Rule 10b-5 and the Corporation's Duty to Disclose Merger Negotiations: A Proposal for a Safe Harbor from the Storm of Uncertainty

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UNCERTAINTY

Introduction

A wave of corporate mergers and acquisitions has swept the investment community in recent years. The negotiations preceding the consummation of these deals are high pressured events with substantial benefits for both the acquiring corporation and the shareholders, such as profits or operating advantages, at stake. If negotiations are disclosed or information is leaked before the discussions solidify, market activity increases as investors rush to buy the target company's stock in order to cash in on the merger premium. As increased trading drives the market price nearer to the offered price, the acquiror may be forced to abandon the discussions, resulting in a loss to the corporation and investors. Consequently, corporations prefer to keep the negotiations secret for as long as possible. Investors, however, want timely disclosure of material corporate information, and the securities laws exist to ensure that they

1. The recent wave of corporate acquisitions and buyouts is the largest in American history. The value of mergers and acquisitions in 1985, at an estimated $125 billion, nearly quadrupled the 1979 level of $34.2 billion, and nearly doubled the 1981 level of $67 billion, the year in which the current merger wave began. See Silk, The Peril Behind the Takeover Boom, N.Y. Times, Dec. 29, 1985, § 3, at 1, col. 2; see also Lawrence, Merger Mania: House of Cards May Collapse, L.A. Times, Feb. 15, 1987, Part IV, at 1, col. 1 ("mark to market" is the jargon used to characterize the current merger mania).

2. The shareholders have the potential to realize a substantial profit by selling their shares at a premium over the market price. See Prokesch, Merger Wave: How Stock & Bonds Fare, N.Y. Times, Jan. 7, 1986, at A1, col. 1, continued at D4, col. 1. The offered price is typically 40-50% above the market price before any takeover action begins. See id.; see also infra notes 42-43 and accompanying text.

3. Operating advantages include the benefits traditionally associated with corporate mergers, such as expansion and diversification, see Silk, supra note 1, at 6, col. 1, and operating efficiencies such as modern manufacturing facilities, an improved sales and marketing network, and a better research and development team. See F.T. Davis, Business Acquisitions Desk Book 49-50 (2d ed. 1981).

4. To illustrate, in 89 large takeovers (more than $100 million in size) in 1984, the target company's stock rose an average of 12% in the month before the takeover announcement, and some of the stocks rose an average of 18.4% in the week prior to announcement. See Bleakley, Wall St. Worries Over Insider Leaks—Merger Bids Bring Abuses, N.Y. Times, Jan. 25, 1985, at D1, col. 4.

5. See infra notes 46-50 and accompanying text.

6. The acquiror desires confidentiality both to avoid an investor stampede on the market, which increases the market price and shrinks the merger premium, thus forcing the offeror to increase the offered price, see infra notes 42-46 and accompanying text, and to avoid drawing competitors into in a bidding war over the target. See Practicing Law Institute, Mergers and Acquisitions, Corporate Law and Practice Transcript Series Number 3, at 36 (1969); see also Bleakley, The Perils of the Takeover Game, N.Y. Times, Jan. 15, 1984, § 3, at 10 ("one takeover bid often sparks another").

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Corporations are faced with a myriad of differing and often conflicting standards as to whether and when they have a duty to disclose negotiations. None of the standards sufficiently balances the competing interests of the corporation for confidentiality with the needs of the investors and purpose of the securities laws for disclosure of material corporate information.

This Note discusses the corporation's obligations to disclose material information generally in Part I, and specific obligations relating to materiality of merger negotiations in Part II. Part III discusses the conflicting standards relating to the corporation's duty to disclose negotiations and the policy interests involved. Part IV argues that the Securities and Exchange Commission should adopt a single Safe Harbor Rule, and proposes a rule that clarifies a corporation's duties concerning disclosure of merger negotiations. The proposed rule creates a definite guideline regarding the content of disclosure that balances the interests of the investor and the corporation.

I. DISCLOSURE OBLIGATIONS GENERALLY

The primary purpose of the securities laws is to protect investors by ensuring that they have an intelligent basis to form decisions regarding the purchase or sale of securities. To achieve this goal, the securities laws set up an intricate system for timely disclosure of material information. The anti-fraud provisions of the Securities Exchange Act of 1934, section 10(b) and Rule 10b-5, impose liability on any person.
who makes an oral or written disclosure that falsely states a material fact, or omits to state a material fact needed to prevent a statement from being misleading in light of the circumstances under which it is made. 18

To determine whether preliminary merger negotiations must be disclosed under 10b-5, courts and the Securities and Exchange Commission (the SEC or the Commission) focus on two elements of the 10b-5 analysis: 19 whether the negotiations were material and whether the company was under a duty to disclose. 20

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18. Rule 10b-5 provides in pertinent part:

\[\text{It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—}\]

\[\text{(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.}\]


17. Neither section 10(b) nor Rule 10b-5 explicitly provides for a private cause of action, but it is well settled that an implied private cause of action exists. The first case on the issue to reach the Supreme Court was in 1971. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971). Lower courts had recognized an implied private cause of action for twenty-five years preceding that case. See, e.g., Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946) (first case to decide the issue). The principle was so well settled by the time it reached the Supreme Court that the Court disposed of the issue in a footnote. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. at 13 n.9. See generally, 5 Jacobs, supra note 11, §§ 8-8.04, at 1-210 to -226 (discussing the origin of the implied private cause of action and its bases). Indeed, the Supreme Court has referred to the 10b-5 implied private cause of action as the "judicial oak which has grown from little more than a legislative acorn." Blue Chips Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975).

18. Rule 10b-5 provides in pertinent part:

\[\text{It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,}\]

\[\text{(a) To employ any device, scheme, or artifice to defraud,}\]

\[\text{(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.}\]


19. There are four elements to a violation of 10b-5: duty to disclose, material fact(s), scienter on the defendant's part, and reasonable reliance by the plaintiff. Levinson v. Basic Inc., 786 F.2d 741, 746 (6th Cir. 1986), cert. granted, 107 S. Ct. 1284 (1987) (listing all four elements); e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976) (intentional misconduct/scienter required); Mills v. Electric Auto-Lite Co., 396 U.S. 375, 380 (1970) (finding that the misstatement caused the plaintiff to act in reliance is a predicate to determination of liability); Financial Indus. Fund v. McDonnell Douglas Corp., 474 F.2d 514, 517 (10th Cir.) (plaintiff must demonstrate reliance), cert. denied, 414 U.S. 874 (1973); see also infra notes 20 & 61-62 and accompanying text.

20. Levinson v. Basic Inc., 786 F.2d 741, 746-47 (6th Cir. 1986) (10b-5 analysis begins with duty and materiality), cert. granted, 107 S. Ct. 1284 (1987); Starkman v. Marathon Oil Co., 772 F.2d 231, 238 (6th Cir. 1985) (there must be a duty before disclosure is
II. Materiality of Preliminary Merger Negotiations

In general, corporate information, including preliminary merger negotiations, does not have to be disclosed unless it is material. There are two predominant standards used to determine materiality of preliminary merger negotiations in actions brought under Rule 10b-5. The Supreme Court set forth the definition of materiality currently applied to 10b-5 actions in *TSC Industries v. Northway, Inc.* Under this standard, a fact is material if there is a substantial likelihood that knowledge of the fact would influence a reasonable investor. The fact need not actually cause

required under 10b-5, and the duty only applies to material facts), *cert. denied*, 106 S. Ct. 1195 (1986); Greenfield v. Heublein, Inc., 742 F.2d 751, 756 (3d Cir. 1984) (discussing duty to disclose, and materiality of merger negotiations), *cert. denied*, 469 U.S. 1215 (1985); Staffin v. Greenberg, 672 F.2d 1196, 1202 (3d Cir. 1982) (2-tier analysis: duty and materiality); *In re Carnation Co.*, Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,595 (July 8, 1985) (legal analysis of disclosure requirements). The interaction of duty and materiality determines whether disclosure is required. Once the court determines that there should have been disclosure, then the scienter and reliance elements are considered to determine if 10b-5 has been violated. Because this Note addresses only the controversy over disclosure of negotiations, it is only concerned with materiality and duty.

21. The wording of Rule 10b-5 prescribes that the fact in issue be material. See supra note 18; Starkman v. Marathon Oil Co., 772 F.2d 231, 238 (6th Cir. 1985) (it is a "basic proposition that only material facts . . . must be disclosed"), *cert. denied*, 106 S. Ct. 1195 (1986); see also 3 A. Bromberg & L. Lowenfels, Securities Fraud & Commodities Fraud § 6.5(421) (1986) ("The sine qua non of an antifraud violation by misrepresentation or omission in a merger is material . . . .") [hereinafter 3 Bromberg & Lowenfels]; 5A Arnold S. Jacobs, Litigation and Practice Under Rule 10b-5 § 61.02[a], at 3-103 (2d ed. 1986 rev.) [hereinafter 5A Jacobs]; Hewitt, *Developing Concepts of Materiality and Disclosure*, 32 Bus. Law. 887, 892 (1977) ("The concept of materiality operates as a limit on the amount of information that must be disclosed under the securities acts . . . [e]xcept for certain detailed affirmative statutory requirements, information must be furnished only if material.") (quoting Securities and Exchange Commission, Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices 21 (May 12, 1976) (footnote omitted)); cf. 17 C.F.R. §§ 240.12b-2, 230.405 (1986) (limits the information required to be disclosed to those matters to which an investor is substantially likely to attach importance).


