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Target Corporation Disclosure of Soft Information in Tender Offer Contests

Kenneth M. Tallering

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NOTES
TARGET CORPORATION DISCLOSURE OF SOFT INFORMATION IN TENDER OFFER CONTESTS

Introduction

During a tender offer contest, shareholders must decide whether to tender their shares to the offeror. To make an informed decision disclosure is necessary. Current law places very few disclosure requirements on the tender offer target corporation, which possesses much of the information the investor needs. This information is often "soft information." Soft information includes projections, appraisals and other hypothetical, non-verifiable information. While disclosure of such information is not specifically required by statute, if soft information is "material" it must be disclosed by the target to avoid liability under the anti-fraud provisions of both the Williams Act and the Securities Exchange Act of 1934 (1934 Act). The courts must therefore determine when soft information is "material." The Third and Sixth Circuits have proposed standards for determining when soft information is "material" in tender offer contests. Although proposing standards is a constructive step, flaws in the proposed standards are apparent. Part I of this Note examines these standards and their shortcomings. Part II balances the potential utility of soft information with its potential harm and proceeds to propose standards.

I. Current Disclosure Requirements and Their Shortcomings

A. Types of Tender Offers

The amount and type of disclosure necessary to protect investors depends on the situation creating the need for disclosure. This Note examines the tender offer and the disclosure requirements of the target during the contest. Three types of tender offers can be distinguished: cash, exchange (for securities of the offeror) and hybrid (part cash and part securities of the offeror). Within each category, another distinction must be made. Some offers seek all the shares stockholders would be willing to tender at a given price while others seek only a specific percentage of the

1. See infra note 46 and accompanying text.
2. See infra notes 50-51 and accompanying text.
5. See infra notes 49, 51 and accompanying text.
6. See infra notes 61-75 and accompanying text.

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outstanding shares. These distinctions will later be discussed with regard to the disclosure requirement of both the target and the offeror.

A shareholder may respond to a tender offer in one of three ways. He may sell to the offeror, sell on the market (arbitrage) or hold the shares. If the shareholder opts to hold the shares, the nature of his holdings becomes dependent on the success of the offer. If successful, the shareholder owns part of the offeror company; if not, the shareholder retains his ownership in the target.

B. Current Disclosure Requirements

The goal of the Williams Act, which governs tender offer disclosure, is similar to that of the other securities acts—investor protection. The Supreme Court has stated that the “sole purpose of the Williams Act [is] the protection of investors who are confronted with a tender offer.” The goal is to be accomplished by “full and fair disclosure” to shareholders. Congress also adopted a policy of neutrality between the target and the offeror in the tender offer contest.

The Williams Act imposes two disclosure requirements on the target. First, the target must mail to shareholders or publish a statement stating its position with regard to the offer within ten days after the commencement of the offer. The target may recommend acceptance or rejection of the offer, remain neutral (expressing no opinion) or state that it is unable to take a position. The second requirement compels the target to file a statement with the Securities and Exchange Commission (SEC) “as soon as practicable” after the recommendation letter is sent giving reasons for the target’s recommendation and any other information necessary to prevent the target’s disclosure from being misleading.
C. Disclosure by Whom and for Whom

Courts must determine whether these requirements provide adequate investor protection. This determination depends on who should be disclosing and for whose benefit. The only parties on whom disclosure requirements could be placed are those with access to material information. Parties possessing this information include the target and the offeror and may also include brokers, analysts or financial newspapers.\(^2\) The information available from brokers, analysts and financial newspapers "will often be derived from that prepared or held by the offeror or the management."\(^2\) It is therefore more appropriate that the original sources, the target and the offeror, disclose the information.\(^3\)

The second issue, who should be the intended beneficiary of disclosure, is more difficult to resolve. Traditionally, the SEC's disclosure policy has focused on protecting unsophisticated investors.\(^2\) Unsophisticated investors, however, are at one end of the spectrum of investor sophistication. At the other extreme are analysts who study the disclosure and use independent investigation for verification. Sophisticated investors and professional advisors fall somewhere between these extremes.\(^2\) This spectrum of sophistication leads to three approaches to disclosure.

Disclosure may be directed toward the protection of the unsophisticated investor by ensuring that an amateur can understand all that is disclosed.\(^2\) This approach, historically adopted by the SEC\(^2\) and the courts,\(^2\) has protected investors yet has precluded disclosure of much valuable information, often soft information, because some amateurs

\(^{21}\) See Note, A Proposal for Affirmative Disclosure by Target Management During Tender Offers, 75 Colum. L. Rev. 190, 190-91 & n.6 (1975) [hereinafter cited as Affirmative Disclosure].

\(^{22}\) Id. at 191. Another reason that brokers should not be subject to disclosure requirements is that brokers have a potential conflict of interest that might bias their disclosure. A broker effectively receives triple commission if a shareholder tenders through him. Double commission is often paid on the actual tendering and commission is also charged when reinvesting the money. This creates a "significant conflict of interests between the broker and its client." Id.

\(^{23}\) See id.


\(^{26}\) See Fiflis, supra note 24, at 105.

\(^{27}\) See supra note 24.

\(^{28}\) See Asset Appraisals, supra note 24, at 700 & n.127 (the courts implicitly based their fear of misinterpretation by investors on the model of the unsophisticated investor); see, e.g., Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1294 (2d Cir. 1973) (one reason for the SEC's policy against disclosure of asset appraisals is its concern that investors would overestimate their value); Union Pac. R.R. v. North W. Ry., 226 F. Supp. 400, 409 (N.D. Ill. 1964) ("Predictions, estimates, and opinions are more elusive and may present grav[e] dangers of misleading the investing public.").
A disclosure scheme might also seek to protect unsophisticated investors by disclosure targeted at the sophisticated professional who in turn is expected to filter the information to the unsophisticated investor. This approach would tolerate disclosure of much more soft information because “sophisticates can themselves weigh its relevance against its reliability.” Proponents of this approach overlook the goal of disclosure—investor protection. The unsophisticated investor receives only second-hand information tainted by the views and sales interest of the professional. Under this approach, it is likely that such an investor will be deprived of an opportunity to take advantage of undervalued stock. The “efficient capital market hypothesis” suggests that by the time information is filtered down to the unsophisticated investor, a stock’s price will reflect its true value with regard to all publicly disclosed information. This approach does not protect the investor; it simply forces him to seek professional guidance.

29. See Fiflis, supra note 24, at 105; Safe Harbor, supra note 24, at 610.
30. See House Comm. on Interstate and Foreign Commerce, Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission, 95th Cong., 1st Sess. 344-79 [hereinafter cited as Report], abstracted in [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,357, at 88,665 (Nov. 3, 1977) (disclosure of information useful to reasonably knowledgeable investors should be encouraged while disclosure of simplified formats and summaries useful to amateurs should be left to disseminators); Fiflis, supra note 24, at 106 & n.37 (disclosure should be for sophisticates who will filter the information to the public and thereby cause market prices to adjust efficiently to the information as interpreted by the knowledgeable).
31. Fiflis, supra note 24, at 107; see Asset Appraisals, supra note 24, at 701-02; Safe Harbor, supra note 24, at 611-12.
32. The information must pass through the investment advisor who simplifies it and includes his subjective evaluation and bias in it before disclosing the information to his client.
33. See Fischel, Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers, 57 Tex. L. Rev. 1, 3-5 (1978). “An efficient capital market is one in which a trader cannot improve his overall chances of speculative gain by obtaining public information . . .” Id. at 3-4 (footnote omitted). This type of market results from the competitive efforts of analysts and investors who strive to gain superior returns by identifying undervalued or overvalued securities. This competitive process ensures that market prices reflect all publicly available information. Insider trading restrictions create inefficiency in the market because insiders cannot trade based on their information. Id. at 4. See generally Note, The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry, 29 Stan. L. Rev. 1031, 1034-41 (1977).
34. If disclosure is aimed at sophisticates, the individual investor will lose the chance to trade misvalued stocks before the competitive process makes price equal to value. This will occur because those who receive information first-hand (brokers) and those who are informed directly thereafter (large, institutional clients) will trade the stock enough to correct the misvaluation. See Note, The SEC Policy for Projections: New Problems in Disclosure, 21 UCLA L. Rev. 242, 245-46 (1973) [hereinafter cited as New Problems].
35. See Mann, Prospectuses: Unreadable or Just Unread?—A Proposal to Reexamine Policies Against Permitting Projections, 40 Geo. Wash. L. Rev. 222, 227 (1971); Safe Harbor, supra note 24, at 612-13 (“if investors must rely on the filtration process to receive necessary information, the . . . disclosure program has not fulfilled its statutory purpose”); New Problems, supra note 34, at 245-46.
The third, and most appropriate, approach provides disclosure for both the sophisticated and the unsophisticated investor. This "differential disclosure" policy attempts to strike a "pragmatic balance . . . between the needs of the unsophisticated investor and those of the knowledgeable student of finance." Such disclosure should include a "clearly written narrative statement outlining the major aspects . . . and particularly speculative elements, as well as detailed financial information which will have meaning only to the expert." Disclosure premised on this model would still promote filtering of information that could not be understood by the unsophisticated, but at the same time would allow the educated investor, if he or she so chooses, to decide whether to tender without referring to an investment professional. Like disclosure for sophisticated, this approach promotes the use of soft information. "Differential disclosure," however, also requires that precautionary steps be taken to avoid misleading investors. "Differential disclosure," by meeting the needs of the entire spectrum of investors, has gained acceptance by many courts and commentators.

