(a) Any written solicitation or recommendation which is published or sent or given to security holders in connection with the solicitation or recommendation referred to in Item 4.

(b) If any oral solicitation or recommendation to security holders is to be made by or on behalf of the person filing this statement, any written instruction, or other material which is furnished to the persons making the actual oral soliciation or recommendation for their use, directly or indirectly, in connection with the solicitation or recommendation.

(c) Any contract, agreement, arrangement or understanding described in Item 3(b) or the pertinent portions(s) of any proxy statement, report or other communication referred to in Item 3(b).

Signature. After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

(Date)

(Signature)

(Name and Title)

Instruction. The original statement shall be signed by each person on whose behalf the statement is filed or his authorized representative. If the statement is signed on behalf of a person by his authorized representative (other than an executive officer of a corporation or a general partner of a partnership), evidence of the representative's authority to sign on behalf of such person shall be filed with the statement. The name and any title of each person who signs the statement shall be typed or printed beneath his signature.

IV. 17 CFR Part 240 is amended by adding new §§ 240.14e–1 and 240.14e–2 (Regulation 14E) to read as follows:

Regulation 14E

§ 240.14e–1 Unlawful tender offer practices.

As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, no person who makes a tender offer shall:

(a) Hold such tender offer open for less than twenty business days from the date such tender offer is first published or sent or given to security holders: *Provided, however,* That this paragraph shall not apply to a tender offer by the issuer of the class of securities being sought which is not made in anticipation of or in response to another person's tender offer for securities of the same class.

(b) Increase the offered consideration or the dealer's soliciting fee to be given in a tender offer unless such tender offer remains open for at least ten business days from the date that notice of such increase is first published, or sent or given to security holders: *Provided, however,* That this paragraph shall not apply to a tender offer by the issuer of the class of securities being sought which is not made in anticipation of or in response to another person's tender offer for securities of the same class.

(c) Fail to pay the consideration offered or return the securities deposited by or on behalf of security holders promptly after the termination or withdrawal of a tender offer;

(d) Extend the length of a tender offer without issuing a notice of such extension by press release or other public announcement, which notice shall include disclosure of the approximate number of securities deposited to date and shall be issued no later than the earlier of (i) 9:00 a.m. Eastern time, on the next business day after the scheduled expiration date of the offer or (ii), if the class of securities which is the subject of the tender offer is registered on one or more national securities exchanges, the first opening of any one of such exchanges on the next business day after the scheduled expiration date of the offer.

§ 240.14e–2 Position of subject company with respect to a tender offer.

(a) *Position of subject company.* As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices withing the meaning of section 14(e) of the Act, the subject company, no later than 10 business days from the date the tender offer is first published or sent or given, shall publish, send or give to security holders a statement disclosing that the subject company:

(1) Recommends acceptance or rejection of the bidder's tender offer;

(2) Expresses no opinion and is remaining neutral toward the bidder's tender offer; or

(3) Is unable to take a position with respect to the bidder's tender offer. Such statement shall also include the reason(s) for the position (including the inability to take a position) disclosed therein.

(b) *Material change.* If any material change occurs in the disclosure required by paragraph (a) of this section, the subject company shall promptly publish or send or give a statement disclosing such material change to security holders.

(Secs. 7, 10, 19(a), 48 Stat. 78, 81, 85; secs. 205, 209, 48 Stat. 9067, 908; sec. 8, 68 Stat. 685; sec. 308(a)(2), 90 Stat. 57, secs. 3(b), 10(b), 13, 14, 23(a), 48 Stat. 882, 891, 894, 895, 901; sec. 203(a), 49 Stat. 704; sec. 8, 49 Stat. 1379; secs. 4, 5, 78 Stat. 569, 570; secs. 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3–5, 84 Stat. 1497; secs. 3, 10, 18, 89 Stat. 97, 119, 155; sec. 308(b), 90 Stat. 57; secs. 202, 203, 91 Stat. 1494, 1498, 1499; sec. 20, 49 Stat. 833; sec. 319(a), 53 Stat. 1173; sec. 38(a), 54 Stat. 841; 15 U.S.C. 77g, 77j, 77s(a), 78c(b), 78j(b), 78m, 78n, 78w(a), 79t, 77ttt(a), 80a–37(a)).

Authority

The Commission hereby adopts: amendments to Rule 434(b) (§ 230.434(b)) pursuant to sections 7, 10 and 19(a) of the Securities Act; amendments to Schedule 13D (§ 240.13d–101) pursuant to sections 13(d) and 23(a) of the Exchange Act; Rules 14d–1, 14d–2, 14d–3, 14d–4, 14d–6, 14d–7, 14d–8, 14d–9 Schedule 14D–9 and amendments to Schedule 14D–1 (§ 240.14d–100) pursuant to sections 3(b), 10(b), 13(d), 14(d), 14(e), and 23(a) of the Exchange Act; Rule 14d–5 pursuant to section 19(a) of the Securities Act; sections 3(b), 10(b), 13(d), 14(d), 14(e) and 23(a) of the Exchange Act; section 20 of the Public Utility Holding Company Act of 1935 (15 U.S.C. 79a et seq.); section 319(a) of the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.); and section 38(a) of the Investment Company Act of 1940 (15 U.S.C. 80a et seq.); Rules 14e–1 and 14e–2 pursuant to sections 14(d), 14(e) and 23(a) of the Exchange Act.

By the Commission.

George A. Fitzsimmons,

Secretary.

November 29, 1979.

[FR Doc. 79–37406 Filed 12–5–79; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230 and 240

[Release Nos. 33-6159, 34-16385, IC-10959; File No. S7-812]

Proposed Amendments to Tender Offer Rules

AGENCY: Securities and Exchange Commission.

ACTION: Proposed amendment to rules.

SUMMARY: The Commission is publishing for comment amendments to new Regulations 14D and 14E pertaining to tender offers and is proposing to rescind Rule 10b-13. The proposals include: a definition of the term "tender offer"; provisions requiring equal treatment of security holders in the context of tender offers; certain antifraud provisions concerning trading by certain persons on the basis of material non-public information relating to a tender offer; and a prohibition of certain purchases not made by means of a tender offer. The proposals are applicable to any tender offer and would implement and augment the present statutory requirements. The proposed amendments are necessary to explicate certain consequences of making a tender offer and to enhance the protection of investors against fraudulent, deceptive and manipulative acts or practices.

DATE: Comments must be received on or before February 1, 1980.

ADDRESSES: Comments should be submitted in triplicate to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. Comment letters should refer to File No. S7-812. All comments received will be available for public inspection and coping in the Commission's Public Reference Room, 1100 L Street, NW., Washington, D.C. 20549.

FOR FURTHER INFORMATION CONTACT: John Huber or John Granda (202-272-2589), Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today published for comment proposed amendments to Regulation 14D (17 CFR 240.14d-1 through 240.14d-101) and to Regulation 14E (17 CFR 240.14e-1 and 240.14e-2) pursuant to sections 3(b), 10(b), 13(d), 13(e), 14(d), 14(e) and 23(a) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. 78a et seq. as amended by Pub. L. No. 94-29 (June 4, 1975)]. If adopted, these proposals would implement and augment the present statutory requirements by providing a definition of the term "tender offer," additional substantive protections, and antifraud protections applicable to any tender offer. The Commission is also proposing to rescind Rule 10b-13 (17 CFR 240.10b-13) and to adopt in lieu thereof proposed Rule 14e-5.

The Commission is also concurrently adopting amendments to Regulations 14D and 14E. Regulation 14D provides specific filing and disclosure requirements, optional dissemination provisions, and additional substantive protections with respect to tender offers subject to section 14(d) of the Exchange Act. Regulation 14E is applicable to any tender offer other than one involving exempted securities and includes provisions relating to the length of the tender offer and extensions thereof, payment of the consideration offered, and disclosure of the subject company's position with respect to the tender offer.

These proposals are not applicable to presently pending tender offers or to any tender offer commenced prior to the actual adoption and effectiveness of the proposals herein. Rule 10b-13 will continue in effect unless and until proposed Rule 14e-5 becomes effective. The proposals are based in part on the record in the Commission's Public Fact Finding Investigation in the matter of Beneficial Ownership, Takeovers and Acquisitions by Foreign and Domestic Persons ("Tender Offer Hearings"),[1] the 105 letters of comment [2] received in response to the tender offer proposals published for comment in Release No. 34-15548 (February 5, 1979) (44 FR 9956) (the "February Release"), judicial decisions, and the Commission's experience. A discussion of each of the proposals follows.

Discussion

A. Proposed Rule 14d-1(b)(1): Definition of the term "Tender Offer"

The term "tender offer" is not defined in the Williams Act.[3] Since the passage of the Williams Act, the Commission has been continually involved in the development of the meaning of the term [4] but has not adopted a definition.

This position has been premised upon the dynamic nature of these transactions and the need for the Williams Act to be interpreted flexibly in a manner consistent with its purposes to protect investors. Consequently, the Commission specifically declined to define the term on two prior occasions.[5]

While there has been essential compliance with the provisions of the Williams Act when people seek shares through a public announcement and filings with the Commission, many persons have not complied with the Williams Act when they have invited tenders for shares in other ways. Many persons have deliberately structured tender offers in an effort to evade the provisions of the Williams Act. These approaches have included purported privately negotiated transactions, wide-scale solicitation of members of one family and various forms of massive open market purchase programs. In the Commission's judgment, these tender offers, however packaged, are subject to the provisions of the Williams Act and are required to be effected in accordance with its provisions.

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[1] Securities Act Release Nos. 5529 (September 9, 1974) (39 FR 33935) and 5538 (November 5, 1974) (39 FR 41223).

[2] Letters were received from the following categories of commentators: corporations (63); law firms and associations (11); trade organizations and associations (10); state administrative agencies (7); securities industry (6); academicians (1); and other interested persons (7). Copies of these letters are available for public inspection and copying at the Commission's Public Reference Room (File No. S7-770). For the convenience of the public, a copy of the summary of these comment letters, which was prepared by the staff of the Commission, has been placed in File No. S7-770 and is also available for public inspection and copying.

[3] Both the Senate and House Reports describe the characteristics of a typical cash tender offer. S. Rep. No. 550, 90th Cong., 1st Sess. 2 (1967) ("1967 Senate Report") H.R. Rep. No. 1711, 90th Cong., 2d Sess. 2 (1968) ("1968 House Report").

[4] The involvement of the Commission and its staff has included: determinations relating to specific transactions, see Securities Exchange Act Release No. 8392 (August 30, 1968) (33 FR 14109); participation *amicus curiae* in litigation, *see e.g.* Memorandum of the Securities and Exchange Commission as Amicus Curiae *Cattlemen's Investment Company* v. *Fears*, 343 F. Supp. 1248 (W. D. Okla. 1972); enforcement actions, *see, e.g., Securities and Exchange Commission* v. *Sun Co.*, reported sub nom. *Wellman* v. *Dickinson* [Current] CCH Fed. Sec. L. Rep. ¶96,918 (S.D.N.Y. 1979); investigative hearings, *see* Public Fact-Finding Investigation in the Matter of Beneficial Ownership, Takeovers and Acquisitions by Foreign and Domestic Persons, Securities Act Release Nos. 5529 (September 9, 1974) (39 FR 41123); no-action and interpretive letters, *see e.g.*, Letter to William Gleeson, Esq. re: Methode Electronics, Inc. (December 29, 1976); and monitoring tender offer practice.

[5] Release Nos. 34-12676 (August 6, 1976) (41 FR 33004, 33005) and 34-15548 (February 15, 1979) (44 FR 9956, 9960).

Recognizing the dynamic nature of these activities, the Commission has proposed a definition which would include within its coverage at least certain of these diverse forms of transactions. The Commission has done so because it believes that in substance many of these transactions are in reality tender offers and that the public is entitled to the benefits that would flow from their specific inclusion within the provisions of the Williams Act.

In developing the proposed definition, the Commission considered the provisions and purposes of the Williams Act, its legislative history, applicable case law, enforcement actions, administrative proceedings and positions, legal commentary and past and present tender offer practice. The proposed definition does distinguish between tender offers and transactions involving open market or privately negotiated purchases. However, not all so-called open market or privately negotiated purchases are automatically exempted from the definition simply because they occur on or off the market, and certain of these programs would be defined as tender offers.[6]

In proposing a specific delineation, the Commission is aware that the scope of the definition may include transactions which others believe ought to be excluded and may exclude transactions which others believe ought to be included. While this is a necessary consequence of any definition, the Commission invites public comment as to the scope of the term and what transactions should be excluded and included. In addition, the Commission requests specific suggestions as to the appropriate methods for taking account of such transactions.

Moreove, the scope of the proposed definition reflects the Commission's long-standing position that the term "tender offer embraces" not only tender offers formally announced by communications to shareholders but also offers accomplished by other means.[7] This position is supported by the case law [8] and legal commentators.[9]

The definition in proposed Rule 14d–1(b)(1) is designed to provide guidance to members of the financial community and their advisers. The proposal is divided into two tiers which would operate independently of each other. That is, an offer is a tender offer if it meets the test in either of the two tiers.

Under the first tier, proposed Rule 14d–1(b)(1)(i), the term "tender offer" consists of four elements: (1) one or more offers to purchase or solicitations of offers to sell securities of a single class; (2) during any 45-day period;[10] (3) directed to more than 10 persons;[11] and (4) seeking the acquisition of more than 5% of the class of securities.[12]

In order to be a tender offer within the meaning of proposed Rule 14d–1(b)(1)(i), all four elements must be present. Thus, an offer to purchase more than 5% of a class of securities from nine persons within a 45 day period would not constitute a tender offer. It should be noted that a block transaction which meets the four elements would be a tender offer subject to the Williams Act unless the exception, discussed below, is applicable.

The Commission recognizes that ordinary open market purchases which are part of the "free and open auction market" [13] should not be regulated as tender offers. To say that purchases take place on the floor of a securities exchange, however, does not end the inquiry. The use of facilities of a exchange may be a mere formality to disguise what is otherwise in effect a tender offer that should be subject to the requirements of the Williams Act. While the proposal contemplates that certain open market purchasing programs meeting the four elements discussed above would be tender offers, others are excepted. The exception would be limited to offers by a broker and its customer or by a dealer at the then current market price [14] on a national securities exchange or in the over-the-counter market if in connection with such offers three conditions are present.

First, neither the person making the offers nor the broker or dealer solicits or arranges for the solicitation of any order to sell. With respect to offers at the then current market on a national securities exchange, a broker or dealer who merely talked to the specialist(s) or the persons in the crowd on the floor of the exchange would not in the Commission's view be making a solicitation as that term is used in the definition. However, if the person making the offers and/or the broker or dealer talked to persons off the floor of the exchange and/or arranged for them or their representatives to be present in the crowd on the floor to accept the offer, such conduct would in the Commission's judgement be a solicitation and the exception would not

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[6] Section 14(d)(1) of the Act provides in pertinent part:

> It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce *or of any facility of a national securities exchange* or otherwise, to make a tender offer (italics supplied).

Thus, the statute recognizes that a tender offer may be made directly or indirectly by using the facilities of a national securities exchange. For example, a special bid, *see* New York Stock Exchange Rule 391 and American Stock Exchange Rule 560, is a tender offer within the meaning of the Williams Act. See Securities Exchange Act Release No. 8392 (August 30, 1968) (33 FR 14109).

[7] Release No. 34–15548 (Feb. 5, 1979) (44 FR 9957); Release No. 34–12676 (Aug. 6, 1976) (41 FR 33004); Securities Exchange Act Release No. 8392 (Aug. 30, 1968) (33 FR 14109); Memorandum of the Securities and Exchange Commission as *Amicus Curiae, Cattlemen's Investment Co.* v. *Fears*, 343 F. Supp. 1248 (W.D. Okla. 1972). The inclusion of various forms of tender offers within the meaning of the term "tender offer" was recognized by the Commission, Securities Exchange Act Release No. 8392 (Aug. 30, 1968), and by commentators at the time of the Williams Act's passage. *See, e.g.*, O'Boyle, *The Williams Amendments (S.510) to the 1934 Act*, in Fleischer & Flom, *Texas Gulf Sulphur: Disclosure & Insiders*, 126 (1968).

[8] *See, e.g., Cattlemen's Investment Co.* v. *Fears*, 343 F. suppl 1248 (W.D. Okla. 1972); *Loews Corp.* v. *Accident & Casualty Insurance Co.*, No. 74 C 1396 (N.D. Ill. bench opinion Aug. 20, 1974); *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579 (5th Cir. 1974); *S–G Industries, Inc.* v. *Fuqua Investment Co.* [Current] CCH Fed. Sec. L. Rep. ¶96,750 (D. Mass 1978). Other cases, while not holding a transaction to be a tender offer, have recognized that the term goes beyond formal offers. *See, e.g., Nachman Corp.* v. *Halfred, Inc.*, [1973–1974 Transfer Binder] CCH Fed Sec. L. Rep. ¶94,455 (N.D. Ill. 1973); and *Kennecott Copper Corp.* v. *Curtiss-Wright Corp.*, 449 F. Supp. 951 (S.D.N.Y. 1978), *aff'd in part and rev'd in part*, [1978 Transfer Binder] CCH Fed. Sec. L. Rep. ¶96,565 (2d Cir. 1978).

[9] *See, e.g.*, Note, *The Developing Meaning of "Tender Offer" Under the Securities Exchange Act of 1934*, 86 Harv. L. Rev. 1250 (1973); and Lipton, *Open Market Purchases*, 32 Bus. Law. 1321 (1977).

[10] Offers within any 45 consecutive calendar day period would be included within this element, for example, offers to purchase made on June 1 and July 10 would be aggregated, whereas another offer made on December 1 would not be included therein.

[11] The Commission requests specific comment on the appropriate meaning of the term "person" as used in proposed Rule 14d–1(b)(1)(i), *e.g.*, whether the term should have the same meaning as in section 3(a)(9) of the Exchange Act or additionally include accounts administered by financial institutions in a manner similar to that set forth in Preliminary Note 5 to Rule 146 (17 CFR 230.146) or whether the term should have another meaning. The Commission recognizes that under certain circumstances certain persons, such as tightly knit family members, should be treated as one person with respect to the computation of the ten person limitation. The Commission requests comment on whether there is a need for a specific provision in the definition to this effect and whether other relationships should be included in such a provision.

[12] This element makes that offer itself is seeking more than 5% of the class of securities. The shares of the class beneficially owned by the offeror prior to his making the offer(s) would not be included. For example, if a person who is not the beneficial owner of any securities of a class of securities seeks to acquire 6% of such class, the elment would be satisfied. In contrast, the offer to acquire 4% of a class of securities by a person who had acquired 2% of such class more than 45 days prior to the first offer for such 4% would not come within this requirement.

[13] 113 Cong. Rec. 856 (1967) (Statement of Senator Williams).

[14] The term "then current market price" would generally refer to the higher of the last sale price or the highest current independent bid.

be available. Moreover, special bids and "assembling a block" off the floor which is then crossed on the exchange would also be viewed as solicitations. with respect to offers at the then current market price in the over-the-counter market, the mere fact that a market maker who has previously made quotes on a continuous basis in the securities being sought during the period that the offer is made should not be viewed as a solicitation by the dealer. Finally, with respect to both exchange and over-the-counter market transactions, the person making the offers to purchase will be considered to have solicited or arranged for the solicitation of sell orders if that person has, directly or indirectly, publicly announced or stated that it intends or is about to engage in a substantial purchase program.

The second condition to the availability of the exception to proposed Rule 14d–1(b)(1)(i) is that the broker or dealer performs only the customary functions of a broker or dealer. Finally, the broker or dealer can receive no more than the broker's usual and customary commission or the dealer's usual and customary mark-up for executing the trade.

If the conditions discussed above are satisfied, offers at the then current market price by a broker or dealer on a national securities exchange or in the over the counter market would be excluded for all purposes from the four elements of proposed Rule 14d–1(b)(1)(i).