23. "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Industries*, 426 U.S. at 449.

To formulate an objective definition of materiality, courts have struggled with the standard of probability necessary for information to impact on the investor. The definition went through various changes prior to adoption of the current definition that there be a "substantial likelihood" that the fact "would" influence an investor. The first definition
the investor to change his decision regarding the transaction. It merely has to be substantially likely that the investor would consider it in making his decision, and would view as having "significantly altered the 'total mix' of information made available."

The Court of Appeals for the Second Circuit, in SEC v. Texas Gulf Sulphur Co., articulated a standard that is used to measure the materiality of an expected future event. Under this test, whether a fact is material depends on balancing both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the

adopted by a court of appeals was that a fact is material if it "might" affect the value of the corporation's stock. E.g., Kohler v. Kohler Co., 319 F.2d 634, 642 (7th Cir. 1963). With this test it was fairly easy for a fact to be deemed material. In the years following Kohler, a trend in favor of corporations emerged that made the test of materiality more difficult to meet. For example, in 1965 the Second Circuit defined a material fact as one to which a reasonable investor "would attach importance." List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965) (quoting Restatement, Torts § 538 (2) (a)), cert. denied, 382 U.S. 811 (1965). The Second Circuit altered the definition in 1969 to a fact that "may affect" an investor's decision. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). The Supreme Court, in 1970, combined the "might" standard with a criterion that the fact have a "significant propensity to affect" the investor. Mills v. Electric Auto-Lite Co., 396 U.S. 375, 384 (1970) (emphasis omitted). Finally, in 1976 the Supreme Court articulated the TSC Industries definition, currently in use, that a fact is material if there is a "substantial likelihood" that a reasonable shareholder "would" consider it important. TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976). For detailed discussions of the evolution of the objective standards of materiality see Hewitt, supra note 21, at 893-99, and 5A Jacobs, supra note 21, §§ 61.02[b], at 3-114 -140.


28. Id. at 849. That the rule refers to a future event is implicit in the court's reference to events that "will occur." Id. (emphasis added); see also SEC v. Shapiro, 494 F.2d 1301, 1305-06 (2d Cir. 1974) (balance test used to determine whether facts relating to a future event are material); 5A Jacobs, supra note 21, § 61.02[b][ii], at 3-134 (balance test used to measure the materiality of an uncompleted event).
totality of the company's activity. This test is especially well suited to determine the materiality of merger negotiations since negotiations, by their very nature, deal with a future event.

The Texas Gulf Sulphur test, rather than being an alternative to the TSC Industries definition of materiality, merely delineates specific considerations to determine the materiality of a future event. Both have been used simultaneously to determine the materiality of preliminary negotiations.

III. DUTY TO DISCLOSE UNDER 10b-5

A determination that a fact is material alone does not require disclosure; a duty to disclose also must exist. Corporations subject to regulation by the securities laws and stock exchange rules currently are faced with a myriad of conflicting rules as to when a duty to disclose merger negotiations arises.

30. 5A Jacobs, supra note 21, § 61.02[b][ii], at 3-134. The balance test has been used in cases concerning the materiality of merger negotiations. See, e.g., Michaels v. Michaels, 767 F.2d 1185, 1196 (7th Cir. 1985) (in the context of acquisition negotiations, the court, while applying the TSC definition, analyzes the magnitude of the event's effect on the company), cert. denied, 106 S. Ct. 797 (1986); SEC v. Geon Indus., 531 F.2d 39, 47 (2d Cir. 1976) (merger negotiation context); SEC v. Shapiro, 494 F.2d 1301, 1305-06 (2d Cir. 1974) (merger negotiations).
31. See supra note 28.
32. Even the Texas Gulf Sulphur court did not use its newly-articulated balance test exclusively. Although the case was decided before TSC Industries, the court used both its newly-articulated balancing test and the definition of materiality that preceded the TSC Industries definition (see discussion of the evolution of the definition of materiality, supra note 23). See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969); see also, e.g., Michaels v. Michaels, 767 F.2d 1185, 1196-97 (7th Cir. 1985) (within its application of the TSC Industries definition, the court analyzed the magnitude of the event on the company, which is part of the balance test, although the court did not cite Texas Gulf Sulphur), cert. denied, 106 S. Ct. 797 (1986); SEC v. Gaspar, No. 83 Civ. 3037 (S.D.N.Y. April 15, 1985) (same), reprinted in [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,004, at 90,977; In re Carnation Co., Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 n.7 (July 8, 1985) (applying the TSC Industries definition and referring to balance test); SEC v. Geon Indus., 531 F.2d 39, 47 (2d Cir. 1976) (decided before TSC Industries, but using the Texas Gulf Sulphur balancing test along with the definition of materiality that preceded the TSC Industries definition); SEC v. Shapiro, 494 F.2d 1301, 1305-06 (2d Cir. 1974) (same).
33. See supra note 20 and accompanying text.
34. A corporation's options, and the current conflicting standards of liability for statements made in response to rumors, unusual market activity, or a stock exchange inquiry can be summarized as follows. Under the securities laws the corporation can choose to remain silent or respond "no comment" and possibly incur exchange sanctions, see infra notes 80-88 and accompanying text, or the company can disclose the negotiations and risk disrupting them, or the market. See infra notes 42-46 and accompanying text.

Conversely, the corporation can opt to respond with a "no corporate development" statement, omitting the negotiations and risk possible 10b-5 liability under several theories. First, the duty not to mislead may require disclosure of the negotiations in the initial
A. Affirmative Duty

Courts and the SEC agree that there is no affirmative duty\(^{35}\) to make an initial disclosure of merger negotiations\(^{36}\) unless insiders are trading.\(^{37}\)

statement if they are deemed material. See infra notes 53-55 & 61-62 and accompanying text. Second, the corporation possibly can incur 10b-5 liability for the omission if the courts adopt the interpretation of In re Carnation Co., Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801 (July 8, 1985), that negotiations are presumed material, thus by simply making a statement the company would incur a duty to disclose. See infra notes 104-108 and accompanying text. Third, the initial statement may be proper, but subsequent events may make it misleading, imposing a duty to update. See infra notes 56-62 and accompanying text. Or last, the company might incur no liability for the “no corporate development” statement if the court adopts the reasoning in Greenfield v. Heublein, Inc., 742 F.2d 751, 756 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985), that there is no duty to disclose negotiations until an agreement in principle is reached, even when a statement is made, because they are deemed immaterial as a matter of law. See infra notes 69-71 and accompanying text.

35. “Affirmative duty” refers to the duty to make an initial disclosure. See Levinson v. Basic Inc., 786 F.2d 741, 746 (6th Cir. 1986), cert. granted, 107 S. Ct. 1284 (1987). Although the courts impose a duty to correct a prior statement that has become misleading, see infra notes 56-62 and accompanying text, and correction may include disclosure of negotiations, this Note does not refer to the duty to correct as an “affirmative duty.” Rather, the duty to correct a prior statement that has become false or misleading is treated separately, and referred to throughout this Note as “the duty not to mislead” or the “duty to update.”

36. Under the rules applicable to tender offers, an affirmative duty to disclose negotiations arises when an agreement in principle is reached. Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1986); see also In re Revlon, Inc., Exchange Act Release No. 23320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006, at 88,146 (June 16, 1986) (once negotiations ripen into an agreement in principle they must be disclosed). The Court of Appeals for the Third Circuit, in Staffin v. Greenberg, adopted this affirmative duty in the context of merger negotiations. 672 F.2d 1196, 1207 (3d Cir. 1982) (“where an agreement in principle has been reached a duty to disclose does exist”) (emphasis in original), and a later Third Circuit case, Greenfield v. Heublein, Inc., adopted it as a bright line rule. 742 F.2d 751, 756 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985). It is referred to as a “bright line rule” because the Greenfield court applied it without regard to a prior statement. See infra notes 69-76 and accompanying text). Other courts have subsequently cited Greenfield for its statement of the duty to disclose merger negotiations. See infra note 76. The courts citing this rule, however, have not found a duty based on their factual analyses. See, e.g., Greenfield, 742 F.2d at 757-78 (no duty to disclose because the negotiations were preliminary, no agreement in principle had been reached); Staffin, 672 F.2d at 1207 (no evidence that the discussions developed to an agreement in principle); Guy v. Duff & Phelps, Inc., 628 F. Supp. 252, 255 (N.D. Ill. 1985) (no agreement in principle was reached prior to plaintiff’s decision to leave and resell his stock to the company). Although the duty is stated in the negative, the courts’ factual analyses suggest that if they found an agreement in principle had been reached, they would have found a duty to disclose the merger negotiations. This result is a departure from the long-standing view that, absent certain circumstances there is no duty to disclose merger negotiations. See infra notes 37-40 and accompanying text.

