Defense of Rule 133—A Case for Administrative Self-Restraint, 13 Bus. Law. 389 (1958); Purcell, A Review of the "No Sale" Theory of Rule 133, 24 Brooklyn L. Rev. 254 (1958); Nelson, Recent Developments in the No Sale Theory, 47 Calif. L. Rev. 112 (1959); Hanes, Rule 133 and the No Sale Theory, Interpretation or Legislation, 13 Jr. of Pub. L. 520 (1964); Sommer, Mergers, Consolidations, Sale of Assets – Rule 133, 16 West. Res. L. Rev. 11 (1964); Volker, The Securities Act of 1933 and the Stockholders of Acquired Corporations, 1965 Duke L. Jr. 1 (Winter; Schneider, Acquisitions Under the Federal Securities Act – A Program for Reform, 116 Pa. L. Rev. 1323 (1968).

2/ 1 Loss, Securities Regulation 522 (2d ed. 1961).

If excessive formalism were the only problem with the Rule, its continued existence over many years would constitute a powerful argument against any disruption of the status quo.[3/] Unfortunately, however, experience with Rule 133 has given rise to problems which must be faced in any review of disclosure policy. Consideration of these problems has led the Study to reexamine the Rule, not so much from a theoretical as from a practical point of view. Can the important differences which presently exist in the '33 Act consequences of different methods of business combination –differences which inevitably affect the choice of the method to be used—be justified? If not, can a workable procedure be devised to eliminate those differences?

3/ It might be argued further that the failure of Congress to reverse the "no sale" theory when it amended Section 2(3) of the '33 Act in 1954 gives Rule 133 the force of law. However, the authorities are clear that the power of an agency to change rules prospectively is not impaired by "reenactment" of the statute when prior rules are in effect. 1 Davis, Administrative Law Treatise, 357; American Chicle Co. v U.S. 316 U.S. 450 (1942); Helvering v Reynolds, 313 U.S. 428 (1940); See: Helvering v Wilshire Oil Co., 308 U.S. 90, 100-01 (1938).

> "The more reenactment of a statute following administrative construction should be given no weight whatever in determining the proper construction of the statute." Griswold, A Summary of the Regulations Problems, 54 Harvard L. Rev. 398, 400 (1941).

B. Application of ’33 Act requirements to offers of securities made in connection with business combinations involves both uncertainty and inconsistency. A solution is needed which would reduce the area of uncertainty and eliminate substantial distinctions from a ’33 Act standpoint between different types of business combinations.

1. The protean history of the “no sale” concept as applied to business combinations.

Almost from the outset, the Commission has been plagued by problems engendered by its reliance upon a “no sale” concept in applying the provisions of the ’33 Act to business combinations. A brief outline of the recurring difficulties experienced with this concept is essential to place today’s disclosure policy dilemma in proper perspective.[4/]

(a) The early position of the Federal Trade Commission.

At an early stage in the administration of the ’33 Act, a question arose as to whether its disclosure provisions applied to a business combination effected by merger, consolidation or sale of assets, assuming that the securities issued in the combination were not specifically exempt from registration under Section 3 of the Act.[5/] An affirmative answer was implied in a much quoted

---

4/ For those interested in a more detailed history of the “no sale” concept reference is made to the excellent discussion in 1 Loss, Securities Regulation 518-542 (2d ed. 1961).

5/ Section 3(a)(10) exempts any security issued in exchange for the outstanding securities of another corporation if the terms and conditions of the exchange are approved after a hearing by an authorized federal or state official.

passage from the legislative history[6/] and in the brief period prior to the establishment of the Securities and Exchange Commission, the Federal Trade Commission, while administering the '33 Act, took the position that a merger was a "sale" subject to the registration and disclosure requirements of the Act.

(b) The Merck decision

Shortly after the Securities and Exchange Commission was entrusted with administration of the '33 Act, the applicability of its registration provisions to a proposed statutory consolidation involving Merck Corporation and Merck & Co., Inc. came before the Commission. Counsel for Merck argued that when the consolidation became effective, the shareholders of the two corporations were transformed by operation of law into shareholders of the new corporation so that the exchange of their old shares for new shares

---

6/ The passage reads as follows:

> Reorganizations carried out without such judicial supervision possess all the dangers implicit in the issuance of new securities and are, therefore, not exempt from the act. For the same reason the provision [Section 3(a)(10)] is not broad enough to include mergers or consolidations of corporations entered into without judicial supervision. (H.R. Rep. No. 85, 73d Cong., 1st Sess. 16 (1933)).

Professor Loss comments:

> If this does not say in so many words that mergers and the like effectuated by "corporate" rather than "individual" action are covered by the statute unless specifically exempted, it does seem to squint pretty hard in that direction. (1 Loss, Securities Regulation 519 (2d ed. 1961)).

was not a "sale". By a divided vote, the Commission decided not to require registration.

This decision should be considered in its context. The Commission had just take up its responsibilities. Mergers and consolidations were a relative rarity. Controversial issues of far greater consequence faced the Commission, and insistence on disclosure in mergers may not have seemed to be a particularly pressing matter under the circumstances of that day.

(c) The Note to Rule 5 of Form E-1

The Commission's position in the Merck case was given formal expression in Note to Rule 5 of Form E-1 adopted, again by a divided vote, in September 1935.[7/] In the Note it was stated that the Commission deemed "no sales to stockholders of a corporation to be involved" where, pursuant to provisions of a statute or of the certificate of incorporation, a majority vote of the stockholders was required to approve a plan for a statutory merger or consolidation or an exchange of the assets of the corporation for stock of another company.

7/ Securities Act Release No. 493 (September 19, 1935). Form E-1 was a special form for registration of securities in connection with a "reorganization" which had been initially adopted by the Federal Trade Commission in May, 1934. In 1947, this form was abolished, including the Note to Rule 5; however, the Commission continued to follow administratively the "no sale" theory embodied in the Note, until the earliest version of Rule 133 was adopted.

(d) The Leland Stanford case and its aftermath

In 1943, the Commission indicated the view amicus curiae that a consolidation of two existing companies into a new company did not constitute a "sale" under the '33 Act for any purpose. In other words, the view was taken that neither the registration nor the anti-fraud provisions of the Act applied in such a transaction. This view was expressed in Commission briefs filed in the course of private litigation in which Stanford University sought to recover the value of certain securities it had held prior to a consolidation which terminated the existence of the issuer of those securities.[8/] The University complained, among other things, of a violation of the '33 Act by the defendant and specifically charged that it had received misleading and fraudulent proxy material when its vote was solicited on the consolidation. The Court of Appeals for the Ninth Circuit decided in the defendant's favor on ground of estoppel but observed, without comment, that it was in agreement with the views of the Commission.

