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What Is a Misleading Statement or Omission Under Rule 10b-5?

Cover Page Footnote

The author gratefully acknowledges the invaluable substantive suggestions of Ed Kaufmann and Fredric J. Klink, members of the New York Bar, the editorial aid of Ellen K. Jacobs and Ann S. Kheel, and the stenographic help of Mary Ann Assicurato.

WHAT IS A MISLEADING STATEMENT OR OMISSION UNDER RULE 10b-5?

ARNOLD S. JACOBS*

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I. INTRODUCTION

SECTION 10(b) of the Securities Exchange Act permits the Securities and Exchange Commission to promulgate rules to prohibit "any manipulative or *deceptive* device or contrivance."¹ The SEC effectuated the intent of that section by adopting rule 10b-5.²

The Rule is the most powerful and most widely-used tool in the federal arsenal of securities remedies. It prohibits a wide variety of conduct in many areas, including those of broker-dealers' activities,³

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1. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1970) (emphasis added) [hereinafter cited by section as 1934 Act].

2. The text of rule 10b-5 [hereinafter cited as "the Rule" or "10b-5"] is as follows:

"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,

(a) To employ any device, scheme, or artifice to defraud,

(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, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (1973).

3. See Jacobs, *The Impact of Securities Exchange Act Rule 10b-5 on Broker-Dealers*, 57

manipulation,⁴ mismanagement,⁵ exchange offers and tender offers, and tipping of inside information. But by far the majority of 10b-5 cases arises under a sixth category—misrepresentations and omissions.

To state a 10b-5 cause of action, a successful plaintiff must demonstrate, among other things, that a statement or omission is misleading.⁶ The question of when an assertion or omission is misleading is the topic of this article.

Of 10b-5's three clauses, the second is on its face the most germane. It declares that it is unlawful

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. . . .⁷

Although clauses (a) and (c) may seem less relevant, they also play an important role in the determination of misrepresentations and omissions. Courts do not rely strictly on the wording of the three clauses to ascertain the Rule's outer limits. Nevertheless, the word "untrue" in clause (b) could be considered narrower than the phrase "false or misleading" found in some other 1934 Act provisions.⁸ The difference is more apparent than real however,⁹ and in any event clauses (a) and (c) are broad enough to remedy any shortcoming in clause (b) arising from the absence of the phrase "false or misleading." Therefore, cases arising under remedies granted by other securities acts are persuasive authority with regard to whether or not the plaintiff was misled.

The Rule prohibits misrepresentations, half-truths, omissions, and concealments of after-acquired information.¹⁰ Deception may be accomplished either by words or by nonverbal conduct.¹¹

Cornell L. Rev. 869, 871 & n.8 (1972); Comment, Broker Silence and Rule 10b-5: Expanding the Duty to Disclose, 71 Yale L.J. 736 (1962).

4. See Jacobs, Regulation of Manipulation by SEC Rule 10b-5, 18 N.Y.L.F. 511 (1973).

5. See Jacobs, The Role of SEC Rule 10b-5 in the Regulation of Mismanagement, 59 Cornell L. Rev. 27 (1973).

6. As to the other elements of a 10b-5 action generally, see 3A H. Bloomenthal, Securities and Federal Corporate Law § 9.21 (1972).

7. 17 C.F.R. § 240.10b-5(b) (1973).

8. The "false or misleading" wording is used, for example, in 1934 Act §§ 9(a)(4) & 18(a), 15 U.S.C. §§ 78i(a)(4) & 78r(a) (1970).

9. In practice, the courts have drawn no distinction between the two formulations. But see *Gould v. American Hawaiian S.S. Co.*, 319 F. Supp. 795, 801-02 (D. Del. 1970).

10. Misrepresentations and omissions are the most common 10b-5 violations. *SEC v. National Bankers Life Ins. Co.*, 324 F. Supp. 189, 195 (N.D. Tex.), aff'd, 448 F.2d 652 (5th Cir. 1971).

11. For examples of nonverbal violations see *Carroll v. First Nat'l Bank*, 413 F.2d 353 (7th Cir. 1969), cert. denied, 396 U.S. 1003 (1970); *Brennan v. Midwestern United Life Ins. Co.*, 259 F. Supp. 673 (N.D. Ind. 1966), trial on the merits, 286 F. Supp. 702 (N.D.

A misrepresentation is defined as a statement which conveys a false impression to a reasonable investor.¹²

A half-truth is a statement which accurately discloses some facts but misleads the listener or reader by concealing other data necessary for a true understanding. One example of a half-truth is a statement that the value of a company's inventory increased without disclosure that the increase arose from an arbitrary revaluation.¹³ Half-truths are, perforce, usually more difficult to detect than outright lies.¹⁴

Clause (b) of the Rule prohibits both misrepresentations and half-truths, but it alone may not reach the third category, complete silence. However, clauses (a) and (c) have been interpreted to proscribe complete silence when there is a duty to disclose.¹⁵ When this duty does exist, a plaintiff would be misled by defendant's failure to reveal facts of which plaintiff was unaware. The principal applications of the silence

Ind. 1968), *aff'd*, 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970); *Cochran v. Channing Corp.*, 211 F. Supp. 239, 241-43 (S.D.N.Y. 1962); *Pro Rata Stock Distributions to Shareholders*, SEC Securities Exchange Act Release No. 9618 (June 1, 1972), 4 CCH Fed. Sec. L. Rep. ¶ 72,146.

12. See generally notes 22-30 *infra* and accompanying text regarding the definition of "misleading." Numerous cases have held that misrepresentations are actionable. See cases cited in Part II *infra*.

13. *Bowman & Bourdon, Inc. v. Rohr*, 296 F. Supp. 847, 851 (D. Mass.), *aff'd per curiam*, 417 F.2d 780 (1st Cir. 1969). A small sampling of other half-truth cases would include *SEC v. North Am. Research & Dev. Corp.*, 424 F.2d 63, 77 (2d Cir. 1970); *SEC v. Great Am. Indus., Inc.*, 407 F.2d 453, 461 (2d Cir. 1968), cert. denied, 395 U.S. 920 (1969); *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, 307 F. Supp. 910, 913-14 (S.D.N.Y. 1969), *aff'd*, 425 F.2d 842 (2d Cir. 1970); *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757, 762, 773 (D. Colo. 1964); *Meisel v. North Jersey Trust Co.*, 218 F. Supp. 274, 278 (S.D.N.Y. 1963); *Cochran v. Channing Corp.*, 211 F. Supp. 239, 243 (S.D.N.Y. 1962). The concept of half-truth has also been expanded to include failure to correct a misleading impression the defendant knew plaintiff received from another party. *Moerman v. Zipco, Inc.*, 302 F. Supp. 439, 446 (E.D.N.Y. 1969), *aff'd per curiam*, 422 F.2d 871 (2d Cir. 1970).

The Commission has taken the concept a step further by "urging" reporting of an adverse development when favorable information is made public, even though the two items are not related. Comment on *Timely Disclosure of Material Corporate Developments*, SEC Securities Exchange Act Release No. 8995 (Oct. 15, 1970), [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,915.

14. *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. 66, 95 (E.D.N.Y. 1969), *aff'd*, 478 F.2d 1281 (2d Cir. 1973).

15. *Myzel v. Fields*, 386 F.2d 718, 733 & n.6 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968); *List v. Fashion Park, Inc.*, 340 F.2d 457, 461-62 (2d Cir.), cert. denied, 382 U.S. 811 (1965); *SEC v. Crofters, Inc.*, 351 F. Supp. 236, 255 (S.D. Ohio 1972); *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757, 762 (D. Colo. 1964); *Meisel v. North Jersey Trust Co.*, 218 F. Supp. 274, 278 (S.D.N.Y. 1963); *Cochran v. Channing Corp.*, 211 F. Supp. 239, 243 (S.D.N.Y. 1962); *Cady, Roberts & Co.*, 40 S.E.C. 907, 913 & n.20 (1961).

prohibition are to transactions in the over-the-counter market or on a national securities exchange, but, theoretically, it could also pertain when a trade is made in a face-to-face meeting.

The final type of misleading activity is the concealing of after-acquired information which indicates that a statement previously made was misleading. Certified independent public accountants have a duty to disclose after-acquired information,¹⁶ and issuers also may have this obligation.¹⁷

II. GENERAL RULES

The Rule prohibits a wide variety of misleading written and oral statements.¹⁸ The same standard for determining whether a statement is misleading is not applied to all types of statements; for example, courts tolerate a lower standard of accuracy for (and hence do not condemn as quickly) misstatements or half-truths in shorter, less formal statements prepared under the exigencies of time pressure.¹⁹ Thus, proxy statements and registration statements are usually viewed with a more

16. Note, *Accountants' Liability for Nondisclosure of After-Acquired Information: Strict Liability Under Rule 10b-5?*, 22 Rutgers L. Rev. 554, 568-69, 576-77 (1968) (discussing in particular *Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967)).

17. See Note, *supra* note 16, at 579-80; note 230 *infra* and accompanying text.

18. In discussing the standards for misleading statements, no distinction is drawn between oral and written representations since the same rules apply. Oral statements can be classified as either formal or informal, depending upon the circumstances, although they would usually be informal.

The majority of the text is directed to misrepresentations and half-truths, but the same principles apply to silence and concealment of after-acquired information. In addition, the concepts of whether a statement is misleading and of when a fact is material are sometimes confused but are nevertheless distinct questions. Some of the authorities mentioned here in the discussion of misleading statements also consider the concept of materiality at the same time.

19. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 362 n.14 (2d Cir. 1973), cert. denied, 94 S. Ct. 232 (1973), rev'g 337 F. Supp. 1128 (S.D.N.Y. 1971) (interpreting 1934 Act § 14(e), 15 U.S.C. § 78n(e) (1970), and quoting *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 948 (2d Cir. 1969)); *Kohn v. American Metal Climax, Inc.*, 313 F. Supp. 1251, 1258, 1260 (E.D. Pa. 1970) (denial of preliminary injunction). See *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255, 286-87 (3d Cir.) (concurring and dissenting opinion), cert. denied, 409 U.S. 874 (1972), modifying 322 F. Supp. 1331 (E.D. Pa. 1970); *Electronic Specialty Co. v. International Controls Corp.*, *supra*; *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 883 (2d Cir. 1968) (en banc) (dissenting opinion), cert. denied, 394 U.S. 976 (1969), on remand, 312 F. Supp. 77 (S.D.N.Y. 1970), modified, 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 337 F. Supp. at 1136; cf. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-94 (1963) (different standards at common law); *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159, 162 (2d Cir. 1968), cert. denied, 393 U.S. 1026 (1969) (proxy rules and election contest).

critical eye than either press releases or letters to stockholders mailed during a proxy fight or tender offer. Aside from practical considerations, this flexible approach is based soundly on a desire not to impair the flow of voluntarily-released corporate information by imposing too strict a standard.²⁰

With this caveat in mind, we can explore a number of general rules courts have used to judge whether or not a statement is misleading. Later, we shall also discuss some standards for special applications.²¹

In general, a statement can be misleading for either of two reasons: the items disclosed do not describe the facts accurately, or insufficient data are revealed.²² The Tenth Circuit summarized these two points nicely:

The misleading, misrepresented or untruthful character of the release may appear from the nature of the statement considered alone, *or*, when the facts are fully disclosed, from the half truths, omissions or absence of full candor concealed therein.²³

Regarding the first reason, the Second Circuit in 1968 equated the questions of whether a press release was "misleading" with "whether it conveyed to the public a false impression of the drilling situation at the time of its issuance."²⁴ The court elaborated on the point when it remanded the case to the district court "for a determination of the character of the release in the light of the facts existing at the time of the release, by applying the standard of whether the reasonable investor, in the exercise of due care, would have been misled by it."²⁵ Therefore, a

20. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 882 (dissenting opinion); see Lester v. Preco Indus., Inc., 282 F. Supp. 459, 464 (S.D.N.Y. 1965). This consideration, though, relates only to corporate publicity, since registration statements, proxy statements, reports filed with the SEC, and the like are mandatory. Therefore, any loosening of the standards will relate to voluntary-type publicity.

21. See Part III *infra*.

22. The common law recognizes other types of misleading statements. According to Restatement of Torts § 526 (1938), a misrepresentation is fraudulent if the maker:

"(a) knows or believes the matter to be otherwise than as represented, or

(b) knows that he has not the confidence in its existence or non-existence asserted by his statement of knowledge or belief, or

(c) knows that he has not the basis for his knowledge or belief professed by his assertion."

The concepts embodied in all three clauses should be equally applicable to the Rule.

23. Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 97 (10th Cir.), cert. denied, 404 U.S. 1004 (1971) and 405 U.S. 918 (1972) (emphasis added); accord, Gilbert v. Nixon, 429 F.2d 348 (10th Cir. 1970):

"The misrepresentation or omission must be misleading. This may appear from its nature considered alone, or because it is not explained in a way to obviate its otherwise misleading character." *Id.* at 356.

24. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 862.

25. *Id.* at 863. On the prior page, the court had observed that the "appropriate primary

statement might be misleading under the first reason because it was not understandable at all, it was unclear and hence was interpreted incorrectly, it contained a false statement, or it concealed data needed to make itself accurate.

Whether a statement is misleading for the second reason—failure to disclose sufficient data—depends on the context in which the statement is made. When securities are bought, sold, or held on the basis of the statement, sufficient facts must be disclosed so that an informed investment decision can be made.²⁶ Similarly, a proxy statement²⁷ sent to voting stockholders must make “full and fair disclosure of those facts that a stockholder might reasonably need in order to make an intelligent decision with respect to the proposal.”²⁸ The test in a tender offer or

inquiry [should be] into the meaning of the statement to the reasonable investor and its relationship to truth.” *Id.* at 862. The Second Circuit also noted that the public should be able to evaluate a statement without having to read between the lines. *Id.* at 864. See also *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 362-63 (“reasonable investor”); *Hohmann v. Packard Instrument Co.*, 471 F.2d 815 (7th Cir. 1973) (“certainly gave adequate information to advise any reasonably prudent investor.” *Id.* at 821); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 863 (a “reasonable investor” might have read between the lines); *Reynolds v. Texas Gulf Sulphur Co.*, 309 F. Supp. 548, 562 (D. Utah 1970), modified sub nom. *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir.), cert. denied, 404 U.S. 1004 (1971) and 405 U.S. 918 (1972) (press release must be accurate, fair and complete).

Note that the court in *Kaplan v. Vornado, Inc.*, 341 F. Supp. 212 (N.D. Ill. 1971) seemed to confuse two issues. The court properly observed that “[a] reasonable man, or, as it has been called, a reasonable investor standard is to be used in determining whether the contested representation is misleading or deceptive.” *Id.* at 215. The judge then elaborated on the decision in *City Nat’l Bank v. Vanderboom*, 422 F.2d 221, 230-31 (8th Cir.), cert. denied, 399 U.S. 905 (1970), which is really a test for determining under what conditions the “in connection with” requirement of the Rule is satisfied by misrepresentations and omissions. The Eighth Circuit’s intent in the *Vanderboom* case is evidenced clearly by its discussion in 422 F.2d at 229-30.

26. *SEC v. North Am. Research & Dev. Corp.*, 424 F.2d 63, 77 (2d Cir. 1970). This is analogous to the treatment of half-truths; see notes 13-14 *supra* and accompanying text.

In *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971), the following test was espoused with regard to registration statements: “[T]he objectives of full disclosure can be fully achieved only by complete revelation of facts which would be material to the sophisticated investor or the securities professional not just the average common shareholder. But, at the same time, the prospectus must not slight the less experienced. They are entitled to have within the four corners of the document an intelligible description of the transaction.” *Id.* at 566.

27. A proxy statement could also be the basis for a trading decision, in which case the test in the text accompanying note 26 *supra* would apply.

28. *Richland v. Crandall*, 262 F. Supp. 538, 553 (S.D.N.Y. 1967); accord, *Allen v. Penn Cent. Co.*, 350 F. Supp. 697 (E.D. Pa. 1972) (“read as a whole by a reasonable shareholder,” *id.* at 702; “must explain the proposal accurately and fully,” *id.* at 705); *Nanfuto v. Tekseed Hybrid Co.*, 341 F. Supp. 240 (D. Neb. 1972) (“full disclosure of all informa-

exchange offer is whether the security holder receives sufficient facts to make a reasoned decision whether or not to tender or exchange his certificates.²⁹ Finally, stockholders in a proxy contest must be well enough informed to be able to decide to whom to grant their proxy.³⁰

These general tests apply when the recipient of the statement is, depending upon the circumstances, a reasonable investor, reasonable voting stockholder, or reasonable security holder in a tender or exchange offer.³¹ This is, therefore, a reasonable man standard,³² and includes speculators and chartists.³³ But the Second Circuit has indicated that a statement is misleading only if it appears so to a reasonable investor who exercises due care.³⁴ This aspect should be distinguished from the reasonable or justifiable reliance which some courts have required.³⁵

tion which the ordinary investor of common business experience would require in making an informed investment decision." *Id.* at 243, *aff'd*, 473 F.2d 537 (8th Cir. 1973) ("all information which would have enabled [plaintiff-stockholder] to determine how her interest in the corporation might be altered" in the merger. *Id.* at 541); *Browning Debenture Holders' Comm. v. DASA Corp.*, 357 F. Supp. 1010 (S.D.N.Y. 1972) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970) and quoting *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519 (S.D.N.Y. 1970), where it was said that it was "enough if proxy material sets forth all the facts necessary to enable a reasonably intelligent stockholder to make his own informed decision." *Id.* at 524); *cf. Robinson v. Penn Cent. Co.*, 336 F. Supp. 655 (E.D. Pa. 1971) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)) ("our concern is not the sophisticated analyst, but the reasonable stockholder . . ." *Id.* at 657). Compare *Rafal v. Geneen*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,505, at 92,442 (E.D. Pa. 1972) (proxy rules; may make a difference only to a few stockholders but nevertheless misleading).

