99-9374

THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

RICHARD MORALES,

Plaintiff-Appellant,

v.

QUINTEL ENTERTAINMENT, INC. AND PETER STOLZ,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN SUPPORT OF APPELLANT ON ISSUES ADDRESSED

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MISCELLANEOUS

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION AND SUMMARY OF ITS POSITION

The Securities and Exchange Commission, the agency responsible for the administration and enforcement of the federal securities laws, submits this brief as amicus curiae to address important issues relating to the "short-swing" trading provision in Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b).

The objective of Section 16(b) is to deter corporate insiders from trading in their companies' securities on the basis of inside information to which they have access by virtue of their positions. Congress determined that such persons should not be allowed to profit from short-swing trading -- purchases and sales occurring within a period of less than six months -- which it viewed as a type of trading that posed a particular risk of misuse of inside information . 1/ Although Section 16(b) is enforced in private actions only, and not in Commission enforcement actions, the Commission has an interest in assuring that proper private actions can be brought. As the Supreme Court has repeatedly recognized, such actions "provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985), quoting J.I. Case Co. v. Borak, 377 U.S. 426,

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1/ In enacting Section 16(b) "Congress recognized that insiders may have access to information about their corporations not available to the rest of the investing public." Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232, 243 (1976). The provision was designed to "curb the evils of insider trading [by] * * * taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418, 422 (1972). Congress presumed that persons owning more than ten percent of a class of an issuer's registered equity securities would have access to inside information. Id. at 424. See also Gollust v. Mendell, 501 U.S. 115, 121 (1991).

432 (1964); see Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975).

Congress concluded that the persons who should be subject to the constraint of Section 16(b) include not only corporate officers and directors, but also the beneficial owners of more than ten percent of a class of an issuer's registered equity securities. Section 16 of the Act, however, contains no definition of beneficial owner. Accordingly, in 1991 the Commission promulgated Rule 16a-1(a)(1), 17 C.F.R. 240.16a-1(a)(1), for the purposed of determining who is a ten percent beneficial owner. The rule generally adopts the definition of beneficial owner applied under Section 13(d) of the Act, 15 U.S.C. § 78m(d), and rules thereunder. Under Rule 13d-5(b)(1), 17 C.F.R. 240.13d-5(b)(1), a group of shareholders is deemed the beneficial owner of the securities owned by each member of the group if the group acts with the purpose of acquiring, voting, holding, or disposing of the securities of an issuer.

In this case the plaintiff, a shareholder of Quintel Entertainment Inc. who is suing on under Section 16(b) on company's behalf, claims that defendant Peter Stolz was a member of a group whose members beneficially owned in excess of 10% of the stock of Quintel, and seeks recovery of profits realized on short-swing trades in Quintel stock engaged in by Stolz. The district court rejected that claim,

holding that Stolz was not part of a Section 13(d) beneficial ownership group and thus not liable as a statutory insider under Section 16(b). The court granted summary judgment for Stolz.

The Commission expresses no view on that result. As a general matter, the question whether shareholders are acting as a Section 13(d) group depends on whether the facts and circumstances demonstrate that they were acting for the common purpose of acquiring, disposing, or holding securities. In some cases this can be resolved on summary judgment because there is no genuine factual dispute as to the presence, or lack, of such a common purpose. In other cases, where the motivations and relations among the shareholders are less clear, summary judgment may not be appropriate. The Commission expresses no view as to whether, based on these facts, summary judgment was properly granted.

The Commission, however, has serious concerns about portions of the district court's analysis in which the court appeared to draw, or at least imply, incorrect legal conclusions. First, the court relied in part on an interpretive letter issued by the Commission's Division of Corporation Finance in connection with a different transaction, interpreting certain aspects of Rule 16a-1(a)(1). Although the Commission's staff concluded that on the facts of that transaction no Section 16 concerns were raised, the facts and circumstances of that transaction were very

different from those presented here. The district court, however, drew from that letter overbroad and incorrect conclusions that Section 16 concerns may not be present here. The district court should not have relied on the letter.