Early in the 1950's, the Commission found it necessary to retreat somewhat from the position it had taken in Leland Stanford

---

8/ Leland Stanford, Jr. University v National Supply Co., 46 F. Supp. 389 (N.D. Cal. 1942), rev'd. 134 F2nd 689 (9th Cir. 1943, cert. den. 320, U.S. 773 (1943).

The circumstances are described by former Chairman Manuel F. Cohen:[9/]

> In 1951, one of our Regional Administrators advised that he had received complaints regarding certain mergers brewing in his area. He referred to the repeal of Form E-1 in 1947 and sought instructions whether it was appropriate to investigate these matters, since the antifraud provisions of Section 17 related only to "sales". About this time, a case had also arisen under Section 16(b) of the Securities Exchange Act of 1934 in which one issue was whether the acquisition of securities in a merger could be treated as a purchase and matched with a sale of these securities within 6 months. [Blau v. Hodginson, 100 F. Supp. 361 (S.D. N.Y., 1951.]
>
> The Commission determined to appear in the Section 16(b) case amicus curia to urge that a "purchase" within the meaning of Section 16(b) had taken place and that the "no sale" theory which had been raised by way of defense had no application under the 1934 Act . . . The Commission also directed that the Regional Administrator be advised that the position previously reflected in the Note to Form E-1, which had been rescinded, should not be construed as in any way limiting the Commission's jurisdiction under Section 17 of the Act or Section 10 of the Securities Exchange Act of 1934.

The foregoing quotation states the position which has been taken by the Commission in cases subsequent to Leland Stanford. During the decade of the sixties, a number of court decisions supported the view that a statutory merger or consolidation involved a "sale" of securities within the meaning of the antifraud provision of the '33 and '34 Acts, despite existence of a Commission rule to

---

9/ Cohen, Rule 133 of the Securities and Exchange Commission, 14 Record of the Association of the Bar of the City of New York (1959).

the effect that such transactions are not "sales" for the purposes of Section 5.[10/] Very recently, the Supreme Court in Securities and Exchange Commission v. National Securities, Inc. (decided January 27, 1969) reached the same conclusion. The majority opinion written by Mr. Justice Marshall observes:

> Whatever the terms "purchase" and "sale" may mean in other contexts, here an alleged deception has affected individual shareholders' decisions in ways not at all unlike that involved in a typical cash sale or share exchange. The broad anti-fraud purposes of the statute and the rule [10(b)(5)] would clearly be furthered by their application to this type of situation. Therefore we conclude that Producers Life's shareholders "purchased" shares in the new company by exchanging them for their old stock.[11/]

(c) Rule 133.

The administrative practice originally embodied in the Note to Form E-1 was given the status of a Commission rule in August, 1951.[12/] The new Rule 133 expressly stated that the Commission

---

10/ Mader v. Armel, CCH Fed. Sec. L. Rep. (Current) [illegible] 92,294, (6th Cir., No. 17976, Oct. 29, 1968); Dasho v. The Susquehanna Corp., 267 F. Supp. 508 (N.D. Ill., E.D., 1966), 380 F. 2d 262 (7th Cir. 1967), cert. den. Sub nom. Bard v. Dasho, 389 U.S. 977 (1967); Vine v. Beneficial Finance Co., Inc., 374 F. 2d 627 (2d Cir. 1967), cert. den., 389 U.S. 970 (1967); Simon v. New Haven Board & Carton Co., 250 F. Supp. 297 (D.C. Conn. 1966); Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del. 1965); H.L. Green Co. v. Childree, 185 F. Supp. 95 (S.D.N.Y. 1960).

11/ CCH Fed. Sec. L. Rep. (Current), V 92,334.

12/ Securities Act Release No. 3420 (August 2, 1951).

considers mergers, consolidations and similar transactions not to involve a "sale," but only for purposes of Section 5 of the '33 Act.

Within five years, however, the Commission was persuaded that the position it had taken in the "no sale" rule should be reexamined. Notice was published in October, 1956 that the Commission had under consideration a complete reversal of Rule 133. The proposed amendment to the Rule provided affirmatively that all mergers, consolidations and similar transactions should be deemed to involve the offer and sale of securities. The Commission's release did not suggest how registration under the '33 Act was to be effected in these transactions. It was observed, however, that provision would be made so that information furnished in a '33 Act prospectus would not be "unnecessarily duplicated" in a proxy statement where the Commission's proxy rules applied.

Adverse reaction to the Commission's proposal was strong. Many of the comments observed that disclosure was needed in these transactions but that it should be provided by the furnishing of a proxy statement. The Commission was urged to seek legislation which would subject over-the-counter companies to the proxy rules. The Commission determined to defer action on the proposal pending further study.13/

In September, 1958, the Commission published a proposal to revise Rule 133 by specifying those persons deemed to be "underwriters"

13/ Securities Act Release No. 3761 (March 15, 1957).

of the securities newly issued in mergers, consolidations and similar transactions. Persons controlling the acquired corporation in such transactions, although not in control of the surviving corporation, were defined as "underwriters" if they acquired their newly issued shares with a view to distribution. However, their subsequent sales were not deemed to be "distributions" requiring registration if they occurred in brokerage transactions subject to limitations identical to those contained in the Commission's Rule 154.

The accompanying release observed that the new proposal was based upon certain conclusions reached by the Commission's staff after detailed examination of all relevant statutory materials, prior Commission and staff actions, and the various arguments which had come to its attention. The first conclusion of the staff was expressed as follows:

> We do not agree with the proposition that the transactions described in Rule 133 do not involve a "sale" within the meaning of that term as defined in Section 2(3) of the Securities Act and that, therefore, the Securities Act has no application to such transaction. We reach this result essentially for two basic reasons:
>
> (1) the concept of "sale" as defined in Section 2(3) is broader than the commercial or common-law meaning of that term, and embraces a number of situations which would not be regarded as sales in the commercial sense but fall within the purposes of the Securities Act and
>
> (2) the transactions described in Rule 133 do not, as is often said, occur solely by operation of law and without the element of individual consent by security holders, but on the contrary are basically contractual in their foundation, reflecting essentially contractual relationships among security holders and between security holders and corporations.

The ultimate conclusion of the staff was, however (1) that the procedural and liability provisions of the '33 Act as they affect issuers, underwriters and dealers would not operate reasonably and effectively in the types of transactions covered by Rule 133, and (2) that, despite its view that the transactions described in Rule 133 come within the definition of "sale" in Section 2(3) of the '33 Act, it would be reasonable for the Commission to declare by appropriate interpretation of statutory language that such transactions do not involve "offers" or "sales" for purposes of the registration requirements.

