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## Corporate Disclosure of Securities Information Prior to Registration: The Effect of Chris-Craft Indus., Inc. v. Piper Aircraft Corp.

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CORPORATE DISCLOSURE OF SECURITIES INFORMATION  
PRIOR TO REGISTRATION: THE EFFECT OF CHRIS-CRAFT  
INDUS., INC. V. PIPER AIRCRAFT CORP.

In recent years there has been an increasing tendency on the part of large corporations to publicize information regarding corporate affairs. This trend reflects growing recognition by the business and investment communities of the importance of informing the investing public of anticipated business and financial developments.<sup>1</sup> Voluntary public disclosures by corporations have, however, given rise to the problem of determining under what circumstances such disclosures violate federally imposed restrictions on publicity involving unregistered or pre-effectively registered securities.<sup>2</sup> The case of *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*<sup>3</sup> is the most recent example of the difficulties involved in making such a determination. There, the Court of Appeals for the Second Circuit, although affirming the denial of preliminary injunctive relief to Chris-Craft on other grounds, reversed the district court's finding that a preregistration press release did not violate the federal regulations, and remanded the case for a determination of the proper remedy. The purpose of this comment is to examine, primarily in light of the *Chris-Craft* decision, the problems presented by corporate disclosures involving prefiling publicity and their relation to the federal securities regulations.

I. FEDERAL DISCLOSURE REQUIREMENTS

The basic federal disclosure requirements are contained in the Securities Act of 1933, which is intended to provide "for full and fair disclosure of the character of the securities sold."<sup>4</sup> The purpose of the Act is to insure that prospective investors are informed of the relevant facts concerning securities offered, and to restore the confidence of such investors in relation to the selection of sound securities.<sup>5</sup>

The machinery for achieving adequate disclosure is found in the registration and prospectus requirements of Section 5 of the Act. Section 5(a) makes it unlawful to sell any security for which a regis-

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<sup>1</sup> SEC Securities Act Release No. 33-3844 (Oct. 8, 1957), 1 CCH Fed. Sec. L. Rep. ¶ 3250, at 3108.

<sup>2</sup> Federal securities regulations provide that before any security may be lawfully offered to the public, a registration statement covering the proposed sale and containing information regarding the issuer and its securities must be filed with the SEC. 15 U.S.C. § 77e (1964). Registration ordinarily becomes effective 20 days after the initial filing. 15 U.S.C. § 77h (1964). Any attempt, either directly or indirectly, to sell a security prior to registration is strictly forbidden. 15 U.S.C. §§ 77e (1964). Sales offers, providing they are made through the use of an approved prospectus, may be made during the 20-day, pre-effective waiting period. 15 U.S.C. §§ 77e, j (1964).

<sup>3</sup> Current CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,372 (2d Cir. 1969).

<sup>4</sup> Securities Act of 1933, ch. 38, preamble, 48 Stat. 74.

<sup>5</sup> S. Rep. No. 47, 73d Cong., 1st Sess. (1933).

CORPORATE DISCLOSURE PRIOR TO REGISTRATION

tration statement is not in effect,<sup>6</sup> and section 5(b) provides that an approved prospectus must accompany or precede the sale of any registered security.<sup>7</sup> The question whether a prefiling disclosure constitutes an illegal offer of an unregistered security arises under section 5(c), which makes solicitations of offers prior to the filing of a registration statement unlawful.<sup>8</sup>

Rule 135<sup>9</sup> of the Securities Exchange Commission (SEC or Commission) exempts certain types of disclosures made prior to registration from the requirements of Section 5 of the 1933 Act. The rule primarily exempts advance notices sent by an issuer to its stockholders or employees advising them of upcoming securities offers, as well as notices sent to shareholders of another issuer informing them of an impending exchange offer. However, the rule stipulates that such notices must state that the offering will be made only by means of a forthcoming prospectus. In addition, the content of the notice must be strictly limited to such basic information as the name of the issuer, the title of the security to be offered, and, in the case of exchange offers, the title of the security to be surrendered and the basis upon which the proposed exchange is to be made.<sup>10</sup>

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<sup>6</sup> 15 U.S.C. § 77e(a) (1964) provides:

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

1. to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
2. to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purposes of sale or for delivery after sale.

<sup>7</sup> 15 U.S.C. § 77e(b) (1964) provides:

It shall be unlawful for any person, directly or indirectly—

1. to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this subchapter, unless such prospectus meets the requirements of section 77j of this title; or
2. to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 77j of this title.

Section 77j essentially provides that the prospectus must contain substantially the same information required in the registration statement.

Section 77b(10) defines a prospectus as "any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale . . ."