In practice, however, corporations often announce the merger when an agreement in principle is reached. See, e.g., Levinson v. Basic Inc., 786 F.2d 741, 745 (the offer was accepted on Dec. 19th, and was announced on Dec. 20th), cert. granted, 107 S. Ct. 1284 (1987); Greenfield, 742 F.2d at 754 (on July 29th the offer was approved by the Board and announced); In re Carnation Co., Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,595 (July 8, 1985) (agreement approved by both Boards on September 3rd, and announced September 4th).

the company is trading in its own securities, or the company is the source of leaks or market rumors pertaining to the negotiations. Absent disclose depends on a special relationship between buyer and seller, such as an insider, fiduciary or tippee; Staffin v. Greenberg, 672 F.2d 1196, 1203 (3d Cir. 1982) (a duty to disclose under 10b-5 arises when insiders trade, and the duty is phrased in the alternative: either disclose or abstain from trading); Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir. 1976) (same), cert. denied, 429 U.S. 1053 (1977); State Teachers Retirement Bd. v. Fluor Corp., 500 F. Supp. 278, 291-92 (S.D.N.Y. 1980) (duty to disclose arises when corporate insiders desire to trade), aff'd in relevant part, 654 F.2d 843 (2d Cir. 1981). See generally 3 Bromberg & Lowenfels, supra note 21, § 7.4(366)(1), at 7:158.88-91 (discussing the duty to disclose when insiders are trading).


Since unusual market activity is a good indication that undisclosed information is being leaked, some courts and commentators assume that the company is responsible for the leak and, thus, has a duty to disclose. See, e.g., Greenfield v. Heublein, Inc., 742 F.2d 751, 763 (3d Cir. 1984) (Higginbotham, J., dissenting) (defendant "knew of information that if leaked would have explained the [unusual market activity]" and a company should not be "free to assume that its confidences are maintained and accorded complete secrecy, even in the face of otherwise inexplicable investor activity") (emphasis in original), cert. denied, 469 U.S. 1215 (1985); Schlangen v. Four-Phase Sys., 582 F. Supp. 128, 133 (S.D.N.Y. 1984) (defendant had a duty to disclose merger negotiations on the date the trading soared and the stock exchange made an inquiry, because on this date the company "knew of no other fact, apart from leaks, which could have explained the sudden rise in price and volume.") (emphasis in original). The stock exchanges also seem to adopt this view. For example, the New York Stock Exchange (NYSE) requires that if rumors or unusual activity indicate information was leaked, a disclosure is "clearly required." New York Stock Exchange Listed Company Manual § 202.03, reprinted in 3 Fed. Sec. L. Rep. (CCH) ¶ 23,517, at 17,212 (1985) [hereinafter NYSE Manual]. The American Stock Exchange (AMEX) requires that the company inquire into whether it is the source of the leak, and if it cannot determine the source then the Exchange "suggest[s]" that it make at least a "'no news' release." American Stock Exchange Guide § 402(d), reprinted in 3 Fed. Sec. L. Rep. (CCH) ¶ 23,124B, at 17,097-16 (1983) [hereinafter AMEX Guide]. The practical effect of suggesting a "'no news' release" is actually to require one since the company risks exchange sanctions if it does not comply with the request. See infra note 88 and accompanying text); see also Bloomenthal, Materiality and Disclosure of Merger Negotiations—Part III, 8 Sec. & Fed. Corp. L. Rep. 137, 142 (July-Aug., 1986) (a company that makes a statement that there are no corporate developments to explain the market activity "implies that the [company] is unaware of any facts which if leaked are likely to affect the market price of the stock") (emphasis added). But the majority opinion in Greenfield, expressly disagreeing with the dissent, concluded that a mere probability of a leak is not enough to raise an assumption that the company was the source; there must be proof that the company was the source of the leak or rumor. See Greenfield, 742 F.2d at 759 & n.6.

There are problems with both positions. The former, which assumes the company is the source of the leak, disregards the difficulty a company faces in determining whether leaks are attributable to itself. A leak can originate from any of several sources involved
any of these circumstances, there is no affirmative duty to disclose merger negotiations, primarily because disclosure itself can be misleading. When facts are in a state of flux, successive public statements based on changing facts may be more confusing to investors than enlightening.

Further, premature disclosure can harm both the acquiring corporation and the target's shareholders. An offer for a merger or acquisition is usually at a price substantially above the market price—a premium—in order to induce shareholders to accept the offer. When the public learns, or suspects, that negotiations are in progress, speculative investment increases and the volume of trading in the target's stock usually leaps dramatically, driving up the market price. The higher market

with the negotiations, such as attorneys, investment bankers, accountants and printers. See 3 Bromberg & Lowenfels, supra note 21, § 7.4(366)(1), at 7:158.89. On the other hand, the latter position, which requires proof that the company is the source of the leak, ignores that the negotiating parties are not naive, but are highly sophisticated businessmen who understand and recognize the link between unusual market activity and a leak of information regarding merger negotiations. See supra note 4, infra notes 44-45 and accompanying text. Although the controversy has not been settled, the weight of authority tips in favor of assuming the company is the source of the leak, particularly since the majority opinion in Greenfield v. Heublein, Inc., has been severely criticized. See infra notes 72-73 and accompanying text.

40. See Reiss v. Pan Am. World Airways, Inc., 711 F.2d 11, 14 (2d Cir. 1983) ("[M]erger negotiations are inherently fluid and the eventual outcome is shrouded in uncertainty. Disclosure may in fact be more misleading than secrecy so far as investment decisions are concerned."); Staffin v. Greenberg, 672 F.2d 1196, 1206 (3d Cir. 1982) (disclosure itself may be misleading); Susquehanna Corp. v. Pan American Sulphur Co., 423 F.2d 1075, 1084-85 (5th Cir. 1970) (it would have been misleading to disclose merger plans which were so tentative that they were rejected in two days); see also TSC Indus. v. Northway, Inc., 426 U.S. 438, 448-49 (1976) ("bury[ing] the shareholders in an avalanche of trivial information . . . is hardly conducive to informed decisionmaking.").

41. AMEX Company Guide § 402(a), supra note 39, ¶ 23,124B, at 17,097-11 ("successive public statements concerning the same subject (but based on changing facts) may confuse or mislead the public rather than enlighten it"). The AMEX Guide gives acquisition negotiations as an example of a situation that may warrant delayed disclosure until an agreement in principle is reached, but then goes on to say that the company must be prepared to make an immediate public announcement if there are signs of a leak. See id. at 17,097-11; see also NYSE Manual § 202.06, supra note 39, ¶ 23,520, at 17,213 ("a volume of press releases is not to be used since important items can become confused with trivia"); supra note 40.

42. See Prokesch, supra note 2 at D4, col. 1 (the offered price is typically 40-50% above the market price); see also, e.g., Levinson v. Basic Inc., 786 F.2d 741, 745 (6th Cir. 1986) (on July 14, 1978, Basic's stock sold at 26 7/8 per share, on Dec. 14th the tender offer for $46 per share was announced), cert. granted, 107 S. Ct. 1284 (1987); Starkman v. Marathon Oil Co., 772 F.2d 231, 233 (6th Cir. 1985) (Marathon's stock sold for $78 per share the day before the tender offer, at $125 per share, was announced), cert. denied, 106 S. Ct. 1195 (1986).

43. See Staffin v. Greenberg, 672 F.2d 1196, 1206 (3d Cir. 1982) (quoting Hearings on S. 510 before the Subcommittee on Securities of the Senate Committee on Banking & Currency, 90th Cong., 1st Sess. 72 (1967) (statement of Mr. Calvin on behalf of the New York Stock Exchange)).

44. See supra note 4 and accompanying text; infra note 45 for examples.

45. In Levinson v. Basic Inc., 786 F.2d 741 (6th Cir. 1986), cert. granted, 107 S. Ct. 1284 (1987), trading in Basic's stock rose from its normal average of 2,000 to 8,000 shares
price shrinks the premium, thus reducing the incentive for shareholders to accept the tender offer and, possibly, forcing the offeror either to increase the offering price or abandon the offer since even a slight increase in the offered price per share may be more than the offeror can afford, or is willing to pay. If the offeror abandons the deal, the target's shareholders suffer because they lose the opportunity to sell for a premium. Those who bought the stock have paid an inflated price. The offeror loses the potential for realizing an immediate profit by liquidating the acquired company, or the opportunity to diversify, expand, or take advantage of existing or anticipated operating advantages such as modern plant facilities and improved sales and marketing networks. Thus, confidentiality at this early stage benefits both the corporation and the shareholders.

Finally, courts impose no affirmative duty to disclose preliminary negotiations, in part, because of the traditional judicial deference to management discretion known as the business judgment rule. A leak or premature disclosure also may draw competitors into a bidding war over the target. The attendant rise in cost from the bidding war may be too formidable for the original offeror to meet. See Practicing Law Institute, Mergers and Acquisitions, Corporate Law and Practice Transcript Series Number 3, at 36 (1969) ("some of its competitors . . . [may] com[e] in to outbid it"); see also Bleakley, The Perils of the Takeover Game, N.Y. Times, Jan. 15, 1984, § 3, at 10, col. 1 ("one takeover bid often sparks another").