Second, the decision of the district court is susceptible to being construed, and has been construed by some commentators, as holding that a Section 13(d) group cannot exist unless the alleged group members have a common objective related to corporate control of the issuer. We do not believe that the district court intended its decision to so hold, and such a holding would be incorrect. Accordingly, this Court should make clear that a Section 13(d) group is not limited in that manner.

Finally, we believe that the district court unduly restricted the circumstances under which an acquisition of stock in exchange for the sale of assets can manifest a Section 13(d) group purpose to acquire securities, and also improperly restricted the circumstances in which a contractual agreement to restrict the sale of a security (a "lock-up" provision) can manifest a group purpose to hold securities. The district court incorrectly relied on the fact that the alleged group members were selling an asset as precluding a purpose by them to acquire securities, and on the fact that the buyer of the asset insisted on the lock-up as ruling out a purpose by the alleged group to hold securities. While we take no position on the factual

question whether the alleged group in this case had these purposes, such purposed cannot be ruled out as a matter of law on the bases relied on by the court.

ISSUES ADDRESSED BY THE COMMISSION

The Commission's brief addresses the following questions:

1. Whether the district court properly relied on a staff letter relating to The Goldman Sachs Group, Inc., No-Action Letter [1999 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶77,552 (April 30, 1999), in concluding that the defendant was not a more than ten percent beneficial owner for Section 16(b) purposes.

2. Whether shareholders must have a common objective related to corporate control in order to constitute a beneficial ownership group under Section 13(d) of the Exchange Act.

3. Whether an agreement to acquire securities in exchange for the sale of an asset necessarily manifests only a purpose to the sell the asset, and precludes finding a purpose to acquire securities.

4. Whether a lock-up agreement restricting the sale of securities may, depending on the circumstances, demonstrate an agreement by the alleged group to hold and/or dispose of securities within the meaning of Section 13(d) and Rule 13d-5(b)(1).

STATEMENT OF THE CASE

A. Factual Background

Defendant Stolz was an eleven percent shareholder of Psychic Reader's Network ("PRN"), a privately held company. The other shareholders, Steve Feder and Thomas Lindsey, each owned 44.5 percent of PRN's shares. In 1996, Feder, Lindsey, and Stolz agreed to sell to Quintel PRN's interest in New Lauderdale LLC ("New Lauderdale"), a joint venture between PRN and Quintel. Pursuant to an agreement executed in September 1996 ("PRN/Quintel Agreement" or "Agreement"), Feder and Lindsey each received 7.7 percent, or more, of Quintel's shares, and Stolz received 352,000 shares or about 2.5 percent of Quintel's shares (A175, 511). Feder was, under the Agreement, employed by Quintel to operate New Lauderdale (A262).

The PRN/Quintel Agreement contained lock-up provisions restricting the three PRN shareholders from selling the Quintel stock they received as consideration for their interest in New Lauderdale. 2/

2/ The first lock-up provision prevented the PRN shareholders from selling Quintel stock for two years unless a principal of Quintel sold shares. In the event that a Quintel principal did sell shares, each PRN shareholder had the right to sell a number of Quintel shares in accordance with a set formula. The second lock-up provision

(continued...)

In December 1996, Stolz, Feder, and Lindsey jointly filed with the Commission, pursuant to Section 13(d), a Schedule 13D reporting their acquisition of Quintel stock (A30) and stating that "[t]he Reporting Persons may be deemed to be a 'group' within the meaning of Rule 13d-5(b)(1)." Subsequently, Stolz, Feder, and Lindsey jointly filed four amendments to their Schedule 13D containing statements to the same effect (A78-80, 85-87, 92-94, 99-101). 3/ Stolz also filed, pursuant to the reporting provisions in Section 16(a), six Forms 4 and one Form 5 with the Commission between February 1997 and September 1998 in which he stated that his relationship to Quintel was that of a "Member of 13(d) group owning more than 10%" (A110, 112, 116, 120, 124, 128, 132). 4/

Between November 1996 and August 1998, Stolz made forty purchases and fifty-one sales of Quintel stock (A21-23).

2/(...continued)
restricted the number of shares the PRN shareholders could sell within any given quarter (A50-52, 177-80).

