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COMMENT

SHAREHOLDERS AFTER MERGER: WHAT THEY CAN AND CANNOT DO UNDER SEC RULES 144 AND 145

PATRICK D. HALLIGAN*

The purpose of this article is to illustrate the ways in which SEC Rules 144¹ and 145² affect various classes of shareholders in mergers. The key to its analysis is the placing of the shareholder into one of nine possible categories. As to the acquired corporation, he may be an affiliate, an ordinary investor or unconnected. The same three possibilities exist for his relationship to the acquiring corporation. Thus there are nine combinations that can describe his status with respect to the merging corporations. Three of the nine combinations present no SEC problem—namely, those three in which the shareholder has no connection with the acquiring corporation. In two of these three situations—where he is an affiliate of, or an investor in, the acquired corporation—he will be paid in cash and left without stock to worry about. The third situation, which obviously presents no problems, is that of a stranger connected with neither corporation. The six remaining combinations are the ones with which this article is concerned. The charts accompanying this article are constructed according to the various categories into which shareholders may fall. The rows show the status of the shareholder relative to the acquired corporation. The columns show his status relative to the acquiring corporation. The intersection of each column and row shows the category in which a shareholder is situated.

In order to understand Rule 145 one must look at its predecessor, Rule 133.³ Although Rule 145 for the most part replaces Rule 133, interest in Rule 133 itself will persist in three ways. First, the SEC has preserved Rule 133 in the case of companies regulated by government agencies which, prior to January 1, 1973, have sought agency approval to merge even though stockholder consent has not

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¹ 17 C.F.R. § 230.144 (1973).

² 17 C.F.R. § 230.145 (1973).

³ 17 C.F.R. § 230.133 (1972), rescinded effective Jan. 1, 1973, SEC Securities Act Release No. 5316 (Oct. 6, 1972).

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yet been sought by the directors.⁴ Second, the same section of the release preserves Rule 133 for incomplete mergers wherein directors have submitted merger plans for shareholder consent before January 1973.⁵ Third and most significant, shareholders holding securities acquired in mergers long since completed under Rule 133 will have recurring occasion to request opinions concerning the sale of their stock. Rule 133 continues to regulate them. Thus, while *corporate* level interest in Rule 133 will soon pass, *shareholder* interest in Rule 133 will continue indefinitely. The practical lawyer advising such persons must be familiar with Rule 133 as well as with Rules 144 and 145. For these reasons it is practical to look at the operation of Rule 133. Chart 1 does this. Its operation with and without registration is shown. The operation without registration is shown at the top of each category. The operation with registration for any category of shareholder is shown in the lower portion of the box reserved for that category. Registration means registration under the Securities Act of 1933 (1933 Act),⁶ either by Form S-1⁷ or by Form S-14.⁸

Chart 2 shows the operation of Rules 144 and 145 for each combination, both with and without registration. In this chart the upper part of each box shows the operation of the rules with registration; the lower part of each box summarizes the operation of the rules without registration for the category of shareholder to which that box is reserved in Chart 2. Registration means compliance with one of the alternatives of Rule 144(c).⁹

Six categories of shareholders with SEC problems times two operative rules (old Rule 133 of Chart 1 and new Rule 145 of Chart 2) times two alternatives as to registration (with or without) equals 24 situations requiring comment. These 24 situations are discussed in the 24 notes. The note numbers correspond to reference numbers in the boxes of the charts. The charts should be used first. The corresponding note number should then be consulted for a practical comment directed specifically to the rule, the shareholder category and the applicable registration situation.¹⁰

⁴ Section I under the heading "Operation of the Rules," SEC Securities Act Release No. 5316 (Oct. 6, 1972).

⁵ *Id.*

⁶ 15 U.S.C. §§ 77a-77aa (1970).

⁷ See 1 CCH Fed. Sec. L. Rep. ¶ 7121 (1971).

⁸ See 1 CCH Fed. Sec. L. Rep. ¶ 7271 (1971). See also Form S-14, General Instructions A, Rule as to use of Form S-14, 1 CCH Fed. Sec. L. Rep. ¶ 7281 (1972).

⁹ 17 C.F.R. § 230.144(c) (1973).

¹⁰ As used in the charts and in Rule 144, the word "affiliate" of an issuer means a person directly or indirectly controlling, controlled by or under common control with that issuer. See Rule 144(a)(1). The identity of such controlling persons has been the subject of much litigation. See Sommer, Who's in "Control"—S.E.C., 21 Bus. Law. 559 (1966). As used in the charts, "ordinary" shareholder means one who is not an "affiliate."