D. Soft Information

1. Definition

Soft information is a highly relative concept that cannot be clearly delineated from hard information. Soft information may be defined as information other than objectively verifiable or historical facts (hard information). It includes projections of future earnings, appraised asset

36. See Fiflis, supra note 24, at 105-06; Asset Appraisals, supra note 24, at 702.
39. The statutory goal of allowing investors to make informed decisions would therefore be fulfilled. See Mann, supra note 35, at 227.
40. See Safe Harbor, supra note 24, at 611-12.
41. See id. at 612. See infra note 166 and accompanying text.
43. See Asset Appraisals, supra note 24, at 702-03; Safe Harbor, supra note 24, at 611-12; cf. Mann, supra note 35, at 227 (prospectus intended to furnish all information necessary for both individual investors and investment services).
44. Schneider, Nits, Grits, and Soft Information in SEC Filings, 121 U. Pa. L. Rev. 254, 256 (1972); see Fiflis, supra note 24, at 96 & n.3.
valuations and other hypothetical data. No definition is exhaustive because "[m]any apparently hard statements have soft cores and vice versa." The indicia of soft information include its subjectivity and its presentation as opinion, belief, plan or expectation rather than affirmative representation.

Target companies have no specific legal obligation to disclose soft information. Since no provision directly requires disclosure of soft information, courts must determine whether Rule 10b-5 requires its disclosure as "material" information. Discretion is left to the courts to determine what soft information, if any, is "material."

2. SEC Treatment of Soft Information

Courts have deferred to the SEC in determinations of materiality. Prior to 1972, the SEC generally prohibited disclosure of soft information. The SEC, however, was more tolerant of soft information in

Sec. L. Rep. (CCH) ¶ 81,357, at 88,667 (Nov. 3, 1977); Schneider, supra note 44, at 254-57. 46. Kohn v. American Metal Climax, Inc., 458 F.2d 255, 265 (3d Cir.), cert. denied, 409 U.S. 874 (1972); see Fiflis, supra note 24, at 96 n.3 ("Soft information includes forecasts of earnings, revenues, and other financial data; budgets for capital expenditures; future dividend policy; management analyses of financial statements; or any other forward-looking or even past, but subjectively determined, information concerning prospects of a company for investment use.").

47. Schneider, supra note 44, at 256. Even traditionally hard information ("facts") such as historical financial statements may have a soft core because accounting is an inexact science based on subjective evaluations. Alternatively, a statement regarding one's reputation is not a "fact," yet it is often considered a "fact" that can be proven in court under traditional rules of evidence. Id.; see Fiflis, supra note 24, at 96 n.3.

48. See Schneider, supra note 44, at 256-57 ("The relative hardness of a statement should turn less on its form (for example, a statement concerning what will happen as opposed to a statement of present expectation) and more on the underlying substance.").

49. See Starkman v. Marathon Oil Co., 772 F.2d 231, 239 (6th Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986); Resource Exploration v. Yankee Oil & Gas, Inc., 566 F. Supp. 54, 64 (N.D. Ohio 1983). Other cases implicitly support this proposition by proceeding directly to a discussion of "materiality" and therefore assuming that disclosure is not required. See, e.g., Harkavy v. Apparel Indus., 571 F.2d 737, 740 (2d Cir. 1978); SEC v. Texas Gulf Sulpher Co., 401 F.2d 833, 847-48 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).

50. Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985), promulgated pursuant to Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), provides in pertinent part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, . . . (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, . . . in connection with the purchase or sale of any security.

51. See supra note 49.

52. See Schneider, supra note 44, at 257-58; Safe Harbor, supra note 24, at 608 & n.3. Disclosure of soft information was required when it created specific negative inferences. See Schneider, supra note 44, at 261-62.
tender offers or proxy contests than in prospectuses and other filings.\textsuperscript{53} Such information was often disseminated through informal press releases and publications.\textsuperscript{54} In 1976, the SEC deleted earnings projections from a list of potentially misleading disclosures\textsuperscript{55} as it shifted its position on soft information toward greater permissiveness. For example, the SEC adopted a "safe harbor" provision in 1979.\textsuperscript{56} Its purpose was to encourage disclosure of projections by protecting issuers from liability if the disclosure was made in good faith and had a reasonable basis.\textsuperscript{57} A burden of proof was placed on the party seeking to establish liability.\textsuperscript{58} By the late 1970's, the SEC actually began to encourage disclosure of projections.\textsuperscript{59} The Advisory Committee Report to the SEC in 1977 urged the SEC to "encourage responsible experimentation with disclosure of soft information."\textsuperscript{60} The SEC has yet to promulgate rules mandating disclosure of soft information despite the policy of encouraging its disclosure.

3. Standards Proposed by the Courts

The courts have been slow and inconsistent in following the SEC's shifts in position. In 1984, the Third Circuit's decision in \textit{Flynn v. Bass Brothers Enterprises, Inc.}\textsuperscript{61} noted the evolution of the SEC's policy toward encouraging disclosure of soft information in tender offer contests.\textsuperscript{62} The court proposed a standard, however, that provides no guidance for corporations in their disclosure decisions.\textsuperscript{63} \textit{Flynn} involved a tender offer for National Alfalfa Dehydrating and Milling Company (National Alfalfa) by Bass Brothers. Bass Brothers had purchased asset appraisals for the assets of National Alfalfa.\textsuperscript{64} The court held that there existed no duty to disclose the asset appraisals\textsuperscript{65} but that asset appraisals are not as a matter of law immaterial and in appropriate cases must be disclosed.\textsuperscript{66} The court stated that the duty to disclose asset valuations and other soft information should be made on a "case by case basis, by weighing the potential aid such information will give a shareholder against

\textsuperscript{53} See Schneider, supra note 44, at 261 & n.20.
\textsuperscript{54} See \textit{Safe Harbor}, supra note 24, at 608.
\textsuperscript{56} 44 Fed. Reg. 38,810 (1979) (codified at 17 C.F.R. \S 230.175 (1985)) (commenting on 17 C.F.R. \S 230.175 (1979)).
\textsuperscript{58} See \textit{id.} at 38,811.
\textsuperscript{59} See \textit{id.}; see also \textit{Safe Harbor}, supra note 24, at 608-09.
\textsuperscript{61} 744 F.2d 978 (3d Cir. 1984).
\textsuperscript{62} \textit{id.} at 986-88.
\textsuperscript{63} See \textit{infra} note 68.
\textsuperscript{65} See \textit{id.} at 990-01.
\textsuperscript{66} See \textit{id.} at 988.
the potential harm, such as undue reliance, if the information is released with a proper cautionary note. The court then listed the factors that must be considered in this balancing process. They include:

- the facts upon which the information is based; the qualifications of those who prepared or compiled it; the purpose for which the information was originally intended; its relevance to the stockholders' impending decision; the degree of subjectivity or bias reflected in its preparation; the degree to which the information is unique; and the availability to the investor of other more reliable sources of information.

A somewhat more definitive position was adopted by the Sixth Circuit. In Starkman v. Marathon Oil Co., the court considered whether Marathon had a duty to disclose asset appraisals and earnings projections during U.S. Steel's tender offer for control of Marathon. The court held that no such duty existed, and in so doing articulated its standard for disclosure of soft information. The tender offer target "must disclose projections and asset appraisals based upon predictions regarding future economic and corporate events only if the predictions underlying the appraisal or projection are substantially certain to hold." This is because predictions that are "substantially certain to hold" are material information and therefore require disclosure. The target may choose to disclose projections and appraisals not rising to this level of certainty and, if so, "must also inform the shareholders as to the basis for and limitations on the projected realizable values." The Sixth Circuit criticized the Third Circuit's "case by case" standard as "uncertain and unpredictable." The Sixth Circuit's standard, which focuses on the certainty of the data, "ensures that the target company's shareholders will receive all essentially factual information, while preserving the target's discretion to disclose more uncertain information without the threat of liability, provided appropriate qualifications and explanations are made."