As previously noted, the four elements embodied in proposed Rule 14d–1(b)(1)(i) are intended to distinguish tender offers from other transactions, including open market and privately negotiated purchases. The Commission notes that other percentage tests, time periods and numbers of solicitees have been suggested in other approaches, and specifically requests comment as to whether one of these or any other percentages test, time periods or numbers of solicitees should be included in the first tier of the definition. The Commission also requests comment on the interrelationship of the proposed exception to the four elements generally and specifically requests comment on the following questions: (1) whether the exception is necessary in Rule 14d–1(b)(1)(i) as proposed since most ordinary open market purchase programs rarely exceed 5% within a 45-day period; (2) whether the exception would be unnecessary if other elements of proposed Rule 14d–1(b)(1)(i), such as the percentage, were increased; (3) whether the exception should be retained in any event; and, (4) if so, the proper form and scope thereof. The Commission also requests specific comment on what customary practices should be included within the meaning of customer functions of a broker or dealer.

The Commission requests specific comment from the public and from members of the brokerage community in particular concerning the extent, if any, to which a broker-dealer engages in transactions during any 45-day period which involve offers to purchase or solicitations of offers to sell in excess of 5% of a single class of securities from more than 10 persons, where such offers are not on behalf of any single person or group other than such broker-dealer acting in the ordinary course of business. In connection with this inquiry, the Commission requests that commentators provide examples of any such situations together with supporting details concerning these transactions. The Commission also inquires whether it would be appropriate to except such offers from the first tier of the proposed definition.

The second tier of the definition of tender offer is set forth in proposed Rule 14d–1(b)(1)(ii). Unlike the first tier, the second tier does not contain a specific percentage test,[15] time period or number of solicitees. Under the second tier, one or more offers to purchase, or solicitations of offers to sell, securities of a single class would be a tender offer if three conditions are present. First, the offers to purchase or the solicitation of offers to sell must be disseminated in a widespread manner.[16] While this requirement could be satisfied through public announcements by means of newspaper advertisements or press releases, the absence of such announcements would not be determinative. A tender offer may be widely disseminated by other means, including telephone solicitations,[17] the use of the mails [18] and personal visits to security holders.[19]

Second, the price offered must represent a premium in excess of the greater of 5% of or $2 above the current market price [20] of the securities being sought. The third condition of the second tier is that the offers do not provide for a meaningful opportunity to negotiate the price and terms. Thus, truly negotiated purchases of securities would not be regulated as a tender offer under the second tier.[21] The Commission asks for general comment on the appropriateness of the three criteria and whether additional standards should be included.

As noted above, the two tiers of proposed Rule 14d–1(b)(1) are intended to operate independently of one another. One or more offers to purchase or solicitations of offers to sell can therefore be a tender offer under one tier of the definition even though they

[15] Proposed Rule 14d–1(b)(1)(ii) thus recognizes that offers to purchase or solicitations of offers to sell may constitute a tender offer even though the person making the offers is seeking less than 5% of the class of securities. This comports with the provisions of the Williams Act. Section 14(d)(1) is applicable to a tender offer for less than 5% of the securities of a class of securities described in that sub-section if the bidder already is the beneficial owner of more than 5% of such class or who would be the beneficial owner of more than 5% of such class upon consummation of the tender offer. Section 14(d)(8)(A) of the Act provides an exemption from section 14(d) if the acquisition of such securities together with all other acquisitions by the same person of the same class during the preceding twelve months do not exceed 2% of the class. Thus, under section 14(d)(8)(A) a tender offer for less than 2% of a class of securities described in Section 14(d)(1) would be exempt from the provisions of Section 14(d) but would be a tender offer nonetheless and would still be subject to section 14(e) of the Act. Section 14(e) is applicable to any tender offer whether or not it is made for securities of a class described in section 14(d)(1). *See, e.g., Butler Aviation Int'l Inc.* v. *Comprehensive Designers Inc.*, 307 F. Supp. 910, 914–15 (S.D.N.Y. 1969), *aff'd*, 425 F.2d 842 (2d Cir. 1970) (cause of action under Section 14(e) in an exchange tender offer, although such offers at that time were exempt from section 14(d)(1)); *Bertozzi* v. *King Louie International* 420 F. Supp. 1166 (D.R.I 1976) (issuer tender offer in a going private transaction); *Jack Smith* v. *The Newport National Bank*, 326 F. Supp. 874 (D.R.I. 1971) (tender offer for securities of a national bank); *Weeks Dredging & Contracting Inc.* v. *American Dredging Co.*, 451 F. Supp. 469 (E.D. Pa. 1978); and *A & K Railroad Materials Inc.* v. *Green Bay and Western Railroad*, 437 F. Supp. 636 (E.D. Wis. 1977) (securities of target companies were not registered pursuant to section 12 nor were the issuers of such securities subject to the periodic reporting requirements of section 15(d)). There is no percentage test in section 14(e). Therefore, section 14(e) contemplates that a transaction or transactions may be a tender offer regardless of the amount of securities being sought therein.

[16] The Commission expects that the term "widespread" would be interpreted in a manner consistent with the case law. *See Wellman* v. *Dickinson* [Current] CCH Fed. Sec. L. Rep. ¶96,918 (S.D.N.Y. 1979); *The Hoover Co.* v. *Fuqua Ind. Inc.*, Civil Action No. C79–1062 (N.D. Ohio, June 11, 1979).

[17] *See, e.g.*, Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong. 1st Sess. 107 (1967) (Testimony of Robert W. Haack) ("1967 Senate Hearings").

[18] *See, e.g., The Hoover Co.* v. *Fuqua Ind. Inc.*, Civil Action No. C79–1062 (N.D. Ohio, June 11, 1979).

[19] *See, e.g., Cattlemen's Investment Co.* v. *Fears*, 343 F. Supp. 1248 (W.D. Okla. 1972).

[20] For a description of the meaning of "current market price", *see* footnote 14, *supra*.

[21] In determining whether private negotiations are truly private or actually constitute a tender offer, the number of persons contacted by the person making the offers is of great significance. Aranow, Einhorn and Berlstein, *Developments in Tender Offers for Corporate Control* 9–10 (1977). Therefore, even though the offers may not be a tender offer under the second tier because of the provision for a meaningful opportunity to negotiate the consideration, such offers could nonetheless constitute a tender offer under the first tier of the definition if the offers were directed to more than ten persons and the other elements of proposed Rule 14d–1(b)(1)(i) are present.

would not constitute a tender offer under the other tier. In view of the complexity of securities transactions, the diverse and dynamic nature of tender offers, and the need to provide adequate protection of investors within the purposes of the Williams Act, the Commission believes that the two tier approach embodied in proposed Rule 14d–1(b) is feasible, and capable of providing guidance and certainty to practitioners and their clients and would not be unduly burdensome to prospective bidders.

The issue of what constitutes a tender offer is not limited to resolving the issues of whether privately negotiated and open market purchases can be tender offers. Another question is whether an exchange of securities pursuant to a statutory merger or consolidation which is the subject of a shareholder vote is a tender offer. The Commission believes that statutory mergers and consolidations are not tender offers within the meaning of the definition proposed for comment.[22] Under proposed Rule 14d–1(b)(1), and exchange of securities pursuant to a statutory merger or consolidation would not constitute an offer to purchase or a solicitation of an offer to sell securities. Rather, the exchange would be viewed as part of the mechanics of the merger process itself.[23] Similarly, certain repurchases of securities by corporations which are imposed by statute would not be viewed as tender offers within the meaning of proposed Rule 14d–1(b)(1). These would include purchases in court approved bankruptcy reorganizations and repurchases by a corporation of securities owned by shareholders who dissented from a proposal to eliminate mandatory preemptive rights when such obligation is imposed by statute.[24] The Commission requests specific comment on other repurchases which corporations are obligated by statute to make which should not be deemed offers to purchase within the meaning of the proposed definition.

In light of the foregoing and its experience in administering the Williams Act since 1968, the Commission proposes for comment the definition of the term "tender offer" in proposed Rule 14d–1(b)(1) pursuant to sections 3(b), 13(e), 14(d), 14(e) and 23(a) of the Exchange Act.[25] In addition, the Commission requests comment on the general issue of defining the term "tender offer" as well as approaches other than that set forth in the proposal. In this regard, the Commission requests specific comment with respect to the need for a provision which would permit transactions to be exempted by the Commission from the application of the definition as well as the scope and terms of such a provision.

As provided in Rule 14d–1(b), the adoption of which is announced in the companion release and in the revisions to that rule proposed for comment herein, the definition of the term "tender offer" in proposed Rule 14d–1(b)(1) would, if adopted in the form proposed or as revised, be applicable to sections 14(d) and 14(e) of the Exchange Act as well as the rules promulgated thereunder, including Regulations 14D and 14E.

B. Proposed Rule 14e–3: Trading in Subject Company Securities on the Basis of Material Non-Public Information.

As discussed more fully in the February release,[26] the testimony in the Senate and House Hearings on the legislation which became the Williams Act highlighted the market disruption and abusive practices associated with leaks of the intention of a bidder to make a tender offer.[27] During the hearings on the Williams Act amendments in 1970, the matter was brought to Congress attention in the context of the manner in which the Commission would implement its rulemaking authority under section 14(e).[28]

In the February release the Commission expressed serious concern about trading on the basis of material, nonpublic information leaked to the market.[29] Not only does this practice create disparities in market information[30] and market disruption,[31] but it also undermines the purposes of the Williams Act. Security holders who sell to persons with such material, nonpublic information are effectively denied the benefits of disclosure and the substantive protections provided by the Williams Act. If furnished with such information, these shareholders would be able to make an informed investment decision, which may involve deferring the sale of the securities until the actual commencement of the tender offer. On the other hand, the persons trading on such non-public information, who are usually short term investors, receive all the protections of the Williams Act. Finally, leaks may lead to the same "stampede effect"[32] which the Williams Act was designed to avert in the context of tender offers.

The Commission addresed this issue in the February release when it published for comment proposed Rule 14e–2. Paragraph (a) of that proposal applied to any person, other than a bidder, in possession of nonpublic information received directly or indirectly from a bidder that the bidder would make a tender offer for the subject company securities. Proposed Rule 14e–2(a) would have proscribed any purchase of subject company securities unless prior to the purchase the person publicly announced the information received and its source.

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[22] By taking the position, the Commission affirms the view of the Division of Corporation Finance set forth in Release No. 34–14699 (April 24, 1978) (43 FR 18163).

[23] *Accord*, Aranow and Einhorn, *Tender Offers for Corporate Control*, 76 (1973). *Cf. Dyer* v. *Eastern Trust & Banking Co.*, 336 F. Supp. 890 (D. Me. 1971). This position would be consistent with the Fifth Circuit's decision in *Smallwood* v. *Pearl Brewing Co.*, 489 F.2d 579 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974). There the Fifth Circuit found that a letter sent to shareholders of the acquired company after the merger vote constituted a tender offer. *Id.* at 596–99. Such a letter solicitation of subject company shareholders would also be a tender offer under the proposed definition.

[24] *See Leighton* v. *AT & T*, 397 F. Supp. 133 (S.D.N.Y. 1975).

[25] In the past, the Commission has found it helpful to employ various factors which are derived from case law and legal commentary. *See Securities and Exchange Commission* v. *Sun Co., reported sub. nom. Weelman* v. *Dickinson*, [Current] CCH Fed. Sec. L. Rep. ¶96,918 (S.D.N.Y. 1979); *Brascan Ltd.* v. *Edper Equities Ltd.*, [Current] CCH Fed. Sec. L. Rep. ¶96,882 (S.D.N.Y. 1979); and *Hoover Co.* v. *Fuqua Ind. Inc.*, Civil Action No. C79–1062 (N.D. Ohio, June 11, 1979). The Commission believes that, in the absence of the adoption of a specific definition such as proposed Rule 14d–1(b)(1), these factors should be applied by prospective bidders and their legal advisers during the planning stages of an acquisition program.

[26] 44 FR 9976.

[27] *See, e.g.*, 1967 Senate Hearings at 69 *et passim*.

[28] During his testimony at the Senate hearings, then Chairman Budge was asked by Senator Williams to give the committee some examples of fraudulent, deceptive or manipulative practices used in tender offers which would be prevented by the rulemaking authority to be granted to the Commission under the proposed amendment to section 14(e) of the Act. 1970 Senate Hearings at 11. In response to this specific request, a memorandum from the Commission's Division of Corporation Finance was submitted for the record. Among the "problem areas" enumerated by this memorandum which the staff proposed to deal with by rulemaking authority under section 14(e), as amended, was the situation in which

> The person who has become aware that a tender offer is to be made, or has reason to believe that such bid will be made, may fail to disclose material facts wih respect thereto to persons who sell him securities for which the tender bid is to be made.

Id. at 12.

[29] 44 FR 9976–79.

[30] The term "market information" has been described as information that affects the price of a company's securities without affecting the firm's earning power or assets. *U.S.* v. *Chiarella*, 588 F.2d 1358 (2d Cir. 1978), *Cert. granted*, 47 U.S.L.W. 3747 (U.S. May 14, 1979) (No. 78–1202).

[31] Such purchases may create an artificial demand for the subject company's stock resulting in a distortive effect on the free play of market forces envisioned by the securities laws.

[32] *Rondeau* v. *Mosinee Paper Co.*, 422 U.S. 49, 58 n. 8 (1975).

Thus, proposed Rule 14e–2(a) would have affirmed a duty of disclosure on any person other than the bidder who purchased subject company securities on the basis of only one item of material, nonpublic information—the undisclosed intention of the bidder to make a tender offer. Since no duty would have arisen under proposed Rule 14e–2(a) if the person with such knowledge refrained from trading, the proposal would have established a "disclose or abstain from trading" rule under section 14(e).

Due in part to its concern that the scope of proposed Rule 14e–2(a) was not sufficiently broad to reach other aspects of the misuse of material, nonpublic information relating to a tender offer, the Commission did not adopt the proposal. Material, nonpublic information relating to a tender is not confined to the undisclosed intention to make a tender offer. The amount and class of securities being sought, the price or range of prices being offered therefor, and the date of commencement are among the other items of information which are material to investors in the context of a prospective tender offer. There are also items of information that are material to investors in the context of an on-going tender offer as well. Included within this category, for example, are price increases, the receipt of regulatory approval, or the withdrawal of the offer. Thus, purchases or sales of subject company securities on the basis of material, nonpublic information relating to a tender offer, whether made prior to the commencement of or during a tender offer, present issues and abusive practices similar to those addressed by proposed Rule 14e–2(a).

Proposed Rule 14e–3(a) addresses this broader problem directly. The proposal would apply to any person other than a bidder who is in possession of material nonpublic information relating to a tender ("tippee") by another person if the tippee knows or has reason to believe that the information was received directly or indirectly from such other person or a person acting on behalf of such other person. Any purchases or sales of subject company securities or options to purchase or sell securities by a tippee while in possession of such material, nonpublic information would be proscribed unless prior to the purchase the person publicly announced the information received and its source.

Like proposed Rule 14e–2(a), proposed Rule 14e–3(a) would affirm a duty of disclosure on any person, other than a bidder, who purchases on the basis of material, nonpublic information obtained directly or indirectly from a bidder, such as from persons involved or consulted by the bidder in the planning, financing, preparation or execution of the tender offer. However, proposed Rule 14e–3(a) would also pertain to sales of securities under such circumstances since sales can involve the same abusive acts and practices. Moreover, since no duty to disclose would arise if a person subject to the proposal refrains from trading, the proposal, if adopted, would also establish a "disclose or abstain from trading" rule under section 14(e). As with proposed Rule 14e–2(a), the Commission does not believe that making the disclosure required by proposed Rule 14e–3(a) prior to a purchase of subject company securities would be a defense for a breach of duty owed by such person.

Proposed Rule 14e–3(a) differs in several respects from proposed Rule 14e–2(a). Since proposed Rule 14e–3(a) comprehends any material, nonpublic information relating to a tender offer, including, but not limited to, the undisclosed intention to make a tender offer, it would, unlike proposed Rule 14e–2(a), apply throughout the period from the determination [33] to make a tender offer through its termination. Proposed Rule 14e–3(a) also requires that the person in possession of material, nonpublic information know or have reason to believe that such information was obtained directly or indirectly from the person who has determined to make a tender offer or a person acting on that person's behalf. This requirement addresses the commentators' concern with respect to the difficulty under proposed Rule 14e–2(a) of separating rumors and speculation from leaks from the person making the tender or persons acting on behalf of that person. In their view, many persons would be unwilling to trade for fear that their actions would be viewed as violative of the rule, unless the problem were addressed.

[33] The Commission believes that a bidder's determination to make a tender offer may be discerned from the facts and circumstances involved. Relevant factors include, but are not limited to, consideration or a resolution by the bidder's board of directors relating to the tender offer; the formulation of the intention to make a tender offer by the bidder or the person(s) acting on behalf of the bidder; or activities which substantially facilitate the tender offer such as: a plan to make a tender offer for a specific subject company's securities; arranging financing for a tender offer; preparing or directing or authorizing the preparation of tender offer materials; and authorizing negotiations, negotiating or entering into agreements with any person to act as a dealer manager, soliciting dealer, forwarding agent or depository in connection with the tender offer.

The abuse at which proposed Rule 14e–3(a) is directed is the actual misuse of material nonpublic information relating to a tender offer. The Commission recognizes that the proposal is capable of being applied to a person which is not a natural person even though the individuals making the investment decision on behalf of such person did not know and did not have access to material, nonpublic information. This could occur, for example, where one department of a multiservice financial institution received material, nonpublic information relating to a tender while a separate and independent department of the same organization made the decision to purchase (or sell) securities of the subject company without any knowledge of or access to such information. There would have been no actual misuse of material nonpublic information, yet the institution would constitute a person which purchased (or sold) subject company securities in apparent violation of proposed Rule 14d–3(a).

The Commission requests comment on alternative ways in which the impact of proposed Rule 14e–3(a) on multiservice financial institutions might be mitigated consistently with the prevention of the abuses noted above. There are a number of approaches to the conflicts faced by multiservice financial institutions in this context, some of which are discussed below. However, the Commission emphasizes that the discussion does not include all approaches and that the inclusion or exclusion of a particular alternative is no reflection on its adequacy. Moreover, the publication for comment of proposed Rule 14e–3(b), discussed below, is intended to promote meaningful and detailed public discussion of this difficult problem and does not necessarily reflect a preferred choice by the Commission.

Prompt disclosure of material, nonpublic information is clearly the preferred approach. However, this approach is not feasible where the institution is unable to persuade the person who has determined to make or is making the tender offer to disclose the information, the disclosure by the institution would violate a confidential relationship with such person and such person has a right to withhold disclosure for a proper purpose.

The internal isolation of material, nonpublic information, the so-called "Chinese Wall," is generally the approach taken in proposed Rule 14e–3(b). Under the proposal, conduct by a person other than a natural person which would, but for the application of

proposed Rule 14e–3(b), violate proposed Rule 14e–3(a), would be deemed nonviolative if the person who otherwise would have violated proposed Rule 14e–3(a) can show that the individuals who made the investment decision on its behalf did not know and did not have access to material, non-Public information relating to the tender offer. Thus, in the above illustration, the department of the multiservice financial institution that made the decision to purchase (or sell) subject company securities without knowledge of or access to the material, nonpublic information in the possession of the other department would not be viewed as having constructively received that information. With respect to the required showing, the proposal provides that the existence of policies and procedures to ensure that material, nonpublic information will not be used in violation of proposed Rule 14e–3(a) may, depending upon the facts and circumstances, be taken into account with respect to whether the department in fact had access. This test would ensure that the reality of the situation in question, i.e., the particular facts, would govern. However, it is also an acknowledgement that prescribing an exhaustive list of criteria which are capable of being applied to all of the factual situations comprehended by the proposal is not feasible. Moreover, even if such policies and procedures were found to be relevant in a particular case, they would merely be probative of whether access to material, nonpublic information relating to a tender offer is or was regularly provided. Thus, the ultimate issue would be whether there was knowledge of or access to material, nonpublic information in the particular case.

Another approach would be to require, either alone or together with a "Chinese Wall," a restricted-list procedure, whereby the institution is precluded from investing in any security on the list for its own account as well as from making recommendations to its customers with respect to the security. Under one variant, securities would be required to be placed on the list whenever the institution received material, non-public information with respect thereto and would be removed from the list once the information becomes public. Under another variant, the securities would be placed on the list when the firm entered into a relationship which would be likely to lead to the acquisition by the institution of material, non-public information and would remain restricted until the relationship is terminated or the information disclosed. Because the restricted list serves functions in addition to the prevention of misuse of material, non-public information, such as the prevention of violations of Rule 10b–6 (§ 240.10b–6), the placement of a security on the list does not necessarily signal the existence of material, non-public information with respect to that security. However, the Commission is concerned by this possibility and therefore requests specific comment as to how inferences as to the existence and nature of material, non-public information can be avoided.