29. See *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 564-65 (E.D. N.Y. 1971); 3A H. Bloomenthal, *Securities and Federal Corporate Law* § 13.23 (1972).

30. See *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159, 162 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969).

31. The Second Circuit did not elaborate on the meaning of "reasonable investor," except to indicate that speculators and chartists are included in the definition. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 849. On remand, the district court did not elaborate either. 312 F. Supp. 77, 83 (S.D.N.Y. 1970), modified, 446 F.2d 1301 (2d Cir.), *cert. denied*, 404 U.S. 1005 (1971). The same result obtains under the tests for misleading proxy statements when votes are taken. See note 28 *supra* and accompanying text for a treatment of the concepts "reasonably needed" and reasonable stockholder.

32. *Kaplan v. Vornado, Inc.*, 341 F. Supp. 212, 215 (N.D. Ill. 1971). No case discusses the standard of conduct to which the reasonable investor must conform. *Cf. Securities Act of 1933* § 11(c), 15 U.S.C. § 77k(c) (1970) [hereinafter cited by section as 1933 Act] ("prudent man in the management of his own property") and *Trust Indenture Act of 1939* § 315(c), 15 U.S.C. § 7700o(c) (1970) ("as a prudent man would exercise or use under the circumstances in the conduct of his own affairs").

33. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 849; *id.* at 888 (dissenting opinion).

34. See text accompanying note 25 *supra*.

35. The issue as regards the misleading nature of a statement is whether a reasonable investor would take away an impression which is contrary to the facts. Reasonable reliance

As a corollary of this reasonable man standard, investors and stockholders can be presumed to have a general understanding of the business world when determining whether a statement is misleading.⁸⁶ Courts must read this qualification neither too broadly, which would defeat otherwise valid claims, nor too narrowly, which would lead companies to issue statements containing much obvious, commonly-known information. This qualification is also clearly applicable to unspoken assumptions. For example, an announcement of a large new contract is not misleading merely because it omits a boilerplate sentence to the effect that "there can be no assurance that the contract will be profitable." Nor would a summary of the terms of a nonconvertible security be misleading if it failed to mention lack of convertibility, since a reasonable investor would properly assume that the security carried no conversion privilege.⁸⁷ Similarly, disclosure of a prospective purchaser's rights is permissible without stating the rights he does not have.⁸⁸ On the other hand, a statement is misleading if a reasonable investor would assume from the release that the underlying and undisclosed facts were typical, while in reality they were not.⁸⁹ More difficult is the question of whether a *misrepresentation*, rather than an omission, can be so outlandish to a reasonable investor as to preclude the statement from being misleading. While there is no controlling authority, a strict application of the test

pertains to the question of whether a reasonable man would believe the statement. For example, an assertion that the company's president had learned to fly by flapping his hands is misleading because it conveys a false impression, but it would not be believed because it is so outrageous.

36. E.g., *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840 (2d Cir. 1967) (question of tax law "of doubtful materiality in view of the wide awareness of the tax consequences of selling stock and the availability of tax advice." *Id.* at 843); *Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co.*, 356 F. Supp. 1066, 1071 (S.D.N.Y.), *aff'd*, 476 F.2d 687 (2d Cir. 1973); *Armstrong v. Sailboat Marine, Inc.*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,105, at 91,050 (E.D.N.Y. 1971) (not misrepresentation for outsider to tell insider that corporation will go bankrupt); *Swanson v. American Consumer Indus., Inc.*, 288 F. Supp. 60, 65 (S.D. Ill. 1968), *rev'd on other grounds*, 415 F.2d 1326 (7th Cir. 1969) (spoon-feeding not required); *Richland v. Crandall*, 262 F. Supp. 538 (S.D.N.Y. 1967) ("not required to address . . . stockholders as if they were children in kindergarten." *Id.* at 554); see *Bowman v. Hartig*, 334 F. Supp. 1323, 1328 (S.D.N.Y. 1971). See also *Jacobsen Mfg. Co. v. Sterling Precision Corp.*, 282 F. Supp. 598, 602 (E.D. Wis. 1968) (placing one stock price in tender offer material is not misleading by virtue of failure to give range of prices, since these prices are readily available).

37. *Were v. Mack*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,956, at 90,520 (S.D.N.Y. 1971).

38. *Ashton v. Thornley Realty Co.*, 346 F. Supp. 1294 (S.D.N.Y. 1972), *aff'd*, 471 F.2d 647 (2d Cir. 1973).

39. In such a situation, disclosure must be made if the issuer is, or should be, aware of the facts.

for determining when a statement is misleading would prevent recovery.⁴⁰ However, it does not follow that a naive plaintiff should never be able to sue successfully⁴¹ if the fact misrepresented is material.⁴² And a particular plaintiff may be prohibited from invoking the Rule if he knows, or perhaps if he should know, of the statement's misleading nature. In short, a statement is not misleading if a reasonable investor knows, or perhaps in the exercise of due diligence should know, the truth concerning an omitted or misstated fact. Courts should make an exception to this rule and consider a statement misleading when the speaker knows the recipient will misconstrue it, although a reasonable investor would not.⁴³

A number of other principles supplement these tests for ascertaining when enough data are disclosed. First, the statement must always be *materially* misleading.⁴⁴ This requirement does not arise from the Rule's wording. Rather, courts have added it to preclude recovery for a minor error. For example, a corporation might issue a press release reporting earnings of \$5.27 per share for the year when it knew the true figure was \$5.26 per share. A person purchasing on that basis has relied on a misstatement (he received the wrong impression) of a material fact,⁴⁵ but he should not be permitted to recover damages. Perhaps this is equivalent to saying the statement caused him no injury. Second, a series of minor imperfections can be cumulated to render a statement misleading. Judge Wright treated this issue under the guise of materiality, but his discussion better relates to the question of whether a statement is misleading:

[I]t is proper to find a proxy statement . . . violated [section 14(a) of the 1934

40. See notes 24-25 *supra* and accompanying text.

41. In fact, only the unsophisticated investor could perhaps show reliance.

42. In considering the issue of materiality, one must ask if the misstated or omitted fact is material assuming the statement as made would mislead a reasonable investor. 3A H. Bloomenthal, *Securities and Federal Corporate Law* § 9.21, at 9-73 (1972).

43. Cf. Restatement of Torts § 538(b) (1938) (reaching same result in determination of materiality).

44. See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 383 (1970); *Chris-Craft Indus., Inc., v. Piper Aircraft Corp.*, 480 F.2d at 362-63; *id.* at 398-99 (concurring and dissenting opinion); *Hope v. Hayden-Stone, Inc.*, 469 F.2d 1060, 1061 n.1 (5th Cir. 1972); *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 271 (concurring and dissenting opinion); *Green v. Jonhop, Inc.*, 358 F. Supp. 413, 418 (D. Ore. 1973); *Republic Tech. Fund, Inc. v. Lionel Corp.*, 345 F. Supp. 656, 662 (S.D.N.Y. 1972), *rev'd in part*, 483 F.2d 540 (2d Cir. 1973); *Nicholson File Co. v. H.K. Porter Co.*, 341 F. Supp. 508, 521 (D.R.I. 1972), *aff'd*, 482 F.2d 421 (1st Cir. 1973); cf. *Allen v. Penn Cent. Co.*, 350 F. Supp. at 702 (proxy rules).

45. Earnings are almost always material, since they almost always affect the value of the corporation's stock, which is the definition of materiality used in, e.g., *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965); *Kohler v. Kohler Co.*, 319 F.2d 634, 642 (7th Cir. 1963).

Act, 15 U.S.C. § 78n(a) (1970)] if one misstatement or omission influences another and to find the aggregate "material." After a further development of the facts, it may become apparent that although some or all of the alleged misstatements and omissions are only slightly inaccurate or misleading, the combination of these misstatements will amount to inadequate disclosure

This Court is of the view that [section 14(a) does not allow] a proxy [statement] to omit a factor or two here, disperse others through the proxy statement, make a slightly misleading statement there, and rest on the assumption that the drafter's task has been adequately performed if he can avoid blatant fraud and still keep the stockholder from discovering which shell the pea is under.⁴⁶

Third, a difference of opinion has developed as to whether "puffing" or "sales talk" is permissible.⁴⁷ The better view is that such statements should be considered misleading, even though the reliance requirement sometimes may render them immune from a successful damage action.

46. *Gould v. American Hawaiian S.S. Co.*, 319 F. Supp. 795, 809-10 (D. Del. 1970) (motion for partial summary judgment); accord, *Gould v. American Hawaiian S.S. Co.*, 331 F. Supp. 981, 997 n.18 (D. Del. 1971) (second motion for partial summary judgment), modified, 351 F. Supp. 853 (D. Del. 1972); *Dillon v. Berg*, 326 F. Supp. 1214, 1234 (D. Del.), aff'd per curiam on other grounds, 453 F.2d 876 (3d Cir. 1971); Note, *Publicity and the Security Market: A Case Study*, 7 U. Chi. L. Rev. 676, 691 (1940). Compare *Gilbert v. Nixon*, 429 F.2d 348, 358-59 (10th Cir. 1970) (misrepresentation on some geological leases does not carry over to other leases which are geologically unconnected).

The aggregating of facts within a single document to determine if the document is misleading is different from the question whether a series of accurate statements closely related in time and dealing with the same subject can be cumulated to make the series misleading. Cf. *AMEX Company Manual* § 403(5), at 110 (1968) (when series of public announcements can be "unwarranted promotional activity"). One example would be announcements pertaining to a merger issued when negotiations commenced, when an agreement in principle was reached, when each of the boards approved the transaction, when stockholders of each constituent corporation voted, and when the merger was consummated. The theoretical basis for considering this a 10b-5 breach is not readily apparent. Perhaps an argument could be made that while each statement alone is accurate, the overall impression from so many statements is misleading.

47. Authorities permitting some puffing include: *Bowman v. Hartig*, 334 F. Supp. 1323, 1328 (S.D.N.Y. 1971) (permissible if reasonable person would not believe the "puff"); *Phillips v. Reynolds & Co.*, 294 F. Supp. 1249, 1256 (E.D. Pa.), motion to amend denied, 297 F. Supp. 736 (E.D. Pa. 1969) ("puffing" not grounds for civil liability unless grossly exaggerated); *Dolgow v. Anderson*, 43 F.R.D. 472, 490 (E.D.N.Y. 1968), rev'd, 438 F.2d 825 (2d Cir. 1971); *SEC v. Chamberlain Associates*, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,228, at 94,070 (S.D.N.Y. 1963); Comment, *Texas Gulf Sulphur: A Logical and Necessary Extension of Judicial History?*, 17 U. Kan. L. Rev. 263, 276 (1969) [hereinafter cited as *Texas Gulf Sulphur Comment*] (minor puffing permissible where no intent to harm); Note, *Civil Liability Under Section 10B and Rule 10B-5: A Suggestion for Replacing the Doctrine of Privity*, 74 Yale L.J. 658, 688-89 (1965); see *Green v. Jonhop, Inc.*, 358 F. Supp. at 418.

Cases refusing to recognize puffing are cited in 6 L. Loss, *Securities Regulation* 3541-43 (Supp. 1969).

Fourth, the accuracy of a statement is measured at the time it is made.⁴⁸ Accordingly, a defendant cannot defend successfully on the ground that a subsequent fortuitous event rendered a misleading statement true if plaintiff was committed to act prior to such event. But a plaintiff should not be permitted monetary recovery if he acted after, and *knew* of, the subsequent event, even though the defendant breached the Rule. Conversely, subsequent unforeseeable events cannot render misleading a statement which was true when made.⁴⁹

A number of circumstances have been cited as extrinsic evidence that a statement is misleading.⁵⁰ Failure of one side in a proxy contest or contested tender or exchange offer to object to a statement by the other side has been held to be some evidence that the statement is not misleading.⁵¹ On the other hand, absence of insider trading should not demonstrate that a statement is true.⁵² Finally, market price movements have been inspected to ascertain whether a release was bullish or bearish.⁵³ An increase in the market price of a corporation's stock after a statement is disseminated, absent an intervening event or market trend, is evidence that reasonable investors viewed the statement as favorable. Similarly, a decline in the price tends to show the announcement was viewed pessimistically. However, this standard must be applied judiciously when rumors are circulating or if the market has already discounted the occurrence of the event. In the latter situation, the market movement after a release probably would reflect a comparison between a reasonable investor's view of the release on the one hand, and the rumor or the anticipated scope of the event in the eyes of the investment community on the

48. *Abrahams v. Aptman*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,818, at 93,550 (S.D.N.Y., Mar. 9, 1973); *Fenstermacher v. Philadelphia Nat'l Bank*, 351 F. Supp. 1015, 1022 (E.D. Pa. 1972).

49. For instance, an accurate announcement of the possibility of an ore strike is not rendered misleading by a subsequent earthquake. *Texas Gulf Sulphur Comment*, *supra* note 47, at 276-77. The result might be otherwise if the events were foreseeable to a reasonable issuer. Nevertheless, there might be a duty to correct the earlier release. On the other hand, it would be misleading to state a fact which was true at the time made if the speaker concealed that the situation would change. Compare *Abrahams v. Aptman*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,818, at 93,550 (S.D.N.Y., Mar. 9, 1973).

50. As a matter of proof, where a contract memorializes the transaction in question, that contract can be used as evidence of the understanding at the time of the signing. *Bowers v. Columbia Gen. Corp.*, 336 F. Supp. 609, 626 (D. Del. 1971). The contract does not foreclose attack by the plaintiff, however. *Id.*

51. Cf. *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159, 162 (2d Cir. 1968), cert. denied, 393 U.S. 1026 (1969) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)) (it is evidence of lack of materiality if the other side does not object during proxy contest).

52. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 860 (absence of insider trading also does not prove absence of motive).

53. *Id.* at 863; *id.* at 866 (concurring opinion); *id.* at 880 (dissenting opinion).

other. It follows that a market decline after a release could mean either that the release was adjudged unfavorable, or that the release was believed favorable but not as bullish as the result the market had assumed would occur.⁵⁴

Whether an item is misleading is a fact issue.⁵⁵ Ambiguities should be construed in favor of investors, tendering or exchanging security holders, and voting stockholders, since the securities laws are intended to protect them.⁵⁶

Merely because a statement is misleading does not mean the Rule has been violated.⁵⁷ And even if an infraction has occurred, the plaintiff does not *ipso facto* have a cause of action for damages.⁵⁸

Judicial views have been expressed regarding the type of information which must be disclosed in a document. Courts have opined that only "facts,"⁵⁹ and not conclusions or predictions,⁶⁰ must be revealed. Indeed,

54. This type of comparison was made in the dissenting opinion in *Texas Gulf Sulphur* but not in the opinion of the court. Compare *id.* at 863 (majority opinion) with *id.* at 880 (dissenting opinion). Significant market reaction to a statement correcting a prior release should be evidence that the prior release was misleading.

See also *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 292-93 (concurring and dissenting opinion) (permissible to disclose "actual" state of affairs, although not technically true; however, case deals with atypical fact pattern).

55. See *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 293 (concurring and dissenting opinion); note 25 *supra* and accompanying text.

56. See *SEC v. North Am. Research & Dev. Corp.*, 424 F.2d 63, 77 (2d Cir. 1970); *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. 66, 95 (E.D.N.Y. 1969), *aff'd*, 478 F.2d 1281 (2d Cir. 1973); cf. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 385 (1970) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)) (once materiality is shown, should resolve all doubts regarding causation in favor of stockholders, since statute designed to protect them); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 375 (tender offer provisions); *id.* at 399 (concurring and dissenting opinion). See also *Restatement of Torts* § 527 (1938) (construe ambiguous representation against maker if he intended that false meaning should be conveyed).

57. For instance, the information contained in the statement may be false—causing the statement to be misleading—but no violation would ensue if the facts were gathered by the issuer with due diligence.

58. One instance would be where a press release was misleadingly pessimistic and plaintiff bought securities as a result. Cf. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 293 (concurring and dissenting opinion) (full disclosure would have given even more reason for the shareholders to vote as they did); *List v. Fashion Park, Inc.*, 227 F. Supp. 906, 912 (S.D.N.Y. 1964), *aff'd*, 340 F.2d 457 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965) (concealment of pessimistic fact when plaintiff sells). This is a question of reliance or causation.

59. See authorities cited in note 72 *infra*.

This is a different concept from the construction of the word "fact" in the context of "material fact." Thus, for instance, the SEC's position for many years has been that projections and forecasts cannot be placed in a prospectus, even if such information were material facts. See *Daum & Phillips, The Implications of Cady, Roberts*, 17 *Bus. Law.* 939, 954 (1962); Part III-G *infra* (regarding projections and forecasts). But projections are

disclosure of vague generalities rather than facts can be objectionable.⁶¹

Naturally, a statement is not inherently misleading if facts as well as conclusions or future events are presented fairly, but liability may still flow from an erroneous conclusion or prediction.⁶² Thus a corporation need not reveal conclusory material such as: explanations made to establish anticipatory defenses to stockholders' claims;⁶³ the possible social effects of business practices;⁶⁴ arguments against an adequately described course of action or conflicting interpretations of the facts;⁶⁵ alternative courses of action;⁶⁶ or arguments against a proposal submitted to stockholders.⁶⁷ Nor is there any need to prophesy future effects of a transaction where they are "remote, uncertain or possible consequences [and] beyond [the defendant's] control."⁶⁸ Yet disclosure should be required of consequences which are relatively sure to flow from the transaction but may not be obvious to the reasonable investor.

facts in the sense that a cause of action arises if they are stated and are misleading. See Part III-G *infra*.

60. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 864 ("conclusory assertions of success" unnecessary); Green v. Jonhop, Inc., 358 F. Supp. at 418 (do not have to disclose accounting change if do not know if it will affect earnings); Prettner v. Aston, 339 F. Supp. 273, 290 (D. Del. 1972) (allow stockholders to evaluate facts; no need to prophesy). See also Allen v. Penn Cent. Co., 350 F. Supp. at 703-04 (proxy rules; speculations should not be placed in proxy statement since like a prediction which is prohibited by note to 1934 Act Rule 14a-9, 17 C.F.R. § 240.14a-9 (1973); wild guesses also should not be included). Explicit disclosures are preferred since they do not encourage a "rumor mill." SEC v. Texas Gulf Sulphur Co., 401 F.2d at 864 (quoting the lower court opinion, 258 F. Supp. 262, 296 (S.D.N.Y. 1966)). See also Nanfito v. Tekseed Hybrid Co., 341 F. Supp. 240 (D. Neb. 1972), *aff'd*, 473 F.2d 537 (8th Cir. 1973) (management does not have to interpret information or "provide an expert opinion as to all the possible ramifications." *Id.* at 243).

61. SEC v. Texas Gulf Sulphur Co., 401 F.2d at 863-64 (urgency no excuse for vagueness); see Texas Gulf Sulphur Comment, *supra* note 47, at 278 (do not give inferences and conclusions until "they have been reasonably substantiated").

62. See, e.g., Part III-G *infra*.

63. Gerstle v. Gamble-Skogmo, Inc., 298 F. Supp. at 95.

64. Prettner v. Aston, 339 F. Supp. at 291-92.

65. Abramson v. Nytronics, Inc., 312 F. Supp. 519, 524 (S.D.N.Y. 1970); cf. Allen v. Penn Cent. Co., 350 F. Supp. at 705 (proxy rules).

66. Cf. Allen v. Penn Cent. Co., 350 F. Supp. at 703 (construing proxy rules); Puma v. Marriott, 348 F. Supp. 18, 22-23 (D. Del. 1972) (1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)).

67. Allen v. Penn Cent. Co., 350 F. Supp. at 704-05.

68. Crane Co. v. American Standard Inc., [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,228, at 97,061 (S.D.N.Y. 1968), modified on other grounds, 419 F.2d 787 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970); accord, Colonial Realty Corp. v. Brunswick Corp., 337 F. Supp. 546, 552-53 (S.D.N.Y. 1971) (prediction of saturation of market not made in prospectus; no cause of action since prediction was at best an educated guess); Most v. Alleghany Corp., [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,583, at 98,666 (S.D.N.Y. 1970). See Part III-G *infra* concerning projections of future events.

None of this permits announcement of bare facts if key issues are not clearly defined,⁶⁹ nor does it justify beclouding a document.⁷⁰ The drawback of disclosing facts but not conclusions or future effects is that the unsophisticated stockholder may be unable to evaluate the facts as well as sophisticated investors or insiders. Everyone has a relatively equal chance when, for example, news of a dividend cut is published, but the situation is quite different when a company announces an ore strike by summarizing an assay report. The most that can be said for mere disclosure of facts is that, while it places the average investor who needs the greatest protection at a disadvantage, it does satisfy the Rule's policy that investors be given equal *access* to information.⁷¹

A related problem is, what facts must be disclosed? First, disclosure is required only of important facts.⁷² Placing all facts, however trivial, in a document would confuse the reader rather than aid him.⁷³ Furthermore, the Rule is breached only by a misleading statement of a "material" fact. It follows that only the essence of a point need be disclosed, not the minute details. For example, it is sufficient if a buyer of a security is aware that the issuer has gone bankrupt because of unwise and now worthless investments; he need not know what the investments were or that the management was warned about the speculativeness of its holdings. Second, the important facts which must be disclosed are those which are known, or in exercise of due diligence should be known, by the maker of the statement.⁷⁴ Thus, a release normally must contain

69. *Robinson v. Penn Cent. Co.*, 336 F. Supp. 655, 658 (E.D. Pa. 1971).

70. *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 95; see *Kohn v. American Metal Climax, Inc.*, 322 F. Supp. at 1361 (even if statements literally true, this is insufficient where the general effect is to mislead); cf. *Allen v. Penn Cent. Co.*, 350 F. Supp. at 702 (insufficient if no major misstatement but still conveys misleading impression); *Felt v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 549, 564-65 (E.D.N.Y. 1971) (re 1933 Act § 11, 15 U.S.C. § 77k (1970)). See also *Abramson v. Nytronics, Inc.*, 312 F. Supp. at 524 ("It is of course possible to present facts in a manner calculated to confuse and deceive . . ." *Id.*).

71. *Texas Gulf Sulphur Comment*, *supra* note 47, at 278; 35 *Brooklyn L. Rev.* 326, 332 (1969). But equal access is of course only one of many policies underlying the Rule.

The approach in the text is also consistent with the view that the results of the insider's perceptive analysis need not be disclosed. *Id.* at 332-33 & n.41.

72. *Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co.*, 476 F.2d 687, 697 (2d Cir. 1973); see *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d at 800; *Dolgow v. Anderson*, 53 F.R.D. 664, 688 (E.D.N.Y. 1971), *aff'd per curiam*, 464 F.2d 437 (2d Cir. 1972); *Richland v. Crandall*, 262 F. Supp. 538, 553 (S.D.N.Y. 1967).

73. Cf. *Allen v. Penn Cent. Co.*, 350 F. Supp. at 703, 705 (proxy rules).

74. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 863; cf. *SEC v. Great Am. Indus., Inc.*, 259 F. Supp. 99, 109 & n.6 (S.D.N.Y. 1966), *rev'd on other grounds*, 407 F.2d 453 (2d Cir. 1968), *cert. denied*, 395 U.S. 920 (1969) (not misleading unless issuer knows the fact or statement was recklessly made). The knowledge of an employee of a corporation is

up-to-date information.⁷⁵ But this may be impossible when a fast-moving situation develops at a distant point. Under such circumstances, a document may be issued containing the most recently available facts if the inherent staleness of the data is made clear.⁷⁶ This is part of the problem of timing press releases. A company runs risks if it discloses too soon or too late. Should hindsight indicate that a premature statement was misleading, the issuer is likely to be sued even if it distributes a clarifying release.⁷⁷ On the other hand, insiders might trade or tip, and thus violate the Rule, while the release of important data is being delayed.⁷⁸ And third, ordinarily the impact on the company is all that must be disclosed; but in a transaction with an insider, the benefits accruing to the insider also should be revealed.⁷⁹

Courts have split on whether a subjective or an objective standard should be used to determine which facts to include in a statement. Some opinions condone the use of reasonable business judgment or permit reliance on expert opinions.⁸⁰ The better-reasoned conclusion, however, is to reject these defenses because investors and stockholders are entitled to full disclosure rather than to what the issuer believes is proper.⁸¹ It follows that some courts would not compel disclosures which

naturally less broad in general than that of his employer. See *Bahlman*, Rule 10b-5: The Case for its Full Acceptance as Federal Corporation Law, 37 U. Cin. L. Rev. 727, 763 (1968).

75. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 863-64.

Giving a financial statement to a person when the facts have changed materially since the date of the statement would usually be a half-truth; however this is not always true. See *Lane v. Midwest Bancshares Corp.*, 337 F. Supp. 1200, 1210 (E.D. Ark. 1972).

76. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 863-64; see *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 98 (10th Cir.), cert. denied, 404 U.S. 1004 (1971) and 405 U.S. 918 (1972).

77. See note 94 *infra*; cf. note 252 *infra* and accompanying text.

78. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 850 n.12.

79. Cf. *Puma v. Marriott*, 348 F. Supp. 18, 22-23 (D. Del. 1972) (proxy rules).

80. *Dolgow v. Anderson*, 53 F.R.D. at 679-80, 688 (no liability for using accounting treatment in accord with expert opinion; can also use business judgment); *Stull v. Kaymarq Consol. Corp.*, [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,508, at 98,364 (S.D.N.Y. 1969); *SEC v. Great Am. Indus., Inc.*, 259 F. Supp. at 107.

81. *Waddell & Reed, Inc.*, SEC Securities Exchange Act Release No. 9790 (Sept. 25, 1972), [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,049, at 82,274 n.4 (cannot shift duty to counsel); see *National Underwriters, Inc.*, SEC No-action letter (Dec. 27, 1971), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,720, at 81,518; cf. *Chris-Craft Indus., Inc. v. Independent Stockholders Comm.*, 354 F. Supp. 895, 915 (D. Del. 1973) (concerning 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)) (can rely on experts but still must read proxy statement and correct facts which knew or should know are wrong); *Gould v. American Hawaiian S.S. Co.*, 351 F. Supp. 853, 863, 867-68 & n.20 (D. Del. 1972) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)) (no defense that relied on attorneys to prepare proxy statement; leave open question of

would injure a corporation's business,⁸² whereas others correctly require the baring of all significant facts.⁸³ Publicizing data which could injure the issuer's competitive position is one manifestation of this last point. Another example is a premature announcement in a proxy statement or registration statement of a contemplated closing of a major plant, which could lead to a wildcat strike. Still another example is a company's desire not to disclose in its balance sheet its holdings of stock of another issuer, because the company intends to acquire more shares without driving up the price.⁸⁴ Permitting less than candid announcements because they were in accord with business judgment would open the floodgates, for a business reason for concealing a fact can almost always be manufactured.

Thoughts can be expressed in any of an infinite number of ways so long as the rules discussed above are met.⁸⁵ In other words, courts will not act as a copy editor for statements which meet disclosure standards.⁸⁶ The form of presentation is irrelevant if no other issue is resolved against the maker.⁸⁷

A related topic is that of a corporation's liability when erroneous statements about it are made by newspapers, magazines, financial reporting services (like the stock-market's broad tape), or other types of publications. Two fact patterns are possible. First, one court decided an issuer

liability of person who informs attorney of misrepresentation and receives assurances from him that disclosure is adequate); *Berman v. Thompson*, 312 F. Supp. 1031, 1035 (N.D. Ill. 1970) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)). See also *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 373 n.27 (investment banker cannot rely solely on what company officers tell it); *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 697 (S.D.N.Y. 1968) (1933 Act § 11, 15 U.S.C. § 77k (1970)). Care must be taken to distinguish this from, e.g., the question of how big an accounting reserve should be taken, which is a question of business judgment. See notes 138-39 *infra* and accompanying text.

82. Cf. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 850 n.12.

83. See cases cited in notes 80-81 *supra*. But the data which must be disclosed need not include trade secrets or formulae; it is sufficient to announce the discovery. *Schoenbaum v. Firstbrook*, 268 F. Supp. 385, 395 (S.D.N.Y. 1967), *aff'd*, 405 F.2d 200 (2d Cir.), *rev'd* on other grounds on rehearing *en banc*, 405 F.2d 215 (2d Cir. 1968), *cert. denied*, 395 U.S. 906 (1969); Comment, *The Regulation of Corporate Tender Offers Under Federal Securities Law: A New Challenge for Rule 10b-5*, 33 U. Chi. L. Rev. 359, 369 n.43 (1966).

84. Cf. *Berman v. Thomson*, 312 F. Supp. 1031, 1035 (N.D. Ill. 1970) (interpreting § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a) (1970)).

85. *Richland v. Crandall*, 262 F. Supp. at 553-54; cf. *Allen v. Penn Cent. Co.*, 350 F. Supp. at 703 (construing proxy rules); *Browning Debenture Holders' Comm. v. DASA Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,473, at 92,316 (S.D.N.Y. 1972) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)).

86. Cf. *Browning Debenture Holders' Comm. v. DASA Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,473, at 92,316. See also *Allen v. Penn Cent. Co.*, 350 F. Supp. at 706 (weakness in disclosure due to "inherent limitations of the art form." *Id.*).

87. But see Part III-A *infra* (placement of information in long documents).

was liable when the news media erroneously summarized the company's release.⁸⁸ In that case, the press release could not easily be summarized. A different result should obtain where the press release is clear but the news media are negligent or make a clerical mistake.⁸⁹ Second, cases have failed to hold a corporation legally responsible for inaccurate items appearing in the press when the items are not supplied by or attributed to it.⁹⁰ Any other result would place a burden on companies to read numerous publications, and would force them to correct any misleading impressions at a time when they may desire not to make disclosure for business reasons and may be under no other legal duty to make an announcement. To take one extreme example, were the duty to correct extended to projections made in brokers' market letters, companies would probably be forced to issue their own projections continuously. On the other hand, this reasoning has been justly criticized.⁹¹ The best approach would be to require correction by the corporation if it learns of the statement and has no valid corporate reason for withholding the facts.

The reverse of these two situations occurs when a speaker relies on an outside source for some of his facts. Even if he cites his source,⁹² his statement would be misleading if he goes beyond the information given him by the source or if he knows (or in the exercise of due diligence should suspect) that the source's data were untrue.⁹³

88. *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. 77, 86 (S.D.N.Y. 1970), modified, 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971); see Dayan, *Correcting Errors in the Press*, 5 Rev. of Secs. Reg. 941, 944 (1972). The press release here was "for immediate release," but this should not make a difference in result; see notes 75-78 *supra* and accompanying text. The court in *Texas Gulf Sulphur* made an impractical suggestion that a company should send press releases to stockholders if it wanted to insure that the release would not be distorted by the media. 312 F. Supp. at 86. A better rationale of the decision, which itself seems correct, is that the risk is on the issuer whenever the release can easily be misconstrued. Cf. *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 951 (2d Cir. 1969) (1934 Act § 14(e), 15 U.S.C. § 78n(e) (1970)) (newspaper story based on interview initiated by reporter).

89. A clerical mistake might consist of reporting earnings at \$190,000 rather than \$910,000 because a typist at the news media transposed the numbers.

90. *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d at 949; *Milberg v. Western Pac. R.R.*, 51 F.R.D. 280, 282 (S.D.N.Y. 1970), appeal dismissed sub nom. *Korn v. Franchard Corp.*, 443 F.2d 1301 (2d Cir. 1971).

91. Dayan, *supra* note 88, at 943. In addition, stock exchange rules may require a company to correct rumors and the like not attributable to it. E.g., NYSE Company Manual § A2, at A-18 (1968); AMEX Company Manual § 403(3) (1968).

92. Comment, *Negligent Misrepresentations Under Rule 10b-5*, 32 U. Chi. L. Rev. 824, 843 (1965). A fortiori, failure to reveal a source would lead to liability, at least where a reasonable investor would not realize the speaker had received the information from an outsider.

93. See *Shearson, Hammill & Co.*, SEC Securities Exchange Act Release No. 7743 (Nov. 12, 1965), [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,306, at 82,524.

The final issue is the maximum length of time—as measured between the publication of a misleading statement and plaintiff's trade, vote, or tender based thereon—which will support a 10b-5 claim. Put another way, how long does a false statement survive after its issuance? It is clear that a statement which is still "alive" could not be the basis for a damage action after a correction is disseminated publicly and assimilated by the market.⁹⁴ The length of time a misleading statement survives in the absence of a correcting release is not so clear. One possible view is that the erroneous statement continues indefinitely. Another is to limit the period, based on such factors as: the seriousness of the misrepresentation or omission, the type of data to which the statement relates, the importance of the statement, the degree of defendants' negligence or scienter, the breadth of the statement's distribution, and the frequency with which it continues to be quoted in the investment community. Whatever the appropriate period, it would start anew with each republication.⁹⁵

III. SPECIAL APPLICATIONS

In addition to the general rules regarding the misleading nature of a statement (discussed in the preceding section), several guidelines for special applications have been developed in the following specific areas: long documents (such as proxy statements and registration statements); financial statements; intention and promises; motive; concealment, disclosure, and fairness; implied statements; and opinions and forecasts. We will discuss each of these areas in turn.

A. *Proxy Statements, Registration Statements, and Other Long Documents*

In dealing with relatively long or complex documents, most commonly registration statements and merger proxy statements,⁹⁶ courts in the past have applied two doctrines—the "buried fact" doctrine⁹⁷ and

94. The time for the correction to be assimilated should be the same as would be required for an ordinary press release containing the same information to be absorbed, assuming the corrections were disseminated adequately. See *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d at 103, 105.

95. See *SEC v. Electrogen Indus. Inc.*, [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,156, at 96,717-18 (E.D.N.Y. 1968).

96. A wide variety of other statements may fall into this category. *Kaplan v. Vornado, Inc.*, 341 F. Supp. 212, 216 (N.D. Ill. 1971) (face of debenture) is one other example of the applicability of the two doctrines mentioned in the text. Theoretically, they should apply to long and complex oral assertions too.

See also *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d at 162 (doubtful whether proxy statement is read closely anyway).

97. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 297-300 (concurring and dissenting opinion) (discussing buried facts doctrine).

the "similar emphasis" doctrine. These doctrines are similar in that the underlying issue in both is whether or not a reasonable investor would have or should have discovered the real facts—for one doctrine, the question focuses on the "buried" facts and, for the other, on the data that were not given equal prominence.

In *Gould v. American Hawaiian Steamship Co.*,⁹⁸ disclosure in a merger proxy statement of conflicts of interest of certain directors regarding the proposed merger was attacked by the court under both doctrines. First, a reading of various parts of the proxy statement was necessary to garner all the facts concerning the conflicts. Although all conflicts were revealed, they were not collected in one section. The court held that this was a violation of the "buried facts" doctrine:

The various facts listed previously which the defendants contend adequately reveal any conflict are interspersed throughout the proxy materials and could be gleaned only through a close and prolonged perusal. Under the buried facts doctrine, such disclosures are insufficient.⁹⁹

Other cases have condemned different manifestations of the "buried facts" doctrine: disclosing important data only in appendices to a lengthy document,¹⁰⁰ even though a cross reference to the appendices appears in the body of the material;¹⁰¹ and placing facts where an investor is not apt to see them as, for example, at the end of a section or under an inappropriate heading.¹⁰² Accordingly, the "buried facts" doctrine prohibits both fragmentation of information and placement of important data where they are not likely to be found. All of this does not mean that each fact must be placed in bold face type on the cover page. But the doctrine does mandate that "[t]he more material the facts, the more they should be brought to the attention of the public."¹⁰³

98. 331 F. Supp. 981 (D. Del. 1971), modified, 351 F. Supp. 853 (D. Del. 1972). This was a case arising under the proxy rules, but the same doctrines are equally applicable to 10b-5 cases.