<sup>8</sup> 15 U.S.C. § 77e(c) (1964) provides:

It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security. . . .

Section 77b(10) defines "offer to sell" as "every attempt . . . to dispose of, or solicitation of an offer to buy, a security . . ."

<sup>9</sup> 17 C.F.R. § 230.135 (1959).

<sup>10</sup> Rule 135 provides in part:

Without the specific exemption provided under rule 135, advance notices of this type could be treated as illegal prefling offers under section 5(c). This possibility was recognized by a member of the SEC who stated that "such advance notice for this limited purpose [as set out in rule 135] was permissible under the spirit of the act, if possibly not under its letter, so long as the content of the notice was limited to *notice* and was not embellished with material of a sales character."<sup>11</sup> (Emphasis added.)

Apart from the rather limited exceptions under rule 135, the precise restrictions imposed by section 5(c) on preregistration statements by an issuer remain unclear, both because of the extreme difficulty of drawing definite lines in this area, and because, in the opinion of at least one expert, of the Commission's reluctance to impede the tendency toward increased corporate publicity which goes beyond the statutory limits.<sup>12</sup>

The SEC has, however, recognized the problem and attempted to clarify its position. In a 1935 press release the Commission published the opinion of its general counsel regarding bulletins circulated by underwriters and dealers. The release stated in part that the "legality . . . of preliminary information under Section 5 is dependent upon

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(a) For the purposes only of Section 5 of the Act, the following notices sent by an issuer in accordance with the terms and conditions of this rule shall not be deemed to offer any security for sale:

1. A notice to any class of its security holders advising them that it proposes to issue to such security holders rights to subscribe to securities of such issuer;
2. A notice to any class of security holders of such issuer or of another issuer advising them that it proposes to offer its securities to them in exchange for other securities presently held by such security holders; or
3. A notice to its employees or to the employees of any affiliate advising them that it proposes to make an offering of its securities to such employees.

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(c) The notice shall state that the offering will be made only by means of a prospectus . . . and shall contain no more than the following additional information:

1. The name of the issuer;
2. The title of the securities proposed to be offered;
3. In the case of a rights offering, the class of securities the holder of which will be entitled to subscribe to the securities proposed to be offered, the subscription ratio, the proposed record date, the approximate date upon which the rights are proposed to be issued, the proposed term or expiration date of the rights and the approximate subscription price, or any of the foregoing;
4. In the case of an exchange offering, the name of the issuer and the title of the securities to be surrendered in exchange for the securities to be offered, the basis upon which the exchange is proposed to be made and the period during which the exchange may be made, or any of the foregoing.

<sup>11</sup> Gadsby, Current Problems Under Section 5 of the Securities Act of 1933 and Release No. 3844, 13 Bus. Law. 358, 363 (1958).

<sup>12</sup> 1 L. Loss, Securities Regulations, 216 (2d ed. 1961).

whether or not it is used in connection with or it itself constitutes an 'offer to sell' as that term is defined in the Act."<sup>13</sup>

In 1957 the SEC issued Securities Act Release No. 33-3844 dealing with pre-filing offerings.<sup>14</sup> The Commission warned that in certain instances publicity and public relations activities might violate the securities laws. The Commission cited, in particular, the problem raised by press releases and other similar means of disseminating information prior to registration which, "although not couched in terms of an express offer, may in fact, contribute to conditioning the public mind arousing public interest in the issuer or in the securities of an issuer in a manner which raises a serious question whether the publicity is not in fact part of a selling effort."<sup>15</sup> The Commission added that this problem is apparently not generally understood.<sup>16</sup>

The release also presented several hypothetical situations as examples of the objectionable use of pre-filing publicity. In general the hypotheticals contained in the release presented rather clear instances in which pre-filing publicity was used with the obvious intent of stimulating the public appetite for the securities to be offered. In addition, the pre-filing publicity cited in these examples contained false and misleading statements or omissions of material fact, which of themselves could constitute violations of the anti-fraud provisions of the Securities Act.<sup>17</sup>

One of the examples presented in the release described a situation where a mining company, prior to the filing of a registration statement and the public sale of its securities, issued a number of press releases describing the activities of the company and setting forth optimistic forecasts of its potential future development. The Commission maintained that such advance publicity served to arouse public interest in the issuer and was, in effect, the initial step in the issuer's selling campaign. In addition, the forecasts and predictions contained in this publicity were unreliable and could not have been properly included in either the registration statement or a prospectus sent to potential investors.<sup>18</sup> The Commission concluded that such a promotional cam-

<sup>13</sup> SEC Securities Act Release No. 33-464 (August 19, 1935), 1 CCH Fed. Sec. L. Rep. ¶ 3165, at 3091.

