CHAPTER 67

Going Private — Rule 13e-3

C. James Levin *

SCOPE NOTE

The process by which a publicly traded company is converted to private ownership by persons who are affiliated with it ("going private") is regulated by Rule 13e-3 (the "Rule"), a broad, complex federal rule promulgated under the Securities Exchange Act of 1934 (the "1934 Act") by the Securities and Exchange Commission (the "Commission"). This chapter describes the key provisions of Rule 13e-3 and discusses the difficult issues that may arise under it.

The history of Rule 13e-3 is important in understanding its key provisions. This is the subject of § 67.01. In addition to Rule 13e-3, judicial decisions at the federal and state level have an important effect on going private transactions. Their relationship to Rule 13e-3 is discussed briefly in § 67.02. It is important to understand the interplay of these various matters when faced with a transaction potentially covered by Rule 13e-3.

The first step in the analysis of whether a particular transaction is subject to Rule 13e-3 is to determine if it meets the definition of a "Rule 13e-3 Transaction." This involves an analysis of whether the transaction is of the type covered by Rule 13e-3 and whether it is being proposed by an "affiliate" of the company in question. Even if a transaction meets these initial definitional standards, it must also have certain enumerated effects for Rule 13e-3 to be applicable. These factors are discussed in § 67.03. If Rule 13e-3 is applicable to a particular transaction, it mandates the preparation, filing, and dissemination of certain information with respect to the transaction and the parties engaged in it.

The filing and the dissemination requirements of Rule 13e-3 are set forth in

---

* This chapter was substantially revised by C. James Levin, Esq. in 2005, with the assistance of R. Adam Hornung, Esq. Mr. Levin is a member of the American and State Bar of California Associations. Mr. Levin is a partner of, and Mr. Hornung is an Associate with, O'Melveny & Myers, LLP, Los Angeles, California. Mr. Kent V. Graham and Mr. Levin co-authored the earlier version of this chapter. Mr. Levin notes that much of the chapter continues to reflect the substantial earlier efforts of Mr. Graham, and thanks him for his leadership in this endeavor.

§§ 67.04 and 67.05, respectively.

The most important effects of Rule 13e-3 are discussed in § 67.06, which discusses disclosure requirements. Rule 13e-3 requires detailed disclosures about the history of the transaction, its purposes and effects, and information about its fairness. Detailed information about actual or potential conflicts of interest and the means by which those conflicts have been dealt with is required to be disclosed.

Finally, there are several important exceptions to the coverage of the Rule, which are discussed in § 67.07.

SYNOPSIS

CROSS REFERENCE GUIDE

For additional materials related to this chapter see:

1. Chapter 68, "Going Private": State Law

   Under state laws, directors and (at least potentially) a controlling shareholder owe a fiduciary duty to the public shareholders; a going private transaction is reviewed under state law to determine whether fiduciary duties relating to procedural and substantive fairness to the public shareholders have been met.

2. Chapter 51, Preparation of Proxy Statements and Annual Report to Shareholders

   If the Rule 13e-3 transaction involves the filing of a proxy statement, the transaction statement must be filed concurrently with the filing of preliminary copies of the proxy statement (§ 51.02[4]). The timing of the dissemination of the transaction statement is governed by the proxy rules (§ 51.01[3]).

3. Chapter 22, The Process of Becoming Effective

If the Rule 13e-3 transaction involves the filing of a registration statement, the transaction statement must be filed concurrently with the filing of the registration statement with the Commission (§ 22.02).

§ 67.01 Background

Rule 13e-3[1] (the "Rule") is the Securities and Exchange Commission's ("Commission") attempt to regulate "going private" transactions. Although in form the Rule is designed only to require *disclosures* about such transactions, the scope of these required disclosures reflects a regulatory concern about the fundamental fairness of going private transactions.

"Going private" is the process by which a publicly traded company is converted to private ownership by persons who are affiliated with it. The Rule is broad enough to cover almost any transaction within this general definition, and some that do not fall within the definition. It requires various specific disclosures about going private transactions and the participants in them, provides for certain filings with the Commission, and requires dissemination of key information to the shareholders of the company in question.

The Rule contains a number of provisions that are vague and difficult to apply to particular transactions. The Rule has been clarified to some extent by an interpretive release promulgated by the staff of the Commission (the "Interpretive Release")[2] and certain "no-action" letters and other statements issued by the staff.

The Rule was proposed by the Commission in 1977[3] following a public outcry about the fairness of certain going private transactions that occurred in the early 1970's. In a number of instances, the controlling shareholders of companies that had gone public in the late 1960's bull market used their control ownership to force transactions that had the effect of eliminating public share ownership at prices dramatically below the recent initial public offering price. These transactions were widely viewed as unfair and coercive, but the Commission did not appear to have a satisfactory means of regulating them. For a time prior to the Rule's initial publication, the Commission staff refused to review or process filings relating to going private transactions, which in some cases had the practical effect of preventing them from going forward.