99. *Id.* at 996; accord, *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 265; *Mills v. Electric Auto-Lite Co.*, 403 F.2d 429, 432-35 (7th Cir. 1968), vacated on other grounds, 396 U.S. 375 (1970); *Norte & Co. v. Huffines*, 304 F. Supp. 1096, 1106 (S.D.N.Y. 1968), modified, 416 F.2d 1189 (2d Cir. 1969), cert. denied, 397 U.S. 989 (1970); *Richland v. Crandall*, 262 F. Supp. at 553-54 (dictum).

100. *Cf. Kohn v. American Metal Climax, Inc.*, 458 F.2d at 267-68 (discussing both buried facts and similar emphasis doctrines). Compare *id.* at 297-300 (concurring and dissenting opinion).

101. Thus, a reference in the text to an appendix where a fact is disclosed would be insufficient if the fact were important and the cross reference were a bare one—such as "See Appendix B." By contrast, in *Kohn*, a textual cross reference which alerted the reader to the essence of the topic was sufficient for purposes of the similar emphasis doctrine. *Id.* at 267-68.

102. *Norte & Co. v. Huffines*, 304 F. Supp. at 1106.

103. *Kohn v. American Metal Climax, Inc.*, 322 F. Supp. at 1362. One indication of im-

Second, the court in *Gould* also attacked the proxy statement under the "similar emphasis" doctrine.¹⁰⁴ This doctrine requires that a fact necessary to make a statement not misleading must be revealed with the same amount of prominence as that given to the statement itself.¹⁰⁵ The most common application of this doctrine involves a board of directors' recommendation in favor of a proposition; in such a case, equal emphasis has to be given to any conflicts of interest,¹⁰⁶ to whether any member of the Board dissented from the recommendation, and to suits for mismanagement filed against the directors.¹⁰⁷ However, the "similar emphasis" doctrine does not prevent reasonable latitude in the form of presentation,¹⁰⁸ nor does it preclude using bold face type for only some facts.¹⁰⁹

A statement can violate both the "buried facts" doctrine and the "similar emphasis" doctrine. The latter governs fewer situations, but is more demanding when applicable.¹¹⁰

The SEC reviews all registration statements and most proxy statements. Yet courts generally have not accorded this review any weight when finding breaches of these two doctrines, although by their nature these breaches theoretically should have been detected by the Commission's staff.¹¹¹

In addition to these two doctrines, other rules govern disclosures in proxy statements and registration statements. With regard to the former, the proxy rules do not specifically require information to be updated between the time the material is mailed to stockholders and the meeting. Nevertheless, updated data should be supplied if the facts change ma-

portance in the abstract are those items the SEC requires to be included in a summary prospectus or summary in front of a merger proxy statement.

104. 331 F. Supp. at 995. It also has been called the equal prominence rule. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 267.

105. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 268; *Kaplan v. Vornado, Inc.*, 341 F. Supp. 212, 216 (N.D. Ill. 1971); *Gould v. American Hawaiian S.S. Co.*, 331 F. Supp. at 994-97.

106. *Gould v. American Hawaiian S.S. Co.*, 331 F. Supp. at 994-97; *Mills v. Electric Auto-Lite Co.*, 403 F.2d at 432-35. Cf. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 267.

107. See *Robinson v. Penn Cent. Co.*, 336 F. Supp. 655, 658 (E.D. Pa. 1971) (construing 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1970)).

108. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 267; *id.* at 300 (concurring and dissenting opinion).

109. *Id.* at 267; *Kaplan v. Vornado, Inc.*, 341 F. Supp. at 216.

110. That is, although a fact may not be buried, it may nevertheless not be given similar prominence compared to the statement it is intended to offset.

111. No case other than *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519, 526 (S.D.N.Y. 1970), mentions this point.

terially.¹¹² In addition, the rules discussed below should apply *mutatis mutandis* to a merger proxy statement, which is considered by practitioners as the equivalent of a registration statement for both constituent corporations.¹¹³

Registration statements pose other problems. The SEC has published a number of forms which instruct issuers to place certain information in a registration statement. A rebuttable presumption that a registration statement is misleading should arise from failure to comply with those instructions which are important under the circumstances; yet technical compliance with the form does not insure full disclosure.¹¹⁴ The commission also has promulgated guidelines for disclosures in registration statements,¹¹⁵ but non-observance of these guidelines does not ipso facto render the registration statement misleading, at least when the only issue is the location of data in the prospectus.¹¹⁶ It follows that some facts need not appear on the cover page so long as they are disclosed adequately elsewhere in the prospectus.¹¹⁷

The period during which a registration statement must be accurate is another matter. Section eleven of the 1933 Act mandates that a registration statement be correct only on its effective date.¹¹⁸ The Rule imposes the same requirement; if the registration statement is misleading on the effective date, the Rule provides redress to persons purchasing securities

112. *Gould v. American Hawaiian S.S. Co.*, 351 F. Supp. at 868. In *General Time Corp. v. Talley Indus., Inc.*, the second circuit assumed that 1934 Act Rule 14a-9, 17 C.F.R. § 240.14a-9 (1973), would require updating "although the words of [14a-9] are not exactly apt to that end." 403 F.2d at 163. But it then decided no updating was necessary under the facts because the closer to the meeting date, the greater must be the materiality to warrant correction. Accord, *Allen v. Penn Cent. Co.*, 350 F. Supp. at 705. Rule 14a-9 does, however, clearly require updating of data if further oral or written solicitation is undertaken. But see *Prettner v. Aston*, 339 F. Supp. at 284 (must judge in light of circumstances on date mailed).

113. See Item 14 of Schedule 14A of 1934 Act, 17 C.F.R. § 240.14a-101 (1973). Under 1933 Act Rule 145, 17 C.F.R. § 230.145 (1973), the sort of investor protection provided by the registration process is also extended to most merger proxy statements.

Note that a corporation is not responsible for the content or preparation of the portion of the proxy material relating to its merger partner. *Beatty v. Bright*, 345 F. Supp. 1188, 1191-92 (S.D. Iowa 1972) (not responsible even though party had control over sufficiency of proxy statement); *Alameda Oil Co. v. Ideal Basic Indus., Inc.*, 337 F. Supp. 194, 196-97 (D. Colo. 1972).

114. See 1933 Act Rule 408, 17 C.F.R. § 230.408 (1973); cf. *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 564 (E.D.N.Y. 1971) (interpreting 1933 Act § 11, 15 U.S.C. § 77k (1970)).

115. SEC Securities Act Release No. 4936 (Dec. 9, 1968), [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,636.

116. *DiJulio v. Digicon, Inc.*, 339 F. Supp. 1284, 1289-90 (D. Md. 1972).

117. *Id.* at 1288.

118. 1933 Act § 11, 15 U.S.C. § 77k (1970).

in the offering and also to those who trade in the after-market.¹¹⁰ The Rule also requires accuracy on each day during which securities are being distributed under the registration statement¹²⁰ and during a ninety-day period after the effective date if the 1933 Act¹²¹ necessitates that dealers deliver a prospectus then.¹²² Updating corrections may be made by either affixing a sticker to the prospectus or amending the registration statement.¹²³

Two miscellaneous topics remain. First, a registration statement covering an exchange offer must disclose information concerning the target company since such facts are important to the investment decision of the target-company security holders.¹²⁴ Second, terms of securities and contracts are frequently summarized in registration statements. Prefacing the summary with a statement somewhat as follows will afford some protection to a charge of inadequate disclosure:¹²⁵ "The terms of the Debentures are governed by an Indenture, a copy of which is filed with the Securities and Exchange Commission as an exhibit to the Registration Statement of which this Prospectus is a part, and the following summary of those terms does not purport to be complete and is qualified in its entirety by express reference to the Indenture."

B. *Financial Statements*

Financial statements often are the crux of a securities document. They must conform to the general tests for determining if a document is misleading,¹²⁶ but they also pose special problems of their own.

119. *Speros v. Nelson*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,791, at 93,426 (D. Ore. 1973); *Guarantee Ins. Agency, Co. v. Mid-Continent Realty Corp.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,723, at 93,206-07 (N.D. Ill. 1972); see *Goldsmith v. Pyramid Communications, Inc.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,732, at 93,235 (S.D.N.Y. 1973); *Frankel v. Wyllie & Thornhill, Inc.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,672, at 92,993 (W.D. Va. 1972).

120. For shelf registration statements—where selling security holders dribble their securities into the market over an extended period—as well as for registration statements pertaining to warrants or a typical convertible Eurodollar bond, this imposes on the issuer an obligation to keep the prospectus up-to-date (or "evergreen") for an extended period.

121. 1933 Act § 4(3), 15 U.S.C. § 77d(3) (1970); 1933 Act Rule 174, 17 C.F.R. § 230.174 (1973). The period under certain circumstances can be 40 days. 1933 Act § 4(3), 15 U.S.C. § 77d(3) (1970).

122. *SEC v. Manor Nursing Centers, Inc.*, 340 F. Supp. 913, 933 (S.D.N.Y. 1971), modified on other grounds, 458 F.2d 1082, 1095-96 (2d Cir. 1972); *SEC v. Bangor Punta Corp.*, 331 F. Supp. 1154, 1160 n.10 (S.D.N.Y. 1971), modified sub nom. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973), cert. denied, 94 S. Ct. 232 (1973).

123. See 1 L. Loss, *Securities Regulation* 293 (2d ed. 1961).

124. Cf. *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. at 569.

125. See *Abramson v. Burroughs Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,456 (S.D.N.Y. 1972).

126. See Part II *supra*.

Accountants have formulated generally accepted accounting principles to which financial statements should conform. A number of cases have found disclosure adequate under the Rule if this standard is met.¹²⁷ Yet financial statements are misleading even if prepared in accordance with those principles if the statements do not disclose adequately the true state of affairs. In that event, textual discussion supplementing the statements is necessary. In other words, with respect to disclosure by the company, any conflict between full disclosure and generally accepted accounting principles is resolved in favor of the former.¹²⁸

Applications of this rule are numerous. For instance, it is misleading to conceal that an earnings increase was due to a change in accounting practices;¹²⁹ to show book values of assets in the balance sheet, without revealing the higher market value at some point in the document, if liquidation is intended or can reasonably be anticipated;¹³⁰ to omit explanations of large variations from year to year in a multi-period income statement; or to fail to disclose seasonal factors after an income statement.¹³¹

127. *Kohler v. Kohler Co.*, 319 F.2d 634, 640 (7th Cir. 1963) (it is permissible to set up books in a certain way for sound business reasons, at least absent an intent to mislead); *Colonial Realty Corp. v. Brunswick Corp.*, 337 F. Supp. 546, 551 (S.D.N.Y. 1971); *Dolgow v. Anderson*, 53 F.R.D. at 679-80.

128. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 406 (concurring and dissenting opinion); *SEC v. Bangor Punta Corp.*, 331 F. Supp. at 1163. But cf. *Dolgow v. Anderson*, 53 F.R.D. at 688. However, some liabilities may be disclosed in footnotes. *Blakely v. Lisac*, 357 F. Supp. 255, 261 (D. Ore. 1972).

An auditing accountant's obligations usually should be deemed satisfied if generally accepted accounting principles are applied correctly, but the accountant has a duty to investigate further and make full disclosure if his suspicions are aroused. Cf. *United States v. Simon*, 425 F.2d 796, 805-07 (2d Cir. 1969), cert. denied, 397 U.S. 1006 (1970) (may be very persuasive but not conclusive evidence that accountant acted in good faith and financial statements were not misleading).

129. *Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc.*, 307 F. Supp. 910, 913-14 (S.D.N.Y. 1969), aff'd, 425 F.2d 842 (2d Cir. 1970); cf. *Green v. Jonhop, Inc.*, 358 F. Supp. at 418 (do not have to disclose change of accounting method if do not know if it will affect earnings). See also Address by former SEC Chairman William J. Casey before the Financial Executives Institute at Las Vegas, Nevada, Oct. 18, 1972, in [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,045 (discussing elections and changes in financial statements).

130. *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 103. For a discussion concerning misstatement and concealment of intent to liquidate a corporation see notes 164-75 *infra* and accompanying text.

131. In registration statements and merger proxy statements, disclosures of variations among years and of seasonal differences customarily are placed in the text following the income statement. However, the explanation can be placed anywhere in the document without violating the Rule, so long as the buried fact and similar emphasis rules are followed. See notes 97-113 *supra* and accompanying text for a discussion of these rules.

In a release, the commission has stated:

"Among events and circumstances which may require additional disclosure to provide

It also follows that lack of conformity with generally accepted accounting principles is per se evidence that the statements are misleading.¹³² Thus, statements are deficient when earnings are arbitrarily manipulated by improper deferral techniques,¹³³ debt of consolidated subsidiaries is omitted from a consolidated balance sheet,¹³⁴ pooled results of operations for one year are compared against pre-pooled results for the prior year,¹³⁵ or earnings per share are stated without noting the dilution of residual securities.¹³⁶ And of course, financial statements containing inaccurate figures also are misleading.¹³⁷

information needed for the understanding of reports of operations for successive periods are the seasonal sale of a single-crop agricultural commodity, a business combination treated for accounting purposes as a pooling of interests, the disposition . . . or the acquisition of a significant amount of assets . . . changes in accounting principles or practices or [their application which have a material effect] . . . seasonal or other specified factors contributing to an unusual increase or decrease in net sales or income and material retroactive adjustments . . .” Financial Reporting—Quarterly and Other Interim Reports of Operations, SEC Securities Exchange Act Release No. 9559 (April 5, 1972), corrected, SEC Securities Exchange Act Release No. 9559A (April 21, 1972), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,692, at 81,459.

Other examples include *Bowman & Bourdon, Inc. v. Rohr*, 296 F. Supp. 847, 851 (D. Mass.), *aff'd per curiam*, 417 F.2d 780 (1st Cir. 1969) (inventory misleading unless details of how computed given); Notice to Registrants Engaged in Defense and Other Long-Term Contracts of the Need for Disclosure of Material Information, SEC Securities Exchange Act Release No. 9650 (June 22, 1972), [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,852, at 81,865 (must make proper disclosure in financial statements, and also in text where necessary).

132. Note, Accountants, Financial Disclosure and Investors' Remedies, 18 N.Y.L.F. 681 (1973) (“misleading presentations, misapplication of accounting principles or inadequate disclosure” actionable. *Id.* at 694); see *Green v. Jonhop, Inc.*, 358 F. Supp. at 419 (failure to make reference to footnote elsewhere in financial statement); *Koch Indus., Inc. v. Vosko*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,705, at 93,104-06, 93,133 (D. Kan. 1972) (failure to break out accounts receivable from affiliated companies). Compare *Chris-Craft Indus., Inc. v. Independent Stockholders Comm.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,766, at 93,352 (D. Del. 1973) (proxy rules; no misrepresentation found when statement made that division operated profitably but overhead not allocated to division; court relied on questionable ground that overhead could be allocated arbitrarily).

133. *SEC v. Keller Indus., Inc.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,453, at 92,237-38 & n.7 (S.D.N.Y. 1972).

134. *Gottlieb v. Sandia Am. Corp.*, 452 F.2d 510, 515 (3d Cir.), cert. denied, 404 U.S. 938 (1971).

135. SEC Policy Statement on Conflicting Financial Reports and Earnings Computations, SEC Securities Exchange Act Release No. 8336 (June 18, 1968), [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,567, at 83,196. This is the right result, but a different conclusion was reached in *Chris-Craft Indus., Inc. v. Independent Stockholders Comm.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,766, at 93,352 (D. Del. 1973).

136. SEC Release No. 8336, *supra* note 135, [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. at 83,196-97.

137. See notes 22-30 *infra* and accompanying text. The most famous example, which

Cases also have provided guidance regarding particular balance sheet items. For example, the size of a reserve is unassailable if determined using reasonable business judgment or generally accepted accounting principles,¹³⁸ but arbitrary conclusions will not be condoned.¹³⁹ Similarly, a corporation must write down an investment's artificially-created carrying value when it has notice that the value is substantially in excess of market value;¹⁴⁰ however, this rule does not necessarily apply to a carrying value determined in accord with conventional "transactional" accounting.¹⁴¹ Thirdly, contingent liabilities should be disclosed if material; one case, relying on SEC instructions for S-1 registration statements, used a figure equal to 15 percent of current assets as a guide to whether disclosure was needed.¹⁴² And municipal bonds should not be carried as current assets if the parties who agreed to buy the bonds from the issuer could not perform, interest payments on the bonds were delinquent, or no market for the bonds existed.¹⁴³

C. *Intention and Promises*

Not a few cases have held that a misrepresentation of one's intention is actionable.¹⁴⁴ Yet this is but the beginning of the inquiry into the issue of intention and promises.

contains a detailed discussion, is *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643, 656-71 (S.D.N.Y. 1968) (interpreting 1933 Act § 11, 15 U.S.C. § 77k (1970)).

138. *Colonial Realty Corp. v. Brunswick Corp.*, 337 F. Supp. 546, 552 (S.D.N.Y. 1971), quoting *Escott v. BarChris Constr. Corp.*, 283 F. Supp. at 666 (construing 1933 Act § 11, 15 U.S.C. § 77k (1970)); *Kohler v. Kohler Co.*, 208 F. Supp. 808, 817 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963). See also *Republic Tech. Fund, Inc. v. Lionel Corp.*, 345 F. Supp. 656, 662 (S.D.N.Y. 1972), *rev'd*, 483 F.2d 540 (2d Cir. 1973) (timing of adjustments).

139. *SEC v. Keller Indus., Inc.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,453, at 92,237-38 & n.7 (S.D.N.Y. 1972).

140. *SEC v. Bangor Punta Corp.*, 331 F. Supp. at 1161-62. See also *Chris-Craft Indus., Inc. v. Independent Stockholders Comm.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,766, at 93,351 (D. Del. 1973) (can carry investment in another enterprise at cost if value not permanently impaired; even if no permanent impairment, must disclose problems of corporation held as investment).

141. *SEC v. Bangor Punta Corp.*, 331 F. Supp. at 1162.