<sup>14</sup> SEC Securities Act Release No. 33-3844 (Oct. 8, 1957), 1 CCH Fed. Sec. L. Rep. ¶ 3250, at 3108.

<sup>15</sup> *Id.* at ¶ 3254, 3110.

<sup>16</sup> *Id.*

<sup>17</sup> 15 U.S.C. § 77q (1964), which provides in part:

- (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
1. to employ any device, scheme, or artifice to defraud, or
  2. to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or
  3. to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

<sup>18</sup> The information which must appear in the registration statement is of a

paign constituted an evasion of the section 5 prohibitions against pre-filing offerings as well as violation of the section 17(a) prohibitions regarding deceptive and fraudulent practices.<sup>19</sup>

This example as well as others contained in the Commission's release implies that overly optimistic predictions, glowing generalities and similar types of statements, although not per se violations of the preregistration restrictions, can give rise to a strong suspicion that the preregistration publicity is, in fact, an integral part of the issuer's selling campaign. Through such unregulated statements an issuer can more easily stimulate public interest without having to observe the stringent requirements for specific disclosures found in the registration and prospectus provisions of the 1933 Act.

It is unfortunate that the SEC's release did not provide any concrete guidelines for determining the status of pre-filing publicity, except to the extent of giving examples of the most flagrant types of its misuse. However, a former chairman of the SEC stated that this omission was justified by the peculiarities of the individual cases.<sup>20</sup>

Whether a given activity [i.e., preregistration publicity] would fall within this definition . . . [of a proscribed pre-filing offer under section 5(c)] can be determined only by a consideration of all the facts and circumstances surrounding a particular case. Factors such as intent, knowledge and time would be important considerations. . . . For these reasons the Commission has never believed it appropriate to attempt to formulate a rule-of-thumb definition in this area and has endeavored to deal with the problem on a case-by-case basis.<sup>21</sup>

The commissioner observed that the primary issue was whether the material involved constituted a part of the selling effort, and that such an ultimate determination must be made on an ad hoc basis and must involve the exercise of judgment in evaluating matters of degree.<sup>22</sup> He further stated:

A corporation which is planning to bring an issue to market need not close down its advertising department. . . . But when shortly before the filing of a registration statement . . . public communications . . . appear which discuss such aspects

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factual nature and primarily refers to the financial condition of the issuer, the nature of its business, a listing of its officers, directors and holders of more than 10% of any security of the issuer as well as a statement of capitalization of the issuer and any stock options, existing or to be created. See Securities Act of 1933, Schedule A, 15 U.S.C. § 77aa (1964). The prospectus must contain essentially all the information appearing in the registration statement or an approved summary of such information. See Securities Act of 1933 § 10, 15 U.S.C. § 77j (1964).

<sup>19</sup> SEC Securities Act Release No. 33-3844 (Oct. 8, 1957), 1 CCH Fed. Sec. L. Rep. ¶ 3256, at 3111.

<sup>20</sup> Gadsby, *supra* note 11.

<sup>21</sup> *Id.* at 362. These comments were contained in a speech before an investment association in 1958.

<sup>22</sup> *Id.* at 368.

of the business as its finance, its earnings or its growth prospects in glowing and optimistic terms . . . then this raises a serious question whether the issuer is not, in fact, beginning the offering of the securities by this means.<sup>23</sup>

It was concluded that the purpose of the release was to publicize the Commission's views of the type of activity which constitutes a violation of the statutory prohibitions against pre-filing offerings, and to remind the investment and business communities that the primary responsibility for observing section 5 remains in their hands.<sup>24</sup>

It appears, therefore, that the basic inquiry into whether a pre-filing disclosure constitutes an illegal offer necessitates a determination whether the publicity in question can reasonably be considered as part of the selling effort.<sup>25</sup> The cases involving preregistration publicity, however, reflect the difficulty and uncertainty involved in reaching such a determination.