---

[1] 17 C.F.R. § 240.13e-3. For the text of Rule 13e-3, see Appendix 67A at the end of this chapter.

[2] Exch. Act Rel. No. 17719, 17 C.F.R. § 241.17719, 1981 SEC LEXIS 1647 (Apr. 13, 1981). For the text of the Interpretive Release, see Appendix 67B at the end of this chapter.

[3] Sec. Act Rel. No. 5884, [1977–1978 Transfer Binder] 1977 SEC LEXIS 352 (Nov. 17, 1977).

The Rule, as originally proposed, set forth two alternatives for comment, including a very controversial provision that attempted specific regulation of the fairness of going private transactions. This aspect was met with intense resistance from securities lawyers, many of whom expressed fundamental doubts about whether the Commission had the authority to promulgate a Rule with a fairness (as opposed to disclosure) standard.

The following quote from the 1977 Commission release that promulgated the 1977 proposed Rule illustrates just how intensely the Commission felt about the going private process:

> The nature of, and methods utilized in effecting, going private transactions present an opportunity for fraudulent, deceptive or manipulative acts or practices, particularly overreaching of unaffiliated securityholders by the issuer or its affiliates. This is due in part to the lack of arm's length bargaining position of unaffiliated securityholders under the circumstances of these transactions and the unaffiliated securityholders' inability to influence corporate decisions to enter into such transactions.[4]

The final Rule, first effective September 7, 1979,[5] does not have a specific fairness requirement, but rather focuses primarily on the types of disclosures that, in the Commission's view, were needed to give public shareholders the information to enable them to make an informed decision about the fairness of the transaction. Those disclosure obligations were set forth in a new disclosure schedule ("Schedule 13E-3").[6]

Even though the final Rule dropped the fairness requirement, the Commission did not drop its concerns about fairness. For example, the release promulgating the final Rule in 1979 states, in part, as follows:

> In any event, the Commission believes that increased discussion of factors bearing upon fairness to unaffiliated security holders is necessary in view of the potential for abuse that exists in a Rule 13e-3 transaction. The absence of arms-length negotiations which is characteristic of going private transactions requires that unaffiliated security holders be furnished with detailed information so that they can determine whether their rights have been adequately protected.[7]

Effective in January of 2000, the Commission adopted Regulation M-A, as a significant revision of the disclosure requirements applicable to acquisitive transactions. As a part of its adoption, the Commission amended Schedule 13E-3 to coordinate with Regulation M-A's disclosure requirements. The revision was

---

[4] Sec. Act Rel. No. 5884, [1977–1978 Transfer Binder] 1977 SEC LEXIS 352 (Nov. 17, 1977).

[5] Exch. Act Rel. No. 16076, [1979 Transfer Binder] 1979 SEC LEXIS 970 (Aug. 2, 1979).

[6] 17 C.F.R. § 240.13e-100.

[7] 17 C.F.R. § 240.13e-100.

intended to more closely coordinate the merger and acquisition disclosure requirements applicable in various contexts, such as securities offerings, proxy statements, tender offers, and going private transactions. Now set forth in Items 1000 to 1016 of Regulation M-A, the revision largely accomplished this task.[8] Many of the disclosures previously expressly required only in going private transactions (such as descriptions of the financial advisors' reports) are now more generally applicable. However, a few Items of Regulation M-A, such as Items 1013 and 1014, remain applicable only to going private transactions. Item 1013, much like Item 7 of Schedule 13e-3 prior to the adoption of Regulation M-A, requires disclosure about the reasons for the transaction, the alternatives considered by the subject company, and the effects of the transaction on, among others, the unaffiliated security holders. Similarly, Item 1014 maintained the requirement that the subject company or affiliate filing a Schedule 13E-3 disclose its belief as to the fairness of the transaction to unaffiliated security holders and the factors upon which that belief is based.

Many of the terms used in the Rule either are defined in it or have been interpreted separately by the Commission or its staff. Definitions that are self evident or that are parallel to commonly accepted definitions will not be repeated in this chapter, unless the definition is essential to a full understanding of the scope and application of the Rule. In most cases, the definitions are broad, designed to bring within their sweep any form of transaction that would have one of the effects described below.

§ 67.02 Federal and State Decisions

During the development of the Rule, and subsequent to its adoption, there have been a number of developments under the federal securities laws and state corporate laws that bear importantly on the going private process.