46. See Staffin v. Greenberg, 672 F.2d 1196, 1206 (3d Cir. 1982) (quoting Hearings on S. 510 before the Subcommittee on Securities of the Senate Committee on Banking & Currency, 90th Cong., 1st Sess. 72 (1967) (statement of Mr. Calvin on behalf of the New York Stock Exchange)). A leak or premature disclosure also may draw competitors into a bidding war over the target. The attendant rise in cost from the bidding war may be too formidable for the original offeror to meet. See Practicing Law Institute, Mergers and Acquisitions, Corporate Law and Practice Transcript Series Number 3, at 36 (1969) ("some of its competitors . . . [may] com[e] in to outbid it"); see also Bleakley, The Perils of the Takeover Game, N.Y. Times, Jan. 15, 1984, § 3, at 10, col. 1 ("one takeover bid often sparks another").

47. See Starkman v. Marathon Oil Co., 772 F.2d 231, 239 (6th Cir. 1985). If the deal falls through, stock prices actually may plummet below the pre-takeover-bid price. Bleakley, supra note 46, § 3, at 10, col. 1. The converse may occur if other potential acquirors are drawn into the market and engage in a bidding war. A bidding war can be lucrative for shareholders since the highest bidder, although possibly not the first bidder, may acquire the target, in which case the target's shareholders actually may realize a greater merger premium. See id.

48. See Staffin v. Greenberg, 672 F.2d 1196, 1207 (3d Cir. 1982) (those who buy stock based on information regarding preliminary merger negotiations "are left 'holding the bag' on a stock whose value was inflated purely by an inchoate hope").

49. The offeror has the potential to reap a huge, immediate profit by liquidating the acquired corporation, a new phenomenon that has surfaced in the recent wave of mergers. Silk, supra note 1, at 6, col. 1.

50. See supra note 3 and accompanying text.

51. See Levinson v. Basic Inc., 786 F.2d 741, 746-47 (6th Cir. 1986) (officers and spokespersons of a corporation possess discretion in whether to speak at all), cert.
ment's decision to delay disclosure is warranted when delay serves a valid business purpose.\textsuperscript{52}

B. Duty Not to Mislead—Duty to Update

Despite the absence of an initial, affirmative duty to disclose preliminary merger negotiations, a company may trigger a duty of disclosure under the duty not to mislead if it makes a public statement regarding the negotiations. The duty not to mislead requires that when an issuer makes a statement "in a manner reasonably calculated to influence the investing public," the statement cannot be "false or misleading or . . . so incomplete as to mislead" when viewed in light of the facts existing at the time of the release.\textsuperscript{53} This duty not to mislead is derived explicitly from the language in Rule 10b-5,\textsuperscript{54} and has been adopted by the courts and the SEC.\textsuperscript{55}

Courts have expanded the duty not to mislead to include situations

\begin{itemize}
\item \textsuperscript{52} See, e.g., Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514, 518-21 (10th Cir.) (there was a valid business motive to delay disclosure of decreased earnings until the company could ascertain and verify the amount), \textit{cert. denied}, 414 U.S. 874 (1973); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 n.12 (2d Cir. 1968) (en banc) (material facts do not have to be disclosed immediately; the business judgment of management determines the timing of disclosure), \textit{cert. denied}, 394 U.S. 976 (1969). The Exchanges also recognize that the exercise of business judgment is important in determining the timing of disclosure. See NYSE Manual § 202.06, \textit{supra} note 39, ¶ 23,520, at 17,213 (business judgment must be exercised regarding the timing of public disclosure); AMEX Guide § 402(a), \textit{supra} note 39, ¶ 23,124B, at 17,097-11 (a company may delay disclosure if in its judgment "the unfavorable result to the company outweighs the undesirable consequences of non-disclosure").
\item \textsuperscript{53} See \textit{supra} note 18.
\item \textsuperscript{54} See \textit{supra} note 18.
\item \textsuperscript{55} See, e.g., Levinson v. Basic Inc., 786 F.2d 741, 746 (6th Cir. 1986), \textit{cert. granted}, 107 S. Ct. 1284 (1987); Reiss v. Pan Am. World Airways, Inc., 711 F.2d 11, 14 (2d Cir. 1983) ("Disclosure is a matter of corporate discretion . . . "); Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514, 518-19 (10th Cir.) (discussion of the business judgment rule), \textit{cert. denied}, 414 U.S. 874 (1973); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 n.12 (2d Cir. 1968) (en banc) (material facts do not have to be disclosed immediately; the business judgment of management determines the timing of disclosure), \textit{cert. denied}, 394 U.S. 976 (1969). The Exchanges also recognize that the exercise of business judgment is important in determining the timing of disclosure. See NYSE Manual § 202.06, \textit{supra} note 39, ¶ 23,520, at 17,213 (business judgment must be exercised regarding the timing of public disclosure); AMEX Guide § 402(a), \textit{supra} note 39, ¶ 23,124B, at 17,097-11 (a company may delay disclosure if in its judgment "the unfavorable result to the company outweighs the undesirable consequences of non-disclosure").
\item \textsuperscript{56} See \textit{supra} note 18.
\item \textsuperscript{57} See \textit{supra} note 18.
\end{itemize}
where a voluntary statement, correct and complete when made, becomes misleading due to subsequent material events. The company then must update the prior statement to prevent it from misleading investors. This duty, however, is not indefinite; it exists only as long as investors could reasonably rely on the initial statement. Duration of the duty varies with the circumstances and depends on the importance and nature of the initially released information, the importance of the later information, and the length of time between the initial statement and later developments.

Thus, if a company makes a statement to the public in reference to negotiations, it incurs the duty not to mislead, and possibly the duty to update, even though no affirmative duty exists under the securities laws.

56. See, e.g., Greenfield, v. Heublein, Inc., 742 F.2d 751, 758 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985); Reiss v. Pan Am. World Airways, Inc., 711 F.2d 11, 13 (2d Cir. 1983) (liability rests on showing that the company should have released additional information); Ross v. A. H. Robins Co., 465 F. Supp. 904, 908 (S.D.N.Y.), rev'd on other grounds, 607 F.2d 545 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); Sharp v. Coopers & Lybrand, 83 F.R.D. 343, 346-47 (E.D. Pa. 1979); In re Carnation Co., Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 n.6 (July 8, 1985) (if a statement made in the past has become misleading due to subsequent events, a "no comment" is no longer an appropriate response); NYSE Manual § 202.01, supra note 39, ¶ 23,515, at 17,211 ("[w]here an initial announcement cannot be specific or complete, it will need to be supplemented from time to time").

Logic dictates that the subsequent events should be related to the prior statement. See Schlanger v. Four-Phase Sys., 582 F. Supp. 128, 133 (S.D.N.Y. 1984). In distinguishing Reiss v. Pan Am. World Airways, Inc., the Schlanger court noted that the Pan Am debenture redemption call, which prompted plaintiff to sell his convertible debentures instead of converting them to common stock, was unrelated to the subsequent merger negotiations. The court then concluded that the prior statement cannot be "an otherwise truthful statement concerning an unrelated corporate development." Schlanger, 582 F. Supp. at 133.

57. See supra note 56.

58. See Ross v. A.H. Robins Co., 465 F. Supp. 904, 908 (S.D.N.Y.) (citing 2 A. Bromberg & L. Lowenfels, Securities Fraud & Commodities Fraud § 6.11(543) (1977)), rev'd on other grounds, 607 F.2d 545 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); Bauman, supra note 11, at 963-64. In Greenfield v. Heublein, Inc., 742 F.2d 751, 759 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985), the court recognized the issue that the company's July 14th statement may have expired the next day, but did not feel compelled to address the issue.

59. See Ross v. A.H. Robins Co., 465 F. Supp. 904, 908 (S.D.N.Y.), rev'd on other grounds, 607 F.2d 545 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); Bauman, supra note 11 at 964; see also infra note 60.

60. See Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 103 (10th Cir.) (time lapse between release and when investor sold his stock is a factor in determining if investor relied on the release), cert. denied, 404 U.S. 1004 (1971); Ross v. A. H. Robins Co., 465 F. Supp. 904, 908 (S.D.N.Y.) (effect of time along with the type of later information, and the importance of the earlier information are factors to consider), rev'd on other grounds, 607 F.2d 545 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); United'Indus. Corp. v. Nuclear Corp. of Am., 237 F. Supp. 971, 977 (D. Del. 1964) (discussing the significance of later amendment to a stock purchase contract); see also Bauman, supra note 11, at 964-65 (in determining duration of duty, courts should consider content and predictive nature of statements, and subsequent events after an agreement in principle to merge has been announced).
to make an initial statement at all. Once the duty is established, if negotiations are material in light of existing facts, then the company must disclose the negotiations since the requirements for both materiality and duty—in this case the duty not to mislead—are met.

C. The Bright Line Standard of Duty to Disclose: Greenfield v. Heublein, Inc.

In Greenfield v. Heublein, Inc., Heublein, despite its involvement in merger negotiations, responded to a stock exchange inquiry by stating that it was unaware of any reason for a sudden increase in the trading volume of its stock. The plaintiff relied on the statement and sold his stock the day before trading was halted due to another unusual surge in market activity, and two days before Heublein announced the merger. The Court of Appeals for the Third Circuit, reasoning that preliminary negotiations are immaterial as a matter of law, stated a bright line rule that the negotiations do not have to be disclosed until an agreement in principle is reached. The court went on to define agreement in principle as an agreement on the price and structure of the new company. In considering whether Heublein had a duty to disclose the negotiations at an earlier time, the court, without regard to Heublein's prior statement, applied its bright line rule and found that Heublein had no disclosure.