In July, 1959, the amendments to Rule 133 proposed in September of the previous year were adopted with modifications.[14/] No subsequent material changes have been made in the Rule.

(f) When does Rule 133 apply?

The July, 1959 amendments to Rule 133 reflect certain limitations on the scope of that Rule which had been articulated in two important cases. In its Great Sweet Grass opinion,[15/] the Commission stated that the Rule did not mean that securities issued in a business combination of the type described in the rule are "free" securities which can thereafter be offered and sold to the general public without

---

14/ Securities Act Release No. 4115 (July 16, 1959).

15/ Great Sweet Grass Oils, Ltd., 37 S.E.C. 683 (1957), aff'd per curiam sub nom. Great Sweet Grass Oils, Ltd. V. S.E.C., 256 F 2d 893 (D.C. Cir. 1958); Kroy Oils, Ltd., 37 S.E.C. 683 (1957), petition for review withdrawn sub nom. Kroy Oils, Ltd. V. S.E.C., D.C. Cir., No. 13, 920, Dec. 10, 1958.

registration. The District Court in the Mirco [sic]-Moisture case[16/] held that Rule 133 provides no exemption from registration for the sale of stock received in a stock-for-assets reorganization by persons who acquired control of the issuing corporation in the transaction.

What if the vote of shareholders approving the transaction is a mere formality? In Great Sweet Grass, the Commission stated by way of dictum that where that is the case (because one person or a small group control enough stock to assure the requisite favorable vote), Rule 133 does not apply since the transaction is then not authorized by "corporate action." Although the Commission has never expressly withdrawn this dictum, nothing was said on the point in the amended Rule 133. For this reason, many lawyers concluded that the Great Sweet Grass dictum had been rendered irrelevant.

Moreover, since 1959 the Commission's staff has generally raised no question as to the applicability of Rule 133 where there are public shareholders who will be bound by the results of a shareholders' vote, even though a single shareholder or a small controlling group of shareholders holds the votes necessary to assure the favorable outcome. If, however, the corporate charter, state law, or terms of the reorganization plan call for the unanimous vote of shareholders of the acquired corporation, the staff has taken the position that Rule 133 does not apply. The reasoning is as follows: since one shareholder

---

16/ S.E.C. v. Micro-Moisture Controls, Inc., 148 F. Supp. 558 (S.D.N.Y. 1957) (preliminary injunction), reargument denied, CCH Fed. Sec. L. Rep. ¶ 90,805 (S.D.N.Y. 1957) final injunction, 167 F. Supp. 716 (S.D.N.Y. 1958), aff'd sub nom. S.E.C. v. Culpepper, 270 F. 2d 241 (2d Cir. 1959).

can defeat the transaction by withholding his consent, every shareholder is, in effect, making an individual choice.

Assume that there are only two stockholders of the corporation to be acquired, each of whom holds 50% of the stock. The assent of both is necessary to meet the requirement of state law that the merger be approved by two-thirds of the voting shares. Thus the vote must, as a practical matter, be unanimous. Does this mean that Rule 133 is inapplicable? If so, assume that the number of shareholders is increased to 3, and that each owns one-third of the shares. Would Rule 133 then be applicable because the merger could theoretically be authorized by the vote of only two out of the three?

Assume that the number of shareholders of the acquired corporation is increased to 5 or 10 persons, who will usually be members of the same family group. Normally, an offer of voluntary exchange of shares by the acquiring corporation to a group of such size and character would be considered to be a private offering. It would be accompanied by "investment letters" containing representations by the issuees and, very likely, restrictions on any resale of the securities by them. Is the transaction converted into something entirely different by structuring the transaction so as to require a vote of these shareholders? Is not the shareholder vote, under these circumstances, the merest formality?

The applicability of Rule 133 in the situations described is in doubt. For a time, following the 1959 amendments, the staff of the

Commission granted no-action letters with respect to Rule 133 transactions in which the acquired corporation was held by no more than a handful of shareholders. However, a no-action position was not taken if all of the stock of the acquired corporation was held by a single person.

In 1965, the Division reexamined its position and recommended to the Commission that where only a handful of persons, related by blood or business connections, hold the stock of the acquired corporations, they should be treated as a single person by analogy to the interpretation which had been given to Rule 154. The Commission disagreed.

Shortly thereafter, the Division recommended denial of a “no action” request relating to a transaction in which two persons held the stock of the acquired company in equal amounts and would receive, upon consummation of the sale of its assets, the stock of a company whose shares were listed on the New York Stock Exchange. The Commission rejected the recommendation and granted the request. Additional no action requests under similar circumstances were thereafter granted. In some instances, all of the stock of the acquired corporation was held by a single shareholder.

In the spring of 1967, a request for a “no action” letter came before the Commission involving a transaction in which, although the acquiring corporation was a reporting company, the shares it proposed to issue to the single stockholder of the corporation to be acquired were not listed on a national securities exchange. Inviting the Commission's attention to this fact, the Division recommended against granting the request. The Commission refused a "no action" letter. In August of the same year, in situations where the acquired corporation's stock was held by two and three persons, respectively, and the acquiring corporation's stock was listed on the American Stock Exchange, the Commission likewise refused to take a "no action" position.

Thereafter, the Commission advised its staff that no further "no action" letters be granted in instances where the acquiring company was held by only a relative handful of persons. The Division has since denied "no action" requests in cases where, if the transaction were structured otherwise than as a merger or sale of assets, the issue of the new shares would clearly amount to a private placement. In explaining its denial of "no action," the Division has on occasion referred to what has been termed the "negotiated transaction" exception to Rule 133.[17/] The argument for the exception is this: where the terms of the transaction are essentially "negotiated" by the shareholders of the company to be acquired and representatives of the acquiring company, no "corporate action" really occurs except in a purely theoretical sense; hence the rationale behind the "no sale" concept is missing.

17/ See the discussion in Schneider, Acquisitions under the Federal Securities Act – A Program for Reform, 116 U. Pa. L. Rev. 1323, 1325-26 (1958).

2. Problems and inconsistencies created by Rule 133.

Apart from the uncertainties and anomalies involved in the application to transactions which are essentially private placements, Rule 133 leaves a decided disclosure gap when the company to be acquired is publicly held but has not registered with the Commission under Section 12 of the '34 Act.