## II. THE PREREGISTRATION DISCLOSURE CASES

In *SEC v. Arvida, Corp.*<sup>26</sup> the SEC brought an action against Arvida, Inc., the issuer, and Carl M. Loeb, Rhoades & Co. and Dominck & Dominck, two underwriting partnerships, for alleged violations of Section 5(c) of the 1933 Securities Act. Arvida, Inc. was a newly established Delaware corporation which had been formed for the purpose of developing real estate on Florida's gulf coast. Prior to the registration and public offering of its securities, Arvida issued widely circulated press releases announcing the formation of the corporation and its forthcoming plans concerning Florida real estate. Subsequently, several other press releases were issued by both Arvida and its underwriters, the co-defendants. The SEC, although ultimately successful in gaining a final injunction against Arvida, failed in its efforts to obtain a preliminary injunction against the defendants.<sup>27</sup>

In ruling against the SEC's motion for a preliminary injunction the District Court for the Southern District of New York, although acknowledging that it had no doubt that the publicity had, in fact, induced many investors to seek out the Arvida stock, stated that it knew of no case holding that the mere release of information of a genuine financial interest constituted an offer to sell or a solicitation of offers to buy.<sup>28</sup>

However, in the subsequent action for a permanent injunction, the court found that under the circumstances of the case the defendant's publicity efforts prior to the registration of its securities con-

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<sup>23</sup> Id. at 362.

<sup>24</sup> Id. at 368.

<sup>25</sup> Id. at 367-68.

<sup>26</sup> 169 F. Supp. 211 (S.D.N.Y. 1958).

<sup>27</sup> For the opinion of the court refusing to grant a preliminary injunction see *SEC v. Arvida Corp.* [1957-1961 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 90,883 (S.D.N.Y. 1958).

<sup>28</sup> Id.

stituted an unlawful offer to sell such securities within the meaning of section 5(c).<sup>29</sup> Despite the court's finding of good faith on the part of the defendants, it granted a permanent injunction prohibiting the further solicitation of offers of Arvida securities until a registration statement was filed.<sup>30</sup>

In *In re Carl M. Loeb, Rhoades & Co.*,<sup>31</sup> a companion case against the underwriters of the Arvida securities, the Commission further clarified its position regarding prefling publicity. The press releases issued by these firms in connection with the proposed distribution of Arvida stock were found to be in violation of section 5(c), and the underwriters were given a reprimand for such improper practices. In its decision the Commission stated:

Since it is unlawful under the statute . . . to sell or buy a security . . . prior to the filing of a registration statement, [those] who are to participate in a distribution likewise risk the possibility that the employment by them of public media of communication to give publicity to a forthcoming offering prior to the filing of a registration statement constitutes a premature sales activity prohibited by Section 5(c). . . .<sup>32</sup>

The Commission had little difficulty finding that the publicity was calculated to arouse and stimulate investor interest in Arvida securities. The Commission also found that the preregistration publicity contained misleading statements and omissions of financial facts essential to an intelligent investment decision.<sup>33</sup> The Commission rejected the underwriters' claim that the publicity was "news," stating that section 5(c) was "equally applicable whether or not the issuer has . . . or by astute public relations activities may be made to appear to have, news value."<sup>34</sup> The Commission emphasized that the danger to investors from publicity amounting to a selling effort may be greater in the case where the issuer has "news value" since it may then be easier to whip up a "speculative frenzy."<sup>35</sup> The Commission concluded that the issues involved were basic to the principles of the Securities Act of 1933, because to allow investment decisions to be formulated on the basis of unregulated prefling publicity would make compliance with the registration requirements little more than a meaningless formality.<sup>36</sup>

<sup>29</sup> SEC v. Arvida Corp., 169 F. Supp. 211, 215 (S.D.N.Y. 1958).

<sup>30</sup> Id.

<sup>31</sup> 38 S.E.C. 843 (1959).

<sup>32</sup> Id. at 851.

<sup>33</sup> Id. at 853.

<sup>34</sup> Id. at 852. In this regard the Commission further stated, "Our interpretation of Section 5(c) in no way restricts the freedom of news media to seek out and publish financial news. Reporters presumably have no securities to sell . . . and Section 5(c) has no application to them." Underwriters and issuers are in a different position, however, because "they are in the business of distributing securities, not news." Id. at 852 n.17.

<sup>35</sup> Id. at 853.

<sup>36</sup> Id. It is apparent that in the *Arvida* controversy the SEC's objections to what it termed prefling offerings of securities were reinforced by a finding that such public-



## II. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*

In *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*,<sup>37</sup> Chris-Craft sought a preliminary injunction to prevent a rival company, Bangor Punta, Inc., from retaining several thousand shares of Piper Aircraft securities obtained in an exchange with Piper stockholders.<sup>38</sup> Chris-Craft claimed that a press release announcing Bangor Punta's proposed exchange offer had violated the Federal prohibitions against prefiling offerings. The case arose out of the competing efforts of Chris-Craft and Bangor Punta to gain effective control of Piper Aircraft.

### A. *The Struggle for Control of Piper Aircraft*

In January of 1969 Chris-Craft began acquiring shares of Piper Aircraft on the open market. Later in the month Chris-Craft publically announced an interest in Piper and made a public tender offer for up to 300,000 shares of Piper stock. Piper's management, however, viewed the prospects of a merger with Chris-Craft as against the best interests of the company and it was decided to resist the takeover attempt. Letters were sent to all Piper shareholders advising them not to respond to the tender offer.