3/ Stolz, Feder, and Lindsey had the opportunity to disclaim group membership when they jointly filed their Schedule 13D and amendments, but they did not do so. See Schedule 13D, item 2.

4/ Stolz contends that he acted on the advice of counsel when he signed documents prepared for him by his attorney, who also represented Feder and Lindsey.

B. The Proceedings Below

Plaintiff Morales, a Quintel shareholder, brought this action on behalf of Quintel against Stolz seeking, under Section 16(b), to recover profits Stolz realized on those purchases and sales of Quintel stock that occurred within six months of each other.

The parties cross-moved for summary judgment. On October 27, 1999, the district court granted summary judgment for the defendant. The court recognized that since Stolz admitted to having profited from the purchase and sale of Quintel stock within a six-month period, the only question is whether he is a beneficial owner of more than 10 percent of Quintel's stock, and thus subject to Section 16(b). 5/ Since Stolz personally acquired only 2.5 percent of the Quintel shares, he could only be the beneficial owner of more than 10% if his shares were aggregated with those acquired by Feder and/or Lindsey. Under Rule 16a-1(a)(1), this would be appropriate only if Stolz, Feder, and Lindsey were deemed the beneficial owners of each other's shares under the Section 13(d) group principle. See, e.g., Morales v. Freund, 163 F.3d 763, 766-76 (2d Cir. 1999) (applying Rule 16a-1(a)(1)'s

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5/ It is undisputed that Stolz was not an officer or director of Quintel, positions that would independently have made him subject to Section 16(b).

definition of beneficial owner within the group context).

Commission Rule 13d-5(b)(1) provides that "[w]hen two or more persons act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership * * * of all equity securities of that issuer beneficially owned by any such persons." Thus, the district court correctly pointed out that "if defendant Stolz acted with Feder and Lindsey 'as a group for the purpose of acquiring, holding or disposing of' Quintel securities, their stock holdings would be aggregated to more than 18% and Stolz would be a beneficial owner of more than 10% percent of Quintel stock under §16(b)." 72 F. Supp. 2d at 347 (quoting Section 13(d)(3)). 6/

In order to determine whether Stolz, Feder, and Lindsey acted as a group within the meaning of Rule 13d-5(b)(1), the district court looked to the purpose of Section 13(d). That provision, the district court stated, was enacted "'to alert the marketplace to every large, rapid aggregation or accumulation of securities,

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6/ Although it may be appropriate to aggregate shareholders' interests to determine if they cross the ten percent threshold, that does not render them liable for each others' short-swing trades. They are only liable for the trading of securities in which they have a pecuniary interest. See Rule 16a-1(a)(2), 17 C.F.R. 240.16a-1(a)(2).

regardless of technique employed, which might represent a potential shift in corporate control.'" Id. (quoting GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d Cir. 1971), cert. denied, 406 U.S. 916 (1972)). It logically follows that "[i]n order to form a group under §13(d), the defendants must have 'combined in support of a common objective.'" Id. (quoting SEC v. Savoy Indus., 587 F.2d 1149, 1162 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979)). See also Wellman v. Dickinson, 682 F.2d 355, 362-63 (2d Cir. 1982), cert. denied, 460 U.S. 1069 (1983). The court concluded, "[t]hus, we must consider whether, as a matter of law, the PRN/Quintel Agreement was an agreement between Stolz, Feder and Lindsey to act as a group with the purpose of acquiring, holding, or disposing of Quintel Securities." Id. at 348.

The PRN/Quintel Agreement did not, in the district court's judgment, constitute an agreement for the purpose of acquiring, holding, or disposing of Quintel securities. The court observed that "[t]here is no evidence that Stolz, Feder and Lindsey were trying to effectuate a shift in corporate control through the disposition of Quintel stock." Id. The court further reasoned that the agreement was not one for the purpose of acquiring Quintel shares because "the only common objective that Stolz, Feder and Lindsey shared was to sell PRN's holdings in New Lauderdale LLC." Id.

The district court then held that the lock-up provisions "do not reflect the objectives of Stolz, Feder and Lindsey" to hold and dispose of Quintel shares because those provisions "exist to protect Quintel and Quintel shareholders" from a decline in the price of Quintel stock. Id. The court further stressed that neither Stolz nor the group would be able to exert substantial influence over Quintel because Stolz owned less than 2.5 percent of Quintel shares and the group as a whole owned only about 18 percent. Id. at 349.