142. *Prettner v. Aston*, 339 F. Supp. 273, 290 (D. Del. 1972). The 15 percent figure on which the court relied has been reduced to ten percent. SEC Form S-1 Registration Statement, Item 12.

143. *Filtrol Corp.*, SEC Securities Exchange Act Release No. 9536 (March 20, 1972), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,669.

144. *Richardson v. MacArthur*, 451 F.2d 35, 40-41 (10th Cir. 1971) (intent to convert stock); *Robinson v. Cupples Container Co.*, 316 F. Supp. 1362, 1366 (N.D. Cal. 1970); *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 94; *Electronic Specialty Co. v. International Controls Corp.*, 295 F. Supp. 1063, 1078 (S.D.N.Y. 1968), *modified*, 409 F.2d 937 (2d Cir. 1969); *Keers & Co. v. American Steel & Pump Corp.*, 234 F. Supp. 201, 203

Intentions can be classified as express, concealed, or implied. The first is exemplified by an announced intent to list a security on a specified national securities exchange¹⁴⁵ or a statement by *A* to *B* that *C* intends to perform an act.¹⁴⁶

Concealed intentions must be announced only if they constitute inside information and the defendant is under a duty to disclose.¹⁴⁷ Thus, a purchase of stock by an issuer not revealing its intent to liquidate and realize on its undervalued assets would be actionable.¹⁴⁸

Intentions also can be implied from defendant's actions or words. Hence, the defendant may make a statement or take actions which would be misleading unless his intent were disclosed. Rule 10b-5 decisions have recognized the implied intent arising when parties enter into a contract or understanding. The parties seldom *expressly* represent that they intend to fulfill their contractual obligations. For instance, a customer might instruct his broker to buy one hundred shares of I.B.M. stock for his account without stating that he intends to pay on the settlement date. Nevertheless, courts have permitted the broker to recover under Rule 10b-5 if the customer, when he placed his order, did not intend to pay for the stock if its value declined by the settlement date, and if in fact he did not pay.¹⁴⁹ The duty to disclose inside information

(S.D.N.Y. 1964) (one's state of mind is a fact); see *Allen v. H.K. Porter Co.*, 452 F.2d 675, 677-79 (10th Cir. 1971) (plaintiff did not prove that representation by defendant of intent to foreclose was false or that defendant concealed intent to inject new capital); *Armstrong v. Sailboat Marine, Inc.*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,105 (E.D.N.Y. 1971) (no evidence that there was fraud "in the sense that [defendants] stated intentions that did not exist." *Id.* at 91,049); *Lester v. Preco Indus., Inc.*, 282 F. Supp. 459, 462-64 (S.D.N.Y. 1965) (can have cause of action from misrepresentation of intent but no cause of action under these facts; plaintiff alleged concealment in registration statement of intent to carry out certain acts later); note 153 *infra*; cf. *Oklahoma-Texas Trust v. SEC*, 100 F.2d 888, 894 (10th Cir. 1939) (1933 Act § 8(d), 15 U.S.C. § 77h(d) (1970)).

145. E.g., *Were v. Mack*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,956, at 90,522 (S.D.N.Y. 1971).

146. *Myzel v. Fields*, 386 F.2d 718, 734 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968) (misrepresentation of another's intent or state of mind).

147. See 37 *Fordham L. Rev.* 483, 487-91 (1969).

148. See notes 164-75 *infra* and accompanying text.

149. As to purchases from broker-dealers, see, e.g., *United States v. Bialkin*, 331 F.2d 956, 957-58 (2d Cir. 1964). Intent not to pay for securities purchased from other persons has also been held to be actionable. *Walling v. Beverly Enterprises*, 476 F.2d 393, 396-97 (9th Cir. 1973); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082, 1097 n.19 (2d Cir. 1972) (from underwriters); *Richardson v. Salinas*, 336 F. Supp. 997, 1001-02 (N.D. Tex. 1972) (from private citizen). Similarly, a seller concealing his intent not to sell is also in violation of 10b-5. See *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. 715, 719-20 (S.D.N.Y. 1968) (analyzing the situation along lines of lack of intent to perform).

is one possible justification for finding 10b-5 liability in such a case. Under traditional thinking, however, only an insider¹⁵⁰ with inside information has the duty to disclose. The customer is not an insider, nor is his state of mind inside information. Therefore, he would have no duty to disclose his concealed intent. A better analysis is that his intent to perform his obligations—to pay the amount due in this situation—can be presumed from his entering into the contract.¹⁵¹ The Rule is breached if this presumption of intent to fulfill the contract's terms was incorrect at the time the contract was made.¹⁵² The "in connection with the . . . sale of any security" clause of the Rule is satisfied when the defendant carries out his preconceived intent not to consummate the sale.

An express statement of intent must be correct when made and an implied intent must be true when it is implied.¹⁵³ The Rule generally would not be violated merely because the representer subsequently changed his mind.¹⁵⁴ But he should be liable for failing to convey his

150. An insider is a short-hand designation of persons who have a duty to disclose, for example, corporate officers, directors, and controlling shareholders. 37 *Fordham L. Rev.* 483, 491 (1969).

151. Restatement of Torts § 530, comment b (1938); see *Weisman v. MCA, Inc.*, 45 *F.R.D.* 258, 263-64 (D. Del. 1968) (legal imposition of good faith and fair dealing on security sellers at time of sale); *Voege v. American Sumatra Tobacco Corp.*, 241 *F. Supp.* 369, 375 (D. Del. 1965).

152. Note that a concealed intent not to fulfill the terms of the contract would be material under any definition. On the other hand, disclosure of the intent not to perform would obviate any recovery by the other party to the agreement.

The same result regarding a breach of contract can be reached by viewing contracts as mutual promises to perform certain acts. Making a promise to perform an action is a 10b-5 infraction if the promisor had no intention of keeping the promise. See note 158 *infra* and accompanying text. Cf. *Entel v. Allen*, 270 *F. Supp.* 60, 70 (S.D.N.Y. 1967), which seems to have gone too far, albeit reluctantly, in holding that any undisclosed breach of state contract law is actionable.

153. *Desser v. Ashton*, [1969-1970 Transfer Binder] *CCH Fed. Sec. L. Rep.* ¶ 92,546, at 98,508 (S.D.N.Y. 1969); *Commerce Reporting Co. v. Puretec, Inc.*, 290 *F. Supp.* at 720; see *Richardson v. MacArthur*, 451 *F.2d* at 40 (fact question as to whether just a breach of contract or a 10b-5 violation); *Bowers v. Columbia Gen. Corp.*, 336 *F. Supp.* 609, 626 (D. Del. 1971). It does not follow that an intent was misrepresented merely because the actor subsequently did not perform. Restatement of Torts § 530, comment c (1938); see note 154 *infra* and accompanying text.

Despite the language about a contract in *Voege v. American Sumatra Tobacco Corp.*, 241 *F. Supp.* at 374-75, this case also could be classified properly as an implied representation decision.

154. *Shemtob v. Shearson, Hammill & Co.*, 448 *F.2d* 442, 445 (2d Cir. 1971) (breach of contract insufficient); *Manus v. Bank of Bermuda, Ltd.*, [1971-1972 Transfer Binder] *CCH Fed. Sec. L. Rep.* ¶ 93,299, at 91,650 (S.D.N.Y. 1971) (same); *Pepsico, Inc. v. W.R. Grace & Co.*, 307 *F. Supp.* 713, 720 (S.D.N.Y. 1969) (complaint dismissed where allegation of change of intent after contract was signed); see *Allico Nat'l Corp. v. Amalgamated Meat Cutters & Butcher Workmen of N. America*, 397 *F.2d* 727, 729-30 (7th Cir. 1968) (decision

change of heart to a plaintiff who thereafter made an investment decision, and whom the defendant knew or should have known was relying on his intent.¹⁵⁵ A defendant also violates the Rule if he defers or delays a planned course of action in order to cover up his misrepresented or concealed intent.¹⁵⁶

Other types of statements are treated in the same way as intention, in that they must accurately represent the speaker's view when made. Thus, a person expressing an opinion must hold the opinion;¹⁵⁷ one predicting an event has to think the prediction will come true; a promisor must intend to perform his promise,¹⁵⁸ and a person recommending the purchase or sale of a security must believe his advice is correct.¹⁵⁹

Intent cannot be proved by psychoanalysis; it is a question of fact to be determined by evaluation of external occurrences.¹⁶⁰ Events taking

leaves unanswered the question whether breach of contract alone is sufficient to create liability); *Richardson v. Salinas*, 336 F. Supp. at 1001-02 (court does not decide whether failure to pay is breach of contract or 10b-5 claim, but does not dismiss complaint); *Seward v. Hammond*, 8 F.R.D. 457, 459 (D. Mass. 1948) (complaint characterized as one for breach of contract rather than for fraud under the securities law).

155. See W. Prosser, *Torts* § 109, at 728-31 (4th ed. 1971).

156. *SEC v. Bangor Punta Corp.*, 331 F. Supp. at 1160.

157. *Walling v. Beverly Enterprises*, 476 F.2d 393, 396 n.6 (9th Cir. 1973); *Myzel v. Fields*, 386 F.2d at 734 n.8; *United States v. Grayson*, 166 F.2d 863, 866 (2d Cir. 1948) (construing 1933 Act § 17(a), 15 U.S.C. § 77q(a) (1970)); *Rochez Bros. v. Rhoades*, 353 F. Supp. 795, 798-99 (W.D. Pa. 1973); *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. 757, 769-70, 772 (D. Colo. 1964); *Weinstein v. Zimet*, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,320, at 94,368 (S.D.N.Y. 1964).

158. *Walling v. Beverly Enterprises*, 476 F.2d at 396 n.6; *Ellis v. Carter*, 291 F.2d 270, 274 (9th Cir. 1961) (promise to share control); *Commerce Reporting Co. v. Puretec, Inc.*, 290 F. Supp. at 719-20 (refusal to sell); *Kavit v. A.L. Stamm & Co.*, [1966-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,915, at 96,125-26 (S.D.N.Y. 1967) (reckless promises and other actions by broker-dealer); *Rustic v. Werblin*, [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,637, at 95,376 (S.D.N.Y. 1966); *Keers & Co. v. American Steel & Pump Corp.*, 234 F. Supp. 201, 203 (S.D.N.Y. 1964) (need lack of intention to perform at time promise made); *Trussell v. United Underwriters, Ltd.*, 228 F. Supp. at 769-70, 772; see *M.L. Lee & Co. v. American Cardboard & Packaging Corp.*, 424 F.2d 532, 534 (3d Cir. 1970) (decision leaves open the question of whether unfulfilled promise in letter of intent is actionable); *Whitlow & Associates, Ltd. v. Intermountain Brokers, Inc.*, 252 F. Supp. 943, 948 (D. Hawaii 1966) (promise is a material representation); cf. *United States v. Grayson*, 166 F.2d at 866 (construing 1933 Act § 17(a), 15 U.S.C. § 77q(a)). See note 152 *supra* regarding the relationship between concealment of intent, and promises which are not intended to be performed.

It seems to follow that promising to perform an act the promisor knows or should know is impossible should also be a 10b-5 violation if the impossibility is not readily apparent to the promisee.

159. See *United States v. Grayson*, 166 F.2d at 866.

160. *Richardson v. MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971). A corporation's intent is ascertained from the actions of its officers. *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 93.

place after defendant's intent was represented can be used as evidence in finding whether his representation was true when made.¹⁶¹ Thus, in the absence of an intervening event which could justify the defendant's change of heart, the more pronounced the alteration from the original intent and the shorter the period between the representation and the change, the stronger the inference that the original representation was false.¹⁶² Events intervening between the time the intent was represented and the time when the defendant changed his mind could be either unforeseeable, unforeseen but foreseeable, or foreseen. An unforeseeable intervening event is the strongest evidence a defendant could present to justify his change of intent, while a foreseen occurrence is the weakest.¹⁶³

One type of intent deservedly has received a great deal of attention—the intent of a purchaser of a corporation's stock¹⁶⁴ to take advantage of the excess of the market value of the corporation's assets over their book value.¹⁶⁵ Misleading disclosure of such intent and, under certain cir-

161. *Walling v. Beverly Enterprises*, 476 F.2d at 397 n.8; *SEC v. Glass Marine Indus., Inc.*, 208 F. Supp. 727, 732-33 (D. Del. 1962).

162. 208 F. Supp. at 732, 740-42; cf. W. Prosser, *Torts* § 109, at 729-31 (4th ed. 1971). But a defendant will not be held liable merely because he changes his intent for what others may consider to be an inadequate reason. *Restatement of Torts* § 530, comment a (1933).

163. See *Weisman v. Ashplant*, 326 F. Supp. 825, 826-27 & n.2 (S.D.N.Y. 1971) (defendant stated intent to list a security, and received a preliminary indication of permission from the exchange; earnings then dropped and listing was denied; held that plaintiff failed to prove defendant's lack of intent to list, although event was foreseeable); *Were v. Mack*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,956, at 90,523 (S.D.N.Y. 1971) (not misleading to state intent to list securities on American Stock Exchange when listing subsequently denied because of unpublished standards of the exchange; viewed in light most favorable to plaintiff, event foreseeable but not foreseen).

164. Of course, this concept is not limited to securities of corporations. And the same principles apply to debt securities where there is a question whether the underlying assets would be sufficient to pay the debt in full upon liquidation.

165. The same result would obtain when the market value of all assets exceeds book value, or when the disparity in value is found in only some assets regardless of whether a disparity exists in the assets as a whole.

Among the factors which can be used to determine whether market value exceeds book value are good faith offers of others to buy, and appraisals "by qualified experts [when the appraisals] have sufficient basis in fact." *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 92. The corporation's own asking price is not of the same weight. *Id.*; accord, *In re Brown Co. Sec. Litigation*, 355 F. Supp. 574, 583-84 (S.D.N.Y. 1973).

Although a liquidation or other method of realizing on the discrepancy between the market value and book value is not planned by management, management can point out this discrepancy to stockholders to demonstrate the inadequacy of a tender offeror's price. *Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co.*, 356 F. Supp. at 1071.

The principles set forth here, as applicable to insiders when market exceeds book value, should also pertain when an insider sells knowing that there is an undisclosed excess of book value over market value and that a liquidation is imminent or can reasonably be expected.

cumstances, concealment of intent are both actionable.¹⁶⁶ Misrepresentation of intent has assumed increased importance since 1968, when section 13(d) of the 1934 Act was adopted.¹⁶⁷ Under that section, a person acquiring equity securities registered under the 1934 Act who thereafter owns more than five percent of the shares of a class must file a schedule¹⁶⁸ disclosing his plans to liquidate the issuer, sell its assets, or merge it with another entity. Misrepresentations of plans in the schedule should be 10b-5 violations.

Whether a purchaser must disclose his intent when section 13(d) is inapplicable depends on two sets of variables: is he or is he not either an insider of the issuer or a person seeking to gain control; and does he or does he not intend to take advantage of the excess? A purchasing insider's intent to liquidate the corporation, sell its assets, merge or consolidate it with another entity, or engage in any other act to take advantage of the disparity in prices, is probably not inside information since he did not receive it by access to the corporation. But the disparity in asset values is inside information if he learned it because of his contact with the issuer and it is not publicly known. When inside information, not necessarily important by itself, becomes important in combination with other data (for example, the combination of the disparity in values with the insider's intent to liquidate), the combination is material inside information and therefore a purchasing insider must disclose both. The cases reach this result, although often without detailing the reasoning behind it.¹⁶⁹ But an insider (and a fortiori an outsider) might be

166. *Speed v. Transamerica Corp.*, 99 F. Supp. 808 (D. Del. 1951).

167. 15 U.S.C. § 78m(d) (1970).

168. Item 4 to Schedule 13D under the 1934 Act, 17 C.F.R. § 240.13d-101 (1973). One case discussing this point is *Electronic Specialty Co. v. International Controls Corp.*, 296 F. Supp. at 468 (motion for preliminary injunction).

169. *In re Brown Co. Sec. Litigation*, 355 F. Supp. at 583-84 (disclose only if intent to dispose of assets plus either third party's offer to purchase or appraisals); *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 92 (proxy statement); *Bosche v. Louart Corp.*, [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,231, at 97,066-67 (N.D. Cal. 1968) (plan of stockholders to purchase more shares); *Speed v. Transamerica Corp.*, 99 F. Supp. at 825-26, 828 (written tender offer by majority stockholder); *Ward La France Truck Corp.*, 13 S.E.C. 373, 378-80 (1943) (purchases by insiders). See also Address by former SEC Chairman William J. Casey before the Financial Executives Institute at Las Vegas, Nevada, Oct. 18, 1972, in [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,045, at 82,265 (management should consider disclosing supplementally that book value is less than market value, particularly if assets are liquid; no indication that tied into purchases by insiders).