67. Id. (emphasis added).
68. Id. Courts using this standard can come to any result they wish by placing whatever weights they wish on the factors when balancing potential aid with potential harm. This is unfortunate because both management and counsel need clear standards to help them decide whether and in what form they will disclose forecasts. See Safe Harbor, supra note 24, at 639.
69. 772 F.2d 231 (6th Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986).
70. See id. at 233.
71. See id. at 242.
72. Id. at 241 (emphasis added).
73. See supra notes 50-51 and accompanying text.
75. Id. at 242.
76. Id.
E. Inadequacies of the Current Law

1. Insufficient Information

Under current law, despite the goal of the Williams Act, an investor may be left without the proper information from the target to make an informed decision. The most apparent problem arises under Rule 14e-2 regarding the target company's obligation to make a recommendation to its shareholders. If the target opts to remain neutral (express no opinion) or finds that it is unable to take a position, as it is allowed to do under existing rules, the investor receives no information.

A second deficiency exists because permissive disclosure by the target is based on the market force theory, which, in turn, is based on questionable assumptions. The theory assumes a heated battle wherein each side wants to disclose all information that might strengthen its position, thereby providing the investor with all necessary information. In practice, the investor will not receive adequate information in certain circumstances. If the target has no incentive to fight the offer, the market theory will fail. For example, the offeror may pay the "price for management's support or neutrality [which] may be an attractive employment contract or similar emoluments. Management silence might therefore often conceal bargained-for acquiescence, to the possible detriment of target shareholders interests."

Finally, the flow of valuable soft information to the investor is restricted by court decisions that place undue emphasis on reliability of the

77. See supra notes 15-18 and accompanying text.
78. See supra notes 17-18 and accompanying text.
79. See Johnson, Disclosure in Tender Offer Transactions: The Dice are Still Loaded, 42 U. Pitt. L. Rev. 1, 25-29 (1980) ("management may remain silent as to its position, thus depriving shareholders of the guidance and advice they seek"); cf. Affirmative Disclosure, supra note 21, at 201 (the most serious objection to the law, prior to Rule 14e-2, was that management could readily avoid the 14(d) disclosure requirement by not making a recommendation to shareholders). But cf. Gelfond & Sebastian, Reevaluating the Duties of Target Management in a Hostile Tender Offer, 60 B.U.L. Rev. 403, 405 (1980) (Rule 14e-2 increased the information available to investors, thus aiding open-market determination of the success or failure of an offer).
81. See Safe Harbor, supra note 24, at 623 & n.88.
82. See Affirmative Disclosure, supra note 21, at 206-07.
83. Id. (footnotes omitted). To a great extent this problem has been resolved. Rule 14d-9, 17 C.F.R. § 240.14d-9 (1985), requires that the target file a Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1985), when the target makes its recommendation to shareholders. Item 3(b) of Schedule 14D-9 mandates that "any contract, agreement, arrangement or understanding and any actual or potential conflict of interest" if material, between target management and the offeror, be disclosed. Id. This would help shareholders to evaluate recommendations and possibly prevent the offeror from buying management's support or neutrality. It might also explain why management chose to surrender rather than fight an offer thus providing the investor with valuable information. The problem still arises if an offer is made to target management after the recommendation. In that case, the shareholders may not receive the information.
information while undervaluing the need for such information. These decisions have contributed to a paradoxical situation. Soft information is leaked to investors without verification because it has been excluded from SEC filings to protect investors. Yet if soft information were permisively or mandatorily disclosed it would be subject to SEC scrutiny and would therefore be more reliable.

2. Fairness to the Average Investor

A policy of nondisclosure of soft information may be unfair to the individual investor. If a corporation chooses not to take advantage of the permissive disclosure system, but rather to disseminate the information informally, it is often the analysts, bankers and other investment experts who will receive the information, and not the individual investor.

3. Time Lags

Judicial decisions have done little to resolve the soft information issue, partly because of the time lag between when a challenged tender offer is made and when a trial or appellate court finally renders a decision on it. The case suggesting this time lag dilemma, Flynn v. Bass Brothers Enterprises, Inc., itself exemplifies the problem. The tender offer at issue occurred in 1976; the Third Circuit decision came down in 1984.

84. See, e.g., Starkman v. Marathon Oil Co., 772 F.2d 231, 241 (6th Cir. 1985) (determination as to whether there exists a duty to disclose soft information rests solely on its reliability), cert. denied, 106 S. Ct. 1195 (1986); Kohn v. American Metal Climax, Inc., 458 F.2d 255, 265 (3d Cir.) (applying the general rule of excluding asset valuations from disclosure because no truly reliable estimates had materialized), cert. denied, 409 U.S. 874 (1972). See supra notes 26-29 and accompanying text.
85. See infra notes 86, 88 and accompanying text.
86. See Report, supra note 30, abstracted in [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,357, at 88,667 (Nov. 3, 1977) ("when companies formally publish projections they are likely to exercise greater care in preparing the information"); Asset Appraisals, supra note 24, at 701 ("permissive or mandatory formal disclosure would subject it to the Commission's scrutiny, thereby increasing the protection afforded investors"); New Approaches to Disclosure in Registered Security Offerings - A Panel Discussion, 28 Bus. Law. 505, 508 (1973) (remarks of Carl Schneider) (inclusion of soft information in filings would make it more reliable) [hereinafter cited as New Approaches].
89. See Flynn v. Bass Bros. Enters., 744 F.2d 978, 987-88 (3d Cir. 1984) (time lags have "retarded the evolution of the law concerning disclosure").
90. Id. at 982.
91. Id. at 978.
Such time lags have prevented the courts from keeping up with changing SEC policies because courts are often “loath to impose a huge liability” if the law has evolved in the interim.\footnote{92}{Id. at 978-88 (quoting Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1294 (2d Cir. 1973)). Gerstle, another example of time lags, was decided in 1973, while the proxy statement at issue was disclosed in 1963. See Gerstle, 478 F.2d at 1281, 1287.}

4. Problems with the Standards

The few cases that have been decided provide inadequate guidance for corporations seeking to determine their disclosure obligations for a given piece of data. The two standards available, Flynn and Starkman, are neither compatible with nor sufficiently sensitive to the needs of investors. Part II suggests a standard that more appropriately weighs the potential value of soft information against its potential harm.

II. STANDARDS

Standards for the disclosure of soft information should balance the potential value of disclosure to the investor against the potential harm to both the investor\footnote{93}{See Flynn v. Bass Bros. Enters., 744 F.2d 978, 988 (3d Cir. 1984); South Coast Servs. Corp. v. Santa Ana Valley Irrigation Co., 669 F.2d 1265, 1276-77 (9th Cir. 1982) (Fletcher, J., dissenting).} and the discloser.\footnote{94}{See supra note 93.} The potential value is the additional guidance the investor may derive from the information in making his decision to tender.\footnote{95}{See supra note 93.} The potential harm includes the unreliability of the information,\footnote{96}{See Starkman v. Marathon Oil Co., 772 F.2d 231, 241-42 (6th Cir. 1985) (to increase reliability, the court focused on the certainty of the underlying data), cert. denied, 106 S. Ct. 1195 (1986); Flynn v. Bass Bros. Enters., 744 F.2d 978, 988 (3d Cir. 1984) (consider factors such as the facts on which the information is based, the qualifications of those who prepared it, and the degree of subjectivity or bias in its preparation when balancing potential aid with potential harm).} the possibility of misinterpretation,\footnote{97}{See Safe Harbor, supra note 24, at 610-12; Future-Oriented Information, supra note 87, at 353-55.} the cost to the target of producing the disclosure,\footnote{98}{See Report, supra note 30, at 353, abstracted in [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,357, at 88,667 (Nov. 3, 1977); Affirmative Disclosure, supra note 21, at 215-16; Safe Harbor, supra note 24, at 616; Future-Oriented Information, supra note 87, at 356-57.} the possible weakening of the target’s competitive position\footnote{99}{See Schneider, supra note 44, at 276; Future-Oriented Information, supra note 87, at 357-58.} and the potential for management manipulation of the stock price.\footnote{100}{See Safe Harbor, supra note 24, at 614 & n.33.}

A. Potential Value of Soft Information

Potential value should take the investor’s decisionmaking into ac-
The relevant decision is the one made by a target shareholder to retain his shares or tender them to the offeror. It is not relevant for purposes of the target’s disclosure whether the offer is a cash offer or an exchange offer; nor is it relevant whether it is for control. In either case, the shareholder, using the target’s disclosure, must place a value on each share and compare that value to the offered price.