[1] Federal Court Decisions

The federal courts have wrestled with the question of whether going private transactions apart from disclosure considerations, constitute violations of the federal securities laws. Assuming that full disclosure of all material facts has occurred, the fundamental issue in such cases is whether federal securities laws provide a remedy for breach of fiduciary duty or unfairness by a majority shareholder.

In 1977, the United States Supreme Court in *Green v. Santa Fe*[1] held that the federal securities laws do *not* provide such a remedy. If there has been full and fair

---

[8] Exch. Act Rel. No. 34-24107, [1999 Transfer Binder] October 22, 1999 (1999).

[1] Green v. Santa Fe Industries, Inc., 430 U.S. 462, 97 S. Ct. 1292, 51 L. Ed.2d 480 (1977).

disclosure of all material facts, the federal securities laws do not prohibit unfair transactions. Subsequent decisions interpreting *Green v. Santa Fe* have eroded this position somewhat, but in general the principle still stands.

The federal decisions since *Green v. Santa Fe,* however, have made clear that there must be meticulous disclosure of all the facts that would bear on the question of whether the transaction is fair under state law.

These decisions have held in general that raw data that bear on the fairness question must be disclosed to the public shareholders. The message from *Green v. Santa Fe* and most subsequent decisions is that the federal courts will not play an active role in monitoring internal corporate affairs, unless there has been a failure of full and fair disclosure. Allegations that bear only upon the question of the fairness of the transaction normally will not attract the attention of a federal court.[2]

[2] State Court Decisions

In general, state court decisions provide that under state laws, directors and a controlling shareholder owe fiduciary duties to the public shareholders and that a

---

[2] Another issue considered by the federal courts is whether a private right of action exists under Section 13(e). Although the Sixth Circuit, in Howing Co. v. Nationwide Corporation, 826 F.2d 1470 (6th Cir. 1987), *cert. denied,* 486 U.S. 1059 (1988), has recognized a private right of action under Section 13(e) based on criteria established by the U.S. Supreme Court in Cort v. Ash, 422 U.S. 66, 78, 95 S.Ct. 2080, 2087, 45 L.Ed.2d 26 (1975), the Supreme Court has not spoken on this issue. *Howing* has been, however, cited as standing for that proposition by several courts. *See* Brewer v. Lincoln Intern. Corp., 148 F. Supp. 2d 792 (W.D. Ky. 2000); Dowling v. Narragansett Capital Corporation, 735 F. Supp. 1105, 1116 (D.R.I. 1990); Kahn v. Lynden Incorporated, 705 F. Supp. 1458, 1464 (W.D. Wash. 1989); *see also* Radol v. Thomas, 534 F. Supp. 1302 (S.D. Oh. 1987). Additionally, two law review articles have addressed this issue. *See* Burson, *Securities Law: An Argument for Recognition of an Implied Private Cause of Action for Shareholders Under Section 13(e) of the Securities Exchange Act of 1934 in the Context of Going Private,* 64 Notre Dame L. Rev. 241 (1990); Kofele-Kale, *Some Unfinished Business, Some Unresolved Issues: Section 13(e) and the SEC's Going Private Rules After Howing Co. v. Nationwide Corp.,* 20 U. Tol. L. Rev. 625 (1989).

The Sixth Circuit also has drawn attention by holding in a related case, Howing v. Nationwide Corporation, 972 F.2d 700 (6th Cir. 1992), that loss-of-state-law-remedy provides an acceptable theory of causation supporting a Section 13(e) action by the minority shareholders with insufficient number of votes to block a proposed transaction. 972 F.2d. at 709. This particular issue was that which was left unresolved by the majority in Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 112 S.Ct. 39, 116 L. Ed.2d 18 (1991) in a case brought under Rule 14a-9. The Sixth Circuit's holding has been criticized in at least one law review article. *See* Connell, *Howing Co. v. Nationwide Corp.: The Sixth Circuit Provides the "Solution" to Virginia Bankshares' Causation Query,* 82 Ky. L.J. 285 (1994); *see also* Santori, *Virginia Bankshares v. Sandberg: The Supreme Court Injects Federalism Into the Implied Private Right of Action for Breach of Securities and Exchange Commission Rule 14a-9. A Taste of Things to Come?,* 17 Del. J. Corp. L. 1007 (1992).

going private transaction must be procedurally and substantively fair to the public shareholders. Many of the provisions of the Rule simply require disclosure about facts, events, and procedural steps that a party engaged in a going private transaction should be following in any event because of the guidelines and mandates of important state law decisions.[3]

It is not clear at present whether the Rule adds significantly to the protection of public shareholders in going private transactions, which was its express purpose as reflected in federal and state law since it was proposed and adopted. The Rule does provide, however, a useful checklist for persons involved in going private transactions.