Another method of approaching this problem is to consider the issuer's financial statements misleading because the excess is not shown, at least where there is an intent to realize on the excess. See notes 127-31 *supra* and accompanying text (explanation of financial statements needed in some circumstances).

able to purchase without disclosure if he does not intend to take advantage of the excess.¹⁷⁰

A duty to disclose is more difficult to justify when an outsider seeking control intends to realize on the excess of market over book value. He has no duty when purchasing on the open market (or perhaps even pursuant to a formal cash tender offer, which contains no target-company financial statements), because none of his data is inside information.¹⁷¹ However, if there are any relevant financial statements which are part of a registration statement or proxy statement used in an exchange offer or merger, and if realization on the excess of disparity in values is intended or can reasonably be anticipated, disclosure of the disparity must be made to correct the misleading impression created by the financial statements.¹⁷² By contrast, an outsider *not* seeking to gain control need

170. The fact would still be inside information vis-à-vis the insider, but the duty to disclose would turn on the issue of materiality. However, the question of materiality does not seem to explain the diverse results of the authorities on this point. In *re Brown Co. Sec. Litigation*, 355 F. Supp. at 583-84 (disclose only if intent to dispose of assets plus either third party's offer to purchase or appraisals; therefore, no duty to disclose when no intent to sell assets, no intent to liquidate, and no appraisals); *Lewis v. Bogin*, 337 F. Supp. 331, 337-38 (S.D.N.Y. 1972) (merger with parent; defendant did not know or have reason to believe that asset would be sold at higher value, so no duty to disclose in proxy statement); *Kohler v. Kohler Co.*, 208 F. Supp. 808, 825-26 (E.D. Wis. 1962), *aff'd*, 319 F.2d 634 (7th Cir. 1963) (no duty to disclose on part of purchasing issuer where no intent to liquidate); *Speed v. Transamerica Corp.*, 99 F. Supp. at 825-26 & n.9 (court: no duty of controlling stockholder to disclose increase in inventory where no intent to liquidate; SEC as *amicus curiae*: should disclose increase whether or not intent exists); Note, *SEC v. Texas Gulf Sulfur Co.: The Inside and Outside of Rule 10b-5*, 46 B.U.L. Rev. 205, 223 (1966) (intent to liquidate is what renders difference in value material); Note, *Purchaser's Duty to Disclose Under Securities and Exchange Commission Rule X-10B-5*, 40 Minn. L. Rev. 62, 70-71 (1955) (SEC's view in *Speed* preferable); Note, *The Prospects for Rule X-10B-5: An Emerging Remedy for Defrauded Investors*, 59 Yale L.J. 1120, 1146 (1950) (should disclose important difference in values if sale of assets is likely or if difference is permanent); 55 Ill. B.J. 688, 701 (1967) (without intent to liquidate, probably do not have to disclose); see *Becker v. Schenley Indus., Inc.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,669, at 92,986-87 (S.D.N.Y. 1972) (court seems to indicate that disclosure is necessary only if negotiations have begun). See also *CMC Corp. v. Kern County Land Co.*, 290 F. Supp. 695, 696 (N.D. Cal. 1968) (disclosure sufficient if it merely states assets are worth much more than book value).

171. *Mills v. Sarjem Corp.*, 133 F. Supp. 753, 764-65 (D.N.J. 1955). Courts have not implied a representation that no liquidation is planned. Compare notes 149-52 *supra* and accompanying text. As to the issue of whether a bid for stock at a given price is a representation that the bid is the true value, see notes 188, 196 *infra* and accompanying text.

Implying a duty on the outsider to correct a misleading impression created by the combination of the published target-company financial statements plus his intent to realize on the difference is one argument which plaintiffs could put forward.

172. *Brudney*, A Note on Chilling Tender Solicitations, 21 Rutgers L. Rev. 609, 635 nn.59, 61 (1967) (permissible to buy through broker, but not through tender offer where

not disclose the excess when purchasing, since other outsiders can evaluate the situation as well as he can.¹⁷³

Closed-end investment companies form a good example of a case where the difference between market value and book value is known publicly.¹⁷⁴ Lacking some type of misstatement or half-truth, an insider or outsider purchasing shares in a fund which has a disclosed excess of net asset value over market value need not announce his intent to liquidate.¹⁷⁵

D. *Motive*

The question of motive is closely related to that of intent.

Misrepresentation of a defendant's motive should be actionable if the motive is material. *Concealment* of a motive can arise in any context, but has been discussed most often in mismanagement cases.¹⁷⁶ The majority of opinions do not require that motives be disclosed so long as all the facts surrounding the transaction are revealed.¹⁷⁷ For example, a buyer of a security could not complain if he knows all material facts about an

financial statement is made; should disclose to correct corporation's financial statements); see *Gerstle v. Gamble-Skogmo, Inc.*, 298 F. Supp. at 91-92 (majority stockholder merging subsidiary into itself; question of adequate disclosure in financial statements which are part of merger proxy statement); notes 127-31 *supra* and accompanying text (disclosure in text sometimes necessary to supplement financial statements).

173. This assumes the outsider reached his conclusion based on his analysis of publicly available information. However, where he learned from an insider about the disparity in values or, perhaps, about the insider's intent to liquidate, the outsider would be a tippee to the extent he received "inside information." Similar data received by the outsider from another outsider could, at best, be considered "inside information" only when the original tippee had a duty to disclose.

174. Newspapers disclose daily the net asset value and market value of many mutual funds.

175. The argument concerning the material effect of the combining of intention to liquidate with the inside information regarding the disparity in values is not here tenable because the disparity is public information. See *Fleischer & Mundheim, Corporate Acquisition by Tender Offer*, 115 U. Pa. L. Rev. 317, 334-35 (1967) (need disclose only when board thinks there is a reasonable probability that there will be liquidation).

176. See *Jacobs*, *supra* note 5, for a discussion of Rule 10b-5 and mismanagement.

177. *Segal v. Gordon*, 467 F.2d 602, 609 (2d Cir. 1972); *Krafcsin v. LaSalle Madison Hotel Co.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,586, at 92,728-29 (N.D. Ill. 1972) (do not have to disclose purpose of proposed dissolution); *Crane Co. v. American Standard Inc.*, [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,228, at 97,060 (S.D. N.Y. 1968), modified on other grounds sub nom. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970); see *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519, 526 (S.D.N.Y. 1970) (do not have to present contentions of both sides as long as stockholders get all material facts); cf. Note, *Securities Regulation: Rule 10b-5 Under Securities Exchange Act of 1934 Held Not To Require Privity for Private Recovery*, 1963 Duke L.J. 796, 801 (motive must be disclosed only when there is intent to mislead and self-interest).

enterprise, even though he is not told that the seller's motive for the transaction is to invest the proceeds in a better security of an unrelated issuer. An evil motive is in no case actionable unless translated into deeds.¹⁷⁸

None of the foregoing permits concealment of management's conflicts of interest.¹⁷⁹

E. *Concealment, Disclosure, and Fairness*

Fairness can interact with concealment and disclosure in three situations: when adequate disclosure is not made of a fair transaction; when all material facts about an unfair deal are revealed; and when a transaction is expressly represented to be fair.

The Supreme Court rejected the fairness of a transaction as a defense to faulty disclosure under the proxy rules.¹⁸⁰ As the Court pointed out, any other result would "insulate from private redress an entire category of proxy violations—those relating to matters other than the terms of the [deal]."¹⁸¹

The situation is more controversial where all material facts are disclosed but the unfairness of the transaction is not mentioned.¹⁸² No one seriously contends that a cause of action then arises if the transaction is at arm's length: the buyer and seller have equal access to data, and neither party reposes trust or confidence in the other. The same result does not follow necessarily where one party is a fiduciary, has greater access to facts, or enjoys the other's trust and confidence.¹⁸³ A brokerage firm, for example, owes its customer a fiduciary duty, and the law in effect requires it to disclose any unfairness to him;¹⁸⁴ however, this is not controlling in other circumstances since 10b-5 places special obliga-

178. *Stedman v. Storer*, 308 F. Supp. 881, 887 (S.D.N.Y. 1969).

179. See note 106 *supra* and accompanying text.

180. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 381-82 (1970); accord, *Colonial Realty Corp. v. Baldwin-Montrose Chem. Co.*, 312 F. Supp. 1296, 1299 (E.D. Pa. 1970); cf. *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 572-73 (E.D.N.Y. 1971) (construing 1933 Act § 11, 15 U.S.C. § 77k (1970)). A fortiori, faulty disclosure of an unfair deal is also actionable.

181. 396 U.S. at 382.

182. This should be distinguished from a question raised in *Lerman v. Tenney*, 295 F. Supp. 780 (S.D.N.Y. 1969), modified, 425 F.2d 336 (2d Cir. 1970). There, plaintiff claimed that a partnership did not disclose that it paid too much for its only asset, a building. Thus, the question of fairness related to a transaction in which the issuer engaged, and not the purchase or sale of a security on which suit was brought. It is altogether proper to recognize this as a 10b-5 claim since the essence of the allegation relates to the value of the issuer's assets.

183. Cf. Restatement of Torts § 542 (1938).

184. Cf. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153 (1972) (regarding "market makers").

tions on broker-dealers.¹⁸⁵ The issue also has arisen in the mismanagement area, mainly with proxy statements. The Second Circuit has held that concealment of a merger's unfairness as such is not actionable even if a conflict of interests exists,¹⁸⁶ however, lower courts in that circuit sometimes have reached a different result¹⁸⁷ and other courts of appeals may disagree. The Second Circuit's decision suggests that an insider cannot be criticized for concealing the unfairness of the price at which he buys or sells securities. Yet, cases indicate that there may be an implied representation of fairness regarding a price at which trades are made by an insider, a person having greater access to facts, or someone occupying a position of trust.¹⁸⁸ Perhaps these two apparently conflicting concepts can be reconciled as follows: an insider has no duty to disclose that a price is unfair if the price is established by the market or at the outsider's suggestion, but the insider may impliedly represent fairness when he sets the price.

The final situation is an express statement that a transaction is fair. Such a statement is an opinion governed by the rules pertaining to opinions generally.¹⁸⁹ An opinion of an investment banking firm regarding the fairness to a company's stockholders of a merger or other transaction is one example of an express representation.¹⁹⁰ Also, directors may represent that a deal is fair or state that in their opinion it is fair; however, a board's mere recommendation to stockholders to vote in favor of a transaction should not as such be an implied representation that the deal in fact is fair.¹⁹¹ A statement that a merger is fair is unassailable if

185. See generally Jacobs, *supra* note 3, at 871.

186. *Popkin v. Bishop*, 464 F.2d 714, 718-20 (2d Cir. 1972) (injunction action), noted in 41 *Fordham L. Rev.* 742 (1973); see *Hirschleifer v. Fran-Tronics Corp.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,681, at 93,030 (S.D.N.Y. 1972) (plaintiff attacks wisdom of accepting offer but this is not actionable misrepresentation or fraud); cf. *Allen v. Penn Cent. Co.*, 350 F. Supp. at 702 (proxy rules do not give mandate to pass on wisdom of a proposal). *Contra*, *Cox*, *Fraud Is in the Eyes of the Beholder: Rule 10b-5's Application to Acts of Corporate Mismanagement*, 47 *N.Y.U.L. Rev.* 674, 696 (1972).

187. *Hoff v. Sprayregen*, 339 F. Supp. 369, 374 (S.D.N.Y. 1971) (must disclose excessive fee); *Heit v. Davis*, [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,698, at 95,567 (S.D.N.Y. 1966) ("may" be misleading to state amount without revealing that it is excessive).

188. See note 196 *infra* and accompanying text (implied statements).

189. See Part III-G *infra*.

190. The issue of an investment banker's liability for his opinion on fairness was raised in *Mills v. Sarjem Corp.*, 133 F. Supp. at 766-67, but the court did not directly decide whether the firm would be liable since it held the transaction was fair.

191. While the recommendation is not an implied representation of fairness, the proxy statement or the document would contain a half-truth if the board believed the deal to be unfair. See notes 13-14 *supra* and accompanying text, concerning half-truths.

the opinion accurately reflects the speaker's views, is based on a reasonable investigation, and the transaction is in fact fair.¹⁹²

F. *Implied Statements*

Rule 10b-5 could cover two types of implied statements. First, a person should be responsible for inferences reasonable investors would draw from what he said or did. This is much akin to half-truths.¹⁹³

More difficult is whether the law will imply representations merely because of a person's position, without his specific words or acts as a basis. The "shingle theory" is a vehicle for implying a plethora of representations by broker-agents and by dealer-principals who have gained their customers' confidence.¹⁹⁴ This concept cannot be imported in toto into other areas covered by 10b-5, although it does serve as an analogy. The Supreme Court touched on this subject in a case where defrauded sellers sued bank employees who purchased securities from them. Relying on a broker-dealer case, the Court held:

The individual defendants [the bank employees], in a distinct sense, were market makers This being so, they possessed the affirmative duty under the Rule to disclose this fact to the . . . sellers. It is no answer to urge that . . . these defendants may have made no positive representation or recommendation. The defendants may not stand mute while they facilitate the . . . sales to those seeking to profit in the . . . market the defendants had developed and encouraged and with which they were fully familiar. *The sellers had the right to know that the defendants were in a position to gain financially from their sales and that their shares were selling for a higher price in that market.*¹⁹⁵

This quotation, along with whatever applicability the shingle theory has, suggests that representations might be implied where one party is a fiduciary of the other, has greater access to information, or enjoys the confidence of the other by virtue of their relationship or prior dealings. Courts have adopted this approach by indicating that an insider sometimes impliedly represents to the other person that the price at which

192. *Nanfito v. Tekseed Hybrid Co.*, 473 F.2d 537, 542-43 (8th Cir. 1973).

193. See notes 13-14 *supra* and accompanying text concerning half-truths, and note 56 *supra* and accompanying text concerning the practice of construing ambiguities against the speaker.

194. For a discussion of the shingle theory see 3 L. Loss, *Securities Regulation* 1482-93 (2d ed. 1961); Jacobs, *supra* note 3, at 876-81.

195. *Affiliated Ute Citizens v. United States*, 406 U.S. at 153 (emphasis added) (citations omitted). The Court made clear that this was not based on broker-dealer principles. *Id.* at 154 n.16. This quotation is, of course, on a somewhat different issue (i.e., whether disclosure must be made by a market maker of a market at a higher price), but it is still authority for the proposition for which it is cited.

they are trading is fair.¹⁹⁶ Other representations have also been implied,¹⁹⁷ but some courts have refused to do so in certain situations.¹⁹⁸

196. *Speed v. Transamerica Corp.*, 99 F. Supp. at 843; Daum & Phillips, *The Implications of Cady, Roberts*, 17 Bus. Law. 939, 947-48 (1962); Leech, *Transactions in Corporate Control*, 104 U. Pa. L. Rev. 725, 770 n.124 (1956); Note, *Purchaser's Duty to Disclose Under Securities and Exchange Commission Rule X-10B-5*, 40 Minn. L. Rev. 62, 68, 70 & n.62 (1955); see *Reynolds v. Texas Gulf Sulphur Co.*, 309 F. Supp. at 558; *Fleischer & Mundheim, Corporate Acquisition by Tender Offer*, 115 U. Pa. L. Rev. 317, 338-39 (1967). The broadness of the Speed holding is tempered somewhat by the court's prior statements. 99 F. Supp. at 829-30. The SEC's view is in accord with the text. *Complaint in SEC v. Aldred Inv. Trust*, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,349, at 94,490 (S.D.N.Y. 1963).

In *List v. Fashion Park, Inc.*, the Second Circuit refused to consider plaintiff-seller's contention that the defendant-insider-buyer impliedly represented that the price was fair in an over-the-counter trade where plaintiff was unaware that the buyer was an insider. The court's rationale for failing to discuss the issue was that plaintiff raised it for the first time on appeal and the allegation "raises substantial issues of fact . . . such as the ascertainment of the true value of plaintiff's shares on [the date of the sale]." 340 F.2d at 461. This disposition suggests that the representation is implied in at least some circumstances; were it otherwise, the court could have disposed of the issue as a matter of law. The sales price in *List* was negotiated between the buyer and the seller. 227 F. Supp. at 907-08. If the representation was implied in the *List* case, arising in an over-the-counter trade where plaintiff did not know the buyer was an insider, a fortiori it would be implied in other outsider-insider cases where the parties knew one another. Cf. *Chiodo v. General Waterworks Corp.*, 380 F.2d 860, 867 (10th Cir.), cert. denied, 389 U.S. 1004 (1967) (no representation to selling insider by buying outsider).

On the other hand, many reported cases involving purchases by insiders do not discuss the issue of implied misrepresentation. Yet occasionally in such opinions, the courts have been careful to point out that the selling stockholder initiated the trade and the result might have been different had the stockholder been approached initially by the purchasing insider or had he negotiated the price with the insider. *Hafner v. Forest Laboratories, Inc.*, 345 F.2d 167, 168 (2d Cir. 1965); see *Kohler v. Kohler Co.*, 208 F. Supp. 808, 821-22 (E.D. Wis. 1962), aff'd, 319 F.2d 634 (7th Cir. 1963).

197. *Abramson v. Burroughs Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,456, at 92,254 (S.D.N.Y. 1972) (investor can assume he will get reasonable notice of redemption); *E.L. Aaron & Co., Inc. v. Free*, 55 F.R.D. 401, 402-03 (S.D.N.Y. 1972) (sub silentio that presentment of check is implied representation that check is good); *SEC v. Manor Nursing Centers, Inc.*, 340 F. Supp. at 934 (implied representation that funds in account to back up check for payment of securities); *Speed v. Transamerica Corp.*, 99 F. Supp. at 829 (citing cases); *Peskind, Regulation of the Financial Press: A New Dimension to Section 10(b) and Rule 10b-5*, 14 St. Louis U.L.J. 80, 89 (1969) (could imply representation of disinterestedness); see *Reynolds v. Texas Gulf Sulphur Co.*, 309 F. Supp. at 558 ("implied misrepresentation can be just as fraudulent as an express one . . ." *Id.*).

198. For example, while the presentation of financial statements usually carries with it the implied representation not only that they were true as of their date but also that there has been no material change since then, this is not always the case. *Lane v. Midwest Bancshares Corp.*, 337 F. Supp. 1200, 1210 (E.D. Ark. 1972).

G. Opinions and Forecasts

The final category is a class of statements which might loosely be called opinions and forecasts. This includes recommendations to buy or sell a security, opinions or estimates as to the present or the future status of an event, projections and predictions of future occurrences, and representations that an incident will take place. The courts have begun to clarify the law in this area.