To buttress its conclusion, the district court relied on an interpretive letter issued by the Commission's Division of Corporation Finance to The Goldman Sachs Group, Inc., SEC No-Action Letter [1999 Transfer Binder] Fed. Sec. L. Rep. CCH ¶77,553 (April 30, 1999). That letter addressed whether the 550 managing directors of Goldman Sachs, who received stock upon the firm's becoming a public company, would be subject to the provisions of Section 16 by virtue of aggregating the collective stockholdings of the managing directors as a group. The question presented was whether aggregation would be required as a result of the managing directors' entry into an agreement restricting the sale of their shares and directing the voting of the shares. In that letter, the Division of Corporation Finance expressed the view that each managing director of Goldman Sachs who was included in a joint report of beneficial ownership on Schedule 13D

solely because of his or her participation in that shareholders' agreement, need not include the shares of Goldman Sachs owned by other parties to the shareholders' agreement for purposes of determining whether the managing director was a ten percent beneficial owner under Rule 16a-1(a)(1). 7/

The district court stated that the "SEC has ruled" that Goldman Sachs' partners were not subject to aggregation of their stock for the purpose of determining whether they were ten percent beneficial owners under Section 16(b), even though the shareholders' agreement they signed as a condition for receiving stock included lock-up provisions and voting agreements. 72 F.Supp. at 349. The court emphasized that the staff based its letter partly on the fact that the Goldman Sachs shareholders would be unable to control the firm because of their large

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7/ The staff's interpretive advice addressed Rule16a-1(a)(1), which applies the Section 13(d) definition of beneficial owner for purposes of both the reporting provision in Section 16(a) and the short-swing profits provision in Section 16(b). The staff expressed an interpretive rather than a no-action position. The staff does not issue no-action letters with respect to the Section 16 rules as a matter of policy because the Commission does not have statutory authority to enforce Section 16(b). However, the staff does respond to interpretive letter requests that raise novel issues under the Section 16 rules.

The staff also stated in the letter that it would not recommend enforcement action under Section 13(d) so long as the directors followed certain modified procedures for filing disclosure documents under that provision.

numbers and their small individual holdings. The court also found relevant the involuntary nature of the shareholders' agreement. Here too, the court concluded, the lock-up was an involuntary condition of sale imposed by Quintel, and the shareholders each held only small amounts of Quintel stock. Id. at 349.

ARGUMENT

I. THE DISTRICT COURT IMPROPERLY RELIED ON THE GOLDMAN SACHS LETTER, WHICH WAS RESTRICTED TO A NARROW SET OF CIRCUMSTANCES NOT PRESENT IN THIS CASE.

In the Goldman Sachs letter, the Commission staff stated that a managing director of the firm did not need to include the shares held by other parties to the shareholders' agreement for the purpose of determining the director's status as a ten percent beneficial owner under Rule 16a-1(a)(1). Construing that letter, the district court here stated that the staff

> based its ruling in part on the shareholders' lack of ability to control Goldman Sachs because of the large number of shareholders and their small individual holdings. Similarly, each individual shareholder here owns a small percentage of Quintel stock. Although there are only three shareholders in the alleged group, there is no indication that Stolz, Feder and Lindsey had the ability, or common objective, to exert influence over Quintel.

The court stated that

> [a]lso relevant is whether the PRN/Quintel Agreement was voluntary. In the Goldman Sachs No-Action Letter, the

> SEC also based its ruling on the involuntariness of the shareholder agreement. * * * The partners and employees at Goldman Sachs had to agree to the lock-up and voting provisions, or they could not receive their shares of Goldman Sachs stock. Similarly, the sale of PRN's holding in New Lauderdale LLC would not have occurred unless Stolz, Feder and Lindsey agreed to the lock-up provisions.