This situation will ordinarily exist whenever any one of three circumstances obtains: (1) the company has less than 500 shareholders of record; (b) the company has more than 500 shareholders of record but less than one million dollars in assets; or (c) the company has in excess of 500 shareholders of record and more than one million dollars of assets but no registration of a class of its securities has as yet become effective under Section 12(g).[18/]

If the company to be acquired has registered a class of its securities with the Commission under Section 12, it can normally be assumed that its shareholder will receive disclosure in the form of a proxy or information statement under the Commission's proxy rules adequate to permit them to exercise an informed choice on whether to vote for or against the transaction, i.e., the proposed exchange of their shares. If, however, no registration is in effect, there is no

---

18/ Upon acquiring over 500 shareholders and over $1 million of assets, a company is required to file a registration statement not later than 120 days after the beginning of its ensuing fiscal year. The registration statement becomes effective 60 days after filing. Thus, as long a period as 18 months can elapse between the time a company meets the standards for registration and the time such registration takes place.

such assurance. Under the laws of many states, the only document which must be sent to shareholders in advance of a meeting called to vote on a proposed merger or sale of assets is a bare notice of the meeting. Such proxy solicitation material as may be sent is not subject to any review process to assure that it comports with standards of good disclosure.[19/] The informational gap facing the shareholder is

---

19/ With respect to a sale of substantially all the company's assets: (i) 3 states have no requirement with respect to the notice to be sent shareholders; (ii) 2 states leave the notice provisions to be as prescribed by the company's by-laws; (iii) 3 states require only that the notice give the date, time and place of meeting; (iv) 40 states require that a notice of meeting to vote on a sale of the company's assets also state the purpose of the meeting; (v) 1 state requires that a copy or summary of the terms of the transaction be sent with the notice; and (vi) 1 state requires that the instrument of proxy set forth "in reasonable detail" the purpose of the meeting.

With respect to mergers and consolidations: (i) 1 state has no notice requirement; (ii) 2 states leave the provisions re notice to shareholders to be prescribed by the company's by-laws; (iii) 18 states require that the notice state the purpose of the meeting called; (iv) 22 states require that a copy or summary of the plan of merger or consolidation be sent with the notice of meeting; (v) 1 state requires that the purpose of the meeting be set forth "in reasonable detail" in the notice; (vi) 3 states require a "summary of the plan" of merger or agreement to be included with the notice; (vii) 1 state requires that a copy of the merger or consolidation agreement be sent with the notice of meeting; (viii) 1 state requires that the notice include a statement of the value of the soliciting company's assets, the amount of its indebtedness, and a copy of the agreement; and (ix) 1 state requires that the notice include a copy of the plan or an accurate outline of its material features and financial statements of each company for the past three fiscal years showing their financial condition in reasonable detail.

compounded by the fact that accurate factual information about his company may not otherwise be available since the company is not required to file any reports with the Commission under the '34 Act.

This disclosure gap has become more acute as the number of business combinations has continued to rise.

The Study surveyed a total of 173 corporate acquisitions completed in January and February of 1968, as reported by "Mergers and Acquisitions: The Journal of Corporate Venture."[20/] All of the 144 acquiring corporations involved in these transactions were reporting companies. Only 46 of the total of 186 acquired corporations were required to file reports with the Commission and to comply with the proxy rules if a vote of their shareholders was necessary to authorize the acquisition transaction. An informal inquiry by telephone was made in order to obtain data on a sample of those transactions in which the acquired corporation was non-reporting. The inquiry indicated that in approximately 15% of those transactions, the acquired company had in excess of 25 (but less than 500) shareholders. In such cases, the disclosure to shareholders in connection with obtaining the necessary shareholder vote varied from a bare notice of meeting to a proxy statement about as extensive in scope as that required by the Commission's proxy rules. Instances in which a relatively full proxy statement was used although no such disclosure was legally required

---

20/ Volume 2, No. 2, 85-115 (March-April 1968).

show that careful counsel are concerned about the need for disclosure regardless of the form of the acquisition.[21/]

Many factors are of important in the choice of the form of acquisition, including the nature and provisions of leases and labor contracts of the acquired company, sales and other taxes, problems in transferring certain kinds of assets, avoiding the necessity of a meeting of the shareholders of the acquiring company, and so forth. Unfortunately (in the Study's view), the disclosure consequences under the '33 Act of the various forms of acquisition are, at the present time, also a factor of significance in making that choice.

Moreover, today the form chosen for the acquisition transaction affects the answer to the question: are any of the former shareholders of the acquired company "underwriters" of the newly issued shares which they receive?

Assume that the acquired company is publicly held and that the acquisition is structured as a voluntary exchange of stock. The offer is made by prospectus. Non-controlling shareholders of the acquiring corporation who, before the acquisition, were in control of the

---

21/ One conglomerate corporation advised the Study of a recent acquisition by it, in a Rule 133 transaction, of a company with approximately 300 shareholders. Counsel for the acquired company saw no reason to send to the shareholders of his client anything more than a single page notifying them of the meeting and announcing the proposed merger. However, the acquiring company, as a matter of policy, insisted that a full proxy statement, essentially complying with the Commission's proxy rules, be forwarded to all shareholders of the acquired corporation. Had this same acquisition taken the form of a voluntary exchange offer, the shares to be issued by the acquiring corporation would have been registered under the '33 Act and the solicited shareholders would have been entitled under the law to receive a prospectus giving them full information regarding the proposed exchange.

acquired corporation, are generally deemed not to be "underwriters" and are therefore free to resell their new securities when they wish to do so without registration.

When Rule 133 applies, however, a special set of rules comes into play. As person who controlled the acquired corporation but who does not control the acquiring corporation, may, under Rule 133(c), be an underwriter of the securities he receives. He is deemed <u>not</u> to be an underwriter, however, if he resells only in unsolicited brokerage transactions within the limits specified in Rule 133(d) and (e). The securities must be registered only if his sales exceed these limits. He is treated, in effect, as though he became a controlling person of the acquiring corporation.