61. See supra notes 35-40 and accompanying text.
62. See supra notes 19-20 and accompanying text.
63. 742 F.2d 751 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985).
64. Heublein, Inc., was a public company whose stock was traded on the New York Stock Exchange. See id. at 754.
65. See id. at 753-55.
66. See id. at 754.
67. See id. at 754-55. The NYSE had made a second inquiry and request for a "no corporate development" statement due to unusual market activity and Heublein, unable to issue such a statement, requested that the NYSE suspend trading. See id. at 754.
68. See id. at 754-55. On July 26th, the plaintiff placed a "good till cancelled" order to sell his stock when the market price reached $45.25. See id. at 754. His stock was sold on July 27th at that price. See id. at 754-55. On July 28th trading of Heublein's stock was suspended, and on July 29th the merger was announced. See id. at 755.
69. See id. at 756.
70. See id. at 756. The "functional equivalent" of an agreement in principle, however, may be reached before actual agreement on price and structure. See Staffin v. Greenberg, 672 F.2d 1196, 1207 (3d Cir. 1982) (recognizing the possibility of reaching the "functional equivalent" of an agreement in principle, but declining to state the circumstances under which liability would attach); see also In re Revlon, Inc., Exchange Act Release No. 23320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006, at 88,142, 88,147 (June 16, 1986) (the SEC viewed the first offer, which was rejected, as the time when negotiations should have been disclosed because that offer became "the basis upon which the parties negotiated," thus arguably the functional equivalent of an agreement in principle—by this time the parties knew that ultimate agreement was imminent); Thomas v. Duralite Co., 524 F.2d 577, 585 (3d Cir. 1975) (liability of insider who intentionally suspended negotiations before agreement in principle was reached but after negotiations reached the point where a merger was "likely," so that he could trade before an announcement was made).
duty.\textsuperscript{71}

Other courts, commentators and the SEC agree that \textit{Greenfield} was decided incorrectly because it failed to distinguish between the absence of an initial duty to disclose,\textsuperscript{72} and a duty not to mislead once a company decides to make a statement.\textsuperscript{73} The facts in \textit{Greenfield} did not deal with whether the defendant had an initial, affirmative duty to disclose; rather it dealt with a statement already made by the defendant omitting that preliminary merger negotiations were in progress.\textsuperscript{74} Thus, an initial, affirmative duty to disclose was irrelevant; the real issue was whether Heublein violated the duty not to mislead by omitting the negotiations from its statement. In its opinion, the court acknowledged the duty not to mislead,\textsuperscript{75} yet failed to apply it to the facts. Nonetheless, the Third Circuit has yet to overrule its decision in \textit{Greenfield}.\textsuperscript{76}

Although the \textit{Greenfield} bright line standard provides a concrete guideline for corporations, it is an arbitrary standard that does not satisfy the needs of investors. Mergers and acquisitions are momentous events in a corporation's life, possibly involving significant restructuring or even

\begin{footnotes}
\footnote{\textit{Greenfield}, 742 F.2d 751, 756 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985).}
\footnote{72. There is no initial, affirmative duty to disclose negotiations absent certain circumstances, such as insider trading, a company trading in its own stock, or leaks or market rumors attributable to the company. \textit{See supra} notes 37-39 and accompanying text.}
\footnote{73. \textit{See Levinson v. Basic Inc.}, 786 F.2d 741, 748-49 (6th Cir. 1986) (the context of whether information has to be "initially and affirmatively disclosed" is not the same situation as \textit{Greenfield}, where a voluntary statement was made that was factually untrue), \textit{cert. granted}, 107 S. Ct. 1284 (1987); \textit{Greenfield} v. Heublein, Inc., 742 F.2d 751, 760-62 (3d Cir. 1984) (Higginbotham, J., dissenting) (the majority fails to distinguish between the duty to disclose and the duty not to mislead, which are two separate duties), \textit{cert. denied}, 469 U.S. 1215 (1985); \textit{Schlanger v. Four-Phase Sys.}, 582 F. Supp. 128, 132 (S.D.N.Y. 1984) (\textit{Greenfield} "fails to distinguish between situations involving false or misleading statements, and those involving a decision merely to remain silent and not disclose pre-merger negotiations"); \textit{In re Carnation Co.}, Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,595, 87,596 n.8 (July 8, 1985) (a company incurs duty not to mislead whenever it speaks; \textit{Greenfield} was wrongly decided); 3 \textit{Bromberg & Lowenfels}, \textit{supra} note 21, § 7.4(366)(1), at 7:158.88 (the \textit{Greenfield} holding is "dubious").}

75. \textit{See id.} at 758 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir. 1968) (en banc), \textit{cert. denied}, 394 U.S. 976 (1969)).

76. \textit{Greenfield} has been cited for its general statement of the law but has not been applied to a similar fact situation where a prior statement was made; it has only been cited in cases involving situations where \textit{no} statement was made. \textit{See}, e.g., \textit{Guy v. Duff & Phelps, Inc.}, 628 F. Supp. 252, 254-55 (N.D. Ill. 1985) (no prior statement was made regarding Security Pacific's acquisition offer before plaintiff surrendered his stock upon leaving the company); \textit{Nuts v. Penn Merchandising Corp.}, 610 F. Supp. 1573, 1574-75, 1579 (E.D. Pa. 1985) (during Old Penn Co.'s March offer to buy back its stock, it made no statement of its alleged plan to take private Old Penn Co. by merging with the privately held New Penn Co.), aff'd \textit{without opinion}, 791 F.2d 919 (1986); \textit{Enterra Corp. v. SGS Assocs.}, 600 F. Supp. 678, 682-83, 690 (E.D. Pa. 1985) (Enterra's board made no statement regarding SGS's offer to the board to buy Enterra; the board simply considered and rejected the offer).}
\end{footnotes}
corporate "death." Thus, when a corporation makes a statement, putting rumors or unusual market activity in the spotlight, it incurs the duty not to mislead. Preliminary negotiations, in light of this prior statement, can become material before an agreement in principle is reached. Indeed, the Court of Appeals for the Sixth Circuit has noted that "information concerning ongoing acquisition discussions becomes material by virtue of [a] statement denying their existence." Consequently, disclosure of the negotiations before an agreement in principle is reached may be necessary for shareholders to make informed decisions regarding their investments. The Greenfield standard, or any other bright line rule, simply cannot provide for this disclosure.

D. Stock Exchange Obligations

Although the securities laws do not impose an affirmative duty on issuers to make an initial disclosure of merger negotiations, the stock exchanges may do so. When rumors circulate about a possible merger,

77. SEC v. Geon Indus., 531 F.2d 39, 47-48 (2d Cir. 1976) ("Since a merger . . . is the most important event that can occur in a . . . corporation's life, to wit, its death, [the court thought] that inside information [regarding a merger] can become material at an earlier stage than would be the case as regards lesser transactions—and this even though the mortality rate of mergers in such formative stages is doubtless high.").

The target company "dies" in that it often is dissolved and ceases to exist as a separate entity after a merger; the acquiror absorbs the target's assets and, possibly, its personnel. See Practicing Law Institute, supra note 6, at 55, 58. The target company is restructured in many ways, such as by replacing officers and changing by-laws, changing compensation and benefit packages, and relocating plants with possible employee layoffs. See F.T. Davis, supra note 3, at 95-96. With all these potential radical changes looming behind the scenes of negotiations, it is quite possible that the negotiations would become material earlier than transactions with less drastic consequences.

78. See SEC v. Geon Indus., 531 F.2d 39, 50 (2d Cir. 1976) (a "no corporate development" statement issued during negotiations can be misleading because it gives the impression that "all [is] serene" when there is a "significant risk of trouble"); see infra note 79 and accompanying text.


80. Although the New York Stock Exchange and the American Stock Exchange recognize the corporation's right to confidentiality and delayed disclosure, AMEX Guide § 402(a), supra note 39, ¶ 23,124B, at 17,097-10 to -11 (a company can delay disclosure until an agreement in principle is reached); NYSE Manual § 202.01, supra note 39, ¶ 23,515, at 17,210 (premature public announcement may be avoided when discussions are confined to top management), they do so only as long as strict confidentiality is maintained. AMEX Guide § 402(a), supra at 17,097-10; NYSE Manual § 202.01, supra at 17,210. Once unusual market activity or rumors indicate a leak, the exchanges require that the corporation make a disclosure even if the corporation cannot determine whether the corporation itself is the source of the leak. AMEX Guide § 402(d), supra at 17,097-16 ("If the market action [or rumors result] from the 'leak' of previously undisclosed information, the information in question must be promptly disseminated to the public" or a "'no news' release" must be given if the company is unable to determine the cause of the market action); NYSE Manual § 202.03, supra at 17,212 ("If rumors or unusual market activity indicate that information on impending developments has leaked out, a frank and explicit announcement is clearly required."); see also infra notes 83-86 and accompanying text.
acquisition or take-over, or there is unusual market activity such as a dramatic increase or decrease in the trading volume and market price of the stock, the exchange on which the stock is traded may ask the company whether it can account for the activity.\textsuperscript{81} The courts and the SEC agree that a company engaged in preliminary negotiations, faced with a stock exchange inquiry, may remain silent or give a “no comment” response without incurring 10b-5 liability for the statement either initially or subsequently under a duty to update.\textsuperscript{82}

The stock exchanges, however, do not agree. For example, the New York Stock Exchange Company Manual provides that if rumors are circulating or unusual market activity is present, a company must make an explicit announcement either denying or clarifying the rumors.\textsuperscript{83} If rumors are correct or other developments arise, it must make an initial candid statement to the public “as to the state of negotiations” or the developments.\textsuperscript{84} The American Stock Exchange also requires denial or clarification of rumors containing information that can have a significant effect on the market price or is likely to be considered important by a reasonable investor,\textsuperscript{85} and gives mergers and acquisitions as an example of this type of information.\textsuperscript{86} Thus, silence or a “no comment” as an initial response to a stock exchange inquiry, though not resulting in a violation of 10b-5,\textsuperscript{87} can lead to exchange sanctions such as delisting or a

\textsuperscript{81} See, e.g., NYSE Manual § 202.04, supra note 39, ¶ 23,518, at 17,212; AMEX Guide § 404, supra note 39, ¶ 23,124D, at 17,097-20; see also Greenfield v. Heublein, Inc., 742 F.2d 751, 754 (3d Cir. 1984) (it is standard procedure for the NYSE to request a “no corporate development” statement when unusual market activity indicates that some investors may be trading on nonpublic information), cert. denied, 469 U.S. 1215 (1985).