Piper took other measures to frustrate the efforts of Chris-Craft. Its board of directors approved an agreement with Grumman Aircraft & Engineering Corp. by which Piper agreed to sell 300,000 authorized but unissued shares to Grumman. This sale it was hoped would lay the groundwork for an eventual merger between the two aircraft manufacturers. Although this agreement was never, in fact, consummated, the publicity surrounding these negotiations did have an adverse effect on the Chris-Craft tender offer.<sup>39</sup> Chris-Craft then filed a registration statement and prospectus with the SEC in which it proposed to offer certain of its securities in return for shares of Piper stock.

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ity contained misleading and material omissions which were not consistent with the full disclosure requirements of the securities laws. See also *In re First Maine Corp.*, 38 S.E.C. 882 (1959), in which the underwriters of a life insurance company were suspended for 20 days for offering unregistered securities through prefiling publicity. As in the *Loeb* case, the Commission found that the publicity was primarily aimed at stimulating investor interest and, in addition, was misleading in its general tenor.

<sup>37</sup> 303 F. Supp. 191 (S.D.N.Y. 1969).

<sup>38</sup> *Id.* at 193. In this action Chris-Craft also sought to restrain Bangor Punta from acquiring additional shares of Piper, to prevent the merger of the two companies, and to prevent Bangor Punta from voting 120,000 additional shares of Piper purchased during the period immediately preceding the filing of a registration statement covering its proposed exchange offer. *Id.* See Current CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,373 (2d Cir. 1964).

<sup>39</sup> Piper also issued 469,199 shares of its authorized but unissued stock to acquire control of two other corporations, a Florida construction firm and a closely-held Louisiana corporation. However, the Board of Governors of the New York Stock Exchange held that the distribution of nearly 30% of Piper's stock violated the Exchange's listing criteria and, consequently, the transactions were rescinded. 303 F. Supp. at 193.

The First Boston Corp., the financial advisor to Piper, then began holding preliminary talks with Bangor Punta regarding the possibility of a merger between Piper and Bangor Punta, and a tentative agreement was reached.<sup>40</sup> While the negotiations between Bangor Punta and Piper progressed, Chris-Craft publically announced the terms of its pending registration statement which proposed an exchange offer of Piper stock for Chris-Craft stock.

On the day following this announcement, Piper and Bangor Punta issued a joint press release stating that a final merger agreement had been reached between the two companies.<sup>41</sup> Included in the press release was the following paragraph which was the basis for the subsequent attack by Chris-Craft:

Bangor Punta has agreed to file a registration statement with the SEC covering a proposed exchange offer for any and all remaining outstanding shares of Piper Aircraft for a package of Bangor Punta securities to be valued in the judgment of the First Boston Corp. at not less than \$80 per Piper share. The registration statement covering all securities to be issued will be filed as soon as possible and a meeting of the shareholders of Bangor Punta will be called for approval.<sup>42</sup>

As a result of the subsequent exchange offer, Bangor Punta obtained 107,574 shares of Piper stock. This acquisition brought Bangor Punta's total holdings in Piper to 44 percent of the outstanding shares. Chris-Craft had succeeded in capturing nearly 40 percent of the outstanding Piper stock. However, 259,026 shares of Piper remained in the hands of

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<sup>40</sup> Bangor Punta was reluctant to undertake such a merger unless the Piper family's 501,090 shares of Piper stock, approximately 1/3 of the corporation's outstanding stock, was sold to Bangor Punta. The Piper family eventually accepted this precondition on April 22, 1969. *Id.* at 191.

<sup>41</sup> The agreement provided for the exchange of the Piper family's stock for specified Bangor Punta securities and a pledge by Bangor Punta to use its best efforts to acquire more than 50% of the Piper stock. Bangor Punta also agreed to make an exchange offer to all other Piper stockholders under which such stockholders would be entitled to exchange their securities for Bangor Punta securities and/or cash having a value, in the written opinion of the First Boston Corp., of \$80 or more. *Id.* at 194.