Various formulae for valuing shares during a tender offer contest have been proposed. The common element present in each is a valuation of the subsequent market price of the stock. This process has been described as “capitalizing projected future income.” A second crucial determination is an estimate of the probability of success of the offer.

Much of the information an investor needs to estimate the subsequent market price and probability of success of the offer is soft information that is only known to and therefore only disclosable by the target. Some

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101. See Future-Oriented Information, supra note 87, at 341-43 (“In order to make a realistic, informed investment decision, investors need information about the future of the firm.”); see also Filis, supra note 24, at 100-04 (soft information is relevant to the fundamental decisionmaking process); Johnson, supra note 79, at 4-5 (neither the courts nor the SEC have been sufficiently sensitive to the fact that most investors are future oriented in their decision making); Affirmative Disclosure, supra note 21, at 191-92 (a determination must be made as to what information an investor needs when deciding whether to tender).

102. See Johnson, supra note 79, at 6 (“The shareholder must evaluate his holdings in the target company and must compare his potential future benefits from that company with the benefits that might accrue to him if he accepts the offer.”). Disclosure by the offeror is necessary to evaluate the offer. If the offer is for cash and for control, the shareholder will want to know the prospects of success under the offeror’s management. If the offer is for cash and not for control, disclosure by the offeror is not essential. Furthermore, if the offer is for securities of the offeror, whether or not for control, disclosure by the offeror is necessary to value those securities. See generally Borden & Weiner, An Investment Decision Analysis of Cash Tender Offer Disclosure, 23 N.Y.L. Sch. L. Rev. 553 (1978). This Note is concerned only with disclosure by the target, which is necessary to value the shareholder’s holdings in the target. Hence, the investor needs the same information to evaluate his holdings regardless of whether the offer is for cash or securities and whether or not the offer is for control.

103. See infra note 104.

104. See, e.g., Easterbrook & Fischel, The Proper Role of a Target’s Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1164 (1981) (“The value of any stock can be understood as the sum of two components: the price that will prevail in the market if there is no successful [tender] offer (multiplied by the likelihood that there will be none) and the price that will be paid in a future tender offer (multiplied by the likelihood that some offer will succeed.”); Hayes & Taussig, Tactics of Cash Takeover Bids, Harv. Bus. Rev. 135, 147 (Mar.-Apr. 1967) (“Whether it is better to hold or to sell requires an assessment of the relative merits of the competing groups, an estimate of the probabilities of the tender’s success or failure, and a further estimate of the subsequent price action of the stock in either event.”); Affirmative Disclosure, supra note 21, at 191-92 (one factor in the shareholder’s decision is the “estimated post-offer market value of the target’s shares”).


106. See Affirmative Disclosure, supra note 21, at 191 (the “likelihood of the tender offeror’s success in obtaining its objective” is a factor to be considered in the investor’s decision). See supra note 104.
hard information regarding past performance,\textsuperscript{107} brokerage fees, tax liability\textsuperscript{108} and other investment opportunities\textsuperscript{109} is clearly relevant, but that information is either already included in disclosure or readily available from other sources.\textsuperscript{110} The relevant soft information disclosable only by the target includes: 1) earnings projections (as well as sales, revenues and expenses), which are “among the most significant factors in influencing securities prices;”\textsuperscript{111} 2) asset appraisals, which provide investors with present value information necessary to read income statements and balance sheets without being misled;\textsuperscript{112} 3) management recommendations, which have a direct effect on the success of the offer;\textsuperscript{113} and 4) other plans and expectations, which may inform the investor of the direction the target is headed.\textsuperscript{114}

Some have argued that due to the efficiency of capital markets,\textsuperscript{115} such disclosure is unnecessary because the current market price already reflects all publicly disclosed information.\textsuperscript{116} However, information is reflected in the market price only if it has been publicly disclosed.\textsuperscript{117} Soft information often would not have been disclosed. It would remain as inside information that should not have been traded on due to insider

\begin{itemize}
\item[107.] Past performance is relevant only to the extent that it may enable an investor to predict future results. See Future-Oriented Information, supra note 87, at 341 & n.20.
\item[108.] See Affirmative Disclosure, supra note 21, at 191 (factors to be considered in decision include “adjustments to reflect the shareholder's tax liability if he sells rather than holds and brokerage fees”).
\item[109.] See Future-Oriented Information, supra note 87, at 342-43 (“Comparability across a wide range of investment opportunities . . . is necessary to ensure an optimal investment decision.”).
\item[110.] See Affirmative Disclosure, supra note 21, at 191.
\item[111.] Safe Harbor, supra note 24, at 615.
\item[112.] See Assets Appraisals, supra note 24, at 703. See infra note 201.
\item[113.] See infra note 162.
\item[114.] See infra note 218.
\item[115.] See supra note 33.
\item[116.] See, e.g., Fischel, supra note 33, at 24. The argument against disclosure based on the efficiency of capital markets assumes that information that has not been traded on because of insider trading restrictions is the only information not already taken into consideration in the market price and suggests that even this situation is rare. Given this assumption, it is early to conclude that “any gains from disclosure of inside information that would otherwise not be made public absent an affirmative disclosure obligation do not outweigh the harm.” Id. If all soft information is included in this insider information category, then the “inefficiency” created by such insider information is not rare but rather very common. It becomes more difficult to conclude that the benefits of non-disclosure outweigh the harms. Furthermore, soft information often does not remain entirely “inside.” It is leaked to a select group of analysts and large investors. This is “semi-public” information that could be public, and therefore reflected in the market price, if filtered to the public but may not be if limited to those who received it. See also Report, supra note 30, abstracted in [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,357, at 88,664 (Nov. 3, 1977) (“‘Efficient market hypothesis’ . . . even if valid, does not negate the necessity of a mandatory disclosure system. This theory is concerned with how the market reacts to disclosed information and is silent as to the optimum amount of information.”).
\item[117.] See supra note 33.
\end{itemize}
trading restrictions.\textsuperscript{118} For that reason, additional soft information that has yet to be reflected in the market price should not be barred from disclosure.\textsuperscript{119}

B. Potential Harm of Soft Information

The potential value of soft information to decisionmaking must be weighed against the potential harm of disclosure. The unreliability of the disclosed information is an obvious potential harm.\textsuperscript{120} As mentioned previously, courts have adhered to the traditional SEC position and have exaggerated a legitimate concern for reliable information, fearing that "the inclusion of soft information in filings would clothe such information with an unduly high aura of credibility."\textsuperscript{121} While reliability is a reasonable concern, investor protection would be better served not by prohibiting disclosure and forcing informal disclosure of such information, but rather by subjecting soft information to the scrutiny of the SEC.\textsuperscript{122} This would encourage greater accuracy and would assure that the investor receives information first-hand.\textsuperscript{123} Appropriate cautionary notes accompanying the information would discourage undue reliance on the information by target shareholders.\textsuperscript{124}

A second potential danger is misinterpretation.\textsuperscript{125} This traditional objection to disclosure has become less significant with the adoption of "differential disclosure" (aimed at both sophisticates and unsophisticates).\textsuperscript{126} The assumption "that investors will be misled [by soft information] underestimates the capability of investors, who are generally accustomed to dealing with soft information through the normal workings of the market."\textsuperscript{127} Investors understand the inherent uncertainties of projections, especially when forewarned by cautionary language.\textsuperscript{128} Concern about misinterpretation should therefore weigh less in the decision to disclose

\textsuperscript{118} See \textit{supra} note 116.

\textsuperscript{119} See \textit{Fischel, supra} note 33, at 24.

\textsuperscript{120} If soft information was totally reliable, its disclosure would always be required because of its relevance to the investor's decision.

\textsuperscript{121} \textit{Schneider, supra} note 44, at 258. See \textit{supra} note 84.

\textsuperscript{122} See \textit{supra} notes 85-86 and accompanying text.

\textsuperscript{123} See \textit{supra} notes 85, 88 and accompanying text.