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CHART 1

RULE 133

Without Registration

With Registration

Status of Shareholder as to Acquired Company	Status of Shareholder as to Acquiring Company		
	<i>Ordinary</i>	<i>Affiliate</i>	<i>None</i>
Ordinary without registration	(1) Freely Saleable Stock	(2) No Sale Allowed	Paid in Cash
Ordinary with registration	(7) Freely Saleable Stock	(8) Very Limited; 144(e)-(h); 144(d) questionable; Rule 237 not available	Paid in Cash
Affiliate without registration	(3) Very Limited Sales; 133(d), (e) leakage	(4) No Sale Allowed; like (2)	Paid in Cash
Affiliate with registration	(9) Either Freely Saleable Stock or Very Limited; if Limited, may use either 133 leakage as in (3) or comply with 144(d)-(h) or Rule 237	(10) Very Limited; like (8)	Paid in Cash
None without registration	(5) No Sales for 5 years; Very Limited by Rule 237 thereafter	(6) No Sale Allowed; like (2) and (4)	Stranger
None with registration	(11) Freely Saleable or Very Limited; may comply with 144(d)-(h) or Rule 237, but not 133(d), (e)	(12) Very Limited; like (8) and (10)	Stranger

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CHART 2

RULE 145

Without Registration

With Registration

Status of Shareholder as to Acquired Company	Status of Shareholder as to Acquiring Company		
	<i>Ordinary</i>	<i>Affiliate</i>	<i>None</i>
Ordinary without registration	(13) No Sales for 5 years; Very Limited by Rule 237 thereafter; like (5)	(14) No Sale Allowed; like (2), (4), (6)	Paid in Cash
Ordinary with registration	(19) Freely Saleable Stock	(20) Very Limited; like (8), (10), (12)	Paid in Cash
Affiliate without registration	(15) No Sales for 5 years; Very Limited by Rule 237 thereafter; like (5) and (13)	(16) No Sale Allowed; like (2), (4), (6), (14)	Paid in Cash
Affiliate with registration	(21) Limited; 144(c), (e), (g) apply, but <i>not</i> (d), (h); Rule 237 alternative available	(22) Very Limited; like (8), (10), (12), (20)	Paid in Cash
None without registration	(17) No Sales for 5 years; Very Limited by Rule 237 thereafter; like (5), (13), (15)	(18) No Sale Allowed; like (2), (4), (6), (14), (16)	Stranger
None with registration	(23) Very Limited; 144(c)-(h); 144(d) questionable; Rule 237 available	(24) Very Limited; like (8), (10), (12), (20), (22)	Stranger

NOTES TO CHARTS 1 AND 2

RULE 133 WITHOUT REGISTRATION

1. This category has freely saleable stock. See Ruder, *Federal Restrictions on the Sale of Securities*, 67 *Nw. U.L. Rev.* 60 (Supp. 1972); Schwartz, *Business Combinations Under New SEC Rules*, 67 *Nw. U.L. Rev.* 150, 152, 156-57 (Supp. 1972); Cohen, *Rule 133 and the S.E.C.*, 14 *Record of N.Y.C.B.A.* 167, 177-78 (1959).

2. Rule 144, including 144(c), applies. Thus, without "current information" on file, this category cannot sell at all. Not even Rule 237 applies. See 17 *C.F.R.* § 230.237 (1973).

3. Rule 133(c) gives these persons the use of "leakage sales" under Rules 133(d) and 133(e). "Leakage sales" refers to the provision in the rule that a person subject to its terms may sell unregistered securities to the public in ordinary, unsolicited brokerage transactions, subject however to extreme limitations in quantity. See 17 *C.F.R.* § 230.133(d)(3) (1972), rescinded, *SEC Securities Act Release No. 5316* (Oct. 6, 1972). Rule 144 has similar provisions. See 17 *C.F.R.* § 230.144(e)(1) (1973).

4. Same as category 2; no sales at all, not even after five years, on account of affiliate status.

5. These are limited by new Rule 144. Without Rule 144(c) "current information" on file, they may only sell after five years under Rule 237. Rule 133 does not assist these persons because they had nothing to do with the constituent as to whose shareholders Rule 133 was primarily addressed.