The Commission also requests specific comment as to whether the relief provided to multi-service financial institutions should distinguish between: (1) types of multi-service financial institutions, e.g., banks and broker-dealers; (2) departments within multi-service financial institutions, e.g., commercial and trust departments of a bank; or (3) activities performed by multi-service financial institutions, e.g., arbitrage and market-making. Commentators are requested to discuss the nature of and reasons for such distinctions, if any, as well as the manner in which the proposal should be revised to reflect one or more of the distinctions.

In the February release the Commission also published for comment proposed Rule 14e–2(b). That proposal would have required a bidder who knew or had reason to believe that another person had violated, or was about to violate, proposed Rule 14d–2(a) to make promptly a public announcement of appropriate information with respect to the bidder's tender offer for subject company securities. The proposal was intended to provide a reasonable assurance that the marketplace and investors would be promptly alerted by the bidder of violations of proposed Rule 14e–2(a).

The Commission continues to believe that the bidder's role is critical in preventing the misuse of material, non-public information relating to a tender offer. However, in view of the substantial problems raised by the commentators with respect to proposed Rule 14d–2(b), the Commission has determined that a different approach to the problem is more feasible. While proposed Rule 14e–2(b) attempted to deal with the effects of misuse of material non-public information, proposed Rule 14e–3(c) is designed to prevent the leaks, the source of the problem. Under proposed Rule 14e–3(c) a person who has determined to make or is making a tender offer or any person acting on behalf of such person would be prohibited from communicating material, non-public information relating to such tender offer to any other person if such person knew or had reason to believe that the other person was likely to violate proposed Rule 14e–3(a) by purchasing or selling subject company securities. However, the proviso to proposed Rule 14e–3(c) recognizes that the person who has determined to make or is making a tender offer will normally not have reason to believe that its officers, directors, employees or partners as well as persons involved in the planning, financing, preparation or execution of the tender offer are likely to violate proposed Rule 14e–3(a). Thus, the communication of material, non-public information relating to the tender offer to such persons in order to implement the tender offer will not violate proposed Rule 14e–3(c) unless the person who has determined to make or is making the tender offer has evidence indicating that these persons are likely to violate proposed Rule 14e–3(a).

The Commission's Institutional Investor Study [34] found that bidders frequently give institutions advance notice in either general or specific terms of proposed tender offers.[35] This practice and other forms of "tipping" of material, non-public information relating to a tender offer when coupled with trading on such information undermines the Williams Act. The Commission therefore believes that the prophylaxis of proposed Rule 14e–3(c) is needed to prevent such practices.

The Commission also requests specific comment as to whether the purposes described above can be achieved by an alternative approach to proposed Rule 14e–3(c). As a means reasonably designed to prevent the fraudulent, manipulative or deceptive act or practice described in proposed Rule 14e–3(a), this alternative would make it unlawful for any person who has determined to make or is making a tender offer to communicate material, nonpublic information relating to such tender offer to any person who subsequently violates proposed Rule 14e–3(a) unless the communication (A) was made to a person involved in the planning, financing, preparation or execution of such tender offer, (B) was made in the ordinary course of business and (C) was made in accordance with

[34] Institutional Investor Study Report, H.R. Doc. No. 92–64, 92d Cong., 1st Sess. (1971).

[35] *Id.* at 2773, 2828–29, 2832–33. Among the reasons given for this practice was that, if the institution established a position in the subject company's securities, the bidder could expect to purchase such securities pursuant to the forthcoming tender offer. *Id.* at 2830.

procedures established by the person who has determined to make or makes the tender offer to avoid violations of proposed Rule 14e–3(a).

C. Proposed Rule 14e–4 Equal Treatment of Security Holders

The common practice in making a tender offer is to extend the offer to all the holders of the class of the security which is the subject of the tender offer. Exceptions to this practice have been limited in nature [36] and have not been challenged by the Commission as a matter of policy.[37]

Current tender offer practice thus reflects a common understanding that implicit in the Williams Act is a requirement that a tender offer be made to all security holders. The Congressional purpose underlying the Williams Act was to require fair and equal treatment of all holders of the class of security which is the subject of a tender offer.[38] Moreover, the operation as well as the legislative history of certain substantive provisions of the Williams Act contemplate that the tender offer will be made to all holders of the class being sought. For example, the additional ten-day pro rata period provided by section 14(d)(6) upon an increase in the consideration offered was described in both the Senate and House reports as "allowing all shareholders a fair opportunity to participate in the offer." [39] The Commission has consistently endeavored to fulfill the Congressional purpose by administering the Williams Act to prevent unreasonable discrimination among holders of the class of security which is the subject of a tender offer.

It is also common tender offer practice to pay all tendering security holders the same price for their shares. This practice similarly reflects a common understanding that there is implicit in the Williams Act a requirement to pay to every security holder the highest consideration offered to any other security holder pursuant to the tender offer. This construction furthers the purposes underlying the Williams Act, particularly those of section 14(d)(7) [40] which requires that a bidder pay any increae in the condideration offered to persons who have previously tendered their shares. Section 14(d)(7) has been administered by the Commission to require equal treatment of tendering security holders.[41]

In view of the fact that a definition of the term "tender offer" is being proposed for comment, the Commission believes it is appropriate to also propose for comment rules which would codify the "offer to all" and "highest consideration" requirements discussed above. By proposing these requirements simultaneously with the proposed definition of the term "tender offer," the Commission intends to clarify the distinction between the application of the definition to a transaction and the regulatory requirements that must be observed once it is determined that a tender offer is being made. The fact that an offer is extended to less than all the holders of a class of a security or that different consideration is offered to different holders of the same class of securities or both does not mean that a tender offer has not been made. It does, however, mean that if such a transaction is found to be a tender offer under the proposed definition, the transaction would not have been made in compliance with the proposed requirements that the offer be open to all security holders and that the consideration paid to any security hold be equal to the highest consideration offered to any other security holder. These requirments, like those stated explicitly in sections 14(d)(5), 14(d)(6) and 14(d)(7), are the consequences of making a tender offer and are therefore unrelated to the determination of whether or not a tender offer has been made.

Thus, proposed Rules 14e–4(a) and (b) would, if adopted, make explicit requirements which are implicit in the Williams Act. Proposed Rule 14e–4(a) would require the consideration paid to any security holder to be equal to the highest consideration offered to any other security holder pursuant to the tender offer. With respect to an odd-lot tender offer by an issuer for securities of a class of which it is the issuer, the proviso in proposed Rule 14e–4(a) would permit the consideration paid in such tender offers to be based on a formula such as market price prevailing on the date tendered securities are received by the issuer.

The Commission requests specific comment on whether the objective of proposed Rule 14e–4(a) now expressed in terms of "highest consideration" would be better achieved by another standard such as "same consideration" [42] or "substantially the same consideration." In this context, the Consideration." In this context, the Commission invites comment on whether different forms of consideration which are substantially equivalent ought to be permitted or whether the different forms of consideration such as cash or cash and securities should be offered to all security holders.

Proposed Rule 14e–4(b) would require the tender offer to be open to all holders of the class of securities which is the subject of the tender offer. Two

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[36] *See, e.g.*, Letter to Philip McGuigan, Esq. from the Division of Corporation Finance re: Orange and Rockland Public Utilities, Inc. (October 22, 1976).

[37] *Id.*

[38] This purpose was noted by then Chairman Cohen in his testimony during the Senate hearings:

> [T]he bill is designed to eliminate conditions surrounding the offer which discriminate unfairly among those who may desire to tender their shares.

1967 Senate Hearings at 17.

> The second objective of the bill is to assure fair treatment of all shareholders who decide to accept a tender offer.

Id. at 21.

[39] 1967 Senate Report at 10; 1968 House Report at 11.

[40] The Senate and House Reports on the bill which was finally enacted describe the purpose of section 14(d)(7) as being:

> to assure fair treatment of those persons who tender their shares at the beginning of the tender period and to assure equality of treatment among all shareholders who tender their shares.

1967 Senate Report at 10; 1968 House Report at 11.

The provision which became section 14(d)(7) was first suggested by the Commission, which described the purpose as being

> to remove a purely fortuitous factor from the calculation of the amount security holders should receive for their securities by assuring them of the same price for their securities regardless of when they are taken up and to avoid the discriminating effect of paying some holders more than others, since security holders tendering their shares pursuant to a tender offer normally assure tendering security holders will receive the same price.

112 Cong. Rec. 19003, 19005 (1966) (Memorandum of the SEC to the Committee on Banking and Currency, U.S. Senate on S. 2731, 89th Cong., 1st Sess., 111 Cong. Rec. 28256 (1965)).

[41] *See, e.g.*, Letter to William Gleeson, Esq. from the Division of Corporation Finance re: Methode Electronics, Inc. (December 29, 1976).

[42] *See* Release No. 34–14234, (December 7, 1977) (42 FR 63066, 63069) which published for comment a requirement of same consideration to all security holders in the context of issuer tender offers under then proposed Rule 13e–4(b)(7).

exceptions from this latter requirement are, however, also being proposed with respect to tender offers by issuers for their own securities. The first exception would allow issuer tender offers which are limited to persons who own, of record or beneficially, an aggregate of not more than a specified number which is less than one hundered shares of such security (an "odd lot"). This exception is based on proposed Rule 13e–4(b)(7) published for comment in 1977 [43] (the "1977 proposal"). The commentators generally agreed that the odd-lot holders, as well as the issuer and its other security holders, derive financial benefits from odd-lot tender offers. Holders of odd lots are afforded an opportunity to dispose of their shares without incurring disporportionately high transaction costs. The issuer and its other security holders benefit to the extent that the elimination of odd lots reduces the expenses incurred by the issuer in servicing small shareholder accounts. Although contemplated by the 1977 proposal, the exception has been revised to specifically permit odd-lot issuer tender offers to fewer than all holders of odd-lots. Thus, the issuer is able to determine the maximum odd-lot size for which a tender offer is made. The Commission believes that the exception to permit odd-lot issuer tender offers does not unreasonably discriminate among holders of the class being sought and that, as a matter of policy, such tender offers should not generally be discouraged.

The second exception would permit issuer tender offers which are not make to officers, directors or affiliates. The exclusion of securities held by these persons would operate to reduce the proration risk to an issuer's public security holders and thus would permit them to participate in the tender offer to a greater extent. Moreover, the relationship of the persons covered by the exception to the issuer is such that their exclusion from the tender offer will generally be volitional. Accordingly, the exception is not inconsistent with the purpose of the proposal.

D. Rule 14e–5. Prohibiting purchases not made by means of a tender offer

The Commission is proposing to rescind Rule 10b–13 and to adopt in lieu thereof proposed Rule 14e–5. Rule 10b–13 currently prohibits purchases from being made otherwise than pursuant to a tender offer from the time the tender offer is publicly announced until the expiration of the offer. Proposed rule 14e–5 would prohibit any person who makes a tender offer or simultaneous tender offers [44] for one or more classes of securities issued by a single subject company from making purchases of specified securities except by means of the tender offers [45] during the period from the public announcement of certain information or, if no announcement is made, the date on which the first of the tender offers commences through the tenth business day after the termination of the last of the tender offers to expire. Thus, tender offers for more than one class of securities would be specifically permitted under the proposal so long as purchases were not made outside of the tender offer, during the specified period.

The information which must be included in a public announcement that will trigger Rule 10b–13 is similar to that found in Rule 14d–2(c). However, proposed Rule 14e–5 would prohibit purchases from being made except by means of the tender offer after the public announcement of the information specified in Rule 14d–2(d) through the tenth business day after the termination of the tender offer. By basing the prohibition on the information contained in Rule 14d–2(d), the proposal would interrelate with and augment the protections afforded by Rule 14d–2(b).

Rule 14d–2(b) provides that a bidder's public announcement through a press release, newspaper advertisement or public statement of certain material terms of a tender offer in which the consideration consists solely of cash and/or securities exempt from registration under section 3 of the Securities Act causes the bidder's tender offer to commence under section 14(d).[46] The information which will trigger Rule 14d–2(b) incudes: the identity of the bidder and the subject company; a statement of the class and amount of securities being sought; and disclosure of the price or range of prices being offered therefor. The determination that section 14(d) is applicable upon the date of such public announcement was based on the Commission's judgment that putting such information in the public domain has such a demonstrable impact on both security holders and the market as to constitute the practical commencement of the tender offer. Such public announcements cause investors to make investment decisions with respect to a tender offer on the basis of incomplete information and trigger market activity normally attendant to a tender offer, such as arbitrageur activity.

Rule 14d–2(d) does, however, permit a bidder to make a public announcement of the following information [47] with respect to a tender offer in which the consideration consists solely of cash and/or securities exempt from registration under section 3 of the Securities Act without deeming the tender offer to have commenced under Rule 14d–2(b): the identity of the bidder and the subject company; and a statement that the bidder intends to make a tender offer in the future for a class of equity securities of the subject company which statement does not specify the amount of securities of such class to be sought or the consideration to be offered therefor. While the Commission recognizes that the impact such statements on security holders and the market is not as significant as those in which the price to be offered and the amount of securities to be sought is specified, such statements do have a demonstrable impact and pose the same types of problems, albeit to a lesser extent, as the statements comprehend by Rule 14d–2(b).

In view of their lesser impact and the burden which would be imposed on bidders if such statements were deemed to constitute the commencement of the tender offer, the Commission has determined that such statements will not be viewed as commencing the tender offer. However, the Commission believes that a person who intends to make a tender offer should not be able to purchase securities after such public announcements have been made except by means of the tender offer. Requiring the person who intends to make a tender offer to cease purchasing after such an announcement is made will minimize, to the extent feasible, the abuses noted above. It will also reduce the likelihood

[43] Release No. 34–14234 (December 7, 1977) (42 FR 63066).

[44] Although the discussion will hereinafter refer to a tender offer for a single class of securities, it is equally applicable to simultaneous tender offers for more than one class of securities of a single subject company.

[45] Proposed Rule 14e–5(c) would, however, except certain purchases from the application of proposed rule 14e–5(a).

[46] Under Rule 14d–3(a) a bidder must file and transmit its Schedule 14D–1 on the date of commencement as well as publish or send or give the information required by Rule 14d–6(a) to security holders. It should be noted, however, that Rule 14d–2(b) contains an exception clause which is designed to prevent the imposition of undue burdens on a bidder and to assure the availability of security holder's rights under sections 14(d)(5) and 14(d)(6) and the rules promulgated thereunder. Under the exception clause, the tender offer would not be deemed to commence on the date of the public announcement if within five business days thereof the bidder either: (1) issues a subsequent public announcement stating that the bidder has determined not to continue with the offer; or (2) complies with the filing requirements of Rule 14d–3(a) and disseminates the disclosure required by Rule 14d–6(a) to security holders pursuant to Rule 14d–4 or otherwise. Nevertheless, in the latter case, section 14(d)(7) will apply from the date of such public announcement.

[47] The specified information is set forth in Rule 14d–2(c).

of fraudulent, deceptive or manipulative acts or practices during this period. Moreover, once the specified information has been publicly announced, the proposal removes any incentive on the part of holders of substantial blocks of securities to demand from the person making the tender offer(s) a consideration greater than or different from that currently offered to unaffiliated security holders.

The Commission specifically requests comment on whether the operation of proposed Rule 14e–5(a) should be predicated on an event other than the public announcement of the information contained in Rule 14d–2(d), such as, for example, the announcement of dissemination of the information contained in Rule 14d–2(c). The latter formulation would be consistent with existing interpretations under Rule 10b–13. In addition, the Commission requests comment on the impact which proposed Rule 14e–5(a) would have on the timing of the announcement to make a tender offer.

As noted above, proposed Rule 14e–5 also differs from Rule 10b–13 in that it would prohibit purchases for a period of ten business days after the termination of the tender offer.[48] The Commission believes that this provision may be necessary to ensure that a bidder does not take advantage of unsettled market conditions following the termination of its tender offer. The Commission specifically requests comment on whether a period of ten business days after a tender offer is sufficient to permit the impact of the offer on the market to subside before subsequent purchases can be made. Rule 13e–4(f)(6) (§ 240.13e–4(f)(6)) prohibits purchases of securities of the same class and series which are the subject of a tender offer covered by the rule during the ten business day period subsequent to the termination of the tender offer. Commentators advocating a longer period are asked to consider whether a different period should apply to tender offers which are subject to Rule 13e–4.

Paragraph (b) of proposed Rule 14e–5 specifies the securities to which the rule applies. The securities include not only those to be sought in the bidder's tender offer but also any option, warrant or right, convertible security or other security which involves a contractual right, privilege or other provision to purchase or acquire the security which is the subject of the tender offer. It should be noted, however, that a person meeting the conditions specified in paragraph (c) of proposed Rule 14e–5 may purchase any of these securities pursuant to the exercise of options, warrants or rights, the conversion of convertible securities, or the performance of agreements to purchase such securities. The specified conditions are: that the options, warrants, rights, convertible securities, or agreements were acquired or entered into prior to the time of such public announcement or pursuant to the tender offer; and that such securities or agreements and any exercise thereof are disclosed in any applicable filings under the Williams Act. If adopted, the proposal would change the practice under Rule 10b–13 which limits purchases other than pursuant to the tender offer during the specified period to the exercise of a right of conversion or exchange of another security that is immediately convertible into or exchangeable for the security which is the subject of the tender offer if the other security is owned prior to the public announcement. Specific comment is requested as to whether the expansion of the scope of purchases which are permitted to be made under proposed Rule 14e–5(c) except by means of the tender offer during the specified period is preferable to the limitation under Rule 10b–13. Comment is also requested with respect to the impact of each of these limitations on tender offer practice given the proposed change in the type of announcement that will trigger the prohibition on purchases outside of the tender offer.

Paragraphs (d) and (e) of proposed Rule 14e–5 are the same as paragraphs (c) and (d) of Rule 10b–13. Paragraph (d) would provide an exemption therefrom for purchases under specified conditions pursuant to "qualified stock options," "employee stock purchase plans," and "restricted stock options" as defined in sections 422, 423, and 424(b) of the Internal Revenue Code of 1954, as amended, respectively, as well as purchases under specified types of employee plans. Paragraph (e) would provide that the Commission may, unconditionally or on terms and conditions, exempt any transaction from the operation of the rule if the Commission finds that the exemption would not result in the use of a manipulative or deceptive device or contrivance or of a fraudulent, deceptive or manipulative act or practice within the purpose of the rule.

As proposed, Rule 14e–5 applies to certain purchases subsequent to the termination of any tender offer, whether for all or less than all of a class of securities. Specific comment is requested as to whether the regulation of post-termination purchases should distinguish between a tender offer for any or all securities and a tender offer for only a portion of the securities of a class which would result in pro ration if the offer is over subscribed. Commentators advocating such a distinction are requested to furnish the rationale therefor and to suggest appropriate treatment in each case.

General and Specific Inquiries

A. Issue Relating to Subject Companies

The Commission is becoming increasingly concerned by the effect of defensive corporate charter amendments on the interests of investors, particularly investors who are confronted with a tender offer. On October 13, 1978, the Commission authorized the Division of Corporation Finance to publish the instructions to its staff with respect to the review of proxy or information statements containing proposals relating to such amendments.[49] Since that time the Commission's staff has monitored proxy and information statements containing proposals relating to such amendments. In many instances, these defensive amendments may in part be designed to deter the making of a tender offer for companies with such provisions in their charters. In such cases, security holders of such companies would be denied the benefits of tender offers for their securities which were recognized by Congress in adopting the Williams Act.[50] Because these actions appear to be inconsistent with the protection of investors and the Congressional purpose

[48] This approach is being taken in lieu of the integration approach taken in proposed Rule 14d–8 which was published for comment in the February release. That proposal would have integrated, for purposes of section 14(d)(7) of the Exchange Act, certain purchases of subject company securities made by a bidder or its affiliates within forty business days after the termination of the bidder's tender offer. The commentators raised substantial problems with respect to both the approach taken therein as well as its operation and impact.

[49] Release No. 34–15230 (October 13, 1978) (43 FR 49863).