The Study questions the distinctions thus created between different types of acquisition transactions. A shareholder of the acquired corporation ought not to be deemed an underwriter following a statutory merger or sale of assets if he is not so regarded following a voluntary exchange of securities, and vice versa. If the acquired corporation is publicly held, if there has been full disclosure to its shareholders in connection with the transaction, and if the issuing corporation, as a consequence of the transaction or for other reasons, is required to keep such disclosures reasonably current through periodic reports under the '34 Act, provisions such as Rule 133 (c), (d) and (e) are no longer appropriate.[22/]

3. What is needed.

A renewed attempt must be made to solve the problems associated with business combinations. The following guideposts are suggested:

(a) Commission policy should recognize the fact that when a shareholder is asked to vote on the question whether or not his company should be acquired by another and, accordingly, whether or not he wishes to exchange his shares for the securities of the acquired company, an offer of a security within the meaning of the '33 Act is made to him;

(b) When the offering to such shareholders constitutes a "public offering" within the meaning of the '33 Act, Commission policy should be to give the shareholders of the company to be acquired a disclosure document containing the information essential to an intelligent choice;

22/ There may well be special circumstances under which a person might be deemed to be an underwriter of securities acquired by him in a registered public offering of those securities, whether or not involving an acquisition transaction. Additional study is required on this difficult point, and is presently under way under the auspices of the Commission's Division of Corporation Finance. This report therefore does not recommend a precise policy in this area.

(c) When the offering to such shareholders constitutes a non-public offering under the ’33 Act, Commission policy should be to provide the shareholders of the company to be acquired with clear and appropriate guidelines as to where and how they can resell the new shares which they have received. Such guidelines should eliminate the unwarranted distinctions which presently exist between a business combination accomplished by a voluntary exchange of shares on the one hand, and one which takes the form of a statutory merger or sale of assets on the other.

4. <u>The alternative solutions</u>.

Five possible solutions to the business combination problem suggest themselves. They are:

<u>First</u>: Retain Rule 133 in its present form and announce officially that the rule means precisely what it says: for purposes of Section 5 of the ’33 Act, no sale is made to the shareholders of an acquired corporation, regardless of their number, when the acquisition is structured as a statutory merger or transfer of assets and must be approved by a vote of those shareholders. The Rule presently makes no reference to the number of shareholders. The Commission would make it clear that the Rule applies whether the acquired corporation has a single shareholder or 10,000 shareholders.

This approach would eliminate the confusion created by the Commission’s present unwillingness to agree to the proposition that

Rule 133 is applicable where the acquired corporation is closely held. It has the advantage of clarity. Unfortunately, however, that is its only advantage. Irrational distinctions from the standpoint of disclosure policy between the methods by which business combinations can be effected – distinctions based on legal form – would be perpetuated.

The disclosure gap that now exists whenever the acquired company in a merger or sale of assets has a public body of shareholders but is not subject to the Commission's proxy rules would remain undisturbed.[23/] And when the acquired company is owned by a small group of stockholders, the non-controlling members of the group would be free to dispose of their new shares issued by the acquiring company in any fashion they might choose, provided the acquisition took the form of a statutory merger, consolidation or sale of assets. If the acquisition was structured as a voluntary exchange of securities, however, the shareholders of the acquired company would be subject to all of the restrictions applicable to a private placement.

23/ See pp. 287-9 supra. There are paradoxical instances in which the shareholders of the acquiring corporation receive a prosy statement (as, for example, when the transaction is a statutory merger or consolidation, or a sale of assets in connection with which (1) the authorized stock of the acquiring company must be increased to accommodate the transaction, or (2) the stock exchange on which the acquiring corporation's shares are listed requires approval by its shareholders of the issuance of the necessary additional shares) but the shareholders of the acquired corporation (since they number less than 500) do not.

<u>Second</u>: Retain Rule 133, but amend it by adding an express provision making clear that the Rule applies only to cases in which a public body of shareholders approves proposals negotiated for and recommended to them by management. If the shares of the acquired company are closely held, the acquiring company would have to rely on the exemption from registration in Section 4(2) of the '33 Act unless it chose to register its securities.

This approach would essentially eliminate distinctions between the three types of business combinations where the company to be acquired is non-public. Aside from that, however, it does not satisfy the requirements of good disclosure policy. It would furnish no assurance of adequate information to the shareholder-offerees when their company was not registered under Section 12 of the '34 Act. The incentive to structure such an acquisition as a merger or sale of assets rather than as a voluntary exchange <u>for Securities Act reasons</u> would remain, since only in the latter case would a disclosure document under the Commission's rules be required.

<u>Third</u>: Retain Rule 133, but limit its scope to situations in which the company to be acquired is subject to the Commission's proxy rules.

This alternative would clarify the scope of the rule. Moreover, if the acquired company is publicly held, the shareholder-offerees would receive either a proxy statement or a prospectus and would thus be provided with adequate information on which to base an intelligent choice. An important matter would continue to hinge, however, on the legal form chosen for the transaction. Where the acquisition is structured as a merger or sale of assets, the acquiring company's duties and liabilities under the '33 Act would turn entirely on the acquired company's status under the '34 Act, whereas this would not be the case if the acquisition takes the form of an exchange offer. The Study is strongly of the opinion that such distinctions in legal consequence between the several methods employed in effecting business combinations are essentially unwarranted.

<u>Fourth</u>: Retain Rule 133 for the time being, but recommend legislation that would subject every transaction of the kind referred to in that rule, except for those clearly private in character, to the Commission's proxy rules.

This solution would close the disclosure gap where the acquired corporation is publicly held but not now subject to the Commission's proxy rules. It is sympathetically discussed by a leading commentator who came to the defense of Rule 133 at the time when the Rule was under reconsideration.[24/] However, it would mean referring an essentially technical matter, arising under a doctrine of the Commission's own creation, to an overburdened Congress. If the same result could be accomplished administratively, there would be no justification for a congressional solution. This brings us to the fifth alternative.

Fifth: Replace Rule 133 with a special kind of '33 Act registration procedure adapted to mergers and sales of assets. The new procedure would be consistent with the proposition that where an acquired company is publicly held, a proxy statement under the Commission's rules is both an appropriate and an adequate form of disclosure; nothing additional, by way of a prospectus, is needed.

This last alternative would substantially eliminate all distinctions under the '33 Act between the three types of business combinations. Its effect would be substantially identical to the proposed legislative solution, with one exception; if the disclosure

---

24/ See Throop, In Defense of Rule 133 – A Case for Administrative Self-Restraint, 13 Bus. Law. 389, 416 (1958).

document used in soliciting the vote of shareholders of the acquired corporation is defective, the legislative solution would give those shareholders implied rights of action under the Commission's Rule 10b-5, whereas the administrative solution proposed by the fifth alternative would give them statutory rights of action under Sections 11 and 12 of the '33 Act.

*   *   *   *

A strong argument can be made in favor of continued adherence to the "no sale" approach which has been followed, with ups and downs, since the Commission's earliest days. Nevertheless, on balance, the Study concludes that the fifth alternative offers the best way out of an unsatisfactory situation. The carefully considered 1958 report of the Commission's staff, which recommended retention of Rule 133, was based on certain practical difficulties in applying the '33 Act registration process to transactions covered by Rule 133. The Study does not minimize these practical difficulties. It believes, however, that they are surmountable.[25/] The Commission's General Counsel concurs, particularly in view of the additional authority granted the Commission by the '64 admendments [sic].