To facilitate the use of this chapter in connection with the Rule, the following discussion generally follows the order of the Rule.

§ 67.03 Definition of a "Rule 13e-3 Transaction"

A transaction that is subject to the Rule is called a "Rule 13e-3 Transaction." This is defined in part as "any transaction or *series* of transactions. . . which has either a *reasonable likelihood* or a purpose of producing, either directly or indirectly, any of. . . [certain specified] *effects* . . . ."[1]

[1] Types of Transactions

The Rule covers only a transaction or a series of transactions in which there is a:

- Purchase of any equity security by the issuer or by an affiliate of the issuer [paragraph (a)(3)(i)(A)];
- A tender offer for an equity security by the issuer or such an affiliate [paragraph (a)(3)(i)(B)];
- A solicitation of a proxy or consent authorization or the supplying of information subject to the Commission's proxy rules in connection with a merger, consolidation, reclassification, recapitalization, reorganization or similar corporate transaction of an issuer or between an issuer and its affiliate [paragraph (a)(3)(i)(C)];
- A sale of substantially all the assets of an issuer to its affiliate or group of affiliates [paragraph (a)(3)(i)(C)]; or
- A reverse stock split of a class of equity securities involving the purchase

---

[3] *See* ch. 68 *below* for detailed discussion of state court decisions on going private.

[1] Rule 13e-3(a)(3) (emphasis added).

of fractional interests [paragraph (a)(3)(i)(C)].

Thus if the transaction or series of transactions does not include at least one of the above, Rule 13e-3 has no application.

As a result of this definition, transactions between a company and a third party that is not an affiliate are not covered by the Rule. However, there may be situations where a nonaffiliate becomes an affiliate during the course of a transaction thereby causing the Rule to become applicable.[2]

The Commission staff has taken the position that the issuer is itself engaged in the going private transaction within the meaning of the Rule when the issuer negotiates the terms of a tender offer with the affiliate seeking to take the issuer private and/or facilitates the solicitation of tenders by the affiliate.

[2] Affiliates

The definition of who is an "affiliate" for purposes of the Rule is very important. The Rule defines an affiliate in the same way as under other provisions of the federal securities laws, namely as a person who directly or indirectly "controls, is controlled by, or is under common control with" the company.[3] This is a very broad definition, and the Commission staff is usually not willing to issue a no-action or interpretive letter with respect to whether a person is an "affiliate." In general, the staff takes the position that the determination of who constitutes an affiliate for purposes of this Rule (and most other Commission rules) is basically a factual question, to be answered by the company in question and its counsel.[4]

(Text continued on page 67-11)

---

[2] *See* § 67.03[3] *below.* The Commission staff has, on at least one occasion, issued a no-action letter even though a proposed transaction fell squarely within the definition of a Rule 13e-3 transaction, reasoning that the proposed transaction was part of a reorganization plan and of the type not intended to be regulated by Rule 13e-3 or with respect to which the requirements of Rule 13e-3 were not necessary for the protection of investors, and the proposed transaction was limited in duration. Kurzweil Music Systems, Inc., 1991 SEC No-Act. LEXIS 774 (June 7, 1991).

[3] Rule 13e-3(a)(1).

[4] The Commission staff, however, has on occasion issued no-action letters dealing with the affiliate issue. In Ranco Inc. & Siebe, PLC, 1987 SEC No-Act. LEXIS 2018 (May 1, 1987), the staff concurred with counsel's view that Rule 13e-3 did not apply to a two-step acquisition consisting of (i) open market purchases and lockup options giving Siebe beneficial ownership of approximately 50.1% of Ranco's outstanding shares, and (ii) a subsequent merger in which all shares not then held by Siebe would be converted into the right to receive the merger price. In arriving at its position, the staff noted that (i) Siebe was not an affiliate of Ranco at the time the merger agreement was executed; (ii) Siebe's plan to engage in open market purchases was announced immediately after the merger agreement was executed and such purchases were governed by the terms of the merger agreement at a price approximating, but below, the $40 per share price available throughout the merger; (iii) at the time of the merger vote, Siebe would not have any representation on Ranco's

(Text continued on page 67-11)

Board of Directors and would not have exercised control over the affairs of Ranco; and (iv) Siebe would be entitled to vote only 14% of the outstanding shares at the meeting at which the merger would be considered.

Cf. Technology for Communications International, Inc., 1988 SEC No-Act. LEXIS 215 (February 22, 1988) (staff unable to concur in counsel's view that Rule 13e-3 was not applicable to proposed merger between two companies; staff noted that it could not conclude that the parties, which once had two common directors, were not affiliates, and noted that affiliation could not be eliminated by attempting to otherwise conduct negotiations in an arms-length manner).