[50] In introducing the legislation which became the Williams Act, Senator Williams stated:

> This measure is not aimed at obstructing legitimate takeover bids. In some instances, a change in management will prove a welcome boon for shareholder and employee, and in a few severe situations it may be necessary if the company is to survive.

Cong. Rec. S443–444 (daily ed. January 18, 1967) (remarks by Senator Williams).

> I have taken extreme care with this legislation to balance the scales to protect the legitimate interests of the corporation, management and shareholders without unduly impeding cash takeover bids.

Id. at S444.

> . . . I am certain that this amendment to the Securities Exchange Act will benefit the interests of America's more than 20 million shareholders and will not serve as a device to protect an inefficient management from a legitimate takeover bid.

Id.

underlying the Williams Act, the Commission is requesting specific comment with respect to the following: (1) the impact of defensive corporate charter amendments on tender offer practice and the interests of investors in the context of tender offers; and (2) the need for and type of rulemaking action which should be taken by the Commission under the Exchange Act to address such charter and by-law amendments.

B. Issue Relating to Purchases Contrary to Statements in Schedule 13D

The Commission notes that in responding to Item 4 of Schedule 13D (§ 240.13d–101) there is often included a discussion of a number of alternative courses of action which may be taken. The Commission also notes that open market purchases are frequently made even though such discussion has not been amended prior thereto to reflect the specific intention to make such purchases. However, Rule 13d–2(a) (§ 240.13d–2(a)) requires an amendment to Schedule 13D if any material change occurs in the information set forth in the Schedule, including a change in the filing person's purposes, plans or proposals described under Item 4. While the Commission considers such purchases without a prior amendment to Item 4 to be a specific violation of Rule 13d–2(a), the Commission is also concerned about the deceptive effect such omissions may have on the market place. Therefore the Commission requests specific comment as to whether further rulemaking under section 10(b) of the Exchange Act is necessary. Specifically, such rulemaking would proscribe open market purchases by persons who have filed a Schedule 13D unless there is prior disclosure in such filing or amendments thereto specifically reflecting the intention to do so.

C. Application of Proposals to Tender Offers for Debt Securities

In addition to applying to tender offers for equity securities, the proposals published herein would be applicable to tender offers for debt securities. The Commission recognizes that certain issuer purchases of debt securities to satisfy sinking fund and other mandatory redemption requirements may constitute a tender offer within the meaning of the definition proposed for comment herein. In recognition of this and similar issues, the Commission invites specific comment as to whether or not it is necessary or appropriate in the public interest or for the protection of investors for any or all of these proposals to apply to such tender offers for debt securities, even if made to satisfy sinking fund provisions or requirements.

D. Application of Proposals to Tender Offers for Foreign Securities and Tender Offers Made in Foreign Countries or by Foreign Persons

The Commission invites specific comment with respect to the effect of the proposals published herein on: (1) tender offers by domestic persons for (a) domestic securities held in foreign countries and (b) for foreign securities held in the United States and/or foreign countries; and (2) tender offers by foreign persons for domestic and/or foreign securities held (a) in the United States or (b) in foreign countries. Specific comment is also requested as to the need for and type of exemption(s) from the proposals which might be created for such tender offers.

E. Other Inquiries

In addition to the above and the issues raised by the proposals, the Commission requests written comment on the following: (1) Whether the costs imposed on bidders, subject companies and/or others by the proposals published for comment herein outweigh their benefits to investors and the public interest; and (2) Whether any proposed rule or the proposed schedule, if adopted, would have an adverse effect on competition or would impose a burden on competition which is neither necessary nor appropriate in furthering the purposes of the Exchange Act. Comments on this inquiry should include, to the extent feasible, detailed empirical and evidentiary material in support of any conclusions, opinions or positions. Comments on this inquiry will be considered by the Commission in complying with its responsibilities under section 23(a)(2) of the Exchange Act.

In addressing the issues raised and the proposals published in this release, commentators should feel free to consider the materials accumulated in Commission File No. S7–770.

Text of Proposals

The text of the proposals is set forth below: (Attention—The text of the following proposed amendments uses ► ◄ arrows to indicate additions and [ ] brackets to indicate deletions.)

I. 17 CFR Part 240 is proposed to be amended by revising Regulation 14D (§§ 240.14d–1 through 14d–101) in the following respects:

Section 240.14d–1 is proposed to be amended to read as follows:

§ 240.14d–1 Scope of and definitions applicable to Regulations 14D and 14E.

(a) *Scope.* Regulation 14D (§§ 240.14d–1 through 240.14d–101) shall apply to any tender offer which is subject to section 14(d)(1) of the Act, including, but not limited to, any such tender offer for securities of a class described in that section which is made by an affiliate of the issuer of such class. Regulation 14E (§§ 240.14e–1 [and 240.14e–2] ►through 14e–5◄) shall apply to any tender offer for securities (other than exempted securities) unless otherwise noted therein.

(b) *Definitions.* Unless the context otherwise requires, all terms used in Regulation 14D or Regulation 14E have the same meaning as in the Act and in Rule 12b–2 (§ 240.12b–2) promulgated thereunder. In addition, for purposes of sections 14(d) and 14(e) of the Act and Regulations 14D and 14E, the following definitions apply:

►(1) The term "tender offer" includes a "request or invitation for tenders" and means one or more offers to purchase or solicitations of offers to sell securities of a single class, whether or not all or any portion of the securities sought are purchased, which

(i) During any 45-day period are directed to more than 10 persons and seek the acquisition of more than 5% of the class of securities, except that offers by a broker (and its customer) or by a dealer made on a national securities exchange at the then current market or made in the over-the-counter market at the then current market shall be excluded if in connection with such offers neither the person making the offers nor such broker or dealer solicits or arranges for the solicitation of any order to sell such securities and such broker or dealer performs only the customary functions of a broker or dealer and receives no more than the broker's usual and customary commission or the dealer's usual and customary mark-up; or

(ii) Are not otherwise a tender offer under paragraph (b)(1)(i) of this section, but which (A) are disseminated in a widespread manner, (B) provide for a price which represents a premium in excess of the greater of 5% of or $2 above the current market price and (C) do not provide for a meaningful opportunity to negotiate the price and terms.◄

[(1)]►(2)◄ The term "bidder means any person who makes a tender offer or on whose behalf a tender offer is made: *Provided, however,* That the term does not include an issuer which makes a tender offer for securities of any class of which it is the issuer;

[(2)] ►(3)◄ The term "subject company" means any issuer of securities which are sought by a bidder pursuant to a tender offer►: *Provided, however,* That, with respect to Rule 14e–3, the term includes any issuer of securities which are proposed to be sought pursuant to a tender offer by a person who has determined to make a tender offer◄;

[(3)] ►(4)◄ The term "security holders" means holders of record and beneficial owners of securities which are the subject of a tender offer;

[(4)] ►(5)◄ The term "beneficial owner" shall have the same meaning as that set forth in Rule 13d–3: *Provided, however,* That, except with respect to Rule 14d–3, Rule 14d–9(d) and Item 6 of Schedules 14D–1 and 14D–9, the term shall not include a person who does not have or share investment power or who is deemed to be a beneficial owner by virtue of Rule 13d–3(d)(1) (§ 240.13d–3(d)(1));

[(5)] ►(6)◄ The term "tender offer material" means:

(i) The bidder's formal offer, including all the material terms and conditions of the tender offer and all amendments thereto;

(ii) The related transmittal letter (whereby securities of the subject company which are sought in the tender offer may be transmitted to the bidder or its depositary) and all amendments thereto; and

(iii) Press releases, advertisements, letters and other documents published by the bidder or sent or given by the bidder to security holders which, directly or indirectly, solicit, invite or request tenders of the securities being sought in the tender offer;

[(6)] ►(7)◄ The term "executive officer" means the president, secretary, treasurer, any vice president in charge of a principal business function (such as sales, administration or finance) or any other person who performs similar policy making functions for a corporation;

[(7)] ►(8)◄ The term "business day" means any day, other than Saturday, Sunday or a federal holiday, and shall consist of the time period from 12:01 a.m. through 12:00 midnight Eastern time. In computing any time period under section 14(d)(5) or section 14(d)(6) of the Act or under Regulation 14D or Regulation 14E the date of the event which begins the running of such time period shall be included *except that* if such event occurs on other than a non-business day such period shall begin to run on and shall include the first business day thereafter; and

[(8)] ►(9)◄The term "security position listing" means, with respect to the securities of any issuer held by a registered clearing agency in the name of the clearing agency or its nominee, a list of those participants in the clearing agency on whose behalf the clearing agency holds the issuer's securities and of the participant's respective positions in such securities as of a specified date.

II. 17 CFR Part 240 is proposed to be amended by adding §§ 240.14e–3, 14e–4 and 14e–5 to Regulation 14E (§§ 240.14e–1 and 14e–2) which read as follows:

►§ 240.14e–3 Trading in subject company securities on the basis of material non-public information.

(a) It shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any person who is in possession of material, non-public information relating to a tender offer that another person has determined to make or is making and who knows or has reason to believe that such information was received directly or indirectly from such other person or a person acting on behalf of such other person, to purchase or sell, cause to be purchased or sold or arrange to purchase or sell any security or any option to purchase or sell any security of such subject company unless within a reasonable time prior to any such purchase or sale such person makes a public announcement by press release or otherwise disclosing the information received and its source.

(b) Notwithstanding paragraph (a) of this section, purchases or sales by a person other than a natural person while in possession of material, non-public information relating to a tender offer will be deemed not to be a violation of paragraph (a) if such person can show that the individuals making the investment decision on behalf of such person did not know and did not have access to such material, non-public information. The existence of policies and procedures to ensure that material, non-public information will not be used in violation of paragraph (a) of this section may, depending on the facts and circumstances, be taken into account in determining whether the individuals who made the investment decision on behalf of such person had access to material, non-public information relating to the tender offer.

(c) It shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any person who has determined to make or is making a tender offer or any person acting on behalf of that person to communicate material, non-public information relating to such tender offer to any other person if such person knows or has reason to believe such other person is likely to violate paragraph (a) of this section: *Provided, however,* That, unless such person has evidence indicating that its officers, directors, employees or partners, as the case may be, and any person involved in the planning, financing, preparation or execution of such tender offer is likely to violate paragraph (a), the communication of such information to those persons in order to implement such tender offer will not violate this provision.

§ 240.14e–4 Equal treatment of security holders.

As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act in connection with a tender offer and to ensure equal treatment of holders of securities for which a tender offer is made, no person shall make a tender offer unless:

(a) The consideration paid to any security holder is equal to the highest consideration offered to any other security holder pursuant to the tender offer: *Provided, however,* That in connection with a tender offer by an issuer for securities of a class of which it is the issuer which is made only to holders of not more than a specified number which is less than one hundred shares of such security, the terms of such tender offer may provide for the same formula for determining the consideration offered to all such holders; and

(b) The offer is open to all holders of the class of securities which is the subject of such tender offer *except that* this provision shall not prohibit the issuer from making a tender offer which is (1) limited to persons who own, of record or beneficially, an aggregate of not more than a specified number which is less than one hundred shares of such security; or (2) not made to officers, directors or affiliates of such issuer.

§ 240.14e–5 Prohibiting purchases not made by means of a tender offer.

(a) As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts or practices within the meaning of section 14(e) of the Act, no person who makes a tender offer or simultaneous tender offers for one or more classes of securities issued by a single subject company shall purchase, cause to be purchased or enter into any agreement, arrangement or understanding to purchase securities described in paragraph (b) of this section, except by means of the tender offers, during the period from the

person's public announcement of the information described in Rule 14d–2(d) or, if no such announcement is made, the date on which the first of the tender offers commences, through the tenth business day after the termination of the last of the tender offers to expire.

(b) The security referred to in paragraph (a) of this section includes:

(1) Any security of any one of the same classes of securities sought in the tender offers; and

(2) Any option, warrant, right, convertible security or other security which involves a contractual right, privilege or other provision to purchase or acquire through exercise, conversion, exchange or otherwise any security described in paragraph (b)(1) of this section.

(c) Notwithstanding paragraph (a) of this section, a person referred to in that paragraph may purchsase or cause to be purchased the securities referred in paragraph (b)(1) of this section pursuant to the exercise of options, warrants or rights, the conversion of convertible securities, or the performance of agreements to purchase such securities, subsequent to the time of the public announcement or commencement referred to in paragraph (a) of this section, if the following conditions are satisfied:

(1) Such options, warrants, rights, convertible securities, or agreements were acquired or entered into prior to the time of such public announcement or pursuant to the tender offer; and

(2) Such options, warrants, rights, convertible securities or agreements, and any exercise, conversion or performance thereof, are disclosed in either the Schedule 14D–1 or Schedule 13E–4, if applicable, or amendments to either such schedule, filed by such person and in the tender offer materials disseminated to security holders.

(d) The provisions of this section shall not apply to a purchase of a security of the same class as that which is the subject of a tender offer (or of any other security which is immediately convertible into or exchangeable for such security) if such purchase is made, by the issuer, by participating employees of the issuer or the employees of its subsidiaries, or by the trustee or other person acquiring such security for the account of such employee, pursuant to (1) a stock option plan involving only "qualified stock options," or qualifying as an "employee stock purchase plan," as those terms are defined in sections 422 and 423 of the Internal Revenue Code of 1954, as amended, or "restricted stock options" as defined in section 424(b) of the Internal Revenue Code of 1954, as amended: *Provided, however,* That for the purposes of this paragraph an option which meets all of the conditions of that section other than the date of issuance shall be deemed to be "restricted stock options"; or (2) a savings, investment, pension or other stock purchase plan providing for both (i) periodic payments (or payroll deductions) for acquisition of securities by or on behalf of participating employees and (ii) periodic purchases of the securities by participating employees, or the person acquiring them for the account of such employees.

(e) This section shall not prohibit any transaction or transactions if the Commission, upon written request or upon its own motion, exempts such transaction or transactions, either unconditionally or on specified terms or conditions, as not constituting a manipulative or deceptive device or contrivance or a fraudulent, deceptive or manipulative act or practice comprehended within the purpose of this section. ◄

[Secs. 3(b), 10(b), 13(d), 13(e), 14(d), 14(e), 23(a), 48 Stat. 882, 891, 894, 895, 901; sec. 203(a), 49 Stat. 704; sec. 8, 49 Stat. 1379; secs. 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3–5, 84 Stat. 1497; secs. 3, 18, 89 Stat. 97, 155; sec. 202, 91 Stat. 1494; 15 U.S.C. 78c(b), 78j(b), 78m(d), 78m(e), 78n(d), 78n(e), 78w(a)].

Statutory Authority

The Commission hereby proposes for comment: amendments to Regulation 14D pursuant to sections 3(b), 10(b), 13(d), 14(d), 14(e) and 23(a) of the Exchange Act; proposed Rule 14e–3 pursuant to Sections 14(e) and 23(a) of the Exchange Act; proposed Rule 14e–4 pursuant to Sections 13(e), 14(d), 14(e) and 23(a) of the Exchange Act; and Rule 14e–5 pursuant to Sections 10(b), 13(e), 14(e) and 23(a) of the Exchange Act.

By the Commission.

November 29, 1979.

George A. Fitzsimmons,

Secretary.

[FR Doc. 79–37404 Filed 12–5–79; 8:45 am]

BILLING CODE 8010–01–M

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17 CFR Part 240

[Release No. 33–6160, 34–16386, IC–10960]

Withdrawal of Rule Proposals Concerning Tender Offers.

AGENCY: Securities and Exchange Commission.

ACTION: Withdrawal of Proposals.

SUMMARY: The Commission is withdrawing two proposed rules concerning purchases of securities which are or would become the subject of a tender offer. One of the proposed rules would have integrated for certain purposes purchases of subject company securities during a period of forty business days subsequent to the termination of the tender offer. The other proposed rule dealt with the purchase of subject company securities by certain persons, including the bidder, prior to the bidder's announcement of its intention to make the tender offer. New proposals are being published for comment in a separate release which the Commission believes will deal more effectively with the abuses attendant to such purchases.

DATE: Effective December 6, 1979.

FOR FURTHER INFORMATION CONTACT: John Huber or John Granda (202–272–2589), Office of Disclosure Policy, Division of Corporation Finance, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On February 5, 1979 the Commission published for comment certain proposed rules and a related schedule pertaining to tender offers, including proposed Rules 14d–8 and 14e–2.[1]

Proposed Rule 14d–8 would have integrated, for the purpose of the "best-price rule" embodied in section 14(d)(7) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. 78a et seq., as amended by Pub. L. No. 94–29 (June 4, 1975)] certain purchases of subject company securities by a bidder or its affiliate after the termination of the bidder's tender offer. The Commission has determined to withdraw this proposal for the reasons expressed in Release No. 34–16384 (November 29, 1979) published elsewhere in this issue and is publishing for comment proposed Rule 14e–5, also discussed in that release, to address in a more effective manner the matters sought to be addressed by the proposal.

Proposed Rule 14e–2 dealt with the purchase of subject company securities by certain persons, including the bidder, prior to the bidder's announcement of its intention to make the tender offer. The Commission is withdrawing this proposal for the reasons expressed in Release No. 34–16384 (November 29, 1979) and is publishing for comment a more generic proposal, proposed Rule 14e–3, which is also discussed in that release.

By the Commission.

November 29, 1979.

George A. Fitzsimmons,

Secretary.

[FR Doc. 79–37405 Filed 12–5–79; 8:45 am]

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[1] Release No. 34–15548 (February 5, 1978) (44 FR 9956).

Federal Register

Thursday
December 6, 1979

Part III

Department of Housing and Urban Development

Office of the Assistant Secretary for Housing—Federal Housing Commissioner

Section 8 Housing Assistance Program for the Disposition of HUD-Owned Projects

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Assistant Secretary for Housing—Federal Housing Commissioner

24 CFR Part 886

[Docket No. R-79-732]

Section 8 Housing Assistance Program for the Disposition of HUD-Owned Projects

AGENCY: Department of Housing and Urban Development (HUD).

ACTION: Amended Interim Rule.

SUMMARY: This rule amends the present interim rule implementing the Section 8 Housing Assistance Program for the Disposition of HUD-Owned Projects published September 11, 1978. The present interim rule has been revised based on public comment and amended to add additional provisions covering the disposition of projects where repairs and/or rehabilitation will be accomplished by the purchaser.

DATES: Effective date: December 26, 1979. However, no outstanding sales contracts or project sales procedures past advertisement shall be required to be reopened or repeated in order to bring them into compliance with these rules.

Comments due: February 4, 1980.

ADDRESS: The Department is soliciting comments from the public prior to issuing a final rule. All written comments on this rule should refer to Docket No. R-79-732 and should be submitted to the Rules Docket Clerk Room 5218, Office of the General Counsel, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, D.C. 20410, no later than February 4, 1980. All written comments made in connection with this subpart will be available for public inspection during normal business hours at this office. All comments received will be considered by the Department in preparation of the final rule.

FOR FURTHER INFORMATION CONTACT: Mr. Robert P. Kalish, Director, Office of Multifamily Financing and Preservation, Housing, 451 Seventh Street, SW., Washington, D.C. 20410, 202-755-5730. (This is not a toll free number)

SUPPLEMENTARY INFORMATION: On September 11, 1978, an interim rulemaking was published in the **Federal Register** for public comment (43 CFR 40402). Interested parties were given until December 11, 1978 to submit written comments. The interim rule was to provide a program where HUD could sell HUD-owned projects serving low to moderate income families with Section 8 assistance in order that the projects could be maintained as a source of decent, safe, sanitary and affordable housing for low to moderate income families where a need for such housing exists. This regulation was published to supplement the already existing regulation at 24 CFR 886, Subpart B, which provides for the sale of HUD-owned projects requiring Substantial Rehabilitation with rehabilitation to be accomplished by the purchaser.

Comments were received from twelve governmental offices and organizations. All comments received with respect to the interim rule were carefully considered.

Since the publication and in consideration of the comments, the Department has decided to emphasize an approach which promotes, when and where feasible, the repair of projects by the owners after the sale, rather than the Department undertaking such actions during its ownership. It is intended that this will reduce the time projects remain in HUD's ownership. While this approach is permitted by Subpart B, and consistent with Subpart C, the Department proposes to turn the programs into a revised and expanded Subpart C. Therefore, HUD is revising and amending Subpart C and intends to rescind Subpart B when sales currently being processed under that Subpart are closed. All future sales involving Substantial Rehabilitation will be processed under the amended Subpart C.

