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RUMOR CONTROL AND DISCLOSURE OF MERGER NEGOTIATIONS OR OTHER CONTROL-RELATED TRANSACTIONS: FULL DISCLOSURE OR "NO COMMENT"—THE ONLY SAFE HARBORS

THOMAS LEE HAZEN*

I. INTRODUCTION

The active market for corporate acquisitions has had numerous ramifications with regard to both state corporate law and federal securities law. Over the past several years a major issue confronting management of public issue corporations has been the disclosure obligations attendant to on-going merger negotiations. This issue usually arises when management attempts to frame an appropriate response to inquiries concerning unusual price or volume movement in the company's stock or, alternatively, to questions concerning rumored takeover activity. The federal securities laws approach such disclosure problems in terms of whether a statement is materially misleading. A delicate balance must be struck between investors' access to relevant market information and management's desire for secrecy. Corporate managements have a legitimate interest in not disclosing a possible transaction in its preliminary stages lest the disclosure interfere with the progress of the negotiations. On the other side of the balance is the availability of accurate information that is necessary for an efficient market.

The discussion below focuses on both the best timing and degree of detail in merger negotiation disclosure, as well as the viability of a safe harbor rule that would guide management in such situations. It is suggested herein that the only alternative to full and fair disclosure of the stage of negotiations, regardless of how preliminary, is to issue a "no comment" statement.

This discussion begins with a description of the relevant market environment. It is followed by a brief overview of the provisions of the federal securities laws that bear upon whether a particular disclosure is appropriate. The subsequent analysis of the materiality issue, particularly in terms of the merger negotiation and rumor

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control cases, will demonstrate that rigid rules cannot capture the current state of the law. Since the materiality of a particular item is highly factual, dependent upon the surrounding circumstances, it is not possible to craft a safe harbor rule that would give clear guidelines to management as to what may and may not be said. A safe harbor, short of full disclosure or "no comment," would result in an unfortunate redefinition of traditional concepts of disclosure and materiality, and would permit half-truths that can mislead investors.

II. MERGERS AND THE MARKET ENVIRONMENT— AN INEFFICIENT MARKET

Beginning in the 1960s, investors' focus on corporate combinations has had a significant impact on the securities markets both in terms of day-to-day trading tactics and the markets' overall complexion.[1] The cloak of secrecy under which many takeovers, both hostile and friendly, took place led Congress to impose federal regulation of tender offers through enactment of the Williams Act in 1968.[2] The major thrust of the Williams Act, as is the case with the securities acts generally, is disclosure in order to assure an informed market.[3]

In the past several years the securities markets have witnessed what might best be described as "merger mania." During this period hostile third-party tender offers have proliferated. Both actual and potential takeover candidates have sought friendly suitors, or "white knights," as one of the many defensive tactics available.[4] These friendly combinations, in turn, have supplied additional froth to an already frothy market for control of public issue companies. Investors have a strong incentive for a short-term investment in or-

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1. *See generally* E. ARANOW, H. EINHORN & G. BERLSTEIN, DEVELOPMENTS IN TENDER OFFERS FOR CORPORATE CONTROL (1977); R. PHALON, THE TAKEOVER BARONS OF WALL STREET: INSIDE THE BILLION DOLLAR MERGER GAME (1981). *See also* Leebrom, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. REV. 153 (1986).

2. Pub. L. No. 90-439, §§ 2,3, 82 Stat. 454, 454-57 (1968) (codified at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982)). *See generally* Bromberg, *The Securities Law of Tender Offers*, 15 N.Y.L.F. 462 (1969); Hamilton, *Some Reflections on Cash Tender Offer Legislation*, 15 N.Y.L.F. 269 (1969).

3. *See generally* T. HAZEN, THE LAW OF SECURITIES REGULATION §§ 11.10-.20 (1985 & Supp. 1987).