\textsuperscript{124} See \textit{infra} notes 163-67 and accompanying text.

\textsuperscript{125} See \textit{Note, Mandatory Disclosure of Corporate Projections and the Goals of Securities Regulation}, 81 Colum. L. Rev. 1525, 1534 (1981) (investors can be misled in four ways: 1) by accepting projections as excessively authoritative, 2) by inaccurate forecasts, 3) by wrong information in forecasts, and 4) by focusing the investor on short-term results) [hereinafter cited as \textit{Mandatory Disclosure}]; \textit{Future-Oriented Information, supra} note 87, at 353-55 (misleading investors, a traditional objection to disclosure, is based on fears of investor confusion and management manipulation).

\textsuperscript{126} See \textit{supra} notes 36-43 and accompanying text.

\textsuperscript{127} Safe Harbor, \textit{supra} note 24, at 611-12; see \textit{Asset Appraisals, supra} note 24, at 701; \textit{New Approaches, supra} note 86, at 509.

\textsuperscript{128} See \textit{Safe Harbor, supra} note 24, at 611-12.
soft information and more in deciding how to disclose such information.

The cost of producing and disseminating disclosure is another potential harm. Although the costs of disclosure are sizable, the disclosure of soft information, especially projections, "would not impose significant additional costs, at least for companies that already compile the information for their own internal use." This category includes most businesses. Furthermore, the cost of disclosure "will often be at its lowest point while a tender offer is outstanding." This is so because the duty arises on the occurrence of a readily identifiable event, the offer, and during the offer the media will more readily print releases and investors will be alerted to watch for such disclosure. Cost is always a consideration when imposing a disclosure obligation, but the additional cost of requiring disclosure of soft information is not significant.

The weakening of a firm's competitive position by disclosing future strategy has also been suggested, most often by management, as a potential harm. While the likelihood of weakening a firm's competitive position is greater with soft information than hard information, a carefully conceived disclosure requirement need not require disclosure of specific plans, predictions, expectations and negotiations that could cause this harm. The availability of such specific information is not essential to accomplishing the purpose of disclosure of soft information: protecting investors by "providing an indication to investors of the direction and magnitude of management plans." The disclosure requirements placed on a target will not be detrimental for two reasons: management

129. The decision how to disclose should encompass the format of the disclosure and the cautionary note accompanying the disclosure.
130. See Mandatory Disclosure, supra note 125, at 1539-40 ("extraordinary expense involved in preparing sophisticated financial forecasts and their accompanying underlying assumptions for public dissemination").
131. Safe Harbor, supra note 24, at 616; see Future-Oriented Information, supra note 87, at 356-57. But see Mandatory Disclosure, supra note 125, at 1539 ("Internally generated projections are generally designed for management purposes only, and in many cases are not suitable for public presentation.").
132. See Kripke, supra note 105, at 1197 (most large companies use projections as the basis for making important decisions); Future-Oriented Information, supra note 87, at 357 ("all public companies are now required to maintain systems of internal control and ... most businesses regularly generate projections for internal use") (footnotes omitted).
134. Id. at 215-16.
135. See id. at 216; Safe Harbor, supra note 24, at 616; Future-Oriented Information, supra note 87, at 356-57. But see Mandatory Disclosure, supra note 125, at 1539-40 (costs would be significant).
136. See Schneider, supra note 44, at 276; Mandatory Disclosure, supra note 125, at 1540; Future-Oriented Information, supra note 87, at 357.
137. Schneider, supra note 44, at 276 (significant adverse developments may be "more likely to occur when a company must disclose its future plans, strategies or expectations, as contrasted with historical data").
138. See Future-Oriented Information, supra note 87, at 358.
139. Id.
currently informally disseminates much of the same information without weakening the firm’s position,\textsuperscript{140} and the disclosure of such information, if material, is already required by other disclosure provisions.\textsuperscript{141} There will, however, be one adverse effect of disclosure of even non-specific management direction; management may be in the process of redirecting the corporation in some way—for example, the sale or acquisition of assets—when a tender offer is made and disclosure may place such plans in jeopardy.\textsuperscript{142} When this problem occurs, a disclosure standard should require that plans need not be disclosed unless they are “firm.”\textsuperscript{143} Furthermore, the SEC should develop a petition system that would allow a corporation to prepare its disclosure on the sensitive topic with the SEC’s guidance so as to inform the investor of general trends and not specific information that would jeopardize the transaction.\textsuperscript{144} The possibility of this single adverse effect, and the fear of weakening a firm’s competitive position in general, are not a sufficient basis to preclude disclosure of soft information.\textsuperscript{145}

The final danger is the possible manipulation by management of the stock price through disclosure of soft information.\textsuperscript{146} Manipulation is much more likely in situations other than tender offer contests for two reasons. Corporations may, for ordinary reporting purposes, defer disclosure until a pending project is over.\textsuperscript{147} During a tender offer, however, the target has no choice when to disclose because the duty arises upon the occurrence of the offer. In addition, investors generally scrutinize management disclosure during a tender offer with extra care. They do so with the realization that management’s objective may not be inves-
tor protection but rather retention of control. Furthermore, the target's disclosure is always subject to the anti-fraud provisions of both the Williams Act and the 1934 Act. Fear of manipulation should not restrict the disclosure of soft information.

C. A Proposal for Fair and Predictable Standards

The various factors that must be considered when weighing the potential value of soft information against its potential harm make it extremely difficult to formulate a single standard for disclosure. A standard that varies according to the type of soft information at issue would be more realistic. Soft information includes at least three categories: 1) projections of earnings, sales, revenues and expenses; 2) asset appraisals; and 3) other soft information, including plans and expectations, capital budgeting and expenditures and future dividend policy. These categories are far from exhaustive. Any information that is neither historical nor objectively verifiable may be considered soft information. For example, analyses of management integrity and efficiency are soft information but wholly separate from and outside the scope of this Note. A standard for each category will be proposed.

1. Assumptions

Before proposing standards, certain assumptions that apply to all standards proposed in this Note must be stated. The first assumption is that disclosure should be for both the sophisticated and the unsophisticated investor ("differential disclosure"). The second assumption is that the "efficient capital market hypothesis" does not preclude the need for soft information because only information that has previously been disclosed can be reflected in the market price.

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149. See Future-Oriented Information, supra note 87, at 355.
150. The Starkman standard treats all soft information the same and mandates disclosure solely on the basis of reliability of information. The need for soft information, however, varies drastically according to the type of information. Some soft information is more relevant to the shareholder's decision than other information. The need for other information may arise only in certain circumstances. The Flynn standard does take these variations into account. One of the factors listed by the Third Circuit in Flynn is the information's relevance to the shareholder's impending decision. Flynn v. Bass Bros. Enters., 744 F.2d 978, 988 (3d Cir. 1984). This standard, however, does not provide adequate guidance for corporations to assess their duty to disclose.
151. See supra note 46 and accompanying text.
152. See supra note 47 and accompanying text.
153. See supra note 45 and accompanying text.
155. See supra Part I.C.
156. See supra notes 115-19 and accompanying text.
2. Accompanying Rules

Apart from the underlying assumptions are three rules that, along with the standards to be proposed, comprise this Note's disclosure scheme for soft information. Each is designed to resolve a specific inadequacy in the current law. These rules include mandatory recommendation by management, mandatory disclosure of an appropriate cautionary statement and mandatory disclosure of assumptions underlying the information to be disclosed.