72 F. Supp. 2d at 349.

The district court's reliance on the Goldman Sachs letter is overly broad and misplaced. 8/ The staff viewed the facts presented to it as highly unusual, and carefully limited the interpretive advice it gave Goldman Sachs to the facts presented. 9/ Specifically, the staff was willing to advise Goldman Sachs that

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8/ The staff previously expressed similar interpretive views in letters to two other investment banking firms under virtually the same facts presented by Goldman Sachs. See Morgan Stanley Group, Inc., SEC No-Action Letter [1991 Transfer Binder] Fed. Sec. L. Rep. CCH 79,681 (April 30, 1991); Alex Brown Inc., SEC No-Action Letter [1991 Transfer Binder] Fed. Sec. L. Rep. CCH 79, 725 (July 22, 1991).

9/ Commission no-action and interpretive letters are not official expressions of the Commission's views and do not have the force of law. See NYCERS v. SEC, 45 F.3d 7, 12-13 (2d Cir. 1995) (discussing nature and effects of no-action letters). These letters do, however, "represent the views of persons who are continuously working with the provisions of the statute involved," 17 C.F.R. 202.1(d), and as such they are frequently relied on by interested persons to provide guidance on the application of the securities laws and rules thereunder.

those persons covered by the shareholders' agreement need not aggregate their shares to determine their ten percent status under Section 16 because (1) the participation of a party in the shareholders' agreement "is solely because of his or her status as an employee" and, therefore, "essentially involuntary"; and (2) the covered persons will be "too numerous" and their individual "holdings will be too small, to permit any single Covered Person to exercise control" over the firm through the shareholders' agreement. Goldman Sachs also represented to the staff that information barriers would prevent the misuse of confidential information for personal trading.

The conditions imposed on the managing directors in Goldman Sachs were essentially conditions of their employment. If they wished to continue in their capacity as managing directors, they had to agree to the conditions on their stock ownership. There was no collective investment motive for the conditions. Moreover, it was represented that virtually all the directors would each own one percent or less of the shares covered by the shareholders' agreement and that none of the directors would own more than one percent of the outstanding shares not covered by the agreement. There were approximately 550 persons covered by the agreement. Even though the shareholders' agreement rendered the shareholders a beneficial ownership group for Section 13(d) purposes (which was not disputed),

the circumstances made it clear that they were not, solely by virtue of their participation in the shareholders' agreement, in a position to have access to inside information about the company for Section 16 purposes. Accordingly, the staff concluded that, in this very narrow situation, it was not necessary to apply the Section 13(d) group test in determining whether a person was, solely by virtue of participation in the shareholders' agreement, a ten percent beneficial owner for purposes of Section 16. 10/

The facts of this case are very different. Unlike Goldman Sachs, here the lock-up agreement was entered into in an investment transaction, rather than as a condition to employment. Moreover, in contrast to the more than 500 shareholders at issue in the Goldman Sachs letter, this cases involves only three shareholders who together acquired 18 percent of the company's stock (A256). That scenario presents a greater likelihood that the shareholders might collectively have access to, and improperly use, inside information.

10/ Reflecting the narrow scope of the staff's interpretation, the Goldman Sachs letter added that the staff's position "does not extend to any situation outside the Shareholders' Agreement where a [shareholder] agrees to act together with any other person for the purpose of acquiring, holding, voting, or disposing of shares of Common Stock." Thus, the interpretive letter clearly intended that the Section 13(d) test would apply to other agreements that a shareholder had or could enter into.

This is not to say that Stolz, Feder, and Lindsey necessarily should be treated as Section 16 insiders. But neither can it be concluded, merely on the basis of the size of their holdings or on whether Quintel insisted on the lock-up provision, that they were not. Unlike the Goldman Sachs situation, the facts here do not necessarily demonstrate that the shareholders would not be in a position to engage in the activity with which Section 16 is concerned.

II. A SECTION 13(d) BENEFICIAL OWNERSHIP GROUP MAY EXIST EVEN IF IT DOES NOT HAVE A COMMON OBJECTIVE THAT IS RELATED TO CORPORATE CONTROL.