4. *See* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Herzel, Schmidt & Davis, *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980); Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update*, 40 BUS. LAW. 1403 (1985); Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Warden, *The Boardroom as a War Room: The Real World Applications of the Duty of Care and the Duty of Loyalty*, 40 BUS. LAW. 1431 (1985). *See also* Leebrom, *supra* note 1, at 216-18.

der to take advantage of extraordinarily high control premiums and, thereby, to realize huge profits by purchasing stock before the issuer has been "put into play."[5] Accordingly, investors have created in the market an increased focus on trying to identify takeover candidates. Investors' hunger for "deals" has carried over beyond the market for corporate control in the context of business combinations. Other transactions that frequently result in high premiums include corporate restructuring and taking a public company private through a merger, reverse stock split, or repurchase of its shares.[6] This new-found emphasis on potential control premiums—and other deal-related premiums—takes investors' emphasis away from the company's long-term prospects, in favor of a search for companies likely to be targets in the near future.

The short-term emphasis on the takeover, corporate restructuring, and going private markets, combined with investors' ignorance as to takeovers and mergers in their early planning stages, has led to volatile markets that are significantly affected by rumors. Such an environment is antithetical to the ideal of an efficient capital market.[7] Under the efficient capital market hypothesis, the market price reflects an evaluation of all publicly available information, including any material misinformation.[8] In addition to the misinformation and rumors that may exist, market efficiency is severely hampered by the current environment of investors searching for deal-related stocks. This is in large part due to the furor over takeovers and the

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5. Once a pending takeover has been announced, other potential acquirers may enter the field. When a target company has been identified, it is said to be "in play."

6. These transactions can arise as a result of management's initiative, or they can be in response to or in anticipation of a third-party takeover offer.

7. *See, e.g.*, J. FRANCIS, INVESTMENT ANALYSIS AND MANAGEMENT 651-61 (1979); J. LORIE & M. HAMILTON, THE STOCK MARKET: THEORIES AND EVIDENCE 56, 65 (2d ed. 1985); Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970); Friend, *The Economic Consequences of the Stock Market*, 62 AM. ECON. REV. 212 (1972); Note, *The Efficient Capital Market Hypothesis, Economic Theory, and Regulation of the Securities Industry*, 29 STAN. L. REV. 1031 (1977). For critical views of the efficient capital market hypothesis, see Gordon & Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985); Wang, *Some Arguments That the Stock Market Is Not Efficient*, 19 U.C. DAVIS L. REV. 341 (1986). *See also* Givoly & Lakonishok, *The Information Content of Financial Analysts' Forecasts of Earnings: Some Evidence on Semi-Strong Inefficiency*, 1 J. ACCT. & ECON. 165 (1979); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 276-89 (1983).

8. As one court has summarized the efficient capital market hypothesis: "[E]conomists have now amassed sufficient empirical data to justify a present belief that widely-followed securities of larger corporations are 'efficiently' priced: the market price of stocks reflects all available public information—and hence necessarily, any material misrepresentations as well." *In re* LTV Sec. Litig., 88 F.R.D. 134, 144 (N.D. Tex. 1980).

fact that the market is placing an extraordinarily high premium on takeover and, in some cases, liquidation values.

The stock market is so starved for "deals" that it does not seem to be acting either rationally or efficiently. Many investors are putting unusually high emphasis on finding takeover candidates; this emphasis is magnified by the activities of risk arbitragers. In addition, many individuals and corporations acquiring the target companies seem to be engaged in a game akin to *Monopoly*: they acquire businesses with a view to a quick profit, and then resell within a relatively short period of time if the results are disappointing. For example, consider two recent case histories. In one instance, two major consumer products companies merged, only to have management decide that the merger should be undone. Within a few years after the merger the companies split up.[9] In a second and similar development, a major consumer products company has divested itself of a recently acquired liquor and wine company.[10] These two instances arguably show that even the corporate takeover market is not geared to the long term.

