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SECOND CIRCUIT REVIEW

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'Hallwood': An Issuer's Remedies in the Face of a Takeover

IN THIS MONTH'S column, we discuss a significant decision handed down earlier this month by the U.S. Court of Appeals for the Second Circuit addressing whether the Williams Act provides an issuer with a private right of action for money damages. In *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*,[1] the Second Circuit, in an opinion written by Judge Guido Calabresi and joined by Judge Jose A. Cabranes and Judge Loretta A. Preska (U.S. District Court for the Southern District of New York, sitting by designation), affirmed U.S. District Judge Lewis Kaplan's order holding that §13(d) of the Securities Exchange Act does not provide an issuer with a damages remedy.[2] The decision contains significant rulings both as to an issuer's remedies in the face of a takeover and as to implied rights of action in general.

Facts of 'Hallwood'

Plaintiff Hallwood Realty Partners LP (Hallwood) is a limited partnership, with units traded on the American Stock Exchange. Hallwood is in the business of acquiring, owning and operating commercial real estate. Defendants are a group of corporations and limited partnerships that purchased units of Hallwood between 1992 and 2000.

Defendants Gotham Partners LP, Gotham Partners III LP, and Gotham Holdings II LLC (collectively, Gotham) are private investment funds that first purchased units of Hallwood in 1994. By 1995, Gotham's total holdings of Hallwood units exceeded 5 percent of Hallwood's total outstanding units, triggering the requirement under the federal securities laws that Gotham file a Schedule 13D with the Securities Exchange Commission (SEC). Gotham's Schedule 13D indicated that it had purchased Hallwood units "for investment purposes."[3] In June 1997, by which time Gotham had acquired over 14 percent of outstanding Hallwood units, Gotham amended its Schedule 13D to indicate

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that it sought to replace the general partner of Hallwood.

Defendant Interstate Properties (Interstate) is a partnership that first purchased Hallwood units in 1995. By late 1998, Interstate had acquired more than 5 percent of outstanding Hallwood units and, accordingly, filed a Schedule 13D to disclose that fact. Interstate continued purchasing units of Gotham, and filing amendments to its Schedule 13D, through July 2000, when Interstate owned 9 percent of outstanding Hallwood units.

Defendant Private Management Group Inc. (PMG) is a money management company that first purchased Hallwood units in 1992. By January 2000, PMG held over 6 percent of outstanding Hallwood units. PMG's filings with the SEC stated that its purchase of Hallwood units was "in the ordinary course of business." PMG affirmed that its acquisition of Hallwood units was not "for the purpose of … changing or influencing the control of the issuer … and … not … in connection with or as a participant in any transaction having such purpose or effect."

The remaining defendants never held more than 5 percent of Hallwood units and, therefore, never filed a Schedule 13D.

Hallwood filed suit under §13(d), (g) of the Securities Exchange Act, alleging that Gotham, PMG, Interstate and the other defendants had purchased Hallwood units as part of a scheme to gain control of Hallwood. Hallwood alleged that defendants failed to disclose the existence of their "group" to the SEC or the public as required by §13(d).[4] Defendants contended that their purchase decisions were made independently and not as part of a group plotting to gain control of Hallwood. Hallwood sought injunctive relief and money damages and demanded a jury trial.

The District Court struck Hallwood's demand for a jury trial, concluding that there was no implied private right of action for money damages under §13(d). In a bench trial, Hallwood adduced evidence that, between 1994 and 2000, the defendants communicated regarding Hallwood. Hallwood also showed that certain defendants purchased Hallwood units within the same week. Additionally, Hallwood offered the testimony of a private investigator who had posed as a potential Hallwood investor, and who was allegedly told by someone at PMG that a group led by Gotham planned to take control of Hallwood.

In an oral decision, Judge Kaplan held that Hallwood had failed to prove the existence of a "group" within the meaning of §13(d), and therefore dismissed Hallwood's remaining equitable claims. On appeal, Hallwood argued that (1) the District Court failed to consider the circumstantial evidence regarding the existence of a "group" and (2) the District Court erred by refusing Hallwood's right to a trial by jury because §13(d) should be read to permit issuers to sue for damages.