\textsuperscript{82} See Greenfield v. Heublein, Inc., 742 F.2d 751, 760 n.1, 763 (3d Cir. 1984) (Higginbotham, J., dissenting) (“Silence or a simple ‘no comment’ is always an available option for a corporation. . . . Updates are required only of corporate disclosures, and neither of these responses can be considered a disclosure.” Judge Higginbotham added in a footnote his view that “[i]n no comment” is “the legal equivalent to not making a statement at all.”), cert. denied, 469 U.S. 1215 (1985); SEC v. Geon Indus., 531 F.2d 39, 50 (2d Cir. 1976) (dictum) (parties charged would not have violated 10b-5 by failing to issue a public statement or adopting a “no comment” policy); In re Carnation Co., Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,595-96 n.6 (July 8, 1985) (“no comment” is permissible if the company wants to prevent premature disclosure of merger negotiations, but is not appropriate if, inter alia, a prior statement was made). But see 5A Jacobs, supra note 21, § 61.04(c)(ii), at 3-245 (“no comment” would be misleading if no negotiations were in progress or planned, but it is “unobjectionable if negotiations are planned or in progress and a valid corporate purpose is served in not revealing the facts at that time”).

\textsuperscript{83} NYSE Manual § 202.03, supra note 39, ¶ 23,517, at 17,212.

\textsuperscript{84} Id. The NYSE Manual does not specify “merger” negotiations; arguably, however, its specific reference to negotiations suggests that the provision was drafted specifically to meet the controversy over the duty to disclose merger negotiations.

\textsuperscript{85} See AMEX Guide § 401(c), supra note 39, ¶ 23,124A, at 17,097; see also id. at ¶ 402(d), ¶ 23,124B, at 17,097-16 (disclosure or a “‘no news’ release” is required in response to unusual market activity).

\textsuperscript{86} See id. at ¶ 402(a), ¶ 23,124B, at 17,097-99.

\textsuperscript{87} For a discussion of a possible implied cause of action under Rule 10b-5 for breach of an exchange rule, see Bauman, supra note 11, 977-88.
To avoid sanctions for silence or a reply of "no comment," the company may opt to respond to the inquiry with a "no corporate development" statement that asserts that the company knows of no reason or corporate development that can explain the unusual market activity. Issuing a "no corporate development" statement may satisfy the company's obligations under the exchanges' rules, but it also may lead to substantial 10b-5 liability for a number of reasons.

First, by making a statement, the company triggers the duty not to mislead. Thus, if negotiations are in progress or imminent, and are material, the company may be liable for omitting them. Second, if the "no corporate development" statement is correct and no negotiations are in progress or imminent at the time of the release, but actual or imminent negotiations subsequently develop, then the company may have the duty to update the prior statement to prevent it from misleading investors. This no-win situation for corporations—either remain silent or give a

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89. For 10b-5 purposes the statement is deemed voluntary since a stock exchange inquiry does not impose a duty to disclose under 10b-5. See Greenfield v. Heublein, Inc., 742 F.2d 751, 760, & 761 n.3 (3d Cir. 1984) (Higginbotham, J., dissenting), cert. denied, 469 U.S. 1215 (1985). See also supra note 82 and accompanying text. It is questionable as to how "voluntary" the statement really is in light of the not-so-subtle threat of a trade halt or delisting.


91. AMEX Guide § 402(d), supra note 39, ¶ 23,124B, at 17,097-16 (a "no news" release is desired if the company is unable to determine the cause of the market action); NYSE Manual § 202.03, supra note 39, ¶ 23,517, at 17,212 (a "no corporate development" statement can have a salutary effect on the market).

92. See supra notes 53-55, 61-62 and accompanying text.

93. See supra notes 56-62 and accompanying text.


If the only choices open to a corporation are either to remain silent and let false rumors do their work, or to make a communication, not legally required, at the risk that a slip of the pen or failure properly to amass or weigh the facts—all judged in the bright gleam of hindsight—will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers, most corporations would opt for the former.

Id. at 867 (Friendly, J., concurring).
"no comment" reply at the risk of incurring exchange sanctions, or give a "no corporate development" statement to satisfy the exchanges but risk 10b-5 liability—demonstrates the need for a definite rule clarifying a company's duty when faced with this dilemma.

E. SEC's Position—In re Carnation

In In re Carnation Co.,95 a recent SEC interpretive release96 dealing with whether preliminary merger negotiations must be disclosed,97 the Commission applied the duty not to mislead.98 The Commission concluded that any public statement or response to a stock exchange inquiry concerning "rumors, unusual market activity, possible corporate developments or any other matter" must be accurate and complete, and include sufficient information regarding acquisition discussions that are occurring at the time of the release, if their omission would cause the statement to be materially misleading.99 Carnation has spawned confusion over whether the SEC imposes an affirmative duty to disclose preliminary negotiations.100 This confusion, however, is unfounded because the Commission in Carnation imposes disclosure obligations only when a company has made an initial state-
ment. Thus, *Carnation* does not impose an initial affirmative duty, it merely re-affirms the duty not to mislead. Indeed, the Commission itself denies that *Carnation* imposes an affirmative duty to disclose preliminary merger negotiations.

Less clear, however, is whether *Carnation* proposes that preliminary negotiations are to be *deemed* material as a matter of law when a corporation makes a statement, and consequently must be disclosed. The confusion stems from imprecise language in the release. The Commission states that negotiations "[are] material and must be disclosed," but qualifies its statement by the definition of materiality. In effect, the Commission states that information as to negotiations *is material* and must be disclosed *if material*. This imprecise, circular language can be interpreted in one of two ways. One possible interpretation is that the Commission merely was restating prior law that when a company makes a statement, incurring the duty not to mislead, it must disclose negotiations if they are material. Another interpretation is that the Commission views negotiations as material per se whenever an issuer makes a public statement, thus requiring disclosure since both the duty and materiality elements are present. The Court of Appeals for the Sixth Circuit seems to have adopted the latter interpretation, concluding that "information concerning ongoing acquisition discussions becomes

101. See *In re Carnation Co.*, Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,595 (July 8, 1985) ("If the issuer is aware of nonpublic information concerning acquisition discussions that are occurring *at the time the statement is made* . . .") (emphasis added); *id.* at 87,596 ("*When an issuer makes a public statement, information concerning preliminary acquisition discussions is material and must be disclosed* . . .") (emphasis added); *id.* at 87,597 ("*Issuers that make public statements are required . . . to speak truthfully and to include all material facts [so as not to mislead, and] . . . this requirement applies to issuers engaged in preliminary acquisition discussions.*") (emphasis added).


103. See infra text accompanying notes 104-08.


105. *id.* The Commission quotes the definition of materiality currently applied to 10b-5 actions. *See supra* notes 23-26 and accompanying text.

106. *See supra* text accompanying notes 61-62.

107. This interpretation focuses on the language "*[w]hen an issuer makes a public statement, information concerning preliminary discussions is material and must be disclosed*" without regard to the qualification as to materiality. *See In re Carnation Co.*, Exchange Act Release No. 22214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 (July 8, 1985) (emphasis added); *see also supra* note 100.
material by virtue of the statement denying their existence." The uncertainty created by Carnation provides another reason for a clarifying rule.

IV. A Safe Harbor Rule for the Disclosure of Merger Negotiations

The conflicting standards currently applied to public statements made while merger negotiations are occurring, has caused the securities bar and the SEC to recognize the need for a safe harbor rule to clarify companies' duties and shield them from liability in appropriate circumstances. Such a rule would encourage companies to release at least some accurate information instead of a "no comment" response for fear of liability.

A. A Proposed Safe Harbor Rule

The SEC should adopt a safe harbor rule to clarify when a company has a duty to disclose merger negotiations, and when it can opt to disclose without liability. A safe harbor rule should be flexible and harmonize the needs of investors for timely and accurate information with the

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109. See supra note 34 for a summary of the conflicting standards.