The stock of a number of public companies is trading far below the liquidation value. When a sizable number of companies are worth substantially more in terms of their break-up value as compared with their going-concern value, it is difficult to concede that the market is in fact efficient. Another example of the market's inefficiency and investors' hunger for stocks seen as having the potential for involvement in future deals is the immediate reaction to insider trading scandals. Precipitous declines in takeover-sensitive stocks have followed recent SEC enforcement actions with respect to insider trading.[11] Thus, we are operating in an environment in which the quest for the quick profit and rapid turn-around is acting at cross purposes with an efficient market. The current speculative and unstable environment makes it imperative that companies follow responsible disclosure policies when dealing with merger negotiations or market rumors.

The widespread presence of takeover rumors can, of course, have the effect of injecting misinformation into the market. The

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9. Kraft merged with Dart Industries only to split up a few years later in November of 1986.

10. A few years ago, RJR Corp. acquired Heublein, Inc., and now, subsequent to RJR's merger with Nabisco, the Heublein division is being sold.

11. This was the market's reaction to the settlement involving Ivan Boesky. *See* Wall St. J., Nov. 17, 1986, at 1, col. 6; *see also id.*, Nov. 19, 1986, at 3, col. 1 (market plunges amid rumor of deepening probe); *id.*, Nov. 20, 1986, at 3, col. 2 (takeover stocks take big tumble, hurting speculators).

misinformation increases when people perceived to be knowledgeable and informed are less than fully candid in their public pronouncements. The problem here is not so much the absence of information as to merger negotiations, but rather the presence of half-truths that corporate spokespersons disseminate. While total silence may be justified as a matter of sound business policy, the injection of half-truths[12] and misinformation into the marketplace cannot.[13]

Additional forces have enhanced market inefficiency in the current environment. Although unrelated to the public market for corporate control, the proliferation of options and financial index futures has further focused the market on the short term rather than the long term. Computer-generated buy programs and sell programs, frequently tied into the index options and futures markets, further exacerbate the problem. The resulting high volume and volatility magnify the inefficiency of the market generally and for corporate control specifically. It is ironic that these relatively new financial investments, which were designed to increase market efficiency, appear to have had quite the opposite effect. While the discussion below does not address the problems raised by index futures and options, their impact must be recognized as further compounding the problems raised by the current speculative fever over potential takeover, restructuring, and going private candidates.

There has been much concern over how best to maintain the securities markets as a source of informed investments rather than an arena for frothy and largely uninformed speculation. There have been many calls for new regulation of the takeover markets at both the federal and state level—ranging from tighter controls on defensive tactics[14] to regulation of the structure of takeovers.[15] While

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12. It has aptly been observed that "[f]ragmentary information may be as misleading . . . as active misrepresentation, and half-truths may be as actionable as whole lies . . . ." Kannavos v. Annino, 356 Mass. 42, 48, 247 N.E.2d 708, 711-12 (1969) (quoting 1 F. HARPER & F. JAMES, THE LAW OF TORTS § 7.14, at 586-87 (1956)). *See also* RESTATEMENT (SECOND) OF TORTS § 529, at 62-63 (1976); 2 F. HARPER, F. JAMES & O. GRAY, THE LAW OF TORTS § 7.14, at 472 (2d ed. 1986); 12 W. JAEGER, WILLISTON ON CONTRACTS §§ 1497-1499 (3d ed. 1970).

13. *But see* Flamm v. Eberstadt, 814 F.2d 1169, 1179-80 (7th Cir. 1987); Note, *Disclosure of Preliminary Merger Negotiations*, 8 CARDOZO L. REV. 197, 217 (1986).

14. Fiflis, *Of Lollipops and Law—A Proposal for a National Policy Concerning Tender Offer Defenses*, 19 U.C. DAVIS L. REV. 303 (1986); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377 (1985).