<sup>42</sup> SEC v. Bangor Punta Corp., Current CCH Fed. Sec. L. Rep. ¶ 92,428, at 98,022 (1969). The press release also stated in part:

Bangor Punta Corporation and the Piper family have reached an agreement whereby Bangor Punta will acquire the Piper family's more than 500,000 share interest in Piper Aircraft Corporation. William T. Piper Jr., who is President of Piper Aircraft, and David W. Wallace, Chief Executive of Bangor Punta, jointly announced the agreement and said they regarded the agreement as a first step in a proposed consolidation of the two companies. . . . Mr. Piper said that in view of Bangor Punta's long-standing policy of maintaining autonomy in management of its operating companies and the similarity of operating philosophies between the two companies, he and the Piper family would strongly support the merger and would recommend it to all shareholders. . . . Sales of the combined companies would reach \$450,000,000 in fiscal 1969, with approximately \$180,000,000, or 40 percent in the aircraft, recreational and leisure time fields.

*Id.*

private investors and, consequently, neither company succeeded in gaining effective control.

Following the issuance of the joint press release, the SEC instituted an action against both Bangor Punta and Piper, maintaining that the press release, in announcing the offer and in setting forth a specific value for the Bangor Punta securities to be offered, constituted an effort by the defendants to induce investors to purchase Bangor Punta securities prior to the filing of a registration statement in violation of section 5(c) and rule 135. The Commission contended that the absence of a registration statement covering precise information regarding the securities being offered had the effect of depriving the shareholders of Piper as well as other interested investors of an opportunity to make an informed decision concerning the merits of the offering.<sup>43</sup> Without admitting any of the allegations contained in the complaint, Bangor Punta and Piper consented to the entry of a permanent injunction enjoining them from selling or offering for sale either of their securities until a registration statement was filed with the SEC.<sup>44</sup> Bangor Punta thereafter filed a registration statement.

#### B. *The Suit by Chris-Craft*

Chris-Craft brought an action against Bangor Punta for a permanent injunction alleging that Bangor Punta had unfairly acquired Piper securities through violations of the federal securities laws, and should therefore be forced to divest itself of its holdings in Piper. Chris-Craft also entered a claim for \$45 million in damages based on Bangor Punta's allegedly illegal conduct in its dealings with Piper. Bangor Punta responded with a countersuit against Chris-Craft for \$50 million in damages. While these actions were pending, Chris-Craft sought a preliminary injunction against Bangor Punta to prevent the latter from accepting or retaining the 107,574 shares of Piper stock obtained pursuant to Bangor Punta's General Exchange Offer of July 18, 1969.

In this action Chris-Craft contended that the press release constituted "gun-jumping"—a prefiling offering of unregistered securities in violation of Section 5(c) of the Securities Act and Rule 135. It maintained that the publicity had induced many stockholders to accept the exchange offer prior to the filing of a registration statement, and urged that such stockholders be given an opportunity to rescind their tenders once a "full and fair disclosure" of the Bangor Punta exchange offer had been made.<sup>45</sup>

The District Court for the Southern District of New York, however, rejected these contentions, finding that the press release was not a prefiling offer in violation of section 5(c) or rule 135. Rather, the court concluded that the release was a timely disclosure which served to preclude the possibility of any stock manip-

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<sup>43</sup> Id. ¶ 92,428, at 98,023.

<sup>44</sup> Id. ¶ 92,428, at 98,025.

<sup>45</sup> 303 F. Supp. 191, 193 (S.D.N.Y. 1969).

ulations or unfair dealings in Piper stock.<sup>46</sup> Moreover, the court stated that the release was entirely consistent with, if not required by, the New York Stock Exchange guidelines for corporate disclosures,<sup>47</sup> which provide that where negotiations leading to mergers and other major corporate reorganizations reach a point where the issues involved can no longer be kept strictly confidential, then "fairness requires that the company make an immediate public announcement. . . ."<sup>48</sup> The court found that Bangor Punta and Piper had reached such a stage in their negotiations, and that public disclosure was, therefore, required in order to prevent any unfair dealings in Piper stock.<sup>49</sup> In support of its position that the press release did not constitute an offer to sell securities and therefore was not in violation of the pre-filing restrictions,<sup>50</sup> the court cited rule 135, apparently finding that the release was exempt thereunder since it contained information regarding a proposed exchange offer.<sup>51</sup>

Chris-Craft also claimed that the press release was misleading because it implied that the Bangor Punta securities to be exchanged for each share of Piper would be immediately resalable at \$80.<sup>52</sup> The court rejected this contention, stating that full disclosure called for "public statements . . . definite as to price,"<sup>53</sup> and that rule 135 required a disclosure of the basis of the proposed exchange. The court observed that the statements contained in the release were not misleading because they did not imply that such a value would endure for the duration of the exchange offer and "the vagaries of the marketplace belie such a construction."<sup>54</sup>

In denying Chris-Craft's motion for a preliminary injunction, the court held that the plaintiff had failed to show that it would suffer irreparable damage, or that any of the stockholders who tendered their shares would not have done so if the alleged violation had not occurred.<sup>55</sup> Thus, the court concluded that the equities of the case appeared to speak against the issuance of a preliminary injunction.<sup>56</sup>

On appeal the Court of Appeals for the Second Circuit found that the preliminary injunction sought by Chris-Craft

<sup>46</sup> *Id.* at 195.