Under current law, the target may make a recommendation that effectively provides the investor with no information by remaining neutral or stating that it is unable to take a position. These options should not be permitted. Management should be required to recommend either acceptance or rejection of the offer, to state the reasons for the recommendation, and to warn the shareholders that the recommendation does not take into account personal factors that might enter into the investor's decision. When management has special reasons that prevent making a recommendation, it should be allowed to petition the SEC for an exemption. One empirical study has confirmed that "management's decision . . . is the most significant factor in determining whether the tender offer will succeed." It is therefore vital that management take a

157. See supra notes 77-79 and accompanying text.
158. See Johnson, supra note 79, at 27-28. Subsections (2) and (3) of Rule 14e-2(a), 17 C.F.R. § 240.14e-2(a)(2), (3), the options of remaining neutral or stating an inability to take a position respectively, should be eliminated. Id. See Krasik, Tender Offers: The Target Company's Duty of Disclosure, 25 Bus. Law. 455, 474 (1969). It has been argued that management should not be required to make a recommendation because it will do the stockholder little good and may actually mislead the investor. See Affirmative Disclosure, supra note 21, at 217. This argument is premised on the fact that management and shareholders may have conflicting interests. Id. at 217-18. But cf Klink, Management's Role In Recommending For Or Against An Offer, 39 Antitrust L.J. 325, 325 (1969). Prior to Rule 14e-2 "few managements have remained neutral in the face of a hostile take-over bid. Failure to take a position . . . is viewed by the market and by stockholders as tacit approval of the offer." Id.
159. Item 4 of Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1985), now requires disclosure of "the reason(s) for the position (including the inability to take a position)." This obligation should remain intact. See Krasik, supra note 158, at 474.
160. Krasik, supra note 158, at 474. A cautionary note such as this is necessary to warn investors that what is best for target management may not necessarily be best for an individual shareholder. See Affirmative Disclosure, supra note 21, at 217-18 (management and shareholders may have "sharply conflicting interest").
161. One such situation may occur during an exchange offer (for stock of the offeror). The target may have very little information to value the offeror's stock either because the company is not a reporting company or it has yet to comply with the disclosure requirements placed on the offeror. See supra note 144 for a discussion on the SEC's power to create such an investment system.
162. Affirmative Disclosure, supra note 21, at 206; see Gelfond & Sebastian, supra note 79, at 403 ("Management's position regarding the merits of an offer may be the most significant factor in the offer's success or failure."); see also Johnson, supra note 79, at 6 ("[T]he shareholder is often ill-equipped to make such a determination [whether to tender], and he will, therefore, tend to seek advice from the most logical source—the
SOFT INFORMATION DISCLOSURE

A mandatory cautionary statement appropriate for the type of soft information to be disclosed should also be required. The only issue that the SEC, the courts, and the commentators have agreed on is that cautionary statements are necessary to avoid misleading the investor. These cautionary statements have become increasingly important to avoid misleading investors as disclosure has adapted to serve the needs of the sophisticated as well as the unsophisticated. In order to assure continued protection of the unsophisticated investor, the cautionary statement, though not the entire disclosure, should be written so that an unsophisticated investor can readily understand its limitations and the "inherent uncertainty of the information."

The final policy applicable to all standards is the requirement that all assumptions underlying soft information be disclosed. At present, disclosure of assumptions is encouraged but not required unless it is material to understanding the disclosure. The SEC offered only slight justifica-

163. The SEC has stated that it will not object to good faith projections that have a reasonable basis "provided that they are presented in an appropriate format and accompanied by information adequate for investors to make their own judgments." Fiflis, supra note 24, at 125 (quoting Sec. Act Release No. 5699 [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,461, at 86,202 (Apr. 23, 1976)); see Report, supra note 30, at 345, abstracted in [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,357, at 88,673 (Nov. 3, 1977) (projections should be disclosed in good faith, on a reasonable basis, and "accompanied by an appropriate cautionary statement").

164. See Starkman v. Marathon Oil Co., 772 F.2d 231, 242 (6th Cir. 1985) ("provided appropriate qualifications and explanations are made"), cert. denied, 106 S. Ct. 1195 (1986); Flynn v. Bass Bros. Enters., 744 F.2d 978, 988 (3d Cir. 1984) ("if the information is released with a proper cautionary note").

165. See Fiflis, supra note 24, at 125 (commentators generally agree that qualifying data and contextual format must be disclosed); Schneider, supra note 44, at 305 (suggesting broader use of soft information if "relevant, material, reasonably reliable, and adequately qualified"); Safe Harbor, supra note 24, at 612 (investors are aware of inherent uncertainties of projections, especially when forewarned by cautionary language); Affirmative Disclosure, supra note 21, at 220 (management should state that the information is only a prediction, and thus subject to future change).

166. If information is disclosed in a form readily understandable to the unsophisticated investor, as it was historically, cautionary language is obviously not necessary unless the information is extremely unreliable. When information usable only by sophisticated investors is included or when information is substantially uncertain, cautionary language becomes much more important.


169. See 44 Fed. Reg. 38,810, 38,812 (1979) (codified at 17 C.F.R. § 230.175 (1985)) (commenting on 17 C.F.R. § 230.175 (1979)). The Commission stated that "[u]nder certain circumstances the disclosure of underlying assumptions may be material to an understanding of the projected results." Id. In these circumstances disclosure is necessary to
tion of this policy—to maximize the attractiveness of forecasting.170 According to commentators, assumptions are important because they “provide investors with a framework”171 for analyzing the soft information. Disclosure of underlying assumptions is vital to the investor's ability to understand the information and should therefore be mandatory.172

3. Projections

Projections of earnings, sales, revenues and expenses are extremely valuable to investors because they “have a direct bearing on the estimation of return for investors in [a company’s] securities, which in turn relates directly to present value.”173 One commentator has even suggested that forecasts of future earnings are “perhaps the one piece of information

avoid anti-fraud liability. Disclosure of assumptions may also be necessary to meet the reasonable basis and good faith test set forth in the “safe harbor” rule. 44 Fed. Reg. at 38,812. If assumptions are not disclosed, the disclosure is not protected by the “safe harbor” and may subject the company to anti-fraud liability. See Safe Harbor, supra note 24, at 630; see also Future-Oriented Information, supra note 87, at 355 & n.91 (requirement that relevant assumptions be disclosed along with projections has received judicial support).


171. Safe Harbor, supra note 24, at 629; see 44 Fed. Reg. 38,812 (1979) (codified at 17 C.F.R. § 230.175 (1985)) (commenting on 17 C.F.R. § 230.175 (1979)) (“disclosure of assumptions is believed to be an important factor in facilitating investors’ ability to comprehend and evaluate these statements”); Dean, Public Dissemination of Projected Earnings—Pros and Cons, 25 Mercer L. Rev. 511, 527 (1974) (the soundness of assumptions upon which projections are based are extremely important); Schneider, supra note 44, at 277 (“Once investors know the basis for a prediction, they should be able to assign an appropriate credibility factor to the prediction.”).

172. See Johnson, supra note 79, at 30; Schneider, supra note 44, at 277-78; Asset Appraisals, supra note 24, at 707; Affirmative Disclosure, supra note 21, at 220; Safe Harbor, supra note 24, at 631. Because assumptions must be disclosed if “material” or if relevant enough to place the disclosure outside the safe harbor provision, see supra note 169, their disclosure is usually required. Furthermore, the rationale for voluntary disclosure of assumptions was to maximize the attractiveness of forecasting. This Note proposes a mandatory disclosure obligation for projections, thus negating the rationale. For soft information other than projections, disclosure of assumptions is so important that the need for the assumptions outweighs the rationale. For asset appraisals, the method of appraisal and the qualifications of those who prepared the appraisal are extremely important. See infra note 210 and accompanying text. For “other soft information,” which is inherently less reliable, disclosure of assumptions is also essential. See infra note 211.

The Advisory Committee on Tender Offers recommended that when disclosing projections or asset valuations, the disclosure must include principal supporting assumptions. See Starkman v. Marathon Oil Co., 772 F.2d 231, 241 & n.7 (6th Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986).

173. Fiflis, supra note 24, at 103; see Schneider, supra note 44, at 280 (“Projections and forecasts of financial results—such as . . . projections of revenues, expenses, and earnings—are a special category of forward-looking information highly relevant to investors. Indeed, expected earnings per share in the immediate future is among the most significant factors influencing securities prices and, consequently, investment decisions.”); see also Dean, supra note 171, at 534; Safe Harbor, supra note 24, at 607-08; Future-Oriented Information, supra note 87, at 360-61.
most sorely needed by the investor.” Furthermore, nondisclosure of “material” projections could lead to serious misvaluation of a corporation’s securities.

What harm is to be weighed against the investor’s need for projections? It has been argued that projections, regardless of whether the SEC scrutinizes them, are inherently uncertain because “they are based on numerous facts and assumptions that are subject to frequent change.”

This argument does not justify precluding the disclosure of projections but rather reaffirms the need for the disclosure of assumptions and cautionary statements. The need for projections clearly outweighs their potential harm.

Disclosure of earnings projections, accompanied by sales, revenue and expense projections if possible, for a period of three months to one year into the future should be mandatory. This duty would arise on the occurrence of a tender offer and the corporation would be allowed a reasonable time to respond. It is unreasonable to mandate that a corporation forecast further into the future because forecasts “become even less exact as they predict further into the future.”

Liability for the inaccuracy of mandatory projections would be determined as it would for the “safe harbor;” no liability should be imposed for information disclosed in good faith and with a reasonable basis.