15. *See* 17 C.F.R. §§ 240.13e-4(f)(8)-(11), .14d-10 (1986), which mandate fair prices in two-tiered offers and prohibit exclusionary tender offers.

structural reforms would address the unfairness that results from certain types of transactions, they do not affect the problem addressed herein: the placing of effective limits on the infusion of half-truths and misinformation into the marketplace. Further, while we await the eventual resolution of the various proposed reforms, issuers and the courts continue to struggle with the extent of disclosure obligations by issuers who are, or may be, subject to takeovers, or who are engaged in takeover negotiations.

III. DISCLOSURE OR SILENCE?

As pointed out above, nearly twenty years after the passage of the Williams Act, significant disclosure problems remain in the market for corporate control. In fact, since the Williams Act is triggered only by a tender offer[16] or the acquisition of five percent of a class of a target company's equity securities,[17] its provisions do not apply to mergers or other forms of combination except in connection with a tender offer or five-percent purchase. Other provisions of the federal securities acts, however, do have an impact. Mergers involving companies subject to the reporting requirements of the Securities Exchange Act of 1934 can be accomplished only after a shareholder vote that will be subject to full disclosure under the federal proxy regulation.[18] Also, by virtue of the SEC's "going private rule,"[19] transactions that result in the cessation of Exchange Act reporting requirements are subject to similar disclosures. All of the foregoing provisions focus on the accuracy of the disclosures once the transaction begins. The proxy and going private regulations generally do not bear directly upon the problem addressed herein—what to do in the face of preliminary merger, corporate restructuring, or going private discussions.

Over the past several years the courts and the SEC have begun to grapple with the issue of disclosure obligations in the face of actual or rumored merger negotiations. Although the Williams Act's

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16. Section 14(d) imposes filing requirements with regard to tender offers for target companies that are subject to the 1934 Act reporting requirements. 15 U.S.C. § 78n(d) (1982). Section 14(e) prohibits deceptive conduct as well as material misstatements in connection with a tender offer, regardless of whether the target is a 1934 Act reporting company. *Id.* § 78n(e). With respect to self-tender offers by issuers, see § 13(e) of the Williams Act, *id.* § 78m(e).

17. *Id.* § 78m(d). This provision is limited to target company securities subject to the 1934 Act reporting requirements. *See also id.* § 78m(e) (addressing issuer repurchases of its own shares).

18. *Id.* § 78n(a); 17 C.F.R. § 240.14a-9 (1986).

19. 17 C.F.R. § 240.13e-3 (1986).

general antifraud provision may have some impact,[20] the primary impetus for full disclosure in such situations is SEC rule 10b-5.[21] Additionally, other federal provisions may come into play.[22] As will be explained more fully below, the courts and the SEC have been attempting to find a solution to the problem of deciding at what point an issuer is under an obligation to disclose the existence of pending negotiations that might lead to a transfer of corporate control.

The problem can arise in two different types of transactions. First, issuers that have put their business up for sale, that are engaging in takeover talks, or that are investigating a restructuring or going private transaction must decide at what time information should be released as a result of their own initiative. This determination necessarily involves the exercise of sound business judgment and a balancing between the desire for secrecy and the shareholders' and other investors' need to know. Second, issuers must be prepared to respond to questions from the securities exchanges themselves,[23] the press, the public, or security analysts. Questions directed at corporate management frequently will be spurred by volatile price and volume movements in the company's stock or the presence of rumors. In such situations management does not have the alternative of absolute silence unless management is able to hide from all questioners. Similarly, disclosure problems can arise when a company is meeting with security analysts at a time when undisclosed preliminary takeover talks are taking place. In each of these instances, responses must be carefully worded in order to avoid making

20. Exchange Act § 14(e), 15 U.S.C. § 77n(e) (1982). *See infra* text accompanying notes 41-42.

21. 17 C.F.R. § 240.10b-5 (1986).