<sup>47</sup> *Id.* at 195, 196.

<sup>48</sup> *Id.* at 196.

<sup>49</sup> The court felt that the disclosure of the proposed valuation was especially warranted by the fact that the \$80 figure was substantially above the current market price of Piper stock. *Id.* at 195.

<sup>50</sup> *Id.* at 191.

<sup>51</sup> Notices permitted to be sent under rule 135 and which comply with the terms and conditions of the rule "shall not be deemed to offer any security for sale." *Id.* at 196.

<sup>52</sup> Chris-Craft claimed that as such it constituted violations of the Securities and Exchange Act of 1934 §§ 9, 10(b), 14(e), 15 U.S.C. §§ 78i, j(b), n(e) (1964).

<sup>53</sup> 303 F. Supp. at 196.

<sup>54</sup> *Id.* at 197. In addition, the court observed that Bangor Punta's final prospectus contained statements disavowing any guarantees or representations as to the value of the securities involved in its exchange offer. *Id.*

<sup>55</sup> *Id.* at 199.

<sup>56</sup> *Id.*

had been properly denied, since there had been no showing of the necessary threat of irreparable damage. However, the appellate court, with one judge dissenting, reversed the lower court's findings as to the non-selling character of the press release, holding that the categories of information permitted to be contained in prefiling disclosures under rule 135 were exclusive, and that the rule did not authorize any reference to the value of the proposed offering.<sup>57</sup> The court concluded, therefore, that by setting forth in a release a specific valuation of \$80, Bangor Punta had gone beyond the permissible scope of the rule and had, in effect, made an unlawful prefiling offer.<sup>58</sup> The court rejected Bangor Punta's claim that a disclosure of specific valuation was compelled in this case, even prior to registration, both by *SEC v. Texas Gulf Sulphur Co.*<sup>59</sup> and by the rules of the New York Stock Exchange. The court found that the only material fact, as defined by *Texas Gulf Sulphur*,<sup>60</sup> required to be disclosed was Bangor Punta's commitment to offer its securities for those of Piper, and that rule 135 adequately provides for this type of announcement.<sup>61</sup> In regard to the contention that an immediate and complete disclosure was required under the New York Stock Exchange guidelines, the court observed that although the guidelines were entitled to considerable respect, they could not bind the Commission or the court, and that

to hold that a disclosure would be privileged here because the \$80 value could not be kept secret and might affect the market would mean that many other companies could offer to sell securities before their registration by claiming that the terms of the proposed offer could not be kept totally secret and must therefore be disclosed in full.<sup>62</sup>

As a result of its finding that the press release was, in fact, an offer to sell in violation of section 5(c), the appellate court remanded the case for consideration of a suitable remedy.<sup>63</sup>

### C. *Analysis of the Chris-Craft Opinions*

The appellate court's holding in regard to the press release would appear to be based on a closely reasoned interpretation of both the meaning and intent of rule 135, whereas the district court's determination that the release was an exempted prefiling disclosure under that rule can be challenged on many grounds. Section C of rule 135, for example, provides that all prefiling notices must state that the

<sup>57</sup> *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, Current CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,376 (2d Cir. 1969).

<sup>58</sup> *Id.*

<sup>59</sup> 401 F.2d 833 (2d Cir. 1968).

<sup>60</sup> *Id.* at 849.

<sup>61</sup> Current CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,377 (2d Cir. 1969).

<sup>62</sup> *Id.*

<sup>63</sup> *Id.* The appellate court also found that Bangor Punta had made unlawful purchases of Piper stock during the tenure of its exchange offer and remanded the case for further proceedings on this issue. *Id.* ¶ 92,510, at 98,378.

forthcoming offering will be made only by means of a prospectus.<sup>64</sup> No such statement was contained in the press release. This mandatory provision would seem to be essential to the basic purpose of the rule of permitting brief, preregistration announcements of certain *proposed* offerings. The requirement that a notice, to be exempt, state that the offering will be made by a prospectus serves to reinforce its non-offering nature by reminding the potential investor that a more specific discussion of the proposed offering will be made available.