The district court's decision focuses on whether Stolz, Feder, and Lindsey had a purpose related to control of Quintel and can be construed as holding that a Section 13(d) group must have as its purpose to take over an issuer or influence corporate control. At the outset of its analysis the court recognized that members of a Section 13(d) group might join together for purposes not related to corporate control. The court noted that, in addition to a purpose to control the company or influence its control, "courts have considered [the] common[] objective[] to control the stock price * * * ." 72 F. Supp. 2d at 348. 11/ The court, nevertheless, relied

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11/ The district court also describes two cases where a Section 13(d) group was found to exist without a purpose of corporate control. 72 F. Supp. 2d at 348. (discussing Lerner v. Millenco, 23 F. Supp.2d

(continued...)

heavily on the absence of a corporate control purpose in deciding that a Section 13(d) group did not exist. The court wrote generally that "[t]here is no evidence that Stolz, Feder and Lindsey were trying to effectuate a shift in corporate control through the disposition of Quintel stock." Id. With regard to the acquisition of Quintel shares specifically, the court stated that "although the sale was in exchange for Quintel stock, the purpose of the agreement was not to acquire control of Quintel." Id. "Nor," the court continued, "is there any other evidence of an agreement to attempt a corporate takeover." Id. The court also emphasized that the group did not seek to "influence" control:

> Defendant Stolz did not agree with Feder and Lindsey to use their stock to exert influence over Quintel. * * * Even combining Stolz's interest with the holdings of Feder and Lindsey, the alleged group would own about 18% of Quintel, and would be unable to exert substantial influence over Quintel. Further, there is no evidence that Stolz has attempted to exert influence over or get involved in the management of Quintel.

72 F. Supp. 2d at 348-49.

11/(...continued)
337, 344 (S.D.N.Y. 1998) (finding a group purpose to artificially maintain the price of the stock); Global Intellicom v. Thomson Kernaghan & Co., [1999 Transfer Binder] Fed. Sec. L. Rep. CCH 90,534 (July 27 1999) (finding a group purpose to decrease the value of the stock).

The district court's extensive reliance on the absence of a control purpose has caused its opinion to be interpreted as holding that a Section 13(d) group may exist only where the group seeks corporate control or to influence corporate control. 12/

There is no doubt that "the purpose of Section 13(d) is to require disclosure of information by persons who have acquired a substantial interest, or increased their interest in equity securities of a company by a substantial amount, within a relatively short time," S. Rep. No. 550, 90th Cong., 1st Sess 4 (1967), so that investors might "assess the potential for changes in corporate control and adequately evaluate the company's worth." GAF Corp. v. Milstein, 453 F.2d. 709, 717 (2d Cir. 1971), cert. denied, 406 U.S. 910 (1972). Nothing, however, in

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12/ Two widely read commentators on Section 16 summarized the district court's holding, in part, by stating:

> [T]he court indicated that a Section 13(d) group can exist only where the parties have a common objective that may involve a potential shift in corporate control. Because there was no evidence that the three purported group members had a common objective to effectuate a shift in corporate control through the disposition of the issuer's stock, the court felt there was no basis under 13(d) to find the existence of a group.
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> P. Romeo & A. Dye, Section 16 Updates Vol. IX, No. 4 at 6 (Dec. 1999).

Section 13(d) or the rules thereunder limits the definition of beneficial owner to persons who have a purpose of influencing control.

In specifically describing when a group of shareholders is the beneficial owner of each group member's shares such that they should be aggregated, neither Congress nor the Commission made any mention in Section 13(d) or Regulation 13D of any requirement that shareholders come together for the purpose of influencing control. Rule 13d-5(b)(1) specifically provides that "[w]hen two or more persons agree to act together for purposes of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership * * * of all equity securities of that issuer beneficially owned by any such persons ." The "touchstone of a group within the meaning of Section 13(d)" as described by this Court is not control, but "that the members combined in furtherance of a common objective." Wellman v. Dickinson, 682 F.2d at 363. See also SEC v. Savoy, 587 F.2d 1149, 1162 (D.C. Cir.), cert. denied, 440 U.S. 913 (1978); Bath Industries, Inc. v. Blot, 427 F.2d 97, 111 (7th Cir. 1970). "All that is required is that the members of the group have combined to further a common objective with regard to" acquiring, holding, voting, or disposing of securities. Morales v. Freund, 163 F.3d at 767.