22. For example, § 17(a) of the 1933 Act, which was the basis for rule 10b-5's language, prohibits material misstatements, fraudulent conduct, and conduct that operates as a fraud in connection with the offer or sale of a security. 15 U.S.C. § 77q(a) (1982). This is in contrast to rule 10b-5, which applies in connection with both purchases and sales. Second, rule 14a-9, which requires full disclosure in the solicitation of proxies for issuers subject to the 1934 Act reporting requirements, would apply when the merger negotiations are taking place during proxy season. 17 C.F.R. § 240.14a-9 (1986). Third, § 14(e) prohibits material misstatements and deceptive conduct in connection with a tender offer. 15 U.S.C. § 78n(e) (1982).

23. *See* Brown, *Corporate Secrecy, the Federal Securities Laws, and the Disclosure of Ongoing Negotiations*, 36 CATH. U.L. REV. 93 (1986); Note, *Disclosure of Preliminary Merger Negotiations*, 8 CARDOZO L. REV. 197 (1986); Note, *Stock Exchange Inquiry: Problems with Disclosure of Preliminary Merger or Acquisition Negotiations*, 11 J. CORP. L. 715 (1986); Comment, *Corporate Disclosure of Merger Negotiations—When Does the Investor Have a Right to Know?*, 36 SYRACUSE L. REV. 1155 (1985); Comment, *Disclosure of Preliminary Merger Negotiations Under Rule 10b-5*, 62 WASH. L. REV. 81 (1987) [hereinafter Comment, *Disclosure*].

materially misleading pronouncements. It is suggested herein that "no comment" is the only safe response as an alternative to full disclosure. A "no comment" response is preferable to the misleading "no corporate development" statement in the face of pending negotiations.[24]

It should be pointed out that even full disclosure of preliminary negotiations has the potential for being misperceived and inaccurately (or inefficiently) evaluated by the market. If discussions are at a preliminary stage, any disclosure has the potential for being received by the market more optimistically than warranted because of the current unlimited thirst for takeover candidates. Nevertheless, carefully worded, full and accurate disclosures indicating the preliminary nature of the talks would not be actionable under the securities laws even if misperceived by an inefficient market.

Thus, in theory, an issuer can always fully disclose the nature and stage of the preliminary talks that are taking place. In many cases, however, there is the fear that premature disclosure would severely impede negotiations if not operate as a "show stopper." As SEC Commissioner Grundfest has pointed out, "Clearly, merger negotiations cannot be conducted in a fishbowl."[25] The same is true of discussions relating a possible restructuring or going private transaction. Furthermore, there is a question as to whether a disclosure of preliminary discussions presents a duty to update.[26] Accordingly, full disclosure of negotiations may not be a practical alternative when a transaction is in its early stages.

A frequently suggested solution is that the SEC formulate a safe harbor rule governing both statements made in the course of preliminary negotiations and disclosures designed to control rumors.[27] In theory at least, a safe harbor rule dealing with the materiality issue would solve the dilemma that managements currently face. Contrary to the position taken by other commentators, including Commissioner Grundfest, however, it is submitted herein that, in lieu of full disclosure, the only safe harbor that would operate without changing the existing law of materiality is "no comment."[28]

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24. *See* Brown, *supra* note 23; Comment, *Disclosure*, *supra* note 23, at 104.

25. Grundfest, *Carnation Revisited: Toward an Optimal Merger Disclosure and Rumor Response Policy*, Address to the Federal Regulation of Securities Committee, American Bar Association (Apr. 15, 1986), at 11.

26. *See id.* at 8-9.

27. *See id.* at 11-12.

28. *But see* Flamm v. Eberstadt, 814 F.2d 1169, 1178-79 (7th Cir. 1987) (indicating that "no comment" can be misleading).

Further, any other safe harbor, even if capable of a concise formulation, would operate contrary to the interest of market efficiency.

IV. OVERVIEW OF APPLICABLE DISCLOSURE STATUTES

At this point, it may be helpful to give a brief overview of the various securities law provisions that are applicable to disclosure of preliminary merger negotiations, and that would trigger the duty to disclose the negotiations, or alternatively, to issue a "no comment" response. As mentioned above, SEC rule 10b-5[29] is the provision with broadest applicability to disclosures in the merger negotiation/rumor control context, although, on appropriate facts, other provisions may come into play.