Corporations should be able to petition for exemption from this disclosure requirement. Corporations that cannot compile the data necessary to produce a forecast could request such an exemption. A corporation less than one or two years old, for example, would seek this exemption. An exemption should also be available when the tender offer has

174. Johnson, supra note 79, at 5.
175. See Affirmative Disclosure, supra note 21, at 219.
176. Bauman, Rule 10b-5 and the Corporation’s Affirmative Duty to Disclose, 67 Geo. L.J. 935, 972 (1979); see Schneider, supra note 44, at 280; Fearless Forecasts, supra note 87, at 117; Mandatory Disclosure, supra note 125, at 1534, 1536; Affirmative Disclosure, supra note 21, at 219.
177. Compare supra notes 173-75 and accompanying text with supra note 176 and accompanying text.
178. See H. Kripke, The SEC and Corporate Disclosure: Regulation in Search of a Purpose 317 (1979) (projections should be encouraged both within and outside the mandatory disclosure system); Future-Oriented Information, supra note 87, at 360-61 & n.122 (“[M]anagements should be required to disclose formal financial forecasts. Indeed, it is arguable that the SEC has a statutory duty to ensure access to such information.”); Safe Harbor, supra note 24, at 639 (“The most radical, and perhaps the most effective, amendment would be to require disclosure of forecasts.”); New Problems, supra note 34, at 271 (“Since the decision has been made [in this Note] to classify projections as material facts . . . the rules adopted by the SEC and enforced by the courts should logically require prompt disclosure of the projections.”). Not all commentators have reached this conclusion. See Mandatory Disclosure, supra note 125, at 1526.
179. Safe Harbor, supra note 24, at 616 & n.46.
180. The Advisory Committee suggested that in some circumstances “companies
been made merely to obtain an earnings projection and to impose the costs of producing it on the target.\textsuperscript{181} If the SEC finds bad faith, it should respond by requiring only a three-month projection and imposing its costs on the offeror. Finally, if disclosure of sensitive information would jeopardize a transaction,\textsuperscript{182} the SEC should guide the corporation so that general information can be provided without jeopardizing the transaction.

A "safe harbor" provision for the disclosure of any projection beyond what is specifically required should be established.\textsuperscript{183} This would encourage disclosure of projections disclosed in good faith and with a reasonable basis because they would not subject the target to liability.

In the 1977 Advisory Committee Report to the SEC, four reasons were given in support of a permissive rather than a mandatory disclosure system.\textsuperscript{184} These reasons are no longer valid. The Committee argued that the SEC needed time to experiment with its policy.\textsuperscript{185} This argument is no longer valid because nine years have passed and have been a sufficient period of experimentation. The Committee also feared that some companies might find the burdens of projecting would outweigh the benefits.\textsuperscript{186} It is, however, the investor that must be protected and not the corporations. The third reason was that corporations should not be exposed to liability for inaccurate projections.\textsuperscript{187} The basis for determining liability under the mandatory plan proposed in this Note and the present permissive plan is the same—good faith and reasonable basis. Finally, the Committee stated that it would be difficult for some compa-

\begin{footnotes}
\footnote{181}{Information in projections, even when non-specific, is valuable to competitors. This provision would avoid the situation where a competitor makes a tender offer for shares of a firm for the dual purpose of obtaining this information and imposing the costs on the target.}
\footnote{182}{See \textit{supra} notes 141-44 and accompanying text. Examples of transactions that could be jeopardized are the purchase or sale of assets, the acquisition of or merger with a company, the sale or liquidation of a subsidiary or division, and the hiring of a key employee.}
\footnote{183}{This Note suggests a mandatory short-term projection during a tender offer. If a company wants to disclose a longer-term forecast or to disclose a forecast at some other time, it should still be protected by a "safe harbor" as it is today under 17 C.F.R. § 230.175 (1985). This coincides with the SEC policy of encouraging disclosure of soft information. See \textit{Safe Harbor}, \textit{supra} note 24, at 627 & n.111.}
\footnote{184}{Report, \textit{supra} note 30, at 354, \textit{abstracted in} [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,357, at 88,667 (Nov. 3, 1977). Reasonable projections may not be attainable due to a lack of operating history or due to general economic factors or industry conditions. \textit{Id.}}
\end{footnotes}
nies to project. The petition system should adequately handle this problem. With the declining validity of the traditional arguments against mandatory disclosure of projections, the time is ripe for such a proposal. As the "safe harbor" was an appropriate experiment in 1979, so also is a mandatory disclosure system for projections an appropriate experiment in 1986.

4. Asset Appraisals

Asset appraisals are estimates of the present market value of a company's assets. SEC policy requires, for ordinary reporting purposes, that assets be disclosed at their historical costs—the original cost of purchasing the asset less an allowance for depreciation. The difference between the historical cost and the current value creates the need for asset appraisals in tender offer contests.

Disclosure of appraisals, which has merely been discouraged by the SEC, has usually been prohibited by courts. In certain instances, however, disclosure has been permitted or even required. For example, disclosure was permitted in one case when the appraisal was highly reliable and there was an intent to liquidate the target and in another when the appraisal involved oil and gas reserves. Disclosure of an appraisal is mandatory when prepared by a qualified expert with a sufficient

189. See Asset Appraisals, supra note 24, at 684-85.
190. See id. at 685-86.
191. See id. at 686. No SEC rule or regulation specifically prohibits disclosure of appraisals, but they have been discouraged because "the methods of appraisal are based on subjective assumptions and predictions." Id. In other words, the reasons underpinning this policy include the concern about reliability, the fear of investors giving greater credence than would be warranted, and the impracticability of having the SEC examine appraisals on a case-by-case basis. Flynn v. Bass Bros. Enters., 744 F.2d 978, 985 (3d Cir. 1984).
192. Asset Appraisals, supra note 24, at 687-90; see Flynn v. Bass Bros. Enters., 744 F.2d 978, 985 (3d Cir. 1984); Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1292 (2d Cir. 1973); Kohn v. American Metal Climax, Inc., 458 F.2d 255, 265 (3d Cir.), cert. denied, 409 U.S. 874 (1972). But see Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 575 (E.D.N.Y. 1971) (amount of "surplus" that insurance company retained above what was required by law was held to be a material fact that should have been disclosed).
193. See Asset Appraisals, supra note 24, at 689-95.
194. See Speed v. Transamerica Corp., 235 F.2d 369 (3d Cir. 1956) (corporate insiders, possessing appraisal indicating greatly increased value for inventory traded on commodity markets, offered to buy out minority shareholders and liquidate the company). The court focused on the existence of the appraisal and the failure to disclose rather than on the reliability of the appraisal. Asset Appraisals, supra note 24, at 691-92. Subsequent cases have limited the scope of Speed to extraordinarily reliable valuations. Id.; see Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1293 (2d Cir. 1973).
195. See Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970) (defendant failed to disclose an appraisal of oil reserves that a reasonable investor ought to have been informed of), cert. denied, 416 U.S. 916 (1974); Asset Appraisals, supra note 24, at 693-94.
basis in fact and also when prepared during a freezeout merger.

An investor's need for asset appraisals varies in different circumstances. In situations other than a freezeout merger or an impending liquidation, disclosure of appraisals is not crucial because investors are provided with some present value information through the SEC's requirement that "replacement cost" figures for most companies be disclosed. Appraisals are nonetheless useful to investors, particularly when they differ from available information. Furthermore, investors studying the income statement or balance sheet of a company may be misled if no asset appraisal is provided. If the offeror intends to liquidate the target company or if the value of the target is principally its assets, appraisals are crucial to an investor's decision.

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196. The SEC proposed this rule in its amicus brief in Gerstle. See Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1292 (2d Cir. 1973); see also Flynn v. Bass Bros. Enters., 744 F.2d 978, 987 (3d Cir. 1984); South Coast Servs. Corp. v. Santa Ana Valley Irrigation Co., 669 F.2d 1265, 1272 (9th Cir. 1982).

197. A freezeout merger, referred to as a "going private transaction" in 17 C.F.R. § 240.13e-3 (1985), which governs such transactions, includes any purchase by a company of its own stock, any tender offer for its own stock, or any solicitation to any holder of its stock in connection with a merger, recapitalization, reorganization or similar transaction. Id.

198. See infra note 197.

199. Both the SEC and the Financial Accounting Standards Board have "replacement cost" rules. Inflation created the need for such provisions because historical cost no longer provided a true picture of the value of the assets. See Asset Appraisals, supra note 24, at 697-99. These figures need only be provided on a yearly basis. Id. at 698. Hence, in a tender offer contest, the accuracy of the replacement cost figure may depend on when the tender offer occurred as compared to when the latest figures were disclosed.