Moreover, Congress made it clear that Section 13(d) applies regardless of a

control purpose, when it gave the Commission the authority to exempt from the section acquisitions of stock "not entered into for the purpose of, and not having the effect of, changing or influencing the control of the issuer or otherwise as not comprehended within the purposes of this subsection." Thus, absent a Commission exemption, transactions are within the scope of Section 13(d) even if they do not involve a control purpose. See GAF Corp. v. Milstein, 453 F.2d 709, 719 n.20 (2d Cir. 1971) (recognizing the Commission's prerogative to exempt persons not having a control purpose).

The Commission, however, has not adopted any such exemption. At most, the Commission has only made it easier for certain persons not seeking control to comply with the filing requirements of the Act. For example, when the Commission adopted Regulation 13D, it allowed certain persons who are beneficial owners of securities under Section 13(d) to file a short-form notice so long as the person "acquired such securities in the ordinary course of his business and not with the purpose or with the effect of changing or influencing the control of an issuer." See Adoption of Beneficial Ownership Disclosure Requirements, Exchange Act Release No. 13291, 13 SEC Docket 1779 (Feb. 24, 1977). The Commission expanded use of the short form (Schedule 13G) in 1998 to include "passive investors" who are "not seeking to acquire influence or control of the

issuer and who own less than 20 percent of the class of securities." Amendment to Beneficial Ownership Reporting Requirements, Exchange Act Release No. 39538, 66 SEC Docket 902 (Jan. 12, 1998).

III. AN AGREEMENT TO EXCHANGE AN ASSET FOR SECURITIES MAY MANIFEST A PURPOSE TO ACQUIRE THE SECURITIES.

The district court held that the PRN/Quintel Agreement was not an agreement by the alleged group to acquire Quintel securities. In the court's view, Feder, Lindsey, and Stolz acted for the purpose of selling New Lauderdale alone and not for the purpose of acquiring Quintel shares. The court reasoned that "the PRN/Quintel Agreement was an agreement between two corporations to effectuate a sale of PRN's holdings in another company." 72 F. Supp. 2d at 348. And "although the sale was in exchange for Quintel stock * * * [t]he only common objective that Stolz, Feder and Lindsey shared was to sell PRN's holdings in New Lauderdale LLC" Id.

There is nothing in the record excerpts submitted to this Court, (which apparently include all the papers put before the district court), to support the conclusion that PRN's shareholders acted only for the purpose of selling New Lauderdale. This is not a case where the evidence shows that the sole purpose was to sell the asset and that acquiring Quintel stock was not even a partial purpose.

The district court, rather, appears to have determined that *as a matter of law* a group's acquisition of stock through a merger or a sale of an asset *cannot* manifest an intention by the group to acquire securities and therefore (absent another group purpose) it falls outside the scope of Section 13(d). Yet, there is nothing in Section 13(d) or the rules thereunder to support such a broad statement of law. In fact, Rule 13d-5(a) is at odds with any such notion. That rule provides that "[a] person who becomes a beneficial owner of securities shall be deemed to have acquired such securities for the purposes of Section 13(d)(1) of the Act, *whether such acquisition was through purchase or otherwise*" (emphasis added).

That Stolz and the other two sellers may have been motivated in part by an objective of selling their interest in New Lauderdale does not preclude their also having as a common objective the acquisition of stock in Quintel. The two objectives are not mutually inconsistent. We believe that the district court erred in concluding that, as a matter of law, the agreement could *never* have rendered the shareholders a Section 13(d) beneficial ownership group.

IV. LOCK-UP PROVISIONS, IN APPROPRIATE CIRCUMSTANCES, MAY DEMONSTRATE AN AGREEMENT TO HOLD AND/OR DISPOSE OF SECURITIES.

The district court decided that the lock-up provisions in the PRN/Quintel agreement did not constitute an agreement by Stolz, Feder and Lindsey to hold

and/or dispose of Quintel securities. In this regard, the court wrote that "[t]he lock-up provisions here do not reflect the objectives of Stolz, Feder, and Lindsey, rather they exist to protect Quintel and Quintel shareholders." Quintel, "not defendant Stolz and the alleged group, was trying to affect -- i.e., protect -- the price of Quintel stock." 72 F.Supp. 2d at 348.