A. *SEC Rule 10b-5: An Overview*

Rule 10b-5 prohibits materially misleading statements made in connection with the purchase or sale of a security, regardless of whether that security is subject to the registration requirements of the Securities Exchange Act of 1934.[30] Rule 10b-5 jurisdiction depends upon the use of an instrumentality of interstate commerce.[31] With regard to the "in connection with" requirement, it is not necessary that the defendant in the rule 10b-5 action have been a purchaser or seller of securities since it is sufficient that the statement, when made, was reasonably calculated to affect purchases and sales. Since a reporter's or analyst's question generally is triggered by unusual market activity or rumors, the "in connection with" requirement is easily satisfied in the typical situation involving actual or rumored merger negotiations.

Rule 10b-5 is promulgated under section 10(b), which prohibits manipulative or deceptive conduct.[32] The Supreme Court has held that scienter must be shown as a precondition to a violation.[33] In

29. 17 C.F.R. § 240.10b-5 (1986).

30. Companies are subject to the 1934 Act reporting requirements if their securities are traded on a national securities exchange, or, alternatively, if they have more than five million dollars in assets and a class of equity securities with more than five hundred shareholders. 15 U.S.C. § 78*l* (1982); 17 C.F.R. § 240.12g-1 (1986).

31. 17 C.F.R. § 240.10b-5 (1986). *See* Loveridge v. Dreagoux, 678 F.2d 870, 873-74 (10th Cir. 1982); Dupuy v. Dupuy, 511 F.2d 641, 644 (5th Cir. 1975); Myzel v. Fields, 386 F.2d 718, 727 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

32. 15 U.S.C. § 78j(b) (1982).

33. *See* Aaron v. SEC, 446 U.S. 680, 695 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1977). *See generally* Branson, *Statutory Securities Fraud in the Post-Hochfelder Era: The Continued Viability of Modes of Flexible Analysis*, 52 TUL. L. REV. 50 (1977); Bucklo, *The Supreme Court Attempts to Define Scienter Under Rule 10b-5: Ernst & Ernst v. Hochfelder*, 29

addition to the scienter requirement, a private suit for damages can only be brought by someone who was a purchaser or seller of the securities in question and who was injured as a result of the materially misleading statement.[34] Another precondition to a violation of rule 10b-5 is that there have been some element of deception; mere unfairness or breach of state law duties will not suffice.[35]

B. *SEC Rule 10b-5: When Does an Affirmative Obligation Arise?*

Whether an omission can ever be actionable by itself raises an interesting issue under rule 10b-5.[36] The rule, in addition to prohibiting misstatements, makes it unlawful "to omit to state a material fact necessary *in order to make the statements made*, in light of the circumstances *under which they were made*, not misleading . . . ."[37] As such, the rule on its face contemplates that the omission be from a statement that has been made. Accordingly, it is generally assumed that absent a statement, other affirmative conduct,[38] or a fiduciary duty,[39] there is no affirmative duty of disclosure. In the words of a recent decision holding that pending merger negotiations need not be disclosed: "Absent a specific duty to disclose, even the most material information imaginable may be withheld from the public."[40]

The view that mere nondisclosure will not support a rule 10b-5 violation is supported by the traditional common law of fraud and deceit.[41] Although the courts have developed various exceptions to

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STAN. L. REV. 213 (1977); Cox, *Ernst & Ernst v. Hochfelder: A Critique and an Evaluation of Its Impact Upon the Scheme of the Federal Securities Laws*, 28 HASTINGS L.J. 569 (1977).

34. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 755 (1975).

35. Santa Fe Indus. v. Green, 430 U.S. 462, 473-74 (1977). *See generally* Ferrara & Steinberg, *A Reappraisal of Santa Fe: Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980). *Cf.* Schreiber v. Burlington N., Inc., 472 U.S. 1 (1985) (holding that manipulation alone will not support a violation of § 14(e) of the Williams Act; some element of misrepresentation or deception is required).