The revised and amended interim rule is intended to provide a program which will permit HUD to dispose of projects requiring section 8 assistance in a prompt, economical manner, together with the appropriate section 8 Existing, Moderate Rehabilitation or Substantial Rehabilitation assistance funds allocated as needed in accordance with the rehabilitation accomplished and the reasonable rent test.

The Department wishes to remind the public that the regulations at 24 GFR Part 290 are the basic regulations under which disposition decisions are developed by the Department. This rule is intended to be used as one available disposition alternative when and where conditions are warranted.

The following is a summary of the comments received and the corresponding revisions, as well as additions resulting from the merger of Subparts B and C, made to the interim rule.

Change of Title of Regulations

The title of the regulations in Subpart C has been shortened to Section 8 Housing Assistance Program for the Disposition of HUD-Owned Projects.

Applicability of Regulation

Several comments were received which questioned the applicability of the rule where a great amount of rehabilitation was needed and the Section 8 Existing Fair Market Rents are insufficient to meet the reasonable rent test. The Department has amended the rule to provide for more program flexibility, to emphasize purchaser repair rather than HUD repair, and to permit increased rents. Even though repair by the purchaser is emphasized, HUD does intend to make all necessary repairs on a priority basis whenever the Department determines that there is an immediate threat to the health and safety of the tenants.

Cooperative Sales

Several comments suggested that the language in the interim rule is inconsistent with the use of Section 8 in a cooperative sale, permitted under the interim rule. Among the issues raised were restricting equity appreciation and the government's potential claim on appreciation resulting from subsidy payments. The Department is currently reviewing the issues raised as they affect the cooperative ownership of any project receiving a subsidy and thus affect other Department programs. Therefore, no changes to the interim rule are being made in this area at this time.

Eligibility of Owner Occupants

One comment was received stating that owner occupants should be eligible under this program. The statute prohibits eligibility of owner occupants. Cooperatives, however, are eligible. Owners of projects who wish to reside in the project may do so, but they could not receive Section 8 assistance while they occupy a unit.

Continued Occupancy of Over Income Tenants

One comment received suggested that the rule may cause the displacement of tenants not eligible for Section 8 by raising rents and providing incentives to owners to attract only eligible families. The Department is very interested in seeing that its disposition programs keep displacement of tenants to a minimum. This rule provides for the establishment of reasonable rents, which are the same as the market comparable rents in the basic disposition regulation of 24 CFR 290. HUD's policy is to establish market comparable rents (reasonable) during

HUD's ownership. Therefore, the rents established in selling a project are intended to be the same as during HUD ownership and overincome tenants reside in these projects more by choice than by necessity. The Department does not intent that this rule would force overincome tenants to seek other housing. The Department has determined that if overincome tenants move from a project due to the use of Section 8 or the establishment of market comparable rents (reasonable) they do so voluntarily and not as a result of the Department's action. Where the reasonable rent test requires that rents be raised, the regulations at 24 CFR 290 provide that the rent authorized may be lower if HUD determines that to be desirable to maintain the existing economic mix in the project or prevent undesirable turnover.

PHA Involvement

One commentor suggested that PHA involvement in evictions and inspections could result in jurisdictional problems between HUD, the owner, and the PHA which could adversely affect project monitoring. HUD is required by the statute to involve PHAs in programs using section 8 Existing allocations. In order to keep this program as simple and easy to administer as possible, the role of PHAs has been kept to that of monitoring evictions and performing inspections. While this may in some instances cause jurisdictional problems as suggested by the commentor, no such problems have yet occurred. For those projects located some distance from the filed office, or where the project cannot be effectively monitored by HUD, PHA monitoring may be preferred, and PHAs may be requested to provide other services normally accomplished by HUD.

Housing Quality Standards

Several commentors suggested that the Housing Quality Standards are too general in nature and should be more specific. The Housing Quality Standards used in this rule are based on the Standards adopted by the Department in the section 8 Existing Housing and Loan Management Programs, with slight variations made to reflect the purpose and scope of this program.

While some changes are being made to update and conform these standards with those currently adopted by the Department, the standards are not being altered or changed substantially for projects in need of no repairs, minor repairs, or moderate rehabilitation at the time of sale. The Department needs the flexibility provided by these broad based standards to determine, on a project by project basis, how well projects meet these standards in view of the need for low to moderate income housing in the area and its other disposition alternatives. Projects in need of Substantial Rehabilitation at the time of sale shall be rehabilitated in accordance with HUD's Minimum Design Standards for the Rehabilitation of Residential Properties.

Housing Assistance for Vacancies

One commentor suggested that when an eligible family vacates an assisted unit the owner should receive 100 percent of the contract rent for up to 90 days, rather than 80 percent for up to 60 days as provided for in the interim rule. The Department believes that the current procedure provides sufficient funds to prevent financial difficulties caused by an unexpected vacancy by an eligible family while at the same time encourages a fast rent up of the unit. If an owner complies with the HUD approved Affirmative Fair Housing Marketing Plan, and maintains an approved waiting list, in most cases the unit will not be vacant even for the 60 days for which vacancy payments are permitted. If a project requires substantial rehabilitation the owner may also be eligible for debt service payments as provided in § 886.309(g).

Term of Contract

Several commentors suggested that the 15 year maximum contract term is a serious limitation. Housing Assistance Payments Contracts for units not requiring substantial rehabilitation are limited by statute to a maximum term of 15 years. For substantial Rehabilitation projects a longer contract term is available.

Responsibilities of the Owner Unclear

One commentor suggested that the scope of owner accountability and HUD monitoring be better defined along the lines of the HUD Regulatory Agreement for insured subsidized projects. The Department believes that owner accountability is defined sufficiently to put owners on notice of their obligations. The Department wants to keep its flexibility to alter specific requirements as may be needed on a project by project basis. It must be noted that the majority of the projects sold under this program will be sold with HUD mortgage insurance or a HUD purchase money mortgage which includes use of a Regulatory Agreement, and the Department has developed specific Regulatory Agreement language for use in these sales. In addition, sales documents have been designed to assure the owner's compliance with contractual obligations after the sale. Prior to their submitting an offer to purchase, all prospective purchasers receive a copy of all documents related to the requirements under the program. Thus they should be fully aware of the requirements prior to submitting a bid.

Lease Amendments Should Note Utility Allowance

One commentor suggested that, where the family will be paying for utilities, the utilities should be noted in the lease as well as the amount of the utility allowance. The Department has made an appropriate change in Section 886.332 implementing this suggestion.

Effects on Eligible Family if Contract is Terminated

Several comments were received regarding the impact on, and input from, eligible families if HUD were to abate housing assistance payments as provided under § 886.323(e) due to the owner's failure to maintain a dwelling unit in decent, safe, and sanitary condition. This section has been revised based on the procedure in the Section 8 New Construction program which provides that HUD will exercise its rights and remedies under the contract, and for these projects possibly rescinding the sale, in order to assure that the contract units are decent, safe and sanitary and remain available to eligible families. In addition HUD will provide assistance in finding eligible families suitable units in other buildings or projects in the event assistance payments are abated. However, it is the Department's intention to work with owners, tenants, and other interested parties to the extent possible to forestall such action.

Miscellaneous Comments

Several miscellaneous comments were beyond the scope of these regulations and therefore could not be adopted herein. In some cases, a suggested change would appropriately be made to the regulations at 24 CFR Part 290. The Department considered these suggestions in its preparation of the new 24 CFR 290 regulations which were published on October 1, 1979, effective October 31, 1979. Following is a brief synopsis of these comments:

1. Subpart C does not recognize potential financial problems that may call for innovative or special purchase financing arrangements. Provisions covering the financing of the disposition of a property are found in 24 CFR 290.

2. HUD should indicate whether approved units can or cannot be counted as achievements toward meeting local Housing Assistance goals.

The question of whether or not units assisted under this program should be counted as goal achievements in an administrative decision which need not be covered in these regulations. It is the Department's current policy that these units cannot be counted toward meeting Housing Assistance goals because in the majority of projects, the Department is replacing a previous subsidy with a new one. The Department is studying the situation where new subsidized units are being added through a project's disposition.

3. Regulations should either present a relocation plan or state that tenants are eligible for benefits under the Uniform Relocation Assistance and Real Properties Acquisition Policies Act of 1970. The sale of HUD-owned projects is not subject to the Uniform Act. The Uniform Act only applies to the acquisition of real property by a State agency for a federal or federally assisted project and to resulting displacement. 24 CFR 290 provides a procedure which in some cases permits the payment of out-of-pocket moving costs where tenants are forced to be moved, and sets forth in detail the rights of tenants in occupancy in projects being sold.

4. The regulations should provide more definitive provision on the basis for determining when to dispose of a project through a public bidding and when to negotiate. These provisions are found in 24 CFR 290 and were clarified in the revised 24 CFR 290 regulations based on this comment.

5. The field office should seek comments from the local government and the PHA as part of the process leading to the decision to use Section 8 assistance and not wait until after the decision is made. The regulations at 24 CFR 290 were revised to reflect this suggestion. The decision to use section 8 in a project is the Department's decision, based on the documented analysis provided for in 24 CFR 290 which includes consideration of comments from governmental agencies. Basically, where there is a demonstrated need for section 8 assistance to protect eligible families, the regulations at 24 CFR 290 require that it, or another form of housing assistance, will be used in the disposition. Projects with tenants requiring assistance will not generally be sold without assistance. 24 CFR 290 has been amended considerably to clarify the Department's position on this matter.

6. Tenants should be notified in writing when it has been determined that they qualify for housing assistance. 24 CFR 290 is being amended to reflect this suggestion as this is a basic program determination.

7. Eligible tenants should receive advance notice of any contemplated change in rent and be given an opportunity to comment. This suggestion has not been implemented because eligible tenants are not generally affected by market rent increases as their rents are determined by family income.

8. A complete model form of lease should be provided. The Department is currently developing a model lease. When the lease is available, this regulation will be revised to incorporate that lease.

Expansion of Rule for Moderate and Substantial Rehabilitation

In order to simplify Departmental regulations and assure consistency in disposition decisions regarding the use of section 8 assistance, the Department decided to merge the programs set forth in the interim rule and the rule at 24 CFR 886, Subpart B, with the Moderate Rehabilitation program to develop one concise set of regulations under which HUD owned projects in various stages of repair could be disposed of with Section 8 assistance at appropriate rent levels.

Since Subpart C already included provisions for repairs by the purchaser, the Department has expanded Subpart C to serve as the primary mechanism for disposition with Section 8 assistance.

Following are some of the areas of the interim rule amended herein:

1. A definition for the Agreement to Enter into a Housing Assistance Payments Contract has been added.

2. A definition for decent, safe and sanitary has been added.

3. The definition of Fair Market Rent has been amended to cover projects requiring moderate, substantial rehabilitation or no rehabilitation after the sale.

4. A definition of Minimum Property Standards has been added.

5. Definitions of Moderate Rehabilitation and Substantial Rehabilitation have been added.

6. Section 886.304(b) has been amended to assure that in projects where repairs are to be accomplished by the owner, Section 8 payments may only be made for units that are made decent, safe and sanitary.

7. Section 886.306(a) has been amended to remove unnecessary language and to increase clarity.

8. Section 886.307(m) has been amended to reflect recent Departmental changes in Housing Quality Standards for Congregate Housing and Section 886.307(o) has been amended to reflect the recent Departmental addition of Energy Efficiency Standards.

9. A new Section 886.309(c) has been added to provide owners with at least 80 percent of the Contract rent for contract units not leased up to 60 days subsequent to the effective date of the contract, as long as the owner has taken and continues to take appropriate actions to fill the vacancies.

10. Section 886.309(g) has been added to permit debt service payments for substantial rehabilitation projects.

11. Section 886.310 has been amended to include provisions for Initial Contract Rents for Moderate Rehabilitation and Substantial Rehabilitation projects. In addition, because some projects are located in areas containing no private unassisted projects, and therefore there are no comparable rents in the area a provision has been added to permit comparables based on HUD-insured or HUD-subsidized projects in the area.

12. Section 886.312 has been amended for clarity and to emphasize the fact the Department intends to have owners submit a written request for rent increases on contract units based upon supportable and substantiated evidence of the need for such an increase, rather than depending on the automatic annual adjustment factor. The Fair Market Rent applicable to the project, up to the 20 percent approvable under special circumstances will serve as the ceiling for contract rents.

13. Section 886.313 has been amended to provide for the additional Federal requirements applicable under the expanded Subpart C.

14. In response to one comment received, Section 886.318 has been amended to provide for notification to families, in writing, by the owner when the family has been determined to be eligible for assistance under this Subpart, if the family has not previously been notified by HUD.

Implementation of New Sections

The Department is adding new §§ 886.331 to 886.335 to provide the additional procedures necessary to implement a program where moderate or substantial rehabilitation is required by the purchaser after the sale. These procedures are based on the procedures provided at 24 CFR 881 for Substantial Rehabilitation, and 24 CFR 882 for Moderate Rehabilitation.

Section 886.331 provides for work write-ups and cost estimates of all needed repairs. The work write-ups and cost estimates are to be made by HUD or an agent of HUD such as an Architectural and Engineering firm. An important feature of the cost estimate is the funding of the shortfall in rents on

specific dwelling units which will occur from sales closing prior to execution of the Contract. Since the rents paid by the tenants prior to the sale and prior to the effective date of the Contract do not include housing assistance payments and are, therefore, substantially less than the rent to be received by the owner after the effective date of the Contract, the cost of the shortfall caused by the owners' requirement to maintain this lower rent schedule until the effective date of the contract will be considered a rehabilitation expense, as will the cost of any temporary relocation expenses.

Section 886.332 is added which provides that in order to maintain the Department's control over the project and the owner, and to assure completion of the prompt rehabilitation of the project and implementation of the Contract, an Agreement to Enter into a Housing Assistance Payments Contract is provided similar to that in the Section 8 New Construction and Substantial Rehabilitation programs.

Sections 886.333 and 886.334 cover the owner's obligation during the rehabilitation period, at project completion, and after acceptance of the project units by the Department.

Section 886.335 covers execution of the Contract upon acceptance of the units.

The Department is also in the process of revising the definitions for the Allowance for Utilities and Other Services, Contract Rent, Gross Family Contribution, and Gross Rent. The definitions herein will be revised accordingly in the final rule.

Other Information: A Finding of Inapplicability with regard to the Environmental Impact of these rules has been prepared in accordance with the HUD's Handbook "Procedures for Protection and Enhancement of Environmental Quality." A copy of the Finding is available for inspection and copying during regular business hours in the Office of the Rules Docket Clerk, Room 5218, Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, D.C. 20410.

Based on the fact that immediate implementation of this rule will be beneficial to tenants of HUD-owned Multifamily housing projects and to program administration, and the rule consists of a compilation of procedures which have had the benefit of public comment, the Department finds that good cause exists to make this rule effective as a revised interim rule. A final rule will be published after the comments on this interim rule are received:

For the reasons described above, 24 CFR Part 886, Subpart C is amended to read as follows:

PART 886–SECTION 8 HOUSING ASSISTANCE PAYMENTS PROGRAM—SPECIAL ALLOCATIONS

Subpart C— Section 8 Housing Assistance Program for the Disposition of HUD-Owned Projects

Sec.

886.301 Purpose.
886.302 Definitions.
886.303 Allocation and Reservation of Section 8 Contract Authority and Budget Authority.
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886.314 Financial Default.
886.315 Security and Utility Deposits.
886.316 Establishment of Income Limit Schedules: 30 Percent Occupancy by Very Low-Income Families.
886.317 Establishment of Amount of Housing Assistance Payments.
886.318 Responsibilities of the Owner.
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886.324 Reexamination of Family Income, Composition, and Extent of Exceptional Medical or Other Unusual Expenses.
886.325 Overcrowded and Underoccupied Units.
886.326 Adjustment of Allowance for Utilities and Other Services.
886.327 Inapplicability of Low-Income Public Housing Model Lease and Grievance Procedures.
886.328 Termination of Tenancy.
886.329 Reduction of Number of Contract Units for Failure to Lease to Eligible Families.
886.330 Work Write-Ups and Cost Estimates.
886.331 Agreement to Enter Into Housing Assistance Payments Contract.
886.332 Rehabilitation Period.
886.333 Completion of Rehabilitation.
886.334 Execution of Housing Assistance Payments Contract.
886.335 HUD Review of Contract Compliance.

Authority: Sec. 7(d), Department of Housing and Urban Development Act (42 U.S.C. 3535(d)); sec. 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f).

Subpart C—Section 8 Housing Assistance Program for the Disposition of HUD-Owned Projects

§ 886.301 Purpose.

The purpose of this subpart is to provide for the use of section 8 housing assistance in connection with the sale of HUD-owned housing in order to increase and maintain the amount of decent, safe, and sanitary housing affordable by lower-income families, to minimize displacement of tenants, to preserve and revitalize residential neighborhoods, and to dispose of projects in a manner consistent with HUD's disposition objectives.

§ 886.302 Definitions.

Act. The United States Housing Act of 1937.

Agreement. An Agreement to Enter into a Housing Assistance Payments Contract. See Section 886.332.

Allowance for utilities and other services ("Allowance"). An amount determined or approved by HUD as an allowance for the cost of utilities (except telephone) and charges for other services payable directly by the family.

Contract. (See section 8 contract.)

Contract rent. The rent payable to the owner under the contract, including the portion of the rent payable by the family. In the case of a cooperative, the term "contract rent" means charges under the occupancy agreements between the members and the cooperative.

Decent, safe, and sanitary. Housing is decent, safe, and sanitary if the project does not need Substantial Rehabilitation at the time of the sale and the requirements of § 886.307 are met, or if the project does require Substantial Rehabilitation at the time of sale and after such rehabilitation the Minimum Design Standards for Rehabilitation for Residential Properties are met.

Eligible family ("Family"). A family (including those covered by the definition of "Family" in 24 CFR 812) which qualifies as a lower income family and meets the other requirements of the Act and this part. Lower income single persons residing in projects in need of moderate or substantial rehabilitation, who are displaced as a result of the rehabilitation, may return to occupy an assisted unit as a "Family" in accordance with 24 CFR 812. A family's eligibility for housing assistance payments continues until its gross family contribution equals the gross rent for the dwelling unit it occupies, but the termination of eligibility at such point shall not affect the family's other rights under its lease nor shall such termination preclude resumption of

section 8 assistance as a result of subsequent changes in income or other relevant circumstances during the term of the Contract.

Eligible project or project. A HUD-owned multifamily housing project (see 24 CFR 290) or HUD-owned home properties together having five or more dwelling units: (1) For which the final disposition program developed in accordance with the provisions of 24 CFR 290 involves sale with section 8 housing assistance to enable the project to be used, in whole or in part, to provide housing for lower income families, and (2) the units of which are decent, safe, and sanitary.

Fair market rent. The rent, including utilities (except telephone), ranges and refrigerators, and all maintenance, management, and other services, which is determined by HUD at least annually and published in the **Federal Register.**

(a) For units in projects which are in decent, safe and sanitary condition at sales closing, as determined by HUD, the Fair Market Rent shall be an amount that would be required to be paid in order to obtain privately owned, existing decent, safe, and sanitary rental housing of modest (non-luxury) nature with suitable amenities. Separate Fair Market Rents shall be established for dwelling units of varying sizes (number of bedrooms).

(b) For units in projects sold by HUD which are in need of moderate rehabilitation, as determined by HUD, at sales closing, and the purchaser agrees to rehabilitate the project promptly after the sale, as a condition of the sale, the Fair Market Rent shall be an amount equal to 120 percent of the amount set forth in paragraph (a) for a unit of corresponding type and size.

(c) For units in projects sold by HUD which are in need of substantial rehabilitation, as determined by HUD, at sales closing and the purchaser agrees, as a condition of the sale, to rehabilitate the project promptly after the sale, the Fair Market Rent shall be an amount that would not exceed the amount that would be required to be paid in order to obtain privately developed and owned, newly constructed rental housing of modest (non-luxury) nature with suitable amenities and sound architectural design meeting the objectives of the HUD Minimum Design Standards for Rehabilitation for Residential Properties. Separate Fair Market Rents will be established for dwelling units by various sizes (number of bedrooms) and types (e.g., elevator, row, detached, mobile homes; housing designed for the elderly or handicapped shall be a separate type for this purpose).