Each of these statements is a "fact" within the ambit of the Rule,¹⁹⁹

199. *Chris-Craft Indus., Inc. v. Bangor Punta Corp.*, 426 F.2d 569, 579 (2d Cir. 1970) (concurring opinion) (the Rule covers "information" which does not fit easily into categories of either "fact" or "opinion"); *Myzel v. Fields*, 386 F.2d at 734 n.8; *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 212 (9th Cir. 1962) (misleading profit estimates); *SEC v. American Plan Inv. Corp.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,769, at 93,361 (C.D. Cal. 1972) (consent order enjoining misleading projections); *Dolgov v. Anderson*, 53 F.R.D. at 670, 676-79; *Gordon v. Lipoff*, 320 F. Supp. 905, 917 (W.D. Mo. 1970) (quoting *Myzel v. Fields*, supra); *Sprayregen v. Livingston Oil Co.*, 295 F. Supp. 1376, 1377-78 (S.D.N.Y. 1968) (false statements on projected profits); *SEC v. Glen Alden Corp.*, [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,280, at 97,342-43 (S.D. N.Y. 1968) (tipping of projections); *Fischer v. Kletz*, 249 F. Supp. 539, 541 (S.D.N.Y. 1966) (inflated earnings forecast disseminated both to public and to regulatory agency); *Nicewarner v. Bleavins*, 244 F. Supp. 261, 264 (D. Colo. 1965) (statements about expected profits, likelihood of success of venture, etc., not shown to be in bad faith by the evidence); *SEC v. Broadwall Sec., Inc.*, 240 F. Supp. 962, 968 (S.D.N.Y. 1965) (broker-dealer's predictions and opinions as to future market prices of stock); *Freed v. Szabo Food Serv., Inc.*, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,317, at 94,363-2 to 94,363-3 (N.D. Ill. 1964) (misrepresentation of future earnings); Statement by the Commission on Disclosure of Projections of Future Economic Performance, SEC Securities Exchange Act Release No. 9984 (Feb. 2, 1973), [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,211 [hereinafter cited as Release 9984]; *Mates Fin. Servs.*, SEC Securities Exchange Act Release No. 8836 (Mar. 9, 1970), [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,790 (tipping of sales, earnings, and earnings projections); *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, SEC Securities Exchange Act Release No. 8459 (Nov. 25, 1968), [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,629 (tipped earnings and earnings projections); Statement by former SEC Chairman William J. Casey on Earnings Forecasts and Projections, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,211, at 82,666 (Feb. 2, 1973); *Latty, The Aggrieved Buyer or Seller of Shares in a Close Corporation Under the S.E.C. Statutes*, 18 Law & Contemp. Prob. 505, 526 (1953). See *Milberg v. Western Pac. R.R.*, 51 F.R.D. at 282 (dictum) (good faith estimate of earnings not actionable); cf. *United States v. Grayson*, 166 F.2d 863, 866 (2d Cir. 1948) (1933 Act § 17(a), 15 U.S.C. § 77q(a) (1970)).

Contra, *Chiodo v. General Waterworks Corp.*, 380 F.2d 860 (10th Cir.), cert. denied, 389 U.S. 1004 (1967) (statement "could not rise to the height of a false representation, it could be nothing more than an expression of opinion." Id. at 867). The result in *Chiodo* can perhaps be explained by the facts: the long-term owner of a business alleged he was misled by the buyer's representation of its worth; that is, an outsider misled an owner about the owner's own property. But the court's correct result when finding in favor of the buyer could better have been achieved by dismissing the complaint on the grounds of unjustified

so the issue of when they are misleading must be considered. Statements concerning the future²⁰⁰ are misleading if they are not believed by the speaker when made.²⁰¹ They are also misleading if they do not have a reasonable basis,²⁰² a point which bears further discussion. While a reasonable basis is necessary for all the statements mentioned above, the preponderance of 10b-5 opinions in this area concerns a broker-dealer recommending a security.²⁰³ Three separate duties comprise a reasonable basis: (1) to make a reasonable investigation; (2) to disclose lack of knowledge regarding the issuer, and (3) to reveal data indicating that the recommendation is incorrect. The first of the three, a reasonable in-

reliance. In *Rogen v. Iikon Corp.*, 250 F. Supp. 112, 117 (D. Mass.), rev'd on other grounds, 361 F.2d 260, 267 (1st Cir. 1966), both courts concluded that an opinion, recognized as such, was not actionable where plaintiff showed no reliance. Therefore, although an opinion generally could be actionable, the plaintiff may not be able to demonstrate reliance to the extent necessary. See also *Rochez Bros. v. Rhoades*, 353 F. Supp. 795, 798 (W.D. Pa. 1973) (information equally accessible to both insiders). In *Most v. Alleghany Corp.*, [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,583, at 98,665 (S.D.N.Y. 1970), the court held that an opinion as to the law is not actionable because the question is one of opinion but not fact. This result, reached by relying on common-law authorities, is questionable.

Projections of income and similar statements regarding the future meld with existing fact when they relate to the current period. This would be the case, for instance, when a calendar year company makes a projection in May for the first six months of the year. Cf. *W. Prosser*, *Torts* § 109 (4th ed. 1971) (common law concerning opinion and intention).

There is some authority that statements regarding the future may be opinions or facts, depending upon the circumstances. *Myzel v. Fields*, 386 F.2d at 734 n.8; *Weinstein v. Zimet*, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,320, at 94,368 (S.D.N.Y. 1964). Those authorities do not elaborate on the significance of the distinction. The result seems too harsh if they are suggesting that some statements are facts and hence the speaker is liable regardless of how carefully facts were gathered and analyzed to reach the conclusion. On the other hand, the cases make quite clear that they do not intend to exclude opinion from the scope of the Rule. The Eighth Circuit in *Myzel* states that opinions are sometimes actionable. 386 F.2d at 734 n.8; accord, *Weinstein v. Zimet*, supra at 94,368.

200. Cf. notes 221-26 *infra* and accompanying text concerning opinions and estimates of existing facts.

201. See notes 157-59 *supra* and accompanying text.

202. Note that the test of reasonableness imposed on non-brokers does not depend upon whether negligence is recognized as a basis for a 10b-5 claim. Thus, the Second Circuit has recognized the reasonable basis test—e.g., in *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 363—even though it rejected negligence actions as a basis for suit under the Rule.

203. The SEC has indicated that a brokerage firm generally must have a reasonable basis for its recommendation. *Mac Robbins & Co.*, 41 S.E.C. 116, 119 (1962), *aff'd sub nom. Berko v. SEC*, 316 F.2d 137 (2d Cir. 1963). One circuit has held that a broker violates 10b-5 when he makes a recommendation without a reasonable basis therefor. *Hiller v. SEC*, 429 F.2d 856, 858 (2d Cir. 1970); *Hanly v. SEC*, 415 F.2d 589, 596 (2d Cir. 1969); see 3A H. Bloomenthal, *Securities and Federal Corporate Law* § 12.09[2], at 12-50 (1972).

vestigation, can in turn be divided into a responsibility to gather facts and an obligation to evaluate them,²⁰⁴ both under a standard of reasonableness. Rules established for broker-dealers cannot be incorporated wholesale into all areas²⁰⁵ since brokers are held to a higher standard than other persons.²⁰⁶ This does not mean that a non-broker is excused from making a reasonable investigation before recommending a security.²⁰⁷ However, it does signify that the standard imposed on non-brokers usually should be less than that prescribed for broker-dealers.

The reasonableness of an investigation is, of course, a question of fact. Among the factors to be considered are the relationship between the parties, the nature of the security, the amount of money involved, the speaker's financial capacity to undertake an investigation, and his ability to obtain facts because of his position with respect to the issuer. The last two criteria indicate that the issuer should have a higher duty than an outsider, since its organization is best able to accumulate and analyze the facts about itself.²⁰⁸ A director or officer has freer access to facts than an outsider but usually cannot match the issuer in this regard, so his obligations should fall between those of the issuer and an outsider. Regardless of who makes the assertion, one further factor should be considered for statements other than recommendations to buy or sell a security. Such statements can pertain only to the corporation,²⁰⁹ to a

204. *Dolgow v. Anderson*, 53 F.R.D. at 670, 676-79, contains an excellent, detailed discussion on one corporation's investigation to back-up its projections.

In the broker-dealer area, some information should tend to excite the broker's suspicion and he, therefore, may not rely on that data. This principle should be equally applicable to non-broker situations, though a lesser degree of financial sophistication on the part of the investigator should be taken into account.

The commission has stated that projections would not be misleading if "reasonably based in fact, prepared with reasonable care and carefully reviewed." Release 9984, at 82,668; accord, Statement by former SEC Chairman William J. Casey on Earnings Forecasts and Projections, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,211, at 82,666 (Feb. 2, 1973).

205. Accordingly, to the extent possible broker-dealer opinions have not been used in this section.

206. See *Jacobs*, supra note 3, at 871.

207. *SEC v. Chamberlain Associates*, [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,228, at 94,068-70 (S.D.N.Y. 1963). Non-brokers also have been held to have reasonable basis duties. See authorities cited in note 212 infra.

208. Cf. *Dolgow v. Anderson*, 53 F.R.D. 664 (E.D.N.Y. 1971), aff'd per curiam, 464 F.2d 437 (2d Cir. 1972), where the court dismissed a claim relating to allegedly false projections made by a corporation because the internal estimates "were made honestly, were reasonable, and were the best estimates of the people in [the corporation] most qualified to make them." Id. at 676.

209. Examples would include earnings per share for the next year or the date on which a new product will be offered for commercial sale.

fact external to the issuer,²¹⁰ or to a matter in between.²¹¹ The more closely the statement relates to the issuer, the higher the standard should be. This follows because the public has equal access to information necessary to evaluate facts external to the issuer, but data concerning a particular company are not as readily available.

Under these guidelines, a speaker's duty to investigate may range from very extensive to none at all. But no matter how little the extent of the investigation required, the speaker would still have to reveal his lack of knowledge regarding the company and convey any data indicating the incorrectness of his statement.²¹² As a corollary, he must disclose assumptions on which any statement concerning the future necessarily must be based only when they are different from what a reasonable listener would expect. For example, if a projection is based on the assumption that certain unannounced acquisitions would be made, that assumption should be disclosed.²¹³

Broker-dealer cases also indicate that there can be no reasonable basis for predictions of very substantial and specific market price rises for the stock of an unseasoned company, or for predictions of earnings for such enterprises.²¹⁴ This theory should not be limited to brokerage firms. It also follows that a statement made without a reasonable basis is nevertheless a 10b-5 infraction even though it fortuitously comes to pass.²¹⁵ Private recovery would be inappropriate here because no one could show injury, but the Commission could still bring suit. On the other hand, damages could not be recovered even though an inadequate investigation

210. The state of the economy would be an example. See *Rogen v. Iikon Corp.*, 361 F.2d at 267 (no recovery where opinion related only to state of market for stock).

211. One instance of this would be a prediction of a rise in the price of the issuer's stock. The rise would depend on internal factors (such as earnings and potential profits) and external circumstances (such as the state of the market place in general).

212. Complaint in *SEC v. National Student Marketing Corp.*, Civil No. 225-72 (D.D.C., filed Feb. 3, 1972), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,360, at 91,913 to 91,913-3 (projection of earnings made without disclosing that tentative results showed a downturn in earnings); cf. W. Prosser, *Torts* § 109, at 726, 728 (4th ed. 1971); *Restatement of Torts* § 525, comment e, § 539(1) (1938).

213. Complaint in *SEC v. National Student Marketing Corp.*, Civil No. 225-72 (D.D.C., filed Feb. 3, 1972), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,360, at 91,913-10.

The SEC now proposes to have the underlying assumptions for projections set forth. Release 9984.

214. Similarly, in *Were v. Mack*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,956, at 90,523-24 (S.D.N.Y. 1971), the court noted it could be misleading to predict the market value of preferred stock to be issued in an exchange offer. Moreover, the SEC proposes to limit the class of issuers who can include projections in prospectuses and proxy statements to companies with a record or earnings and budgetary controls. Release 9984.

215. Cf. text accompanying notes 48-49 *supra*.

was conducted if a reasonable investigation would have failed to uncover the concealed data.²¹⁶

While the discussion of reasonable basis has been couched in terms of recommendations to buy or sell a security, the same principles apply to opinions and estimates of the future status of an event, projections and predictions of future occurrences, and representations that an event will take place.²¹⁷ Those principles are also applicable to two other statements which are in the nature of a recommendation to buy or sell a security. First, management must have a reasonable basis when it suggests that stockholders approve a merger; tender their shares in a tender or exchange offer; or buy, sell, or (possibly) hold shares of the issuer.²¹⁸

216. Cf. *Northway, Inc. v. TSC Indus., Inc.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,646, at 92,899 (N.D. Ill. 1972) (duty to investigate buyer of control when on notice of irregularity). However, actions for injunctions or suits by the SEC should be permitted.

217. *Myzel v. Fields*, 386 F.2d at 734 n.8 (can recover for opinions if completely unfounded and reckless, if deliberately intended to mislead, or if defendant thought them false when made); *Blakely v. Lisac*, 357 F. Supp. 255, 262-63 (D. Ore. 1972) (need reasonable basis for predictions of sales, earnings and use of proceeds); *Reube v. Pharmacodynamics, Inc.*, 348 F. Supp. 900, 915 (E.D. Pa. 1972) (predictions of future stock values); *SEC v. American Plan Inv. Corp.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,769, at 93,361 (C.D. Cal. 1972) (consent order enjoining projections without support); *Dolgow v. Anderson*, 53 F.R.D. at 670, 676-79; *Gordon v. Lipoff*, 320 F. Supp. 905, 917 (W.D. Mo. 1970) (quoting *Myzel v. Fields*, supra); *Milberg v. Western Pac. R.R.*, 51 F.R.D. at 282 (no proof that opinion was reckless when made; therefore, no liability); *Nicewarner v. Bleavins*, 244 F. Supp. 261, 264 (D. Colo. 1965) (circumstances made projections believable by defendant, and projections were made in good faith; therefore, no cause of action); *SEC v. Broadwall Sec., Inc.*, 240 F. Supp. 962, 968 (S.D.N.Y. 1965) (broker-dealer as defendant); Release 9984; Statement by former SEC Chairman William J. Casey on Earnings Forecasts and Projections, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,211, at 82,666 (Feb. 2, 1973); *Alberg*, SEC Disclosure Requirements for Corporations, 26 Bus. Law. 1223, 1229 (1971); see *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 212 (9th Cir. 1962) (misleading estimate of profit which did not take into account cost of land or mention that mortgage was coming due); *Derdiarian v. Futterman Corp.*, 38 F.R.D. 178, 179 (S.D.N.Y. 1965) (settlement of class action where basic claim is concealment of lack of reasonable basis for cash flow projections in prospectuses); cf. AMEX Company Manual § 403(1), at 103 (1970) (prepare projections carefully with a reasonable factual basis); NYSE Company Manual § A2, at A-22 (1968) (projections should be soundly based). But see *Green v. Jonhop, Inc.*, 358 F. Supp. at 418-19 ("not every inaccurate prediction is actionable." *Id.* at 418; here, grossly inaccurate); *Phillips v. Reynolds & Co.*, 294 F. Supp. 1249, 1256 (E.D. Pa.), motion to amend denied, 297 F. Supp. 736 (E.D. Pa. 1969) (opinion not actionable unless puffing is grossly exaggerated; broker-dealer is defendant). As to puffing, see note 47 supra and accompanying text.

In *Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co.*, 356 F. Supp. at 1070-71, the court held that management which informed stockholders that it believed a tender offer price was inadequate did not have to tell the basis for its opinion.

218. *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 803 (2d Cir. 1969), cert.

Second, it is a common occurrence that, on the basis of data supplied by the issuer and underwriter of bonds, a bond rating agency will rate bonds in light of its view of the issuer's credit. The agency should be liable to investors purchasing bonds on the basis of its rating if it did not conform to the reasonable-basis rules. It follows that the reasonable investigation standard for a bond rating agency should be at least as stringent as that for a broker-dealer.²¹⁹

A statement made with a reasonable basis is not misleading merely because future events do not bear out the statement.²²⁰ However, if those future events were reasonably foreseeable, that fact alone should be some evidence that the original investigation was not sufficiently complete.

Unlike the other statements discussed in this section, opinions and estimates may relate to a presently existing fact, as well as to a future status. Present facts can be classified into those which can be ascertained with reasonable accuracy after a reasonable investigation (such as the number of items in the inventory of a small business), and those which cannot be so ascertained (such as the amount of ore in a newly-found gold mine). An opinion or estimate regarding an ascertainable fact (the former of the two classes) is the same as a representation of a present

denied, 400 U.S. 822 (1970) (reasonable basis found for recommendation in merger); see *Smith v. Newport Nat'l Bank*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,200, at 91,209 (D.R.I. 1971) (recommendations of tender offer by officers and directors; they acted "honestly and sincerely" and, court indicated, tender offer was fair). Stockholders are likely to rely heavily on recommendations of management in the midst of a battle for control, so its advice must be "meticulous and precise." *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 364-65.

Somewhat related is the question of the necessity of disclosure by management of better offers made by the other party to a merger during the negotiating process, when the offers subsequently were withdrawn, or of items the issuer sought in the bargaining. *Stedman v. Storer*, 308 F. Supp. 881, 886-87 (S.D.N.Y. 1969) held that neither must be disclosed.

219. A broker's fiduciary duty to his customers would suggest a higher standard for brokers, but the resources available to the bond rating agency, the reliance investors place on their opinions, and the large amounts of money to which the ratings relate indicate at least an equal standard for the rating agencies.

A seller using a prime rating on commercial paper when knowing or when he should know the rating was wrong violates the Rule, regardless of whether there was fraud in obtaining the rating. *SEC v. Crofters, Inc.*, 351 F. Supp. 236, 255-56 (S.D. Ohio 1972).

220. *Dolgow v. Anderson*, 53 F.R.D. at 670, 676-79 (intervening cause); *Millberg v. Western Pac. R.R.*, 51 F.R.D. at 282 (cannot reasonably expect projections to be infallible); *Nicewarner v. Bleavins*, 244 F. Supp. at 264 (no responsibility for reasonably cautious predictions); Release 9984; Statement by former SEC Chairman William J. Casey on Earnings Forecasts and Projections, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 79,211, at 82,666 (Feb. 2, 1973); *Alberg*, supra note 217, at 1229.