25/ It is of interest to note that the viewpoint of two very recent commentators appears to be in accord. Schneider, Acquisitions under the Federal Securities Act – A Program for Reform, 116 U. Pa. L. Rev. 1323, 1349 (1958). ("All acquisitions should be treated as sales for purposes of section 5. Registration under that section should be required in all cases, except where [the disappearing corporation] is closely held and the private offering exemption can be applied"); Knauss, Disclosure Requirements—Changing Concepts of Liability, 24 Bus. Law. 43, 47 (1968).

If a decision is made against the fifth alternative, the Study believes the second alternative (confining Rule 133 to those cases in which the acquired company is publicly held) to be the best course of action.

There are three related aspects to the recommendation that the present Rule 133 be replaced. They are examined in the three ensuing sections of this chapter. They are:

(a) A recommendation that where the acquired company is publicly held and the vote of its shareholders is necessary there be made available a registration procedure which would not essentially change the character of, or the manner by which, disclosure is presently provided to the shareholders of an acquired company subject to the proxy rules.

(b) A recommendation that where the acquired company is non-public, definite rules should be adopted to govern the resale by its shareholders of their newly acquired shares—rules which, while consistent in principle with those which would apply in the case of a private financing transaction, give recognition to the special attributes of a business combination.

(c) A recommendation that the Commission provide a guideline to assist in determining when an acquisition transaction does not involve a public offering.

C. Rule 133 should be replaced by application of the fundamental principal of the ’33 Act (disclosure appropriate under the circumstances) if practical problems inherent in the application of that principle to business combinations can be solved. The Study believes that this is possible.

1. What sort of a registration statement would be filed?

For business combinations taking the form of a statutory merger or sale of assets followed by dissolution of the acquired company, the Study proposes a new “wrap around” registration form consisting of a facing sheeting given the name and address of the corporation which will offer and sell its shares in the acquisition, a proxy statement to be sent to the shareholder-offerees (containing the information outlined in Items 14 and 15 of the Commission’s proxy rules), and a back cover sheet containing the requisite signatures.

Exhibits to the registration statement would include: (1) a copy of the agreement of merger or other agreement or plan under which the securities registered are to be offered, (2) the form of proxy, (3) an opinion of counsel as to the legality of the securities being registered, and (4) material contracts, most of which (unless the proposed acquisition is very significant to the issuer’s business) would have been filed on a prior occasion by an issuer subject to the reporting requirements of the ’34 Act, and could be incorporated by reference.

A draft of the new form to be designated Form S-16 is contained in the Appendix VII-1.[26/]

It can be expected that the acquiring company will make a detailed and careful study of the affairs of the acquired company before going forward with the transaction, and will be in a position to assess the accuracy of the disclosures in the proxy statement. Today, its responsibility to the shareholders of the acquired company for such disclosures is indirect. Under the proposed registration procedure that responsibility would become direct. The difference between the two may today be less significant than previously, in light of the development of the case law on implied liabilities under Rules 10b-5 and 14a-9. At all events, the question of potential liability would be the same under the Study's proposal regardless of the structure of the acquisition. The Study believes this to be consistent with sound disclosure policy.

2. What would the prospectus consist of?

The "final prospectus" would consist of that portion of the registration statement between the facing sheet and the signature page, viz., the proxy statement.[27/]

26/ Present Form S-14 would no longer be necessary.

27/ Chapter XI contains the Study's recommendations as to changes in the merger proxy statement.

3. How would the registration statement be processed by the Commission's staff and when would it be made effective?

It is suggested that the registration statement on the new form be processed by the staff in exactly the same fashion as proxy statements relating to business combinations are processed today. The only difference would be that a registration statement (as contrasted with a preliminary proxy statement) is a matter of public record at the Commission as soon as it is filed; this is, of course, also true of registration statements filed in connection with voluntary exchange offerings.

Where the acquired company is subject to the proxy rules, the same filing would satisfy the obligation of the acquired company under Rule 14a-6(a) although, if it wished to do so, the acquired company could file separately under Rule 14a-6(a) for purposes of preliminary review.[28/]

The registration statement would be made effective by an order issued on delegated authority by the staff. Immediately upon its effectiveness, the prospectus (proxy statement) could be mailed.

4. When does the public offering of securities take place?

The public offering would occur when the prospectus (proxy statement) is forwarded to the shareholder-offerees.

28/ Rule 14a-2(d) which exempts from the proxy rules "any solicitation involved in the offer or sale of a certificate of deposit or other security registered under the Securities Act of 1933.", would be amended to require compliance with the proxy rules where the solicitation relates to a merger, consolidation or sale of assets.

5. What restrictions would apply to the offering of securities?

Under Section 5(c) of the '33 Act, an offer of a security cannot take place unless a registration statement has been filed. Accordingly, it has been necessary for the Commission to define as "not constituting an offer" those kinds of advance publicity regarding a forthcoming offer which are appropriate and necessary. Rule 135 presently permits advance public notice of a proposed voluntary offer of exchange. An amendment of this rule[29/] would be desirable to clarify its provisions in various respects, including its applicability to proposed acquisitions by statutory merger or sale of assets.

The proposed amendment to Rule 135 would permit whatever advance notice of a proposed acquisition is appropriate under the "timely disclosure" policies of the principal stock exchanges and the NASD.

During the period between the filing and effective dates, by reason of the provisions of Section 5(b)(1), no written offer may be carried through the mails unless it meets the requirements of Section 10 of the '33 Act. Any appropriate notice permitted by Rule 135 would not constitute an "offer" under this provision.

29/ See Appendix VII-2

After the effective date, if a prospectus has been sent to a person, the offeror may mail additional material to such person. Thus, additional proxy soliciting material forwarded to the shareholder-offerees would not need to be filed under the '33 Act. It would, of course, be subject to the usual filing and review procedures of the Commission's proxy rules if the acquired company has registered a class of securities under Section 12 of the '34 Act.