Second Circuit Discussion

The Second Circuit began by addressing Hallwood's contention that the District Court did not properly consider circumstantial evidence regarding the existence of a "group" within the meaning of §13(d). Citing the Court's 1982 decision in *Wellman v. Dickinson*,[5] Judge Calabresi agreed that the factual determination of whether a §13 group exists must take into account both direct and circumstantial evidence, and determined that Judge Kaplan had considered and weighed all pertinent evidence.

The Williams Act

Next, the court addressed an issue of first impression — whether Hallwood was entitled to a jury trial based on its claim for money damages under §13(d). The Second Circuit observed that the District Court had based its ruling, in part, on the fact that "Section 13 does not explicitly create a cause of action for damages… ." and that "courts repeatedly have held that no such right of recovery may be inferred under Section 13 in favor of shareholders who rely to their detriment on false or misleading statements contained in, or material omissions from, filings under that statute."[6] Hallwood argued on appeal that the District Court erred because, while there might be no private right of action under §13(d) for shareholders, there was an implied cause of action under §13(d) for issuers as established in *GAF Corp. v. Milstein*.[7] Given the existence of an issuer's cause of action under §13(d), the court addressed whether damages was an appropriate remedy.

Implied Private Rights

Implied Private Rights of Action. Despite recognizing the existence of an issuer's remedy under §13(d), the court began by analyzing Supreme Court precedent regarding the conditions under which it is appropriate to infer a private right of action. In *J.I. Case v. Borak*,[8] the Supreme Court found an implied private right of action under §14 of the Securities Exchange Act because such a remedy furthered the statute's broad remedial purpose. Since *Borak*, however, beginning with *Cort v. Ash*[9] in 1975, the Supreme Court has expressed increasing reluctance to infer a private right of action. The touchstone for finding an implied private right of action depends on "whether congressional intent to create a private cause of action can be found in the relevant statute."[10]

The court went on to examine a number of Second Circuit decisions in which courts had declined to find private rights of action in favor of shareholders under §13(d). The court identified three rationales that had been asserted as a basis for denying shareholders a private right of action under §13(d). First, there is nothing in the legislative history of the Williams Act to support the view that shareholders should have a private right of action for money damages. Second, because the statute focused on regulating investors rather than protecting individuals, it was harder to divine an intent that the statute should confer rights on a particular group. Third, because §18(a) of the Williams Act provides an express remedy for shareholders who have detrimentally relied on a material misrepresentation in an SEC filing, the omission of a private right of action under §13 is presumed to have been intentional.

Hallwood argued that these cases and these lines of reasoning were inapposite. First, Hallwood asserted that the existence of a damages remedy under §18 for shareholders did not bear on the question of whether a damage remedy was available to issuers under §13(d), since §18 did not mention issuers at all.

Hallwood's stronger argument was that the Second Circuit had previously found a private right of action under §13(d) for issuers seeking injunctive relief.[11] Moreover, as the Supreme Court held in *Franklin v. Gwinnett County Public Schools*,[12] once a court finds an implied right of action, it should " 'presume the availability of all appropriate remedies unless Congress has expressly indicated otherwise.' "[13] Hallwood maintained that since Congress had not clearly expressed its intent to the contrary, a damages remedy must be available to issuers under §13(d).

Congressional Intent

The Second Circuit rejected Hallwood's reasoning, based on *Salute v. Stratford Greens Garden Apartments*,[14] in which the court held that incompatibility with the statutory purpose satisfied the *Franklin* requirement for an express congressional indication that an implied remedy was not appropriate. Here, the court reasoned that there were sufficient indications that Congress did not intend issuers to be able to sue for money damages under §13(d) because to do so would frustrate the purposes of the Williams Act.