6. Same as categories 2 and 4; no sales at all.

RULE 133 WITH REGISTRATION

7. Category 7 has freely saleable stock. They are not underwriters so the exemption of § 4(1) of the 1933 Act, 15 *U.S.C.* § 77d(1) (1970), is available unless some atypical fact exists. See the authorities cited in Note 1 *supra*. The fact of registration assumed in category 7 should reinforce the Note 1 conclusion as to persons in category 7 even if no public offering is found.

8. Rules 144(c)-(h) apply. Rule 144(c) is fulfilled by the S-14 registration. Rule 144(d) applies despite registration if the distribution is not public. But usually a public offering will be found so that the securities are not restricted in the sense of Rule 144(a)(3), and hence Rule 144(d) will not apply. Thus volume restrictions usually exist, but not "holding period" limitations. Rule 237 is not available as an alternative.

9. If the issuance is considered public, then category 9 has freely saleable stock. Otherwise the shareholders may choose to operate under either the Rule 133(d) or Rule 133(e) leakage provi-

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sions of category 3 or all of the Rule 144(d)-(h) provisions which are substantially (but not exactly) similar to Rules 133(d) and 133(e). In the latter case, Rule 144(h) notice of sale to the SEC is required. The Rule 144 alternatives exist in category 9 since Rule 144(d) "current information" is provided by S-14 registration. This is not so for category 3. The Rule 237 alternative is also open to category 9.

10. Same as category 8. The 144(d) "holding period" requirement is the same as for category 8.

11. Persons in category 11 have either freely saleable stock or restricted stock limited by all of Rule 144(d)-(h), depending on the circumstances of their initial acquisition. Rule 237 is an available alternative. See Note 5 *supra* concerning nonapplicability of Rule 133 leakage.

12. Same as categories 8 and 10.

RULE 145 WITHOUT REGISTRATION

13. Category 13 consists of persons who would ask: "What, if anything, does Rule 145 do for ordinary small shareholders whose company does not provide 144(c) current information?" Their counsel might be tempted to argue that they have freely saleable stock on the strength of the analogy to category 1 and the language of the release quoted in Note 19 *infra*. That quotation uses the word "registered," however, which indicates an assumption that current information is on file with the commission in some form. That assumption is at variance with the hypothesis of category 13, and unlike categories 7 and 19, which do assume filing. The category 1 analogy is weak. Like categories 7, 13 and 19, category 1 persons are ordinary shareholders as to each entity, and, like category 13, category 1 assumes no filing. However, it is premised on a rescinded rule which Rule 145 is designed to supersede. Rule 144 therefore applies unabated by Rule 145 to category 13. Rule 144(c) not being satisfied, no sale is permitted for five years. Rule 237 sales after five years are possible.

14. No sale at any time. Same as categories 2, 4 and 6.

15. No sale for five years. The Rule 145(c) definition of party includes these affiliates but no relief under Rule 145(d) is available. Rule 145(d) requires compliance with Rules 144(c), (e), (f) and (g). By hypothesis here, Rule 144(c) current information is not on file. Rule 237 applies, however, for sales after five years.

16. No sale at any time. Same as categories 2, 4, 6 and 14.

17. No sale for five years. First, as in Notes 13 and 15, the absence of current information filings prevents any operation of Rule 145. Second, like category 13 shareholders, category 17 shareholders are neither parties whose assets or capital structure is altered in the

sense of Rule 145(c), nor are they affiliates of any such party. Third, category 17 persons are associated not with the constituent but only with the acquiring issuer, who is not included in Rule 145(c). Thus, Rule 144 applies unabated. Rule 144(c) not being fulfilled, no sale is permitted for five years. Rule 237 is available after that time.

18. No sale at any time. Like categories 2, 4, 6, 14 and 16, category 18 demonstrates that affiliates of surviving acquiring issuers must look to some form of registration under Rules 144 and 145.

RULE 145 WITH REGISTRATION

19. Freely saleable stock. See authorities cited in Note 1 by analogy. See also § II.D of SEC Securities Act Release No. 5316 (Oct. 6, 1972), the last paragraph of which states: "The securities received in a Rule 145 transaction by persons who are neither affiliates of the acquired company nor of the acquiring company are registered *without restriction on resale.*" [Emphasis added.] The applicability of this quotation to category 13 is questionable. See Note 13 *supra*.