110. Implicit in "safe harbor" is that the rule creates a shield from liability provided it is followed with precision.

111. See Address by Royce Griffin, President of the North American Securities Admin. Ass'n to an SEC forum (Feb. 19, 1986), remarks in 18 Sec. Reg. & L. Rep. (BNA) No. 8, at 253 (Feb. 21, 1986) ("The Commission should set standards as to when preliminary merger discussions should be disclosed."); Address by SEC Commissioner Charles C. Cox to Sixth Annual Northwest Securities Institute (Feb. 22, 1986), remarks in 18 Sec. Reg. & L. Rep. (BNA) No. 9, at 285 (Feb. 28, 1986) ("the SEC may adopt a rule that would allow a corporation to deny a false rumor" and not incur a duty to update, if the statement "were true, accurate and made in good faith"); Address by SEC Commissioner Joseph Grundfest to the Federal Regulation of Securities Commission of the ABA's Section of Corporation, Banking and Business Law (April 5, 1986), remarks in 18 Sec. Reg. & L. Rep. (BNA) No. 15, at 521 (Apr. 11, 1986) (noting the need for "an appropriate safe harbor for statements that have a defined life in the market").

The SEC has adopted safe harbor rules in analogous circumstances in order to encourage voluntary disclosure of information for which there is no legal requirement of disclosure. E.g., Safe Harbor Rule for Projections, Securities Act Release No. 6,084, Exchange Act Release No. 15,944, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,117, at 81,938 (June 25, 1979) (providing a safe harbor for disclosure of "soft information," such as financial projections, management plans, and predictions of future economic performance, to encourage voluntary disclosure).

112. See Address by SEC Commissioner Grundfest, supra note 111 ("Such a rule would allow corporations to speak with greater specificity and could encourage issuers to release at least some accurate information . . . instead of adopting a broad 'no comment' policy [due to] fear of misinterpretation."); Bloomenthal, supra note 39, at 140 ("[a]bsent some type of safe harbor . . . issuers and their counsel are likely to opt for "no comment" or a general statement . . . until an agreement in principle has been reached," thus furnishing no or very little information to investors); see also infra note 114. But see Address by John J. Phelan, NYSE Chairman, to SEC Forum (Feb. 19, 1986), 18 Sec. Reg. & L. Rep. (BNA) No. 8, at 253 (Feb. 21, 1986) ("no comment" response usually signals to the market that something is going on).
needs of the negotiating parties for confidentiality. It should also provide a reasonably definite guideline by which an issuer can tailor its actions regarding the timing, frequency, and content of its public statements without fear of liability. Premature disclosure of negotiations, or the disclosure of too much information, would disrupt both the market and the negotiations, possibly resulting in a loss of premium to all shareholders.

The following proposed rule synthesizes the relevant authority previously discussed and adopts those views that achieve a balance among the competing interests.

1. Silence or “No Comment”

When an issuer is faced with unusual market activity, or rumors about preliminary merger, acquisition, or related negotiations, the rule should reflect current law: absent certain circumstances, the corporation has no affirmative duty to disclose merger negotiations and the company can respond to these events with “no comment” and not incur liability under 10b-5. Such a rule clarifies that a corporation has the discretion to remain silent, dispelling the fear, which has arisen since Carnation, that corporations have an affirmative duty to disclose negotiations.

Further, allowing silence or “no comment” also defers to corporate management’s business discretion regarding the timing of disclosure. Finally, by allowing confidentiality, the silence or “no comment” provision

113. See Greenfield v. Heublein, Inc., 742 F.2d 751, 756 (3d Cir. 1984) (“Merger discussions arise in a wide variety of circumstances and the standard used to determine when disclosure of these is required must be both flexible and specific.”), cert. denied, 469 U.S. 1215 (1985). It seems paradoxical, however, that the Greenfield court saw the need for a flexible standard yet chose the one that it deemed “concrete” and “definite” over the “less rigid” standard of “intent of the parties to merge” suggested by the plaintiff. Id. at 757; see also supra notes 42-50 and accompanying text for a discussion of the effect on the market and negotiations when confidentiality is breached.

114. See TSC Indus. v. Northway, Inc., 426 U.S. 438, 448-49 (1976) (rule should be definite so that management’s fear of substantial liability does not “cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.”); Starkman v. Marathon Oil Co., 772 F.2d 231, 239 (6th Cir. 1985) (rule should eliminate the situation where, for fear of liability, management is induced to disclose “mountains of documents and hourly reports on negotiations ..., a deluge of information which would be more likely to confuse than guide the reasonable lay shareholder” and could interfere with negotiations), cert. denied, 106 S. Ct. 1195 (1986); 5A Jacobs, supra note 21, § 61.02[a], at 3-104 (standard must allow “potential defendants [to] tailor their actions accordingly”).

115. See supra notes 44-47 and accompanying text.

116. Occasionally the proposed rule merely adopts current law, but it is included in the rule for the sake of clarity and completeness.

117. Under certain circumstances, such as insider trading, a company’s trading in its own stock, or when the company is the source of leaks or rumors, an affirmative duty to disclose is imposed. See supra notes 35-39 and accompanying text.

118. See supra note 82 and accompanying text.

119. See supra note 82 and accompanying text.

120. See supra notes 100-02 and accompanying text.
helps further both corporate and investors' interests in achieving a successful tender offer at a premium over market.121

This provision would not solve the company's problem of the stock exchanges requiring a statement.122 One commentator discusses, as a possible solution, that exchange rules be changed to allow "no comment" in response to an inquiry.123 This is an insufficient solution because it reduces the pressure to make a statement from all sources, in effect discouraging disclosure since a company always would opt for a "no comment" as it would incur neither 10b-5 liability nor exchange sanctions. This result neither promotes the disclosure policies of the securities laws nor meets the needs of investors for information.124 Although the proposed rule does not solve the problem of exchange requirements, it makes a trade-off by lessening the potential 10b-5 liability once a statement is made, as set forth below.125

2. Initial Voluntary Statements

Although the rule should enable corporations to remain silent or respond with a "no comment," to meet the disclosure policies of the securities laws it should encourage the corporation to make a statement.

a. Initial Statement—Denial of a False Rumor

The rule should provide a safe harbor from liability for statements that deny a false rumor, and "no corporate development" statements denying knowledge of the reason for the unusual market activity or source of the rumor, if the statements are true, accurate and made in good faith.126

121. See supra notes 42-43 and accompanying text.
122. See supra notes 80-88 and accompanying text.
124. A "no comment" may actually provide information in that it may signal to the market that something is going on. See Address by John J. Phelan, NYSE Chairman, supra note 112, at 253; see also Note, supra note 123, at 557-58 (discussing the problems inherent with a "no comment" response). This type of ambiguous signal, however, is entirely speculative, and is not nearly the type of disclosure sufficient to meet investors' needs or the securities laws' requirements. Indeed, the speculative nature of the "no comment" actually could spur unusual market activity, only adding to the problem. A "no comment" is a disfavored solution, which is one reason why the proposed rule encourages actual disclosure of at least general information, and does not eliminate stock exchange pressure for a statement.
125. See the proposed rule regarding voluntary statements, infra notes 126-149 and accompanying text.
126. Section 23(a) of the Exchange Act, 15 U.S.C. § 78w(a)(1) (1982), provides in part that there is no liability under the securities laws for "any act done or omitted in good faith in conformity with a rule, regulation or order of the Commission." Further, SEC Commissioner Charles C. Cox, in his address regarding the reluctance of companies to deny false rumors due to concern that the statement subsequently will be deemed false or misleading, said that an SEC safe harbor rule should eliminate a duty to update a statement denying false rumors if the initial statement was true, accurate and made in good faith. Address by SEC Commissioner Charles C. Cox to the Sixth Annual Northwest Securities Institute (Feb. 22, 1986), remarks in 18 Sec. Reg. & L. Rep. (BNA) No. 9, at
b. Initial Statement—Disclosure of Information Regarding Negotiations

If the corporation decides to disclose information regarding negotiations, the rule should delineate guidelines that specify content requirements for disclosure. The rule should provide a safe harbor from liability for an initial statement that meets the rule's criteria, if the statement is true, accurate and made in good faith. Such guidelines should specify that if preliminary negotiations relating to an acquisition or merger are occurring or are reasonably imminent at the time of the release, the company must disclose sufficient information regarding these discussions so as to make the statement not materially misleading at the time of the release.

Unlike the provision that allows a company involved in negotiations to postpone their disclosure by remaining silent or responding with "no comment," this provision prevents a company involved in negotiations from postponing their disclosure if it decides to make a voluntary statement. This effectively rejects the Greenfield bright line rule that negotiations do not have to be disclosed until an agreement in principle is reached, and adopts the interpretation of Carnation that negotiations must be disclosed when a corporation makes a statement. By adopting this interpretation, the rule reflects the view that once a statement is made and the company incurs the duty not to mislead, negotiations become material in light of this statement before an agreement in principle is reached.

After requiring sufficient disclosure in voluntary statements, the rule should specify that general disclosure is sufficient until an agreement in principle is reached, and that any statement made may specify the


The rule logically would not protect "no corporate development" statements made when negotiations are actually occurring or are imminent since such a statement is neither true nor accurate, and could not have been made in good faith.