6. How would the prospectus delivery requirements of Section 5(b)(2) be met?

Persons who will receive the stock of the registrant will usually be determined either (1) by the fixing of a record date for shareholders so entitled or (2) by the closing of the stock transfer records of the acquired company, usually accomplished as of a date shortly before the "closing" of a stock-for-assets reorganization. The group of persons thus determined may, because of interim transfer, vary somewhat from the group of persons to whom the final prospectus (proxy statement) was mailed. Section 5(b)(2) of the '33 Act makes it unlawful to send any security through the mails for delivery after sale "unless accompanied or preceded by a prospectus." It would accordingly be necessary for the issuer to check the transfer records for the names and addresses of transferees subsequent to the record date, and to cause a proxy statement to be mailed to such transferees with their new share certificates.

The Study doubts that this additional mailing of the prospectus (proxy statement) is essential to the process of full and fair disclosure in business combinations of the merger or sale of assets variety. In another context, involving the application of Section 5(b)(2) to transactions effected on national securities exchanges where delivery of the prospectus to members of the exchange would otherwise be necessary, the Commission has interpreted the phrase "preceded by a prospectus" to eliminate the requirement of direct delivery of the prospectus in connection with each transaction.[30/] The Study believes that a similar rule might be adopted[31/] providing, essentially, that the phrase "preceded by a prospectus" in respect of the requirement of delivery of a prospectus to shareholders of an acquired corporation who are to receive certificates of the acquiring corporation, may be satisfied by the mailing of the prospectus to all shareholders of the acquired corporation entitled to vote on the proposed transaction.

Will the beneficial owners of shares of the acquired corporation held in street name receive the proxy statement and be afforded the opportunity to vote? Both the New York and American Stock Exchanges have long had rules obligating their members (1) to forward proxy materials to such beneficial owners (whether or not the particular stock is listed) upon being compensated for their reasonable

---

30/ Rule 153.

31/ Appendix VII-3.

expenses, and (2) to vote only as directed by such beneficial owners. The National Association of Securities Dealers recently adopted similar rules. The Study has been advised that it is extremely unlikely that any broker-dealer not a member of the NASD would hold securities of public customers in street name. Should any problem ever arise in this connection, it can be minimized by exercise of the Commission's powers under Section 14(b) of the '34 Act.

Issuers which solicit proxies under the Commission's proxy rules customarily furnish sufficient copies of proxy material to brokers for transmission to beneficial owners. They are not obligated under the rules to furnish proxy statements for this purpose, but if the proxies of beneficial owners are not solicited, issuers remain obligated under Rule 14c-7 to furnish sufficient copies of an information statement in order that all beneficial owners may receive one.

7. What post-effective prospectus deliveries would be required?

During a 40-day period after a registration statement has become effective under the '33 Act (90 days in the case of a first registration statement), dealers are not entitled to the exemption provided by Section 4(3) upon which they can normally rely and must therefore deliver prospectuses in connection with any transactions in the registered securities. The Commission, however, has the authority to shorten these periods, and has eliminated the post-effective prospectus delivery requirement in a number of instances.[32/]

The Study recommends that this be done in the case of all registration statements filed for the purpose of effecting business combinations, including those relating to voluntary exchanges.

8. Who are "underwriters" under the '33 Act?

Where a business combination takes the form of a statutory merger or a sale of assets, it is possible that various persons (including the corporation to be acquired, members of its management and the proxy solicitors it has engaged) might be considered to be "underwriters" of the newly issued securities by virtue of activities related to the acquisition transaction. However, none of these persons, by engaging in such activities, is selling securities in a traditional sense, and the Study sees no substantial benefit to be gained by exposing them to the liabilities of underwriters. Accordingly, a rule is proposed[33/] which would negate that possibility.

9. How can registration be accomplished in a consolidation?

The question has been raised whether registration is a

32/ Rule 174.

33/ Rule 169, included in Appendix VI-1.

practicable procedure in connection with a consolidation of two existing corporations where the ultimate surviving corporation, which is to issue the new securities to the shareholders of the two constituents, will not come into legal existence until after the vote of the shareholders has been taken.

The Study does not consider this issue a serious one. Frequently, the corporation which is to survive will be organized prior to the vote of shareholders of the other constituent corporations. If not, the constituent corporations, which perform all of the acts leading up to the issuance of the new shares by the consolidated corporation, can be regarded as, in practical effect, the "issuer". An analogy could be drawn between the situation and the case of promoters who sell preincorporation subscriptions to the stock of a corporation yet to be formed; such promoters are deemed to be the "issuer" and are required to sign and file the necessary registration statement.

Accordingly, signatures on the registration statement filed in connection with a consolidation could be those of the requisite officers and directors of each of the constituent corporations. Proposed Form S-16 (Appendix VII-1) so provides.

10. When would registration be required in connection with reclassifications of securities?

Reclassifications of securities are essentially of three types:

(1) those which are accomplished by the solicitation of security holders to make a voluntary exchange of one security for another;

(2) those which result from a reorganization either under the provisions of the Bankruptcy Act or under corresponding provisions of state law; and

(3) those which are accomplished by amendment of the corporate charter.

As to the first type, Rule 133 has no application. The issuer would normally be able to claim exemption from registration under Section 3(a)(9) unless paid solicitors are employed. It may be feasible to obtain exemption under Section 3(a)(10). Finally, if both of the foregoing exemptions fail, and if neither the intrastate exemption of Section 3(a)(11) or Regulation A are available, the offer of exchange must be registered.

As to the second type, Rule 133 again has no application, but exemption should be available in most cases either under Section 3(a)(10) or under one or more of the various special exemptions contained in the corporate reorganization provisions of the Bankruptcy Act.

In reclassifications of the third type, as in those of the first type, if it is not necessary to use paid solicitors, exemption from registration can be obtained under Section 3(a)(9). In some circumstances, even if paid solicitors are used, exemption will be available under Section 3(a)(10). One feature distinguishes reclassifications of this type, however. Even though, because of the use of paid solicitors or for other reasons, the transaction is outside the limits of either of the exemptions designed for reclassifications, if the plan relates to corporate stock and the state law or corporate charter requires its submission to a vote of shareholders, Rule 133 expressly applies and makes registration unnecessary.[34/]

This somewhat anomalous result does not, in the Study's judgment, justify retention of Rule 133 for reclassifications of stock, assuming that a simplified registration procedure can be made available.[35/] The procedure outlined in the foregoing subsections of this chapter can readily be used for this purpose. For a reporting company, the registration statement[36/] would consist essentially of a the proxy statement which the company would in any event find it necessary to prepare and use. A publicly held non-reporting company, which now escapes any requirement of disclosure to its shareholders even if it pays solicitors to obtain the necessary votes, would

---

34/ Registration would not, of course, be necessary in any event if the reclassification relates to details which do not amount to the substitution of a new security for the existing security. See 1 Loss, Securities Regulation, 514 (2d ed. 1961).