Affiliates of the acquired corporation are now in a clearer position than they were under Rule 133. The language of the above-quoted release is not qualified. Also, the theory of Rule 145 supports the free stock conclusion better than did the Rule 133 notion. Rule 145 assumes registration or periodic reporting. The "exemption" of Rule 145 thus touches on the availability of information about the security. It is a security exemption. In contrast, Rule 133 is a transaction exemption. The rationale of Rule 133, stated in 133(a), is that no "sale" for purposes of § 5 of the 1933 Act, 15 U.S.C. § 77e, takes place in mergers. Thus, on the face of Rule 133, only the particular exchange or merger transaction is exempt from § 5 of the 1933 Act. Subsequent sales by non-affiliates must find their own exemption. Thus a non-affiliate leaves a Rule 133 exchange as he entered it. This is sometimes called the survival of "taint." See *Thompson Ross Securities Co.*, 6 S.E.C. 1111, 1117-18 (1940); SEC Securities Act Release No. 4248 (July 14, 1960). The commission position shown in the preceding authorities is that certain exemptions, if actually private in character, are to be evaluated as the equivalent of the § 4(2) exemption, a transaction exemption. See 15 U.S.C. § 77d(2) (1970). The exemptions so treated have included some which fall under § 3 of the 1933 Act, 15 U.S.C. § 77c (1970), which are analogous to Rule 133 transactions, viz, §§ 3(a)(9) and 3(a)(10), 15 U.S.C. §§ 77c(a)(9), (10) (1970). Also similarly treated have been "negotiated" merger transactions. See *Disclosures to Investors: A Reappraisal of Federal Administrative Policies*

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Under the '33 and '34 Acts [The Wheat Report], ch. VII, § B.1.(f) (1969). A negotiated transaction is one in which corporate approval is necessary for perfection, a controlling shareholder or group constituting by themselves the majority required for shareholder approval under state corporation law. This requirement created certain potential anomalies under Rule 133. An ordinary investor who had acquired outstanding shares from another non-affiliate investor enjoyed the exemption provided by § 4(1) of the Act, 15 U.S.C. § 77d(1) (1970), and continued to have free stock after a Rule 133 transaction. Under the authorities cited in Note 1 *supra*, and limiting the authorities cited in this Note to their facts, it was possible to argue that all non-affiliates of an acquired company should have free stock. The fact that that is the result under Rule 145 might lend some small measure of added weight to that view. But the consensus has been that non-affiliates of the acquired company had free stock after exchange only if they had it before exchange. See Schwartz, *Business Combinations Under SEC Rules*, 67 Nw. U.L. Rev. 150, 157 (Supp. 1972). Thus, for example, a recipient of a 1933 Act § 4(2) private placement ("letter" stock) arguably continued to have restricted stock after exchange even though similarly situated non-affiliates of an acquired firm had free stock of the same category issued by the acquiring firm. This anomaly is not even argued by the Commission in the release accompanying Rule 145, quoted *supra* in this Note.

20. Same as categories 8, 10 and 12. A grammatical imprecision occurs in Rule 145(c) when it refers to: "any party . . . other than the issuer, or any party who is an *affiliate of such party . . .*" 17 C.F.R. § 230.145(c) (1973) (emphasis added). The ambiguity to be interpreted is this: Does "affiliate of such party" include affiliate of the issuer? If it does, then Rule 145(d) allows such an affiliate to avoid the holding period and notice requirements of Rule 144(d) and Rule 144(h) which would otherwise bind him. The construction adopted here is that affiliates of an acquiring corporation are not protected by Rule 145(d), notwithstanding ambiguity in Rule 145(c). If the opposite construction is taken, holders of restricted securities who are controlling shareholders of a very large firm could avoid parts of Rule 144 by causing their issuer to acquire a very small firm.

21. Rule 145(d) directs application of Rules 144(c) and 144(e)-(g), but excuses compliance with the 144(d) holding period and 144(h) notice of sale limitation for these persons. The Rule 237 alternative is permitted.

22. Same as categories 8, 10, 12 and 20.

23. Category 23 is troublesome. Just as Rule 133 did not protect, perhaps anomalously, persons in categories 5 and 11, so Rule 145 may not protect those in category 23. Rule 145(c) contains a definition of "party" that excludes category 23 non-affiliate shareholders of the surviving entity who were not shareholders of the constituent (vanishing) corporation. Thus Rule 144 applies unabated, specifically 144(d)-(h). Rule 237 alternatives also exist. As to the applicability of 144(d), see Note 8 *supra*.

24. Same as categories 8, 10, 12, 20 and 22.

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