(d) The Fair Market Rent, minus the amount of any applicable allowance for utilities and other services payable directly by the family, shall be the maximum amount that can be approved as the contract rent, except that the maximum approvable amount may be higher or lower as provided in § 886.310 or § 886.312.

Gross family contribution. The portion of the gross rent payable by an eligible family, i.e., the difference between the amount of the housing assistance payment payable on behalf of the family and the gross rent. (See also 24 CFR 889.)

Gross rent. The contract rent plus any allowance for utilities and other services.

HCD Act. The Housing and Community Development Act of 1974.

Housing assistance payment on behalf of eligible family. The portion of the gross rent payable by or at the direction of HUD, i.e., the difference between the amount of the gross family contribution and the gross rent. (See also part 889.)

HUD. The Department of Housing and Urban Development.

Income. Income from all sources of each member of the household as determined in accordance with criteria established by HUD. (See also 24 CFR 889.)

Lease. A written agreement approved by HUD between an owner and an eligible family for leasing of a decent, safe, and sanitary dwelling unit in accordance with the applicable contract. The lease shall comply with the provisions of this subpart, including but not limited to § 886.322.

Lower income family. A family whose income does not exceed 80 percent of the median income for the area as determined by HUD with adjustments for smaller or larger families, except that HUD may establish income limits higher or lower than 80 percent on the basis of its findings that such variations are necessary because of the prevailing levels of construction costs, unusually high or low incomes, or other factors.

Minimum Design Standards for Rehabilitation for Residential Properties. See HUD Handbook 4940.4.

Moderate Rehabilitation. The rehabilitation of an eligible project involving a minimum expenditure of $1,000 per unit, excluding the cost of contract rent shortfalls during rehabilitation and temporary relocation but including its prorated share of work to be accomplished on common areas or systems, to:

(a) Upgrade the property to decent, safe and sanitary condition to comply with the Housing Quality Standards, or other standards approved by HUD, from a condition below those standards and requiring minor repairs or the curing of an accumulation of deferred maintenance (improvements being of a modest nature and other than routine maintenance); or

(b) Repair or replace major building systems or components in danger of failure.

Owner. The purchaser, under this subpart, of a HUD-owned project, including a cooperative entity.

Project account. The account established and maintained in accordance with § 886.308.

Public Housing Agency ("PHA"). Any State, county, municipality, or other governmental entity or public body (or agency or instrumentality thereof) which is authorized to engage in or assist in the development or operation of housing for low-income families.

Section 8 contract ("Contract"). A written contract between the owner of an eligible project and HUD providing housing assistance payments to the owner on behalf of eligible families pursuant to this subpart.

Substantial Rehabilitation.

(a) The improvement of a property to decent, safe, and sanitary condition and in accord with the standards of this part from a condition below these standards. Substantial Rehabilitation may vary in degree from gutting and extensive reconstruction to the cure of substantial accumulation of deferred maintenance. Cosmetic improvements alone do not qualify as Substantial Rehabilitation under this definition.

(b) Substantial Rehabilitation may also include renovation, alteration or remodeling for the conversion or adaptation of structurally sound property to the design and condition required for use under this part or the repair or replacement of major building systems or components in danger of failure.

Very low-income family. A family whose income does not exceed 50 percent of the median income for the area, as determined by HUD, with adjustments for smaller or larger families.

§ 886.303 Allocation and reservation of section 8 contract authority and budget authority.

(a) *Allocation.* The contract authority and budget authority for this program will be provided from the Headquarters reserve authority approved specifically for use in connection with the sale of eligible projects.

§ 886.304 Project eligibility criteria.

(a) *Selection of projects.* HUD shall select projects for sale with assistance

under this subpart on the basis of the final disposition programs developed and approved in accordance with part 290 and the requirements of this subpart. In the evaluation of projects, consideration shall be given to whether there are site occupants who would have to be displaced, whether the relocation of site occupants is feasible, and the degree of hardship which displacement might cause.

(b) *Projects needing repairs.* A project, which is sold subject to the condition that following sale the project will be repaired by the owner so as to become decent, safe and sanitary, will be sold with an Agreement that Section 8 assistance will be provided after the repairs are completed by the owner and the project is inspected and accepted by HUD. In these projects, Section 8 payments may be made only for project units which are determined to be decent, safe and sanitary.

(c) *High-rise elevator projects.* High-rise elevator projects for families with children will not be assisted under this subpart unless the final disposition program, prepared in accordance with 24 CFR 290 indicates that there is a need for assisted housing for families and there is no other practical alternative for providing the needed housing.

§ 886.305 PHA involvement.

HUD, as part of its mortgage servicing activities, performs most of the processing activities normally performed by a PHA in the Section 8 existing housing program. Therefore, duplicative PHA processing activities are not required; however, PHA involvement may be appropriate in some circumstances.

(a) *Invitation to authorize eviction.* The PHA with jurisdiction over the area in which the project is located shall be invited by HUD, in writing, to authorize evictions on contract units for a fee established by HUD and paid by the owner.

(b) *Invitation to perform inspections.* HUD may invite the PHA to perform inspections of contract units on a fee basis, where HUD determines that such inspections will be performed more efficiently and economically by the PHA.

(c) *Other functions.* HUD may invite the PHA to perform other functions.

(d) *PHA Party to contract.* Where the PHA is to perform any functions, the contract between HUD and the owner shall provide that the PHA shall be a party to the contract for the purpose of authorizing evictions, inspections, or for such other purposes as may be agreed upon.

§ 886.306 Notices.

Before a project is approved for sale in accordance with this subpart, and as a part of the process of preparing a disposition recommendation in accordance with 24 CFR 290, the field office manager shall:

(a) *Notify the Local Government.* Notify in writing the chief executive officer of the unit of general local government in which the project is located (or the designee of that officer) of the proposed sale with housing assistance and afford the unit of local government an opportunity to review and comment upon the proposed sale in accordance with 24 CFR 891. Local government review shall address consistency with the housing needs and strategy of the community, not strict conformance to the limitations on variations from housing assistance plan goals which are contained in part 891.

(b) *Notify PHA to participate.* Notify in writing the PHA with jurisdiction over the area in which the project is located and advise it of HUD's intention to sell the project and to enter into a contract for Section 8 assistance with the purchaser. The notification shall invite the PHA to participate in the contract as provided in § 886.305 and to respond to HUD within 30 calendar days from the date of the notification letter.

§ 886.307 Housing quality standards.

Housing used in this program not requiring substantial rehabilitation at the time of sale shall meet the performance requirements set forth in this section. In addition, the housing shall meet the acceptability criteria set forth in this section except for such variations as are approved by HUD. Local climatic conditions and geographic features and local housing and building codes are examples which may justify such variations.

(a) *Sanitary facilities.* (1) Performance requirement. The dwelling unit shall include its own sanitary facilities which are in proper operating condition, can be used in privacy, and are adequate for personal cleanliness and the disposal of human waste.

(2) *Acceptability criteria.* A flush toilet in a separate, private room, a fixed basin with hot and cold running water, and a shower or tub with hot and cold running water shall be present in the dwelling unit, all in proper operating condition. These facilities shall utilize an approved public or private disposal system.

(b) *Food preparation and refuse disposal*—(1) *Performance requirement.* The dwelling unit shall contain suitable space and equipment to store, prepare, and serve foods in a sanitary manner. There shall be adequate facilities and services for the sanitary disposal of food wastes and refuse, including facilities for temporary storage where necessary.

(2) *Acceptability criteria.* The unit shall contain the following equipment in proper operating condition: Cooking stove or range and a refrigerator of appropriate size for the unit, supplied by either the owner or the family, and a kitchen sink with hot and cold running water. The sink shall drain into an approved public or private system. Adequate space for the storage, preparation, and serving of food shall be provided. There shall be adequate facilities and services for the sanitary disposal of food wastes and refuse, including facilities for temporary storage where necessary (e.g., garbage cans).

(c) *Space and security*—(1) *Performance requirement.* The dwelling unit shall afford the family adequate space and security.

(2) *Acceptability criteria.* A living room, kitchen area, and bathroom shall be present; and the dwelling unit shall contain at least one sleeping or living/sleeping room of appropriate size for each two persons. Exterior doors and windows accessible from outside the unit shall be lockable.

(d) *Thermal environment*—(1) *Performance requirement.* The dwelling unit shall have and be capable of maintaining a thermal environment healthy for the human body.

(2) *Acceptability criteria.* The dwelling unit shall contain safe heating and/or cooling facilities which are in proper operating condition and can provide adequate heat and/or cooling to each room in the dwelling unit appropriate for the climate to assure a healthy living environment. Unvented room heaters which burn gas, oil, or kerosene are unacceptable.

(e) *Illumination and electricity*—(1) *Performance requirement.* Each room shall have adequate natural or artificial illumination to permit normal indoor activities and to support the health and safety of occupants. Sufficient electrical sources shall be provided to permit use of essential electrical appliances while assuring safety from fire.

(2) *Acceptability criteria.* Living and sleeping rooms shall include at least one window. A ceiling or wall type light fixture shall be present and working in the bathroom and kitchen area. At least two electric outlets, one of which may be an overhead light, shall be present and operable in the living area, kitchen area, and each bedroom area.

(f) *Structure and materials*—(1) *Performance requirement.* The dwelling unit shall be structurally sound so as not to pose any threat to the health and

safety of the occupants and so as to protect the occupants from the environment.

(2) *Acceptability criteria.* Ceilings, walls and floors shall not have any serious defects such as severe bulging or leaning, large holes, loose surface materials, severe buckling or noticeable movement under walking stress, missing parts or other serious damage. The roof structure shall be firm and the roof shall be weathertight. The exterior wall structure and exterior wall surface shall not have any serious defects such as serious leaning, buckling, sagging, cracks or holes, loose siding, or other serious damage. The condition and equipment of interior and exterior stairways, halls, porches, walkways, etc., shall be such as not to present a danger of tripping or falling. Elevators shall be maintained in safe and operating condition.

(i) In the case of a mobile home, the home shall be securely anchored by a tiedown device which distributes and transfers the loads imposed by the unit to appropriate ground anchors so as to resist wind overturning and sliding.

(g) *Interior air quality*—(1) *Performance requirement.* The dwelling unit shall be free of pollutants in the air at levels which threaten the health of the occupants.

(2) *Acceptability criteria.* The dwelling unit shall be free from dangerous levels of air pollution from carbon monoxide, sewer gas, fuel gas, dust, and other harmful air pollutants. Air circulation shall be adequate throughout the unit. Bathroom areas shall have at least one openable window or other adequate exhaust ventilation.

(h) *Water supply*—(1) *Performance requirement.* The water supply shall be free from contamination.

(2) *Acceptability criteria.* The unit shall be served by an approved public or private sanitary water supply.

(i) *Lead-based paint*—(1) *Performance requirement.* (i) The dwelling unit shall be in compliance with HUD lead-based paint regulations, 24 CFR 35, issued pursuant to the Lead Based Paint Poisoning Prevention Act, 42 U.S.C. 4801, and the owner shall provide a certification that the dwelling is in accordance with such HUD regulations.

(ii) If the property was constructed prior to 1950, the family upon occupancy shall have been furnished the notice required by HUD lead-based paint regulations and procedures regarding the hazards of lead-based paint poisoning, the symptoms and treatment of lead poisoning and the precautions to be taken against lead poisoning.

(2) *Acceptability criteria.* Same as performance requirement.

(j) Access—(1) *Performance requirement.* The dwelling unit shall be usable and capable of being maintained without unauthorized use of other private properties, and the building shall provide an alternate means of egress in case of fire.

(2) *Acceptability criteria.* The dwelling unit shall be usable and capable of being maintained without unauthorized use of other private properties. The building shall provide an alternate means of egress in case of fire (such as fire stairs or egress through windows).

(k) *Site and neighborhood.* Where a project is sold with an insured mortgage, the site selection criteria of the insurance program shall be utilized in lieu of the requirements and criteria in this paragraph.

(1) *Performance requirement.* The site and neighborhood shall be reasonably free from disturbing noises and vibrations and other hazards to the health, safety, and general welfare of the occupants.

(2) *Acceptability criteria.* The site and neighborhood shall not be subject to serious adverse environmental conditions, natural or manmade, such as dangerous walks, steps, instability, flooding, poor drainage, septic tank backups, sewage hazards, or mudslides; abnormal air pollution, smoke, or dust; excessive noise, vibration or vehicular traffic; excessive accumulations of trash; vermin or rodent infestation; or fire hazards.

(l) *Sanitary condition*—(1) *Performance requirement.* The unit and its equipment shall be in sanitary condition.

(2) *Acceptability criteria.* The unit and its equipment shall be free of vermin and rodent infestation.

(m) *Congregate housing.* The foregoing standards shall apply except for paragraph (b) of this section and the requirement in paragraph (c)(2) of this section for a kitchen area. In addition, the following standards shall apply:

(1) The unit shall contain and have ready access to a flush toilet which can be used in privacy, a fixed basin with hot and cold running water, and a shower and/or tub equipped with hot and cold running water all in proper operating condition and adequate for personal cleanliness and the disposal of human wastes. These facilities shall utilize an approved public or private disposal system, and shall be sufficient in number so that they need not be shared by more than four occupants. Those units accommodating physically handicapped occupants with wheelchairs or other special equipment shall provide access to all sanitary facilities, and shall provide, as appropriate to needs of the occupants, basins and toilets of appropriate height; grab bars to toilets, showers and/or bathtubs; shower seats; and adequate space for movement.

(2) The unit shall contain suitable space to store, prepare and serve foods in a sanitary manner. A cooking stove or range, a refrigerator(s) of appropriate size and in sufficient quantity for the number of occupants, and a kitchen sink with hot and cold running water shall be present in proper operating condition. The sink shall drain into an approved private or public system. Adequate space for the storage, preparation and serving of food shall be provided. There shall be adequate facilities and services for the sanitary disposal of food wastes and refuse, including facilities for temporary storage where necessary (e.g., garbage cans).

(3) The dwelling unit shall afford the Family adequate space and security. A living room, kitchen, dining area, bathroom, and other appropriate social and/or recreational community space shall be within the unit and the dwelling unit shall contain at least one sleeping room of appropriate size for each two persons. Exterior doors and windows accessible from outside each unit shall be capable of being locked. An emergency exit plan shall be developed and occupants shall be apprised of the details of the plan. Regular fire inspections shall be conducted by appropriate local officials. Readily accessible first aid supplies and fire extinguishers shall be provided throughout the unit, smoke detectors shall be provided and emergency phone numbers (police, ambulance, fire department, etc.) shall be available at every phone and individual copies shall be provided to each occupant. All emergency and safety features and procedures shall meet applicable State and local standards.

(n) *Independent group residence.* The foregoing standards shall apply except for paragraphs (a), (b), (c), (k), and (m) of this section. In addition, Section 882.109(n) shall apply.

(o) *Energy Efficiency—Performance Requirement.* Appropriate energy conserving improvements such as insulation, weatherstripping and caulking must be accomplished by HUD or the purchaser as part of any rehabilitation under this Subpart. In addition, energy conserving improvements such as storm doors and windows must be considered by HUD and accomplished by HUD or the purchaser provided that these

improvements are determined by HUD to be cost-effective. See 24 CFR Part 39.

§ 886.308 Maximum total annual contract commitment.

(a) *Number of units assisted.* Based on the final disposition program developed in accordance with 24 CFR 290, HUD shall determine the number of units to be assisted up to 100 percent of the units in the project.

(b) *Maximum assistance.* The maximum total annual housing assistance payments that may be committed under the contract shall be the total of the gross rents for all the contract units in the project.

(c) *Changes in contract amounts.* In order to assure that housing assistance payments will be increased on a timely basis to cover increases in contract rents, changes in family composition, or decreases in family incomes:

(1) A project account shall be established and maintained, in an amount as determined by HUD consistent with section 8(c)(6) of the Act, out of amounts by which the maximum annual contract commitment per year exceeds amounts paid under the contract for any fiscal year. This account shall be established and maintained by HUD as a specifically identified and segregated account, and payment shall be made therefrom only for the purposes of: (i) Housing assistance payments, and (ii) other costs specifically authorized or approved by HUD.

(2) Whenever a HUD-approved estimate of required housing assistance payments for a fiscal year exceeds the maximum annual contract commitment, causing the amount in the project account to be less than an amount equal to 40 percent of the maximum annual contract commitment, HUD, within a reasonable period of time, shall take such additional steps authorized by section 8(c)(6) of the Act as may be necessary to carry out this assurance, including (as provided in that section of the Act) "the reservation of annual contributions authority for the purpose of amending housing assistance contracts or the allocation of a portion of new authorizations for the purpose of amending housing assistance contracts."

§ 886.309 Housing assistance payments to owners.

(a) *Payments for eligible families.* Housing assistance payments shall be paid for units under lease by eligible families, in accordance with the contract and as provided in this section. These housing assistance payments will cover the difference between the contract rent and the portion of said rent payable by the family as determined in accordance with the HUD-established schedules and criteria. (See 24 CFR 889.) Where the gross family contribution is less than the allowance for utilities and other services, the owner, on behalf of HUD, shall pay the difference to the family.

(b) *No assistance for owners.* No section 8 assistance may be provided for any unit occupied by an owner. However, cooperatives are considered rental housing rather than owner-occupied housing under this subpart.

(c) *Payments for vacancies from execution of contract to initial occupancy.* If a Contract unit which is decent, safe and sanitary and has been accepted by HUD as available as of the effective date of the Contract is not leased within 15 days of the effective date of the Contract, the Owner will be entitled to housing assistance payments in the amount of 80 percent of the Contract Rent for the unit for a vacancy period not exceeding 60 days from the effective date of the Contract provided that the Owner (1) has submitted a list of units leased as of the effective date and a list of the units not so leased; (2) 60 days prior to the completion of the rehabilitation or the date the agreement was executed, whichever is later, had notified the PHA of any units which the owner anticipated would be vacant on the anticipated effective date of the contract; (3) has taken and continues to take all feasible actions to fill the vacancy including, but not limited to: contracting applicants on the Owner's waiting list, if any, requesting the PHA and other appropriate sources to refer eligible applicants, and advertising the availability of the units in a manner specifically designed to reach low-income families; and (4) has not rejected any eligible applicant except for good cause acceptable to HUD.

(d) *Payments for vacancies after initial occupancy.* If an eligible family vacates its unit (other than as a result of action by the Owner which is in violation of the Lease or the Contract or any applicable law), the owner may receive housing assistance payments for so much of the month in which the Family vacates the unit as the unit remains vacant. Should the unit remain vacant, the Owner may receive from HUD a housing assistance payment in the amount of 80 percent of Contract Rent for a vacancy period not exceeding an additional month. However, if the owner collects any of the family's share of the rent for this period, the payment must be reduced to an amount which, when added to the family's payments, does not exceed 80 percent of the Contract Rent. Any such excess shall be reimbursed by the Owner to HUD or as HUD may direct. (See also § 886.315.) The owner shall not be entitled to any payment under this paragraph unless he or she: (1) Immediately upon learning of the vacancy, has notified HUD of the vacancy or prospective vacancy and the reasons for the vacancy, and (2) has made and continues to make a good faith effort to fill the vacancy, including but not limited to, contacting applicants on the waiting list, if any, requesting the PHA and other appropriate sources to refer eligible applicants, and advertising the availability of the unit, and (3) has not rejected any eligible applicant, except for good cause acceptable to HUD.

(e) *Payments for units where family is evicted.* If the owner evicts a family, the owner shall not be entitled to any payments pursuant to paragraph (d) of this Section unless the request for such payment is supported by a certification that the provisions of § 886.328 have been followed.

(f) *Prohibition for double compensation for vacancies.* The owner shall not be entitled to housing assistance payments with respect to vacant units under this section to the extent he or she is entitled to payments from other sources (for example, payments for losses of rental income incurred for holding units vacant for relocatees pursuant to title I of the HCD Act or payments under § 886.315).