One reading of the district court's decision is that lock-up provisions when insisted on by one party do not serve as a basis for finding a Section 13(d) group purpose by those who do not initiate the provisions. Even this statement would be overbroad. The mere fact that a third-party insists on a lock-up provision does not mean that the provision does not also manifest a common purpose among those subject to its terms to hold securities. The fact that the lock-up was insisted on by a third party may be a piece of evidence suggesting the absence of a group purpose, but it will rarely be conclusive evidence.

In his brief before the district court, however, Stolz argues that "[p]laintiff's suggestion that a lock-up agreement imposed on shareholders by an issuer of securities cause the shareholders to be beneficial owners of each other's shares is also contrary to the longstanding practice of both the securities Bar and the SEC with respect to such lock-ups." (Defendant's Memorandum of Law In Opposition to Plaintiff's Motion for Summary Judgment, p. 10). Stolz supports this statement

with an affidavit from Carl W. Schneider, Esq., who states that "[i]t is generally understood that multiple stockholders who agree to * * * lock-ups do not, as a consequence of such agreement, constitute a Section 13(d) 'group.'" Indeed, after publication of the district court's decision in this case, two widely read commentators on Section 16 stated even more broadly that the "judgment that a lock-up agreement does not result in the creation of a Section 13(d) group is consistent with the SEC staff's longstanding position that such an agreement does not give rise to Section 13(d) reporting obligation." P. Romeo & A. Dye, Section 16 Updates, Vol. IX, No. 4 at 6 (Dec. 1999). Stolz, Schneider, and the commentators appear to assume that *all* lock-up agreements proposed by a third party are involuntarily imposed and that there is a Commission policy that such lock-up agreements can never create a Section 13(d) group. Id.; A184.

There is, however, no Commission policy that lock-up agreements cannot lead to the creation of Section 13(d) groups. Nor could there be such a policy, because whether a lock-up provision creates a Section 13(d) group depends on the specific facts and circumstances of any given case. There are situations where a lock-up agreement might constitute an agreement by a group of shareholders to act together for the purposes of acquiring, holding, or disposing of securities. For example, lock-up agreements entered into by an issuer and a group of shareholders

might serve to support the price of securities by keeping stock off the market at a time when positive information about the issuer is circulating in the media, thereby benefitting both the issuer and the shareholder group. Furthermore, lock-up provisions also have the effect of making shares unavailable for sale to those who might seek to compete for or to influence corporate control, an effect that could be desired both by the issuer seeking to ward off unfriendly bids and by a shareholder group seeking to ward off competitors.

While the district court's decision that the PRN/Quintel Agreement's lock-up provisions did not constitute an agreement to act as a Section 13(d) group may be correct, the purported Commission policy regarding lock-ups, as described in the record in this case and by commentators, does not exist. It would be incorrect to conclude that a lock-up agreement can never create a Section 13(d) group. Whether a lock-up provision constitutes an agreement for the purposes of creating a Section 13(d) group depends on the facts and circumstances of any given case.

CONCLUSION

The Commission urges the Court to correct the district court's reliance on the Goldman Sachs no-action letter and to correct the analysis put forward by the district court as set forth above.

Respectfully submitted,

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No. 99-9374

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RICHARD MORALES,

Plaintiff-Appellant,

v.

QUINTEL ENTERTAINMENT, INC. and PETER STOLZ,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

CERTIFICATE OF COMPLIANCE

I certify that the Brief of the Securities and Exchange Commission, Amicus Curiae in Support of Appellants on Issue Addressed complies with the type volume limitations of Federal Rule of Appellate Procedure 32(a)(7), and contains 6301 words in 14 point Times New Roman.

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CERTIFICATE OF SERVICE

I, Allan A. Capute, am a member of the bars of Maryland and the District of Columbia, and I hereby certify that on March 24, 2000 I caused to be served three copies of the Brief of the Securities and Exchange, Commission, Amicus Curiae, In Support of Appellant on Issues Addressed by overnight Federal Express to:

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