35/ This conclusion appears to be fully supported by the Report of the House Committee on the '33 Act quoted in footnote 6, p. 255, supra.

36/ See recommended Form S-16, Appendix VII-1.

likewise be able to effect registration by preparing a form of proxy statement complying with the applicable items of the Proxy Rules.

11. What sale-of-assets transactions would not require registration?

This question raises the distinction between a sale-of-assets transaction which is essentially a merger of two companies and a casual sale of assets not intended to be followed by dissolution of the selling corporation. It is essential that a clear line of distinction be drawn between the two types of transactions.

Assume that a publicly held corporation sells a part of its assets (a major division of its business, for example) to another corporation for a consideration consisting in whole or part of stock of the latter corporation. Typically, authorization of the sale by shareholders of the seller would not be required, the transaction being within the powers of its board of directors. No public offering of the acquiring corporation's stock occurs which would require registration under the '33 Act. The selling corporation occupies the position of any private purchaser of a block of stock.

If, on the other hand, the vote of the shareholders of the selling corporation is taken to authorize the sale and the selling corporation thereafter decides to dissolve within a relatively short period of time, such as one year, it could be presumed that a sale for value of the purchasing corporation's stock to the shareholders of the selling corporation has occurred. Conversely, if not decision to dissolve and to distribute the stock of the purchasing corporation is made within one year following a sale of part or all of the assets of a corporation, no registration should be required.

The foregoing principles give sensible recognition to the federal tax consequences of business combinations effected by a sale of assets. In almost all cases, the objective of the two corporations is to obtain the benefits of a tax-free reorganization both at the corporate and at the shareholder level. In order to achieve those benefits under IRC Sections 368 and 354, a plan of reorganization will be adopted by vote of the shareholders of the acquired corporation. The acquired corporation must then be dissolved and the stock or securities distributed "pursuant to the plan of reorganization". By reason of these provisions, it is accepted practice for the plan of reorganization to contain a provision requiring the acquired company to be dissolved as expeditiously as possible following the closing of the purchase and sale. Although there is no specific requirement in the Internal Revenue Code that such dissolution occur within one year,[37/] expert federal tax counsel have advised the Study that it would be a very rare instance in which dissolution of the acquired corporation and distribution

---

37/ Assuming that for some reason a proposed tax-free C-type reorganization involving the sale of assets does not qualify under IRC Section 354, dissolution within one year is highly desirable, since it could then be argued that, in all events, no tax is payable at the corporate level by reason of IRC Section 337. This latter section contains a specific one-year provision.

of the shares of stock of the acquiring corporation would be delayed more than one year. In the normal situation, dissolution and distribution occur immediately following the sale.

These principles are embodied in the draft amendment of Rule 133 contained in Appendix VII-4.

D. A more definite guideline would be useful to assist the acquiring company in determining when an acquisition transaction does not involve a public offering.

In the introduction to Chapter VI of this Report, the difficulties encountered in attempting to develop a clear definition of a "public offering" as opposed to a "private placement" are outlined. A comprehensive definition was found to be impracticable.

In the field of business combinations, however, it may be possible to formulate a less ambitious rule which—although not furnishing a solution for every problem—would be of value in answering the question whether a particular transaction may be regarded as one not involving a public offering. A special problem exists in business combinations, where the acquiring company has had no part in the selection of the persons to whom its securities are to be offered. By contrast, if the acquiring company planned a private financing for cash, it would presumably select the offerees with care, having in mind the Ralston Purina criteria for a transaction not involving a public offering. The acquiring company in the acquisition transaction is faced with a situation which it did not plan, and which it cannot remedy.

The Study concluded that <u>no</u> offering made in connection with the acquisition of a corporation with less than 25 shareholders should be regarded as a public offering <u>in itself</u>. The rule adopted for this purpose should not, however, foreclose the possibility that an offering to a larger group of persons might also be non-public under particular circumstances. Moreover, such a rule could not lend assurance of exemption regardless of the resale transactions effected by the offerees. It could only provide assurance that no question would be raised concerning the offerees themselves as constituting the "public."

The suggested rule will be found in Appendix VI-1 (Rule 181).

E. <u>A rule should be adopted governing the resale of shares issued to a non-public group of shareholders of an acquired company which would give recognition to the special characteristics of business combinations</u>.

Chapter VI of this Report discusses the general recommendations of the Study regarding resales of securities acquired by non-controlling persons in non-public transactions. Essentially, they are as follows:

1. If the issuer of securities is a non-reporting company, then, for a substantial period following issuance of the securities, resale to the public should be permitted only if the

securities are registered unless exemption under either Section 3(a)(11) or 3(b) is applicable.

2. If, on the other hand, the issuer of the securities is a reporting company on the Commission's Rule 164 Qualified List, resales in brokerage transactions of an appropriately limited nature should be permitted after a holding period of one year. Such holding period serves to distinguish the true risk investment from the situation in which the seller acts essentially as an underwriter for a public distribution of securities by the issuer.

Applying these principles to business combinations, a question arises concerning the necessity for the holding period. The Study considered this question carefully, bearing in mind those situations in which the Commission has found that a deliberate effort was made "to evade the registration requirements of the Securities Act by creating corporate entities and effecting transactions meeting the requirements of [Rule 133] in appearance only....[38/]" If a corporate entity or partnership could be created by a group of persons, infused with cash or assets, and shortly thereafter acquired by a reporting company, and if the members of such group could immediately sell their newly issued stock in the public market, and [sic] obvious rend in the fabric of disclosure policy

---

38/ Great Sweet Grass Oils, Ltd., 37 S.E.C. 683, 691 (1957).

would be opened. For this reason, the Study concluded that the one-year holding period should be retained for business combinations effected by what are essentially private offerings. The holding period need not commence, however, upon the consummation of the merger or upon the receipt by such shareholders of their newly acquired securities. The problem alluded to can be avoided by provisions which permit a shareholder to "tack" the period during which he previously held the stock exchanged by him in the transaction. Thus, if the shareholder has held any part of his interest in the acquired business for less than one year prior to the transaction, a proportionate part of his newly acquired securities would be subject to such additional holding period as would be necessary to fulfill the one-year requirement.

"Tacking" of holding periods should be permitted only if the business to be acquired has been an active, going business for a reasonable period. To this end, the Study has incorporated into the draft of Rule 162[39/] an appropriate standard phrased in the following language:

> "A bona fide going business which has had, in the ordinary course of its business, gross revenues of not less than two hundred fifty thousand dollars during the 12 calendar months [immediately preceding consummation of the acquisition]".

39/ Appendix VI-1.