(g) *Debt service payments for substantially rehabilitated projects.* (1) If a contract unit continues to be vacant after the 60-day period specified in paragraph (c) or (d) of this section, the Owner may submit a claim and receive additional housing assistance payments on a semiannual basis with respect to such a vacant unit in an amount equal to the principal and interest payments required to amortize the portion of the debt attributable to that unit for the period of the vacancy, whether such vacancy commenced during rent-up or after rent-up.

(2) Additional payments under this paragraph (g) for any unit shall not be for more than 12 months for any vacancy period, and shall be made only if:

(i) The unit is not in a project insured under the National Housing Act except pursuant to section 244 of that Act.

(ii) The unit was in decent, safe, and sanitary condition during the vacancy period for which payments are claimed.

(iii) The owner has taken and is continuing to take the actions specified in paragraphs (c)(1), (2) and (3) or paragraphs (d)(1) and (2) of this section, as appropriate.

(iv) The Owner has demonstrated in connection with the semiannual claim on a form and in accordance with the standards prescribed by HUD with respect to the period of the vacancy, that the project is not providing the Owner with revenues at least equal to the project costs incurred by the Owner, and that the amount of the payments requested is not in excess of that portion of the deficiency which is attributable to the vacant units for the period of the vacancies.

(v) The Owner has submitted, in connection with the semiannual claim, a statement with relevant supporting evidence that there is a reasonable prospect that the project can achieve financial soundness within a reasonable time. The statement shall indicate the causes of the deficiency; the corrective steps that have been and will be taken; and the time by which it is expected that the project revenues will at least equal project costs without the additional payments provided under this paragraph.

(3) HUD may deny any claim for additional payments or suspend or terminate payments if it determines that based on the Owner's statement and other evidence, there is not a reasonable prospect that the project can achieve financial soundness within a reasonable time.

§ 886.310 Initial contract rents.

(a) *Reasonable rent determination.* The HUD-determined contract Rents for Contracts Units in the project shall not exceed rents which are reasonable (comparable, see 24 CFR 290) for the location, quality, amenities, facilities, and management and maintenance services in relation to the rents paid for comparable units, nor shall the contract rents exceed the rents charged by the owner to unassisted families for comparable units. If comparable units in the private sector do not exist in the general neighborhood of the project, then HUD-insured or HUD-subsidized projects may be used as comparables. HUD shall maintain for 3 years all relevant documentation under this pargraph.

(b) *Fair Market Rent limitation.* The sum of the contract rent plus an allowance for utilities and other services (where utilities and other services are not included in the contract rent) shall be determined by HUD. This sum shall not exceed the sum of the published section 8 fair market rents, as defined in § 886.302, for contract units in the project, except that the fair market rents may be exceeded by up to 20 percent where the field office manager determines that special circumstances warrant such higher rents, and such higher rents meet the test of reasonableness in paragraph (a) of this section.

§ 886.311 Term of contract.

The contract term for any unit shall be one of the following:

(a) If the project units require no rehabilitation or moderate rehabilitation, the term shall be 15 years.

(b) If the project units require substantial rehabilitation, the term shall not exceed 30 years, except that the term shall not exceed 20 years in the case of a project financed with assistance of a loan made by or insured, guaranteed or intended for purchase by HUD. Notwithstanding the preceding sentence, in the case of a project financed by a loan or loan guarantee from a State or local agency, the term may not exceed 40 years.

§ 886.312 Rent adjustments.

(a) *Limits.* Housing assistance payments will be made in amounts commensurate with contract rent adjustments under this paragraph, up to the maximum amount authorized under the contract. (See § 886.308.)

(b) *Annual adjustments.* The contract rents may be adjusted annually, at HUD's option, either (1) on the basis of a written request for a rent increase submitted by the owner and properly supported by substantiating evidence, or (2) by applying, on each anniversary date of the contract, the applicable automatic annual adjustment factor most recently published by HUD in the Federal Register. If HUD requires that the owner submit a written request, HUD within a reasonable time shall approve a rental schedule that is necessary to compensate for any increase occurring since the last approved rental schedule in taxes (other than income taxes) and operating and maintenance costs over which owners have no effective control, or shall deny the increase stating the reasons therefor. Increases in taxes and maintenance and operating costs shall be measured against levels of such expenses in comparable assisted and unassisted housing in the area to ensure that adjustments in the contract rents shall not result in material differences between the rents charged for assisted and comparable unassisted units. Contract rents may be adjusted upward or downward as may be appropriate; however, in no case shall the adjusted rents be less than the contract rents on the effective date of the contract, provided there was no fraud or mistake adverse to the Department's interest in determining the initial contract rent.

(c) *Special adjustments.* Special adjustments in the contract rents shall be requested in writing by the owner and may be authorized by HUD to the extent HUD determines such adjustments are necessary to reflect increases in the actual and necessary expenses of owning and maintaining the contract units which have resulted from substantial general increases in real property taxes, utility rates or similar costs (i.e., assessments and utilities not covered be regulated rates) which are not adequately compensated for by the adjustment authorized by paragraph (b) of this section.

(d) *Comparability between assisted and unassisted units.* Notwithstanding any other provisions of this subpart, adjustments as provided in this section shall not result in material differences between the rents charged for assisted and comparable unassisted units, as determined by HUD: Provided, however, That this limitation shall not be construed to prohibit differences in rents between assisted and comparable unassisted units to the extent that such differences may have existed with respect to the initial contract rents assuming no fraud or mistake adverse to the Department's interest.

(e) *Addendums to contract and leases.* Any adjustment in contract rents shall be incorporated into the contract and leases by dated addendums to the contract and leases establishing the effective date of the adjustment.

§ 886.313 Other Federal requirements.

Participation in this program requires:

(a) Compliance with (1) title VI of the Civil Rights Act of 1964, title VIII of the Civil Rights Act of 1968, Executive Orders 11063 and 11246, and section 3 of the Housing and Urban Development Act of 1968, and (2) all rules, regulations, and requirements issued pursuant thereto.

(b) Submission of an approvable Affirmative Fair Housing Marketing Plan.

(c) For projects where rehabilitation is to be completed by or at the direction of the owner, compliance with:

(1) The Clean Air Act and Federal Water Pollution Control Act;

(2) Where the property contains nine or more units to be assisted, prevailing wages must be paid for all rehabilitation work performed and other Davis-Bacon Act requirements must be met and the Labor Standards Provisions contained in the following Acts must be met:

(i) Contract Work Hours and Safety Standards Act.

(ii) Copeland Anti-Kickback Act; and

(iii) National Apprenticeship Act.

(3) Section 504 of the Rehabilitation Act of 1973;

(4) The National Historic Preservation Act (Pub. L. 89–665);

(5) The Archeological and Historic Preservation Act of 1974 (Pub. L. 93–291);

(6) Executive Order 11593 on Protection and Enhancement of the Cultural Environment, including the procedures prescribed by the Advisory Council on Historic Preservation at 36 CFR Part 800;

(7) The National Environmental Policy Act of 1969;

(8) The Flood Disaster Protection Act of 1973;

(9) Executive Order 11988, Flood Plains Management;

(10) Executive Order 11990, Protection of Wetlands.

§ 886.314 Financial default.

In the event of a financial default under the project mortgage, HUD shall have the right to make subsequent housing assistance payments to the mortgagee until such time as the default is cured, or until some other time agreeable to the mortgagee and approved by HUD.

§ 886.315 Security and utility deposits.

(a) *Amount of deposits.* If at the time of the initial execution of the Lease the Owner wishes to collect a security deposit, the maximum amount shall be the greater of one month's Gross Family Contribution or $50. However, this amount shall not exceed the maximum amount allowable under State or local law. For units leased in place, security deposits collected prior to the execution of a Contract which are in excess of this maximum amount do not have to be refunded until the Family is expected to pay security deposits and utility deposits from its resources and/or other public or private sources.

(b) *When a Family vacates.* If a Family vacates the unit, the Owner, subject to State and local law, may use the security deposit as reimbursement for any unpaid Family Contribution or other amount which the Family owes under the Lease. If a Family vacates the unit owing no rent or other amount under the Lease consistent with State or local law or if such amount is less than the amount of the security deposit, the Owner shall refund the full amount or the unused balance to the Family.

(c) *Interest payable on deposits.* In those jurisdictions where interest is payable by the Owner on security deposits, the refunded amount shall include the amount of interest payable. The Owner shall comply with all State and local laws regarding interest payments on security deposits.

(d) *Insufficient deposits.* If the security deposit is insufficient to reimburse the Owner for the unpaid Family Contribution or other amounts which the Family owes under the Lease, or if the Owner did not collect a security deposit, the Owner may claim reimbursement from HUD for an amount not to exceed the lesser of: (1) The amount owed the Owner, (2) two months' Contract Rent, minus, in either case, the greater of the security deposit actually collected or the amount of security deposit the owner could have collected under the program (pursuant to paragraph (a) of this section). Any reimbursement under this section must be applied first toward any unpaid Family Contribution due under the Lease and then to any other amounts owed. No reimbursement shall be claimed for unpaid rent for the period after the family vacates.

§ 886.316 Establishment of income limit schedules: 30 percent occupancy by very low-income families.

(a) *HUD-Established income limits.* HUD will establish schedules of income limits for determining whether families qualify as lower income families and very low-income families.

(b) *Preference to Low-Income Families.* During initial occupancy under a contract pursuant to this Subpart, the owner, in filling vacancies for contract units, shall give preference to very low-income families until at least 30 percent of the contract units are occupied by such families. Thereafter, the owner shall exercise his or her best efforts to maintain at least 30 percent occupancy of contract units by very low-income families.

§ 886.317 Establishment of amount of housing assistance payments.

The amount of the housing assistance payment on behalf of an eligible family shall be determined in accordance with 24 CFR 889. Where an allowance is established for utilities required to be supplied by the family, and the allowance exceeds the gross family contribution, the owner shall pay to the family each month an amount equal to the difference between the applicable utility allowance and the gross family contribution.

§ 886.318 Responsibilities of the owner.

(a) *Management and maintenance.* The owner shall be responsible for the management and maintenance of the project in accordance with requirements established by HUD. These responsibilities shall include but not be limited to:

(1) Payment for utilities and services (unless paid directly by the family), insurance and taxes;

(2) Performance of all ordinary and extraordinary maintenance;

(3) Performance of all management functions including the taking of applications, selection of families in accordance with the owner's tenant selection factors approved by HUD, verification of income and other pertinent requirements, and determination of eligibility and amount of family contribution in accordance with HUD-established schedules and criteria;

(4) Collection of family rents;

(5) Preparation and furnishing of information required under the contract;

(6) Reexamination of family income, composition and extent of exceptional medical or other unusual expenses, and redeterminations, as appropriate, of the amount of family contribution and amount of housing assistance payment in accordance with HUD-established schedules and criteria;

(7) Redeterminations of the amount of family contribution and the amount of housing assistance payment in accordance with HUD-established schedules and criteria as a result of an adjustment by HUD of any applicable allowance for utilities and other services;

(8) Notifying families in writing when they are determined to be qualified for assistance under this subpart where they have not already been notified by HUD prior to sale;

(9) Reviewing at least annually the allowance for utilities and other services;

(10) Compliance with equal opportunity requirements; and

(11) Compliance with Federal requirements set forth in § 886.313(c).

(b) *Contracting for Services.* Subject to HUD approval, any owner may contract with any private or public entity to perform for a fee the services required by paragraph (a) of this section: Provided, That such contract shall not shift any of the owner's responsibilities or obligations.

(c) *HUD review.* The owner shall permit HUD to review and audit the management and maintenance of the project at any time.

§ 886.319 Responsibility for contract administration.

HUD is responsible for administration of the contract.

§ 886.320 Default under the contract.

The contract shall contain a provision to the effect that if HUD determines that the owner is in default under the contract, HUD shall notify the owner of the actions required to be taken to cure the default and of the remedies to be applied by HUD including recovery of overpayments, where appropriate, and that if the owner fails to cure the default within a reasonable time as determined by HUD, HUD has the right to terminate the contract or to take other corrective action, including recission of the sale. When contract termination is under consideration by HUD, HUD shall give eligible families an opportunity to submit written and other comments. Where the project is sold under the arrangement that involves a regulatory agreement between HUD and the owner, a default under the regulatory agreement shall be treated as default under the contract.

§ 886.321 Marketing.

(a) *Marketing in accordance with HUD-Approved Plan.* Marketing of units and selection of families by the owner shall be in accordance with the owner's HUD-approved Affirmative Fair Housing Marketing Plan, HUD-approved tenant selection factors and with all regulations relating to fair housing advertising including use of the equal opportunity logotype, statement, and slogan in all advertising. Projects shall be managed and operated without regard to race, color, creed, religion, sex, or national origin.

(b)(1) HUD shall determine the eligibility for assistance of families in occupancy prior to sales closing. The owner shall be responsible for determination of eligibility of applicants for tenancy after sale, selection of families from among those determined to be eligible, and computation of the amount of housing assistance payments on behalf of each selected family, in accordance with the gross rent and the gross family contribution computed in accordance with 24 CFR 889. Where an allowance is established for utilities required to be supplied by the family and the allowance exceeds the gross family contribution, the owner shall pay to each family each month an amount equal to the difference between the applicable utility allowance and the gross family contribution. Local residency requirements are prohibited. Local residency preferences are discouraged and may be applied in selecting tenants only to the extent that they are not inconsistent with affirmative fair housing marketing objectives and the owner's HUD-approved Affirmative Fair Housing Marketing Plan. With respect to any residency preferences, persons expected to reside in the community as a result of current or planned employment will be treated as residents.

(2) For every family that applies for admission, the owner and the applicant shall complete and sign the form of application prescribed by HUD. When the owner decides to no longer accept applications, the owner shall publish a notice to that effect in a publication likely to be read by potential applicants. The notice shall state the reasons for the owner's refusal to accept additional applications. When the owner agrees to accept applications again, a notice to this effect shall also be published. The owner shall retain copies of all completed applications together with any related correspondence for 3 years. For each family selected for admission, the owner shall submit one copy of the completed and signed application to HUD. Housing assistance payments will not be made on behalf of an admitted family until after this copy has been received by HUD.

(3) If the owner determines that the applicant is eligible on the basis of income and family composition and is otherwise acceptable but the owner does not have a suitable unit to offer, the owner shall place such family on the waiting list and so advise the family indicating approximately when a unit may be available.

(4) If the owner determines that the applicant is eligible on the basis of income and family composition and is otherwise acceptable in accordance with the HUD approved tenant selection factors and if the owner has a suitable unit, the owner and the family shall enter into a lease. The lease shall be on a form approved by HUD and shall otherwise be in conformity with the provisions of this subpart.

(5) Records on applicant families and approved families shall be maintained by the owner so as to provide HUD with racial, ethnic, and gender data and shall be retained by the owner for 3 years.

(6) If the owner determines that an applicant is not eligible, or if eligible, not selected, the owner shall notify the applicant in writing of the determination, the reasons upon which the determination is made, and inform the applicant that the applicant has the right within a reasonable time (specified in the letter) to request an informal hearing if the applicant believes that the owner's determination is based on erroneous information. The procedures of this subparagraph do not preclude the applicant from exercising his/her other rights if he/she believes he/she is being discriminated against on the basis of race, color, creed, religion, sex, national origin, or because of a handicap. The owner shall retain for 3 years a copy of the application, the letter, the applicant's response, if any, the record of any informal hearing, and a statement of final disposition.

(c) *Initial occupancy.* (1) Where moderate or substantial rehabilitation is involved, sixty days prior to the completion of the rehabilitation, or when the rehabilitation is begun, whichever is later, the Owner shall determine whether the tenant population of the project generally reflects the racial/ethnic makeup of the housing market area. Based on this determination, the Owner shall then conduct appropriate marketing activities in accordance with a HUD-approved Affirmative Fair Housing Marketing Plan. Such activities may include special outreach to those groups identified as not ordinarily expected to apply for these units without special outreach; notification to PHA's in the housing market area of any anticipated vacancies; and formulation of waiting lists based on the Owner's HUD-approved tenant selection factors.

(2) Where a PHA is notified, the PHA shall notify an appropriate size family (families) on its waiting list of the availability of the unit and refer the family (families) to the owner. (Since the Owner is responsible for tenant selection, the owner is not required to lease to a PHA selected family, but the owner must comply with § 886.321(b)(6).)

§ 886.322 Lease requirements.

The lease shall contain all required provisions specified in paragraph (b) of this section and none of the prohibited provisions listed in paragraph (c) of this section. It also shall reflect the requirements of § 886.328 and shall otherwise conform to a form of lease approved by HUD.

(a) The term of the lease shall be for not less than 1 year. The lease may, or in the case of a lease of a term of more than one year must, contain a provision permitting termination on 30 days advance written notice by the family.

(b) *Required provisions.* The lease between the owner and the family shall contain the following provisions:

Addendum to lease. The following additional lease provisions are incorporated in full in the lease between ———— (owner) and ———— (family) for the following dwelling unit: ————. In case of any conflict between these and any other provisions of the lease, these provisions shall prevail.

1. The total rent shall be $—— per month.

2. Of the total rent, $—— shall be payable by or at the direction of the Department of

Housing and Urban Development ("HUD") as housing assistance payments on behalf of the family and $—— shall be payable by the family. These amounts shall be subject to change by reason of changes in the family's income, composition, or extent of exceptional medical or other unusual expenses, in accordance with HUD-established schedules and criteria; or by reason of adjustment by HUD of any applicable allowance for utilities and other services. Any such change shall be effective as of the date stated in a notification to the family.

3. The owner shall not discriminate against the family in the provision of services, or in any other manner, on the grounds of race, color, creed, religion, sex, or national origin.

4. The family agrees to notify the owner of a change in family composition, and further agrees to transfer to an appropriate size dwelling unit based on family composition upon appropriate notice by the owner that such a dwelling unit is available within the project.

5. The owner shall provide the following utilities, services, and maintenance: (Information to be inserted by owner). The family is responsible for the payment of the following utility bill(s) ————. (To be used only when appropriate).

6. The owner shall not evict the family unless the owner complies with the requirements of local law, if any, and of HUD regulations. The owner shall give the family a written notice of the proposed eviction, stating the grounds and advising the family that it has 15 days (or such greater number, if any, that may be required) within which to respond to the owner.

7. Because the owner must obtain HUD's authorization for an eviction, a copy of the notice shall be furnished simultaneously to HUD. The notice shall also state that the family may, within the same time period, present objections in writing or in person to HUD. HUD shall forthwith examine the grounds for eviction and shall authorize the eviction unless it finds the grounds to be insufficient under the lease. HUD shall make a good faith effort to notify the owner and the family of its determination within 30 calendar days of the date of the notice to the family whether or not the family has presented objections to HUD.

(c) *When PHA Is Party to the contract.* Where a PHA is a party to the contract between HUD and the owner, the PHA shall assume the responsibilities of HUD under (b)(7) of this section. The PHA shall be entitled to a fee to be paid by the owner as provided in the contract for each proposed eviction action submitted by the owner and reviewed by the PHA.

(d) *Excluded clauses.* Lease clauses which as determined by HUD fall within the classification listed below shall not be included in any lease.

(1) *Confession of judgment.* Consent by the family to be sued, to admit guilt, or to accept without question any judgment favoring the owner in a lawsuit brought in connection with the lease.

(2) *Seize or hold property for rent or other charges.* Authorization to the owner to take property of the family and/or hold it until the family meets any obligation which the owner has determined the family has failed to perform.

(3) *Exculpatory clause.* Prior agreement by the family not to hold the owner or its agents legally responsible for acts done improperly or for failure to act when it was required to do so.

(4) *Waiver of legal notice.* Agreement by the family that the owner need not give any notices in connection with (i) a lawsuit against the family for eviction, money damages, or other purpose, or (ii) any other action affecting the family's rights under the lease.

(5) *Waiver of legal proceedings.* Agreement by the family to allow eviction without a court determination.

(6) *Waiver of jury trial.* Authorization to the owner's lawyer to give up the family's right to trial by jury.

(7) *Waiver of right to appeal court decision.* Authorization to the owner's lawyer to give up the family's right to appeal a decision on the ground of judicial error or to give up the family's right to sue to prevent a judgment from being put into effect.

(8) *Family chargeable with cost of legal actions regardless of outcome of lawsuit.* Agreement by the family to pay lawyer's fees or other legal costs whenever the owner decides to sue the family, whether or not the family wins.

§ 886.323 Maintenance, operation, and inspections.