200. Asset Appraisals, supra note 24, at 709-10. The greater the difference between the appraisal and figures in currently available information, the greater the need for such an appraisal. Id.

201. Id. at 703-07. Depreciation is based on historical cost and is a deduction from income for income tax purposes. Any inflation or technological progress will make the depreciation too low and income after deducting depreciation too high. Id. at 703. Furthermore, when analyzing balance sheets, investors are concerned with return on assets. If assets are at historical cost, an investor may be misled because the undervaluation of the asset would artificially inflate the return. Id. at 705.

202. The only knowledge of an intent to liquidate the target will be the subjective plans of the offeror. Few offerors would disclose this information. The SEC should promulgate a "safe harbor" stating that if the offeror does not disclose an intent to liquidate, it must wait two years to liquidate or liability will exist.

203. See Speed v. Transamerica Corp., 99 F. Supp. 808, 826 & n.9 (D. Del. 1951) ("plaintiffs and the SEC both reluctantly admitted the asset or real value would not be a significant factor in the absence of a plan to liquidate"). Other cases have viewed the
assets are appraised for much more than stated in existing disclosure, investors may hold their shares and wait for a better offer.

The potential harm of asset appraisals is twofold: inherent uncertainty and conscious manipulation by management.\(^2\) Inherent uncertainty can be minimized by strict SEC guidelines governing appraisal methods and disclosure format.\(^2\) Conscious manipulation by management will always be a possible abuse, but can be controlled by imposing stringent standards of anti-fraud liability when appraisals are prepared by management and by disclosing the source of the appraisal with strong cautionary language if prepared by management. Although each harm should be weighed into the decision to disclose appraisals, a prohibition against disclosure of all appraisals particularly when they are disclosed with cautionary notes is unwarranted and would deprive investors of valuable information.

Disclosure of an appraisal should be mandatory when the offeror intends to liquidate the target company and when the value of the target is principally its assets.\(^2\) When liquidation is not intended, disclosure of appraisals should be required if they are reasonably certain to hold.\(^2\) If they are less certain, disclosure should be permissive and protected by a "safe harbor."\(^2\) The standards for oil and gas reserves and freezeout mergers involve entirely separate considerations and should remain as they currently stand.\(^2\) Finally, cautionary notes and assumptions should state how and by whom the appraisal was prepared.\(^2\)

5. Plans, Capital Budgeting and Dividend Policy

The final category of soft information includes information such as plans and expectations, capital budgeting and expenditures, and future dividend policy. The plans and expectations may be to expand, contract or redirect the corporation. Capital budgeting and expenditure is often

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\(^{204}\) Asset Appraisals, supra note 24, at 707.

\(^{205}\) See supra notes 163-67 and accompanying text on need for cautionary statements and supra notes 168-73 and accompanying text discussing the need for disclosure of assumptions.

\(^{206}\) See supra note 203.

\(^{207}\) It would be preferable to have a standard that more clearly defines a corporation’s duty to disclose. The duty is clear, however, if the appraisal was prepared by an independent appraiser; the appraisal must be disclosed. Court decisions will have to clarify the duty for management prepared appraisals. It is certain that this standard will require disclosure more often than the “substantially certain to hold” standard proposed in Starkman v. Marathon Oil Co., 772 F.2d 231, 241 (6th Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986).

\(^{208}\) A provision similar to that for projections, 17 C.F.R. § 230.175 (1985), is appropriate. See Asset Appraisals, supra note 24, at 711.

\(^{209}\) See supra notes 195, 197 and accompanying text.

\(^{210}\) See Asset Appraisals, supra note 24, at 707-08.
the acquisition or sale of assets of the corporation. This information is inherently "softer" than earnings projections or asset appraisals and often more sensitive.211

In 1977, the Advisory Committee suggested that the SEC encourage disclosure of plans and expectations, capital structure policies and dividend policies.213 Rule 175 incorporated these suggestions into the "safe harbor."215 Disclosure of this information is therefore purely permissive. The "case by case" standard proposed in Flynn, however, applies to "other soft information" as well as asset appraisals.216 The Starkman standard, however, is limited to projections and appraisals.217

This "softer" information is still quite relevant to the investor's decision.218 Any information regarding future developments is valuable information to the investor, provided it is either reliable or the investor knows the limitations of its reliability. There are, however, potential harmful effects of this disclosure. The target may suffer competitive harm if disclosure of "softer" information is mandatory.219 Disclosure of long-range plans, expectations and budgets should not be required.

Balancing potential value against potential harm for "softer" information results in a standard similar to that set out in Starkman that did not apply to "other soft information."220 If "softer" information is "substantially certain to hold," then it is effectively not "softer" information, but rather information falling outside of the first two categories, and an affirmative duty to disclose should exist. Should the information not rise to this level of certainty, a "safe harbor" provision should protect those who decide to disclose. This standard requires disclosure less often than the "reasonably certain to hold" standard for asset appraisals yet ensures that the investor will receive all reliable "softer" information and encour-

211. Plans and budgets are more subjective than other soft information because they are based solely on subjective decisions made by management. The data disclosed, therefore, may not be fully reliable. See Fiflis, supra note 24, at 113.

212. Since this category borders on corporate strategy, it is natural that the sensitivity of the information would be greater, as would the potential for harm regarding a competitive disadvantage vis-a-vis competitors. See Schneider, supra note 44, at 276.


215. 44 Fed. Reg. 38,810, 38,814 (1979) (codified at 17 C.F.R. § 230.175 (1985)) (commenting on 17 C.F.R. § 230.175 (1979)) (included in the definition of a "forward-looking statement" is a "statement of management's plans and objectives for future company operations").


218. See Schneider, supra note 44, at 274 ("filings have traditionally excluded a vast reservoir of information which is highly relevant in predicting future developments—namely, the plans and expectations of the company's management"); see also Fiflis, supra note 24, at 113 (disclosing "softer" information will greatly increase the available relevant evidence of a firm's future prospects).

219. See supra note 212.

220. See supra note 217 and accompanying text.
ages corporations to disclose information that is less certain. It does so by protecting corporations to a greater extent by disclosing under the "safe harbor" than by not disclosing and risking anti-fraud liability if the information is held to be "material." Special attention must be paid in this category to the requirement of disclosing assumptions and appropriate cautionary notes.

**Conclusion**

The SEC has abandoned its traditional policy and is now encouraging disclosure of soft information in tender offer contests. The courts should respond to this shift in policy. The Third and Sixth Circuits have proposed standards to provide guidance for courts attempting to do this, but these standards have not fully accomplished their purpose. Both circuits have underestimated the ability of investors to comprehend soft information without being misled and therefore have overemphasized reliability of the information and have undervalued the investor's need for such information. The solution to these problems is to premise disclosure on the "differential disclosure" theory and to categorize soft information, thus allowing the need for the information to be more appropriately weighed against the potential harm of disclosure for each specific type of information.

Disclosure of earnings projections, the first category, should be mandatory. On the occurrence of a tender offer, the target should be required to disclose an earnings projection for a period of three months to one year into the future. In certain situations, however, corporations should be permitted to petition the SEC for relief from some or all of this required disclosure. Any disclosure beyond what is required should be protected by a "safe harbor."

The investor's need for asset appraisals, the second category, is not as great as that for earnings projections. Accordingly, asset appraisals should not be subject to mandatory disclosure unless an intent to liquidate the target is present or the value of the target lies principally in its assets. Absent this intent, disclosure of appraisals should be required as "material" if the appraisal is reasonably certain to hold and beyond that, a "safe harbor" should protect the disclosure of such information.

All other soft information may be grouped into a third category. Disclosure of information in this category should be mandatory only if the information is "substantially certain to hold." If it is less certain, it should be protected by a "safe harbor."

Furthermore, disclosure of assumptions underlying soft information and cautionary notes should be required. Finally, the law regarding management recommendations should be amended to force management

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221. See supra notes 61-68 and accompanying text.
222. See supra notes 69-76 and accompanying text.
223. See supra notes 36-43 and accompanying text.
to make a recommendation that provides investors with valuable information.

This proposed comprehensive disclosure scheme for soft information will minimize the inconsistencies in court decisions and thereby clarify target corporations' duty to disclose. More importantly, it will give investors the information necessary to protect them by allowing them to make informed decisions in tender offer contests.

Kenneth M. Tallering