The court maintained that although the equitable remedy granted to an issuer in *GAF* was consistent with the purpose of the Williams Act, the legal remedy sought by Hallwood in this case would frustrate that purpose. The court reiterated the purpose of §13(d), which it articulated in *GAF*: "[T]o alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control…."[15] The Second Circuit had reasoned in *GAF* that giving the issuer the right to enforce §13(d) would advance this purpose because the issuer was best positioned to know when an investor was accumulating the company's stock, but failed to report the purchases properly.

The *Hallwood* court further explored the legislative history of the Williams Act and found that Congress had intended the statute to benefit shareholders without taking sides in any struggle over the target company. The Second Circuit found it "manifest" that a damage remedy would tip the balance in favor of management at the expense of those seeking corporate control. The court concluded that allowing a remedy for money damages under §13(d) would therefore be incompatible with this underlying purpose of the Williams Act.

Given its conclusion that a damages remedy would frustrate congressional intent, the Second Circuit held that this case came within an exception to the general rule that all remedies are available once a right to a cause of action has been found. The court held, therefore, that the District Court properly struck Hallwood's demand for a jury trial because §13(d) does not support a claim for damages by the issuer. In a final footnote, the court stressed that its opinion did not call into question the continued ability of an issuer to seek injunctive relief for a violation of §13(d) under *GAF*.

Conclusion

Whether it is "manifest" that issuers may seek damages when purchasers fail to file timely and truthful Schedule 13Ds is open to debate. Certainly, such a remedy would place additional pressure on purchasers to make full and accurate disclosures, thereby furthering the central purpose of the Williams Act. Moreover, the Supreme Court requires an express indication from Congress before limiting the remedies available to a court once an implied cause of action has been recognized.[16] Yet, the Second Circuit in *Hallwood* found that this requirement was satisfied by a perceived inconsistency between a remedy and a secondary goal of the statute.

The court's message is clear: Implied private rights of action are strongly disfavored, and the court is loathe to expand the remedies available under implied causes of action recognized pre-*Cort*. The court all but acknowledged that in hindsight the *GAF* decision was a mistake and that the same result would not be reached under *Cort* or its progeny.[17] While an issuer's ability to seek injunctive relief to cure a violation of §13(d) appears secure, the court plainly is opposed to finding new rights or remedies under the Williams Act.

(1) No. 01-7246, 2002 WL 537040 (2d Cir. April 11, 2002).
(2) 15 U.S.C. §78m(d). Under §13(d), any person who acquires more than 5 percent beneficial ownership of any class of equity securities must send notice of that fact to the issuer, the SEC, and exchange on which the security is traded. If the purchaser intends to acquire control of the issuer, this fact must be set forth in the statement.
(3) *Hallwood*, 2002 WL 537040, at *1
(4) Section 13(d) applies to "a group of persons or entities who 'act … for the purpose of acquiring, holding, or disposing of securities …"
(5) 682 F.2d 355 (2d Cir. 1982).
(6) *Hallwood*, 2002 WL 537040, at *3-4 (quoting *Hallwood Realty Partners, L.P. v. Gotham Partners, L.P.*, No. 00-CIV-1115, 2001 WL 46978, at *1 (S.D.N.Y. Jan. 19, 2001)).
(7) 453 F.2d 709 (2d Cir. 1971).
(8) 377 U.S. 426 (1964).
(9) 422 U.S. 66 (1975).
(10) *Hallwood*, 2002 WL 537040, at *4.
(11) Id. at *5 (citing *GAF*).
(12) 503 U.S. 60 (1992).
(13) *Hallwood*, 2002 WL 537040, at *5 (quoting *Franklin*, 503 U.S. at 66).
(14) 136 F.3d 293 (2d Cir. 1998).
(15) *Hallwood*, 2002 WL 537040, at *5 (quoting *GAF*, 453 F.2d at 717).
(16) *Franklin*, 503 U.S. at 66.
(17) *Hallwood*, 2002 WL 537040, at *6 ("[T]he Supreme Court has not sought to reconsider the existence of causes of action, such as the right to injunctive relief recognized in *GAF Corp.*, that were implied under the now dubious analysis of *Borak*.").