In *Kutner v. Gofen & Glossberg*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,109 (7th Cir. 1971), the court held that an investment adviser's hope of future return was not actionable when the return was not achieved. But the adviser should have been held liable if the hoped-for return was not reasonable when made.

fact. Therefore, a statement pertaining to ascertainable facts is misleading if the data are not as represented, even though it is couched in terms of an estimate or opinion. On the other hand, when the facts cannot be reasonably ascertained, the speaker nevertheless should have a reasonable basis for his opinion or estimate and should believe it true, like any opinion or estimate of a future event.²²¹

Another type of opinion pertaining to the present is a legal opinion. The question of when a lawyer's opinion is sufficiently inaccurate to be misleading has received little attention.²²² Like any other opinion, it must represent accurately the views of the speaker. One case found an opinion letter misleading under a modified reasonable-basis standard because the statements went "enough beyond being mere mistakes in legal judgment . . . [and hence] constitute[d] probable violations . . . of the securities laws."²²³ This is a less stringent standard than is applied

221. In *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971) (construing 1933 Act § 11(a), 15 U.S.C. § 77k(a) (1970)), the court rejected a defense based on the ground that "no one could be certain of precisely how much was involved" and suggested "an honest and open statement, adequately warning of the possibilities of error and miscalculation and not designed for puffing . . ." *Id.* at 549.

222. A threshold question is whether a legal conclusion is a "fact". The better reasoned authorities have resolved this issue affirmatively. *SEC v. International Chem. Dev. Corp.*, 469 F.2d 20, 26 (10th Cir. 1972) (misrepresentation that stocks freely tradeable and registered); *Young v. Taylor*, 466 F.2d 1329, 1332 (10th Cir. 1972) (misrepresentation that stock was registered and misstatement of time stock had to be held before transfer); *Hirschleifer v. Fran-Tronics Corp.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,681, at 93,030 (S.D.N.Y. 1972) (misrepresentation of the tax law); *Kohner v. Wechsler*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,537, at 92,564-65 (S.D.N.Y. 1972) (alleged misrepresentation in case concerning antitrust and customs laws); *Abdelnour v. Coggeshall & Hicks*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,340, at 91,818 & n.1 (S.D.N.Y. 1972) (misrepresentation of salability of stock); *SEC v. Century Inv. Transfer Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,232, at 91,443 (S.D.N.Y. 1971) (failure to make known the clear statutory necessity of registering stock); *Dauphin Corp. v. Sentinel Alarm Corp.*, 206 F. Supp. 432, 434 (D. Del. 1962); *SEC Anti-fraud Release Regarding Non-Public Offerings*, SEC Securities Exchange Act Release No. 9444 (Jan. 10, 1972), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,483; see *Symington Wayne Corp. v. Dresser Indus., Inc.*, 383 F.2d 840, 843 (2d Cir. 1967) (question of tax law; court assumes sub silentio that it is a fact); cf. *Puma v. Marriott*, 348 F. Supp. 18, 22 (D. Del. 1972) (proxy rules; concealment that persons can sell some stock immediately under former 1933 Act Rule 133, 17 C.F.R. § 230.133 (1973), rescinded effective Jan. 1, 1973, 37 Fed. Reg. 23,636 (1972)); *Restatement of Torts* § 525, comment c, § 545 (1938). But see *Most v. Alleghany Corp.*, [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,583, at 98,665 (S.D.N.Y. 1970) (rarely is a legal opinion a "fact").

223. *SEC v. Century Inv. Transfer Corp.*, [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,232, at 91,443 (S.D.N.Y. 1971); cf. *SEC v. Spectrum, Ltd.* [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,631, at 92,867-68 (S.D.N.Y. 1972) (not liable as aider and abettor for giving erroneous opinion absent proof lawyer knew of scheme); *Dauphin Corp. v. Sentinel Alarm Corp.*, 206 F. Supp. 432 (D. Del. 1962) (denial of motion for summary judgment) (attorney might be responsible although he claimed there was no proof his opinion "was given with knowledge it was legally incorrect." *Id.* at 434).

to other opinions, and seems to be another manifestation of the "rule" that everyone is presumed to know the law except attorneys.

A person's valuation of a security for which there is no established market is still another opinion of existing fact.²²⁴ Reliance is often an element which must be demonstrated in private damage actions. It will be more difficult to show reliance on an opinion or estimate than on a statement of fact. And reliance on an opinion of *value* might be hardest to demonstrate,²²⁵ since the law generally expects each of the parties to form his own conclusion on that matter.²²⁶

Three issues which relate to publicizing opinions and forecasts remain. The first concerns a person's obligation to publish an opinion or forecast before trading. In general, a company need not disclose its internal projections and opinions concerning its future operations when it trades, so long as it reveals the underlying material facts.²²⁷ (However, the SEC is now seriously considering whether projections can be placed in prospectuses.²²⁸) An insider or tippee must make the same disclosures as the corporation if he knows the company's projections or forms his own based on facts he gathered by virtue of his relationship to the company.²²⁹ But the insider or outsider who reaches a conclusion regarding the future from publicly known facts need make no disclosure when he trades. Second, to keep investors informed, publicized projections of future results must be updated promptly after the issuer revises its esti-

224. See Note, Purchaser's Duty to Disclose Under Securities and Exchange Commission Rule X-10B-5, 40 Minn. L. Rev. 62, 68 (1955).

225. This explains the result in *Myzel v. Fields*, 386 F.2d at 736; *Chiodo v. General Waterworks Corp.*, 380 F.2d at 867; *Rochez Bros. v. Rhoades*, 353 F. Supp. 795, 798 (W.D. Pa. 1973); *Gordon v. Lipoff*, 320 F. Supp. 905, 915 (W.D. Mo. 1970). In all cases, the speaker was less familiar, or equally familiar, with the company than the listener.

226. See *Gulf & W. Indus., Inc. v. Great Atl. & Pac. Tea Co.*, 356 F. Supp. at 1071 (price of a stock determined partly by hunches of the market; therefore, adequacy or inadequacy of tender offer price is subjective and so should not condemn opinion of target company for inadequacy); cf. *W. Prosser, Torts* § 109, at 723-24, 726-28 (4th ed. 1971) (common law); *Restatement of Torts* § 543, comment f (1938).

As to whether an implied representation arises that a price quoted is fair, see notes 188, 196 *supra* and accompanying text.

227. 37 *Fordham L. Rev.* 483, 489 (1969), discussing the Second Circuit opinion in *Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968) (en banc). On the other side of the coin, the projection based on the inside information may not be disclosed selectively. *Merrill Lynch, Pierce, Fenner & Smith, Inc., SEC Securities Exchange Act Release No. 8459* (Nov. 25, 1968), [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,629 (respondent's statement of policy). See cases cited in note 217 *supra*.

228. Release 9984.

229. See *Jackson v. Oppenheim*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,001, at 90,696 (S.D.N.Y. 1971) (indicating that an insider's opinion may not have to be disclosed but his facts must be revealed).

mates.²³⁰ Third, the issuer is precluded from disseminating statements regarding the future when it is in the process of registration.²³¹

IV. DISCLOSURE AND CURING

In the proper situation, a defendant might be able to sever the causal connection between his fraudulent activity and plaintiff's injury by disclosing the facts. Full disclosure might be defined as proper dissemination of a statement which conveys the true state of affairs to a reasonable investor.²³² Passive behavior is not enough. Thus, mere readiness and willingness to disclose is ineffectual.²³³ And despite some early views to the contrary,²³⁴ the availability of information from corporate books (at least where the plaintiff is not an insider) and an offer to answer questions are likewise inadequate.²³⁵ Similarly, the Third Circuit has held that in a proxy contest, defects in one party's proxy material cannot be cured by disclosures in the other party's soliciting material.²³⁶ This result should be limited to proxy statements and registration statements which ought to be self-contained. In general, however, information can be disclosed by anyone as long as it becomes public knowledge.²³⁷

230. Dayan, *supra* note 88, at 944 (must correct); see NYSE Company Manual § A2, at A-18, A-23 (1968) (correction required of rumors, etc.). One of the factors one court used to exonerate a corporation whose estimates turned out to be incorrect was that it reported supervening events and changes in predictions. *Dolgow v. Anderson* 53 F.R.D. at 677-79. The SEC would require updating of projections and reasons for deviations between projected and actual results. Release 9984.

231. Guidelines for the Release of Information by Issuers Whose Securities Are in Registration, SEC Securities Act Release No. 5180 (Aug. 16, 1971), [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,192.

232. This is patterned after the definition of a misrepresentation. See note 12 *supra* and accompanying text.

233. *Stier v. Smith*, 473 F.2d 1205, 1208 (5th Cir. 1973); *Myzel v. Fields*, 386 F.2d at 735, citing *Dale v. Rosenfeld*, 229 F.2d 855, 858 (2d Cir. 1956); *Hughes v. SEC*, 174 F.2d 969, 976 (D.C. Cir. 1949); *Bowman & Bourdon, Inc. v. Rohr*, 296 F. Supp. 847, 851 (D. Mass.), *aff'd per curiam*, 417 F.2d 780 (1st Cir. 1969); *Masland, Fernon & Anderson*, 9 S.E.C. 338, 347 (1941).

234. E.g., *Mills v. Sarjem Corp.*, 133 F. Supp. at 766 (offer to give information).

235. *Stier v. Smith*, 473 F.2d 1205, 1208 (5th Cir. 1973); *Associated Investors Sec., Inc.*, 41 S.E.C. 160, 167 (1962); cf. *Jackson v. Oppenheim*, [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,001, at 90,696 (S.D.N.Y. 1971).

236. *Kohn v. American Metal Climax, Inc.*, 458 F.2d at 265. But see *id.* at 290-91 n.47 (concurring and dissenting opinion) (this rule is correct for proxy violations but not for violations of 10b-5). See also *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 365 (2d Cir. 1973) (disclosure and curing in prospectus and letters). Compare *Chris-Craft Indus., Inc. v. Independent Stockholders Comm.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,766, at 93,351 (D. Del. 1973) (proxy rules; insufficient to make disclosure in annual report and not in proxy statement unless proxy statement clearly refers to annual report).

237. *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 377 (misrepresenta-

The method of disclosure is also important. The controlling issue is whether the information is received by the persons to whom it is directed. Facts can be revealed to one person or a small group either by telephone, by delivery of a written statement, or during a face-to-face meeting. Disclosure to the public would be governed by the standards developed for determining whether a press release or other material is sufficiently disseminated.²³⁸ This rule is subject to one qualification—the public should not be presumed to have knowledge of information disseminated to correct previously circulated data unless the correcting release is given at least as extensive publicity as the misleading announcement.²³⁹

The effect of properly disseminated, understandable disclosure depends upon whether or not the 10b-5 violation was substantive. Substantive breaches would include, for example, certain types of mismanagement of a corporation or manipulation of a market, and are to be distinguished from violations arising only from a misstatement or omission. Disclosure cannot cure substantive violations.²⁴⁰ Even when the only breach of the Rule is a misleading statement or omission, a comprehensible corrective announcement will preclude a damage action²⁴¹ only if the recipients have not acted or were not irrevocably committed to act²⁴² when they absorbed

tion in letters by management cured by letters of one of two suitors); *id.* at 401 (concurring and dissenting opinion).

238. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d at 854.

239. For an example of a suit brought by the Commission based on a false annual report to stockholders see *SEC v. First Standard Corp.*, [1966-1967 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 91,824 (S.D.N.Y. 1966). The court required the corporation to send the "clarifying" release to all persons who received the report and to specified newspapers. *Id.* at 95,836. See also *Rosenblatt v. Northwest Airlines, Inc.*, 435 F.2d 1121, 1128 (2d Cir. 1970) (failure to disclose great losses one year before proxy statement is remedied by placing losses in proxy statement).

240. This is evidenced further by other antifraud rules which are violated even though disclosure is made. See, e.g., 1934 Act Rules 10b-6 and 15c1-7, 17 C.F.R. §§ 240.10b-6, 240.15c1-7 (1973).

241. There is some indication that disclosure does not cure even a non-substantive violation. See *Associated Investors Sec., Inc.*, 41 S.E.C. 160, 167 (1962) (offer to refund price with interest no defense); cf. *SEC v. Great Am. Indus., Inc.*, 407 F.2d 453, 457 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 920 (1969) (apparently under 1934 Act § 13(a), 15 U.S.C. § 78m(a) (1970)). This apparent discrepancy can be explained by treating a proper, timely correction as precluding a damage action since no injury can be shown.

242. *Moerman v. Zipco, Inc.*, 302 F. Supp. 439, 443 (E.D.N.Y. 1969), *aff'd per curiam*, 422 F.2d 871 (2d Cir. 1970); Note, *Purchaser's Duty to Disclose Under Securities and Exchange Commission Rule X-10B-5*, 40 Minn. L. Rev. 62, 73 (1955); see *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d at 363 (earlier promise of value of securities would not influence rational investor who received prospectus containing details); *Slavin v. Germantown Fire Ins. Co.*, 174 F.2d 799, 813 (3d Cir. 1949) (dissenting opinion). See also *SEC v. Texas Gulf Sulphur Co.*, 312 F. Supp. at 84 (no need to wait for promised clarification). Compare *Chris-Craft Indus., Inc. v. Independent Stockholders Comm.*, [1972-

and evaluated the data contained in the announcement.²⁴³ Some schemes raise such serious 10b-5 questions that it is doubtful whether meaningful disclosure can be made.²⁴⁴ Assuming the correction is intelligible and timely, the burden of taking affirmative action can be shifted to voting or tendering stockholders by requiring them to change their vote or withdraw their securities if they so desire.²⁴⁵

A few miscellaneous points remain. First, disclosure in mismanagement situations is somewhat complex.²⁴⁶ Second, a correction of a statement is itself some evidence that the statement was misleading when issued, particularly if no development intervened between the two announcements.²⁴⁷ Third, the change in market price after a correcting release can be used as evidence of the misleading nature of the prior statement.²⁴⁸ Fourth, the Second Circuit held that it is no defense in an action

1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,766, at 93,348 (D. Del. 1973) (proxy rules; informed stockholders as soon as facts were learned); *deHaas v. Empire Petroleum Co.*, 300 F. Supp. 834, 836 n.2 (D. Colo. 1969), modified, 435 F.2d 1223 (10th Cir. 1970) (letter over one month later permissible to correct misleading first letter in proxy material; no discussion of status of votes received in intervening period).

243. But see *Derdarian v. Futterman Corp.*, 38 F.R.D. 178, 180 (S.D.N.Y. 1965) (settlement of class action for misleading statement; class terminates on date of issuance of correcting announcement).

244. *Jerry W. Smith*, SEC No-action letter (May 16, 1972), [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,856 (hypothetical portfolio cannot be meaningful measure of performance as investment advisor); *Ferris & Co.*, SEC No-action letter (Apr. 24, 1972), [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,903 (same); *Progressive Phone Systems, Inc.*, SEC No-action letter (June 30, 1971), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,361 (manipulation); *Edmund C. Mead*, SEC No-action letter (June 18, 1971), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,323 (investment advisory fee if open accounts at named broker-dealer); *Argus Sec. Mgt. Corp.*, SEC No-action letter (June 1, 1971), [1971-1972 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,366 (advisor to customer's broker); *Reinholdt & Gardner*, SEC No-action letter (Mar. 25, 1971), [1970-1971 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 78,120 (broker-dealers). Query whether this concept is limited to substantive violations?

245. *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519, 526 (S.D.N.Y. 1970) (original proxy statement gave clear and fair presentation of facts). In *Electronic Specialty Co. v. International Controls Corp.*, 295 F. Supp. at 1072-73, the court approved a withdrawal offer made by a tenderer to stockholders who had tendered. The offer was timely, contained a complete description of the litigation which was in progress, and extended the stockholders a reasonable time in which to act. In the court's view, this cured the defendant's violation. Accord, *Nicholson File Co. v. H.K. Porter Co.*, 341 F. Supp. 503, 521 (D.R.I. 1972), *aff'd*, 482 F.2d 421 (1st Cir. 1973) (tender offer provisions); *Hirschleifer v. Fran-Tronics Corp.*, [1972-1973 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,681, at 93,030 (S.D.N.Y. 1972).

246. See generally *Jacobs*, *supra* note 5, at 51-61, 67-75.

247. *SEC v. Great Am. Indus., Inc.*, 407 F.2d at 457. But see *Nicholson File Co. v. H.K. Porter Co.*, 341 F. Supp. at 521. It is also subjective evidence of materiality.

248. See notes 53-54 *supra* and accompanying text.

by the Commission that an erroneous 8-K report was corrected before it was placed in the public files;²⁴⁹ but the court noted that inadvertence in preparing the original filing and prompt correction after request "may affect liability for damages . . ." ²⁵⁰ Fifth, a successful suit cannot be precluded by stating in a misleading release that clarification will be issued later.²⁵¹ Indeed, a cause of action could arise out of the confusion of the two announcements if the "clarifying" release is significantly different in content but closely related in time.²⁵² Finally, selective disclosure constitutes tipping when the data are material. The New York Stock Exchange prohibits selective disclosure of even non-material facts,²⁵³ a position which may be stricter than the Rule.²⁵⁴

V. CONCLUSION

This article has attempted to explain what may constitute a misleading statement or omission under Rule 10b-5. It should be obvious from an examination of the authorities cited that courts will differ on the question of whether a particular statement violates the Rule. The topic is far from settled, and so prediction is impossible, if not foolhardy. But patterns are discernable, and this article has pointed out some of them. What lies in the future depends on whether the courts continue to construe the Rule as broadly as they have in the past; if so, the scope of misleading statements may very well encompass statements heretofore thought immune.

249. SEC v. Great Am. Indus., Inc., 407 F.2d at 457 (seemingly discussing 1934 Act § 13(a), 15 U.S.C. § 78m(a) (1970)).

250. Id. at 457.

251. SEC v. Texas Gulf Sulphur Co., 312 F. Supp. at 84.

252. See Reynolds v. Texas Gulf Sulphur Co., 309 F. Supp. at 561-62.

253. NYSE Company Manual § A2, at A-20 (1968).

254. Compare Bromberg, Corporate Information: Texas Gulf Sulphur and Its Implications, 22 Sw. L.J. 731, 752 (1968).