(a) *Maintain decent, safe, and sanitary housing.* The owner shall maintain and operate the project so as to provide decent, safe, and sanitary housing and the owner shall provide all the services, maintenance, and utilities which he or she agrees to provide under the contract and the lease. Failure to do so shall be considered a material default under the contract and Regulatory Agreement, if any.

(b) *HUD inspection.* Prior to execution of the contract, HUD shall inspect (or cause to be inspected) each proposed contract unit and related facilities to ensure that they are in decent, safe, and sanitary condition.

(c) *Owner and family inspection.* Prior to occupancy of any vacant until by a family, the owner and the family shall inspect the unit and both shall certify that they have inspected the unit and have determined it to be decent, safe, and sanitary. Copies of these reports shall be kept on file by the owner for at least 3 years.

(d) *Annual inspections.* HUD will inspect the project (or cause it to be inspected) at least annually and at such other times as HUD may determine to be necessary to assure that the owner is meeting his or her obligation to maintain the units and the related facilities in decent, safe, and sanitary condition and to provide the agreed-upon utilities and other services. HUD will take into account complaints by occupants and any other information coming to its attention in scheduling inspections and shall notify the owner and the family of its determination regarding the condition of the units.

(e) *Failure to maintain decent, safe, and sanitary units.* If HUD notifies the owner that he/she has failed to maintain a dwelling unit in decent, safe, and sanitary condition, and the owner fails to take corrective action within the time prescribed in the notice, HUD may exercise any of its rights or remedies under the contract, or Regulatory Agreement, if any, including abatement of housing assistance payments (even if the family continues to occupy the unit) and rescission of the sale. If, however, the family wishes to be rehoused in another dwelling unit, HUD shall provide assistance in finding such a unit for the family.

§ 886.324 Reexamination of family income, composition, and extent of exceptional medical or other unusual expenses.

(a) *Reexamination of family income.* Reexamination of family income, composition, and the extent of medical or other unusual expenses incurred by the family shall be notice by the owner or HUD that such a dwelling unit is available. Such a family shall have priority over a family on the owner's waiting list seeking the same size unit.

(b) *Change in family composition, owner's responsibilities.* Upon receipt by the owner of a notification by the family of a change in the family size, the owner agrees to offer the family a suitable unit as soon as one becomes vacant and ready for occupancy. If the owner does not have any suitable units or if no vacancy of a suitable unit occurs within a reasonable time, HUD may assist the family in finding a suitable dwelling unit and require the family to move to such unit as soon as possible.

(c) *HUD actions if appropriate size unit is not made available.* If the owner fails to offer the family a unit appropriate for the size of the family when such unit becomes vacant and ready for occupancy, HUD may abate housing assistance payments to the owner for the unit occupied by the family and assist the family in finding a suitable dwelling unit elsewhere.

§ 886.326 Adjustment of allowance for utilities and other services.

HUD shall determine, as part of its annual inspection and at such other times as it deems appropriate, whether an adjustment is required in the allowance for utilities and other services applicable to the dwelling units in the project on grounds of changes in utility rates or other change of general applicability to all units in the project. If HUD determines that an adjustment should be made, HUD shall prescribe the amount of the adjustment and direct the owner to make a corresponding adjustment promptly in the amount of rent to be paid by the affected families and the amount of housing assistance payment.

§ 886.327 Inapplicability of low-income public housing model lease and grievance procedures.

Model lease and grievance procedures established by HUD for PHA-owned low-income public housing are applicable only to PHA-owned projects operated under section 8 commitments pursuant to this subpart.

§ 886.328 Termination of tenancy.

(a) *Applicability.* The provisions of 24 CFR 450 as modified by this section, apply to all decisions by an Owner to terminate the tenancy of a Family residing in a unit under Contract during or at the end of the Family's lease term.

(b) *Entitlement of Families to Occupancy* (1) *General.* The Owner may not terminate any tenancy except upon the following grounds: (i) Material noncompliance with the lease; (ii) Material failure to carry out obligations under any State landlord and tenant act, or (iii) Other good cause, which may include the refusal of a Family to accept a HUD-approved modified lease form (see paragraph (d) of this section). No termination by an Owner will be valid to the extend it is based upon a lease or a provision of State law permitting termination of a tenancy solely because of expiration of an initial or subsequent renewal term. All terminations must also be in accordance with the provisions of any State and local landlord tenant law and paragraph (c) of this section.

(2) *Notice of good cause.* The conduct of a tenant cannot be deemed "other good cause" under paragraph (b)(1)(iii) of this section unless the Owner has given the Family prior notice that the grounds constitute a basis for termination of tenancy. The notice must be served on the Family in the same manner as that provided for termination notices under State and local law.

(3) *Material noncompliance.* The term material noncompliance with the lease includes (i) one or more substantial violations of the lease or (ii) repeated minor violations of the lease which disrupt the livability of the building, adversely affect the health or safety of any person or the right of any tenant to the quiet enjoyment of the leased premises and related facilities, interfere with the management of the building or have an adverse financial effect on the building. Nonpayment of rent or any other financial obligation due under the lease (including any portion thereof) beyond any grace period permitted under State law will constitute a material noncompliance with the lease. The payment of rent or any other financial obligation due under the lease after the due date but within the grace period permitted under State law will constitute a minor violation.

(c) *Termination notice.* (1) The Owner must give the Family a written notice of any proposed termination of tenancy, stating the grounds and that the tenancy is terminated on a specified date and advising the Family that it has 15 calendar days (or such greater time, if any, that may be required by law) within which to respond to the Owner. This notice shall also state that the family may, within the same time period, present its objections to HUD in writing or in person. The owner shall include in this notice the name, address, and telephone number of the appropriate HUD (or PHA) official to whom the family should respond.

(2) When a termination notice is issued for other good cause (paragraph (b)(1)(iii) of this section), the notice will be effective, and it will so state, at the end of a term and in accordance with the termination provisions of the lease, but in no case earlier than 30 days after receipt by the Family of the notice. Where the termination notice is based on material noncompliance with the lease or material failure to carry out obligations under a State landlord and tenant act pursuant to paragraph (b)(1)(i) or (ii) of this section, the time of service must be in accord with the lease and State law.

(3) In any judicial action instituted to evict the Family, the Owner may not rely on any grounds which are different from the reasons set forth in the notice. The owner must obtain HUD's authorization for an eviction; accordingly a copy of the notice must be furnished simultaneously to HUD and HUD must determine that the proposed termination is being performed in accordance with the procedures required in this section.

(i) If the family resides in a unit which is not a moderately or substantially rehabilitated unit, but a unit which is under contract, HUD shall forthwith examine the grounds for the termination and shall authorize the termination unless it finds the grounds to be insufficient under the lease. HUD shall make a good faith effort to notify the owner and the family of its determination within 30 days of the date of notice to the family, whether or not the family has presented objections to HUD.

(ii) Where the PHA is a party to the contract between the owner and HUD for the purpose of authorizing evictions, the PHA shall assume the responsibilities of HUD under paragraph (b) of this section. In this situation a copy of the notice of the proposed eviction shall be sent to the PHA. The PHA shall be entitled to a fee as provided in the contract for each proposed eviction action submitted by the owner and reviewed by the PHA.

(d) *Modification of lease form.* The Owner may, with the prior written approval of HUD, modify the terms and conditions of the lease effective at the end of the initial term or a successive term, by serving an appropriate notice on the Family, together with the offer of a revised lease or an addendum revising the existing lease. This notice and offer must be received by the Family at least 30 days prior to the last date on which the Family has the right to terminate the tenancy without being bound by the modified terms and conditions. The Family may accept the modified terms and conditions by executing the offered revised lease or addendum, or may reject the modified terms and conditions by giving the Owner written notice in accordance with the lease that he/she intends to terminate the tenancy. Any increase in rent must in all cases be governed by this Subpart and other applicable HUD regulations.

(e) *Continued assistance.* Should the Family be evicted in accordance with this section, HUD will have no obligation to continue assistance to the Family.

§ 886.329 Reduction of number of contract units for failure to lease to eligible families.

(a) *Reductions after initial six months.* If at any time, beginning 6 months after the effective date of the contract, the owner fails for a continuous period of 6 months to have all of the contract units leased or available for leasing by eligible families, HUD may on 30 calendar days notice reduce the number of contract units to not less than the number of contract

units under lease, plus 10 percent of such number if the number is 10 or more, rounded to the next highest number. Failure by the owner to make a reasonable effort to lease the contract units to eligible families shall be considered a material default under the contract.

(b) *Amending the contract.* HUD may agree to an amendment of the contract, as appropriate, to provide for subsequent restoration of any reduction made pursuant to paragraph (a) of this section if HUD determines that the restoration is justified as a result of changes in demand and in the light of the owner's record of compliance with his or her obligations under the contract and if annual contributions contract and budget authority are available; and HUD may take such steps authorized by Section 8(c)(6) of the Act as may be necessary to carry out this assurance.

§ 886.330 Work write-ups and cost estimates.

(a) *HUD preparation of work write-up.* A work write-up, including plans and specifications, if needed, will be made by HUD specifying the rehabilitation necessary to make the project units decent, safe, and sanitary and/or to prevent the imminent failure of major building systems or components (e.g., roofs, foundations, electrical system, plumbing system).

(b) *HUD specifies deficiencies and corrective action.* The work write-up will specify deficiencies noted by HUD and describe the manner in which the deficiencies are to be corrected, including minimum acceptable levels of workmanship and materials.

(c) *HUD preparation of cost estimates.* HUD shall perform or cause to be performed a cost estimate to complete these repairs. The cost of any necessary relocation, as determined by HUD as being necessary to expedite the rehabilitation and the estimated cost to the owner of maintaining project rents at the Section 8 level, as required by HUD prior to execution of the Contract, plus other costs allowable by HUD will be included in the cost estimate. The work write-up and cost estimate shall become part of the disposition package and will be used in determining the sales price of the project.

§ 886.331 Agreement to enter into housing assistance payments contract.

(a) *Execution of agreement.* At the sales closing and prior to the Owner's commencement of any rehabilitation under this subpart, HUD will enter into an Agreement with the Owner which contains the following:

(1) A statement that the Owner agrees to rehabilitate the project unit(s) to make the unit(s) decent, safe, and sanitary in accordance with the work write-up and cost estimates provided under this subpart.

(2) A date by which rehabilitation will have commenced and a deadline date by which the rehabilitated project unit(s) will be completed and ready for occupancy. The Agreement may provide for staged rehabilitation, occupancy, and payments under the contract.

(3) The Contract Rent which will be paid to the Owner once rehabilitation is completed, the Contract is executed, and the unit(s) is/are occupied by an eligible family.

(4) A date for final inspection of the unit(s) by HUD and the owner shall be specified. This date shall be as soon as possible after the deadline date specified pursuant to paragraph (a)(2) of this section.

(5) The term of the contract.

(b) *Agreement part of sales contract.* The Agreement will be prepared by HUD and incorporated into the Contract of Sale and Purchase. The Agreement shall include all required information in paragraph (a) of this section and a statement specifying the Owner's responsibility for making relocation payments to Families temporarily displaced.

§ 886.332 Rehabilitation period.

(a) *Immediate start of rehabilitation after sales closing.* After the execution of the Agreement and the sales closing, the owner shall immediately proceed with the rehabilitation work as provided in the Agreement. In the event the work is not immediately commenced, diligently continued, and/or completed by the deadline date stated on the Agreement, HUD will have the right, upon written notification to the owner, to rescind the Agreement and the sale, or take other appropriate action.

(b) *Extensions.* Although extensions of time may be granted by HUD upon a written request from the owner stating the grounds for the extension, no increases in Contract Rents shall be granted for delays.

(c) *Changes.* (1) The Owner must submit to HUD for approval any changes from the work specified in the Agreement which would materially reduce or alter the Owner's obligations or the quality or amenities of the project. HUD may condition its approval of such changes on a reduction of the Contract Rents. If changes are made without prior HUD approval, HUD will have the right to take action consistent with the purpose of this Subpart, including action intended to preclude the owner from benefiting from a change in the work specified without HUD approval. HUD action shall include but is not limited to reducing the Contract Rents, requiring the owner to remedy the deficiency, or rescission of the Contract of Sale with reimbursement to the owner for the HUD determined reasonable cost of work items completed by the Owner and acceptable to HUD.

(2) Contract Rents for moderate or substantial rehabilitation project units shall not be increased except in accordance with this subpart. Should an increase in Contract Rents be necessitated by changes in local codes or ordinances or other unanticipated changes in work items which could not have been anticipated by HUD, an increase will only be approved if HUD approval is obtained prior to incorporation of any changes in the project.

§ 886.333 Completion of rehabilitation.

(a) *Notification of completion.* The owner must notify HUD in writing when work is completed and submit to HUD the evidence of completion and cost certifications described in paragraph (b) and (c) of this section.

(b) *Evidence of completion.* Completion of the project must be evidenced by furnishing HUD with the following:

(1) A certificate of occupancy and/or other official approvals necessary for occupancy as required by the locality.

(2) A certification by the owner that:

(i) The project unit(s) has been completed in accordance with the requirements of the Agreement;

(ii) The project unit(s) is/are decent, safe, and sanitary;

(iii) The project unit(s) has/have been rehabilitated in accordance with the applicable zoning, building, housing and other codes, ordinances or regulations, as modified by any waivers obtained from the appropriate officials;

(iv) The project was treated and is in compliance with applicable HUD Lead Based Paint regulations (24 CFR Part 35) and if the project was constructed prior to 1950, each Family will or has received the notice required by HUD Lead Based Paint regulations and procedures regarding the hazards of lead based paint poisoning, and that records showing receipt of such notice by each Family shall be maintained;

(v) If applicable, the owner has complied with the provisions of the Agreement relating to the payment of not less than prevailing wage rates and that to the best of the owner's knowledge and belief there are no claims of underpayment in alleged violation of said provisions of the

Agreement. In the event there are any such pending claims to the knowledge of the owner of HUD, the owner shall be required to place a sufficient amount in escrow, as determined by HUD, to assure such payments;

(vi) There are no defects or deficiencies in the project except for ordinary punchlist items, or incomplete work awaiting seasonal opportunity such as landscaping and heating system test (such excepted items to be specified); and

(vii) There has been no change in the evidence of management capability or in the proposed management program (if one was required) specified in the approved purchase proposal other than changes approved in writing by HUD in accordance with the Agreement.

(c) *Actual cost and interest rate certifications.* The Owner must provide HUD with statements of the actual costs, including the interest rate incurred for the rehabilitation, Contract Rent shortfalls, and any relocation approved by HUD. The owner shall certify that these are the actual costs. HUD shall review and approve these costs subject to post audit.

(d) *Review and inspections.* (1) Within fifteen working days of the receipt of the evidence of completion, and the owner's certification of costs, HUD shall review the evidence of completion for compliance with paragraphs (b) and (c) of this section.

(2) Within the same time period, a HUD representative shall inspect the unit(s), both assisted and unassisted.

(i) If the units required moderate rehabilitation, the inspection shall determine whether the unit(s) have been completed in accordance with the Housing Quality Standards with HUD approved modifications.

(ii) If the units required substantial rehabilitation, the inspection shall be in a manner sufficient to enable the inspector to report that he/she has inspected the observable elements and features of the project unit(s) in accordance with professional standards of care and judgment and that, on the basis of the inspection, the project has been completed in accordance with the Agreement and that there are no observable conditions inconsistent with the evidence of completion, including the certifications of the Owner.

(e) If the inspection discloses defects or deficiencies, the inspector shall report these with sufficient detail and information for purposes of paragraphs (g)(1) and (2) of this section.

(f) *Acceptance.* If HUD determines from the review and inspection that the project has been completed in accordance with the Agreement, the project shall be accepted.

(g) *Acceptance where defects or deficiencies reported.* If the projects unit(s) are not acceptable under paragraph (f), the following shall apply: (1) If the only defects or deficiencies are punchlist items or incomplete items awaiting seasonal opportunity, the project may be accepted and the contract executed. If the owner fails to complete the items within a reasonable time to the satisfaction of HUD, HUD may, upon 30 days notice to the owner terminate the contract and/or exercise its other rights thereunder, including rescission of the sale.

(2) If the defects or deficiencies are other than punchlist items or incomplete work awaiting seasonal opportunity, HUD shall determine whether and to what extent the defects or deficiencies can be corrected, what corrections are essential to permit HUD to accept the project, whether and to what extent a reduction of Contract Rents will be required as a condition to acceptance of the project, and the extension of time required for the remaining work to be done. The owner shall be notified of HUD's determinations and, if the owner agrees to comply with the conditions, an addendum to the Agreement shall be entered into, specifying the remaining work, pursuant to which the defects or deficiencies will be corrected and the unit(s) then accepted. If the owner is unwilling to enter into such an addendum or fails to perform under the addendum, the units will not be accepted and appropriate remedies will be sought by HUD. Paragraphs (a), (b), (c), (d), (e), (f), and (g) will apply when the remaining work is completed satisfactorily.

(h) *Notification of non-acceptance.* If HUD determines that, based on the review of the evidence of completion and inspection, the unit(s) cannot be accepted, the Owner must be promptly notified of this decision and the reasons and steps shall be taken immediately to rescind the sale, or such other action deemed appropriate by HUD.

§ 886.334 Execution of housing assistance payments contract.

(a) *Time of execution.* Upon acceptance of the unit(s) by HUD pursuant to § 886.333(f), the contract will be executed first by the Owner and then by HUD. The effective date must be no earlier than the HUD inspection which provides the basis for unconditional acceptance.

(b) *Changes in initial contract rents during rehabilitation.* (1) The Contract Rents established pursuant to § 886.310 and 24 CFR 290 will be the Contract Rents on the effective date of the Contract except under the following circumstances:

(i) When, during rehabilitation, work items are discovered which (A) could not reasonably have been anticipated by HUD or are necessitated by a change in local codes or ordinances, and (B) were not listed in the work write-up prepared by HUD but are deemed by HUD, in writing, to be necessary work, and (C) will require additional expenditures which would make the rehabilitation infeasible at the Contract Rents established in the Agreement. Under these circumstances, HUD will:

(A) Approve a change order to the rehabilitation contract, or amend the work write-up if there is no rehabilitation contract, specifying the additional work to be accomplished and the additional cost for this work,

(B) Recompute the Contract Rents, within the limits specified in paragraph (b)(4) of this section, based upon the revised cost estimate, and

(C) Prepare and execute an amendment to the Agreement stating the additional work required and the revised Contract Rents.

(ii) When the actual cost of the rehabilitation performed is less than that estimated in the calculation of Contract Rents for the Agreement.

(iii) When the actual certified relocation payments made by the Owner to temporarily relocated Families varies from the cost estimated by HUD.

(2) Should changes occur as specified in paragraph (b)(1)(ii) or (iii) (either an increase or decrease), HUD may recalculate the Contract Rents and amend the Contract or Agreement, as appropriate, to reflect the revised rents. The rents shall not be recalculated based on increased costs to maintain rents at the Section 8 level during the rehabilitation period.

(3) HUD must review and approve the Owner's certification that the rehabilitation costs and relocation costs are the actual costs incurred.

(4) In establishing the revised Contract Rents, HUD must determine that the resulting Gross Rents do not exceed the Fair Market Rent or the exception rent provided in § 886.310 in effect at the time of execution of the Agreement.

(c) *Unleased unit(s).* At the time the contract is executed, HUD will provide a list of dwelling unit(s) leased as of the effective date of the Contract and a list of the unit(s) not so leased, if any, and shall determine whether or not the owner has met the obligations with respect to any unleased unit(s) and for which of those unit(s) vacancy payments will be made by HUD. The

owner must indicate in writing either concurrence with this determination or disagreement reserving all rights to claim vacancy payments for the unleased unit(s) pursuant to the contract, without prejudice by reason of the owner's signing the contract.

§ 886.335 HUD review of agreement and contract compliance.

HUD will review project operations at such intervals as it deems necessary to ensure that the owner is in full compliance with the terms and conditions of the contract, Regulatory Agreement, and Agreement to Enter into a Housing Assistance Contract, if any. The equal opportunity review may be conducted with the scheduled HUD review or at any time deemed appropriate by HUD.

Issued at Washington, D.C., October 30, 1979.

Morton A. Baruch,

Deputy Assistant Secretary for Housing—Federal Housing Commissioner.

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