Rule 135 also provides that notices must contain only the information explicitly permitted under the provisions of the rule.<sup>65</sup> The press release, however, contained information which was not acceptable under the specific terms of the rule, including sales projections of the combined operations of the two companies, a mutual endorsement of the agreement by the respective managements of Piper and Bangor Punta, and an expression of support of the proposed merger by the Piper family, the leading shareholder in Piper Aircraft. Since these statements are not allowed by rule 135 because they are not therein specifically provided for, they may be construed as attempts to induce sales and thus would be prohibited by section 5(c). The appellate court recognized that an announcement which furnished attractive descriptions of both the securities to be offered and the issuer contained sufficient information to constitute an offer rather than a pre-filing notice.<sup>66</sup>

Section C of rule 135 allows notices of proposed exchange offerings to state the basis upon which the exchange is proposed.<sup>67</sup> It is submitted, however, that this does not permit an issuer to place a *specific* valuation on the securities to be exchanged as was done in the Bangor Punta press release. If, as previously discussed, the purpose of rule 135 is to allow an issuer to send brief, pre-filing announcements to certain stockholders, then it is clearly inconsistent to allow a specific valuation to be included in such an announcement. It would be more reasonable to interpret this section of the rule as providing for no more than a general description of the basis of the proposed exchange, that is, a description of the basic ratio of exchange between the stock being offered and the stock which is being sought. This interpretation is consistent with the appellate court's determination that rule 135 did not provide for a disclosure of the specific value of the offered shares.<sup>68</sup>

The district court's implication that the average knowledgeable investor, one familiar with "the vagaries of the marketplace," would not have been misled by the press release is also of questionable validity. The court of appeals, however, recognizing that the purpose of section 5 and rule 135 is to protect the unwary and inexperienced

<sup>64</sup> See note 10 *supra*.

<sup>65</sup> 17 C.F.R. § 230.135(c) (1959).

<sup>66</sup> *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, Current CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,376 (2d Cir. 1969).

<sup>67</sup> See note 10 *supra*.

<sup>68</sup> *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, Current CCH Fed. Sec. L. Rep. ¶ 92,510, at 98,377 (2d Cir. 1969).

buyer, termed the valuation "potentially misleading" to the extent that some persons would probably construe the \$80 figure as referring to market value.<sup>69</sup>

Regardless, however, of the holding as to the misleading quality of the statements, such a finding would not be determinative as to whether that same publicity constituted a premature selling effort. Thus, the inclusion of specific valuation, whether deemed actually misleading or not, as well as the other information in the release could justifiably be construed, as they were by both the SEC, in its action against Piper and Bangor Punta, and the appellate court in *Chris-Craft*, as amounting to items of a sales nature and, consequently, per se a violation of Section 5(c) of the Securities Act.

Thus, in *Chris-Craft* the appellate court recognized that not all information purportedly classed under the heading of "public disclosures" is per se exempt from the other restrictions of the securities laws. The court, in effect, realized that to permit information of a sales character to reach the public prior to registration under the guise of a timely disclosure would frustrate the policy of the securities regulations.<sup>70</sup> To this end the appellate court strictly interpreted rule 135, holding it to be the exclusive guideline governing the amount of information which may be properly disclosed prior to registration.

Doubtless the line drawing between an announcement containing sufficient information to constitute an offer and one which does not must be to some extent arbitrary. A checklist of features that may be included in an announcement which does not also constitute an offer to sell serves to guide the financial community and the courts far better than any judicially formulated "rule of reason" as to what is or is not an offer. Rule 135 provides just such a checklist, and if the Rule is not construed as setting forth an exclusive list, then much of its value as a guide is lost.<sup>71</sup>

Moreover, under the district court's interpretation of rule 135 it would appear far too easy for an issuer to initiate its selling campaign by means of prefiling publicity.

#### CONCLUSION

With the widespread use of corporate publicity in today's business world, it is inevitable that close and difficult cases will arise as to whether prefiling publicity amounts to an illegal offer to sell unregistered securities. The appellate court's opinion in *Chris-Craft*, however, gives a clearer insight into the important role of rule 135 in regard to prefiling disclosures, and reaffirms the SEC's position that no more than a minimum of information should be contained in such prefiling advance notices. The appellate court also recognized the need for close

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<sup>69</sup> Id. ¶ 92,510, at 98,376.

<sup>70</sup> Id.

<sup>71</sup> Id.

scrutiny of pre-filing disclosures in order to prevent an abuse or circumvention of the pre-filing requirements contained in the Securities Act of 1933.<sup>72</sup>

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<sup>72</sup> In its continuing efforts to establish more clearly defined standards in this area the SEC has recommended certain broadening amendments to rule 135. See SEC Security Act Release No. 33-5010 (Oct. 7, 1969), 1 CCH Fed. Sec. L. Rep. ¶ 3012, at 3053.