127. See supra note 114 and accompanying text.


130. See supra notes 69-71 and accompanying text.

131. See supra notes 107-108 and accompanying text.

132. See supra notes 77-79 and accompanying text.

133. The Court of Appeals for the Sixth Circuit has stated:

The SEC and the courts have enunciated a firm rule regarding a . . . duty to disclose ongoing negotiations: so long as merger or acquisition discussions are preliminary, general disclosure of the fact that such alternatives are being con-
time period to which it refers. General disclosure includes basic information, such as that negotiations are being considered or are in preliminary stages, without specifying details of the terms or parties involved. By providing that general disclosure is sufficient, there is less chance of disrupting negotiations than if disclosure of the tentative terms, the parties involved, or other details were required. General disclosure also satisfies the target’s and acquiror’s interest in keeping certain details confidential, particularly the acquiror’s identity. If the rule compelled a

considered will suffice . . . [until such time as] an agreement in principle, regarding such fundamental terms as price and structure, has been reached. Starkman v. Marathon Oil Co., 772 F.2d 231, 243 (6th Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986); see also Reiss v. Pan Am. World Airways, Inc., 711 F.2d 11, 13 (2d Cir. 1983) (neither the court nor the plaintiff questioned sufficiency of Pan Am’s voluntary general statement that a “firm merger offer was under consideration”); Bloomenthal, supra note 39, at 142 (suggesting that safe harbor rule allow general disclosure). In a tender offer context the SEC specifically allows general disclosure until an agreement in principle is reached. See In re Revlon, Inc., Exchange Act Release No. 23320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006, at 88,146 (June 16, 1986) (disclosure that negotiations are being undertaken or are underway and are in preliminary stages is sufficient; once they ripen into agreement in principle, they must be disclosed); Schedule 14D-9, item 7, 17 C.F.R. § 240.14d-101 (1986) (filings regarding a tender offer).

134. SEC Commissioner Aulana Peters asserted that companies can qualify their statements in some way, such as stating “this is the situation as of right now,” thereby avoiding an updating requirement. Address by SEC Commissioner Aulana Peters to Practicing Law Institute’s “SEC Speaks” (Mar. 7, 1986), remarks in 18 Sec. Reg. & L. Rep. (BNA) No. 11, at 345 (Mar. 14, 1986); see also SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 863-64 (2d Cir. 1968) (en banc) (“it would have been more accurate [for the company] to have stated that the situation was in flux and that the release was prepared as of April 10 information rather than purporting to report [on April 12] the progress ‘to date.’”), cert. denied, 394 U.S. 976 (1969).

135. For example, in Starkman v. Marathon Oil Co., 772 F.2d 231 (6th Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986), Marathon’s letter to its shareholders advising them to reject Mobil’s hostile tender offer, included a copy of Marathon’s Schedule 14D-9 which generally disclosed that Marathon was pursuing several alternatives to the Mobil offer including, inter alia, acquisition of all or part of the company, or a “business combination” with another company, without specifying the other company or the stage of negotiations. Id. at 236. See also, e.g., Reiss v. Pan Am. World Airways, Inc., 711 F.2d 11, 13 (2d Cir. 1983) (Pan Am’s general statement that a “firm merger offer was under consideration” was not questioned); In re Revlon, Inc., Exchange Act Release No. 23320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006, at 88,146 (June 16, 1986) (disclosure that negotiations are being undertaken or are underway and are in preliminary stages is sufficient).

136. The facts change so rapidly during the early stages of negotiations that it may be too difficult to describe the details accurately. See supra notes 40-41 and accompanying text. Additionally, disclosure of details diverts resources from the negotiation process. See Bloomenthal, supra note 39, at 141. Finally, if the corporation had to face potential 10b-5 liability for rapidly changing details, it would doubtless opt not to make a statement at all. See supra note 94.

137. The potential acquiror usually insists on confidentiality. See, e.g., Levinson v. Basic Inc., 786 F.2d 741, 744 (6th Cir. 1986) (the acquiror’s vice president advised against public disclosure after he and an officer of the target company arranged for a “best offer” to be made), cert. granted, 107 S. Ct. 1284 (1987); Staffin v. Greenberg, 672 F.2d 1196, 1207 n.12 (3d Cir. 1982) (strictest confidentiality is often required, and the acquiror (Northern) nearly withdrew from discussions after the target company made a public statement); In re Carnation Co., Exchange Act Release No. 22214, [1984-1985
company that makes a voluntary statement to disclose details, the company doubtless would opt to remain silent to preserve the confidentiality of the acquiror's identity. Such a rule would serve only to discourage disclosure. Requiring only general disclosure respects the company's need for secrecy while encouraging disclosure of at least some accurate information. Further, a general disclosure provision acknowledges that specific details at this stage of negotiations are in flux and their disclosure may mislead, rather than guide, the investor. If a statement meets the disclosure requirements, then the initial statement is not misleading and would not give rise to liability.

The overall result of the provisions dealing with initial disclosure is that a company involved in negotiations can maintain complete confidentiality by remaining silent or issuing a "no comment" response to market rumors, unusual market activity, or a stock exchange inquiry. If the company decides to make a statement, however, it cannot deny or omit the negotiations; it must make at least a general disclosure.

3. Duty to Update

The rule should reflect current law that there is no duty to update a "no comment" response. It should also eliminate the duty to update a true, accurate and good faith denial of a false rumor, or "no corporate development" statement. It should not, however, abrogate the duty to update statements that disclose information regarding negotiations. Such a rule meets the goals of the securities laws for timely disclosure of material corporate information in the following ways.

First, neither the company nor the investor benefits from a false rumor; hence, the best thing for both is to quash the rumor to allow the market to function normally with the existing truthful information. If the rule imposed a duty to update a denial of a false rumor, corporations would be discouraged from making a denial for fear of incurring 10b-5 liability under the duty to update. This result clearly fails to promote dissemination of truthful information. A rule that eliminates the fear of 10b-5 liability for both the initial denial and under the duty to update encourages corporations to make truthful denials, recognizing the valuable effect these statements have in bringing the market back to a normal

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138. See supra note 137.
139. See supra note 112 and accompanying text.
140. See supra notes 40-41 and accompanying text.
141. See supra note 82 and accompanying text. But see supra notes 80-81 & 83-88 and accompanying text.
142. See supra notes 11-13 and accompanying text.
143. See supra note 94 and accompanying text; see also supra notes 56-62 and accompanying text explaining the duty to update.
level of activity. Additionally, it is unfair to impose a duty to update a truthful denial when the corporation did not initiate the false rumor, but was willing to come forward voluntarily and clarify the situation.

Second, to ensure that the goals of the securities laws are served, the rule should provide that when a company makes a statement disclosing information about negotiations, and it has become misleading due to subsequent material events, the company must update the statement to make it once again truthful and reliable. The rule as proposed, however, does not totally disregard corporate interests in favor of the investor. It allows a corporation to qualify its statement as to the time frame to which the statement represents, thus reflecting that statements have a limited life in the market. Consequently, if the company states that the release only represents the state of affairs as of a certain date, an investor reasonably may rely on it for only a short period of time, limiting the time frame within which there exists the duty to update. Totally eliminating the duty to update statements disclosing information would unfairly disregard the needs of investors for accurate information. By preserving the duty, but allowing corporations to shorten the time to which it applies, the rule balances the investors' needs for accurate information with the corporation's need for a guideline. Moreover, a statement that specifies the time period it represents benefits investors by obviating the need to speculate whether it still represents the current state of affairs.

The proposed safe harbor rule encourages corporations to make true and accurate statements regarding rumors or unusual market activity, instead of remaining silent or issuing a "no comment" statement. The proposed rule eliminates the fear of 10b-5 liability for the initial statement, and eliminates or at least decreases the possibility of 10b-5 liability under a duty to update. A statement made in compliance with the proposed rule also meets the exchanges' requirement of prompt, candid disclosure. Finally, encouraging disclosure furthers the purpose of the securities laws, providing investors with timely, accurate information on which to base their investment decisions.

144. See NYSE Manual § 202.03, supra note 39, ¶ 23,517, at 17,212 (a no corporate development statement can have a salutary effect on the market).
145. If the company is the source of the false rumor then there is an affirmative duty to disclose material information under the securities laws and the safe harbor rule is inapplicable. See supra text accompanying notes 35-39.
146. See supra note 134.
147. Address by SEC Commissioner Joseph Grundfest, supra note 111, at 521; supra notes 58-60 and accompanying text.
148. See supra note 134.
149. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 864 (2d Cir. 1968) (en banc) ("it would have been more accurate [for the company] to have stated that the situation was in flux and that the release was prepared as of April 10 information rather than purporting to report [on April 12] the progress 'to date.' "), cert. denied, 394 U.S. 976 (1969).
CONCLUSION

Corporations subject to the securities laws need a single rule clarifying their duty to disclose merger negotiations when faced with rumors, unusual market activity, or a stock exchange inquiry. The proposed safe harbor rule represents an optimal rule because it recognizes the corporation's right to remain silent in these situations, yet encourages disclosure. Through a definite guideline concerning the content of any statement made, the proposed rule clarifies the corporation's duty to disclose negotiations in a voluntary statement, and provides a safe harbor from liability for those statements that meet its criteria. The guideline itself balances corporate and investor interests. Finally, the rule, by encouraging disclosure, promotes the policies behind the securities laws to meet investors' need for timely corporate disclosure of material information.

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