36. *See* Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 GEO. L.J. 935 (1979); Block, Barton & Garfield, *Affirmative Duty to Disclose Material Information Concerning Issuer's Financial Condition and Business Plans*, 40 BUS. LAW. 1243 (1985).

37. 17 C.F.R. § 240.10b-5(2) (1986) (emphasis added).

38. For example, corporate insiders in possession of material nonpublic information are under an alternative obligation to disclose or abstain from trading. *See generally* T. HAZEN, *supra* note 3, at § 13.9. Accordingly, a duty to disclose arises when such persons decide to trade in their company's shares.

39. *E.g.*, Dirks v. SEC, 463 U.S. 646, 664 (1983); Chiarella v. United States, 445 U.S. 222, 232 (1980).

40. Polak v. Continental Hosts, Ltd., 613 F. Supp. 153, 156 (S.D.N.Y. 1985). *See also* Zuckerman v. Harnischfeger Corp., 591 F. Supp. 112 (S.D.N.Y. 1984); T. HAZEN, *supra* note 3, at § 13.10.

41. *E.g.*, Hendrick v. Lynn, 37 Del. Ch. 402, 144 A.2d 147 (1958); Fegeas v. Sherrill, 218 Md. 472, 147 A.2d 223 (1958); Swinton v. Whitinsville Sav. Bank, 311 Mass. 677, 42

the rule of no liability for mere nondisclosure, they are as yet very ill-defined.[42] While the common law of fraud has recognized a fiduciary duty exception to the absence of liability for mere nondisclosure,[43] it does not, absent special facts, apply to the nondisclosure of merger negotiations.[44]

Accordingly, there seems little, if any, basis for the proposition that rule 10b-5 imposes an affirmative disclosure obligation.[45] As the Second Circuit has pointed out: "A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company."[46] In contrast to rule 10b-5, the guidelines established by both the New York and American Stock Exchanges require corporations to make timely disclosure of information material to the reasonable investor.[47] In applying the exchange requirements, the company is entitled to establish business reasons for not disclosing. Thus, for example, in the context of preliminary merger negotiations, secrecy can be justified as necessary to permit discussions to go forward. Violation of the exchange's disclosure guidelines might warrant some disciplinary action, but it is questionable whether it would amount to a 10b-5 violation, even if made with scienter.

In contrast to the stock exchange approach, the SEC periodic reporting requirements, except in very limited circumstances not applicable to preliminary merger negotiations, do not impose an obligation to disclose information as it becomes material to investors. The closest affirmative disclosure requirement is found in SEC form 8K, which must be filed by companies subject to the registration and periodic reporting requirements of the Securities Exchange Act of

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N.E.2d 808 (1942); Iron City Nat'l Bank v. Anderson, Du Puy & Co., 194 Pa. 205, 44 A. 1066 (1899); W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON THE LAW OF TORTS § 106, at 737-38 (5th ed. 1984)[hereinafter PROSSER & KEETON].

42. *See* PROSSER & KEETON, *supra* note 41, § 106, at 738-40.

43. *E.g.*, Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951) (discussing duty of majority shareholder to disclose to minority shareholder in connection with stock redemption to be followed by liquidation); PROSSER & KEETON, *supra* note 41, § 106, at 738-39.

44. *See infra* note 47 and accompanying text.

45. *See* T. HAZEN, *supra* note 3, at § 13.10.

46. State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981) (relying on Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 162-63 (2d Cir. 1980); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 949 (2d Cir. 1969)). *Accord* Etshokin v. Texasgulf, Inc., 612 F. Supp. 1212, 1217 (N.D. Ill. 1984); Zuckerman v. Harnischfeger Corp., 591 F. Supp. 112 (S.D.N.Y. 1984).

47. N.Y.S.E. Listed Company Manual, 3 Fed. Sec. L. Rep. (CCH) ¶¶ 23,121, 23,513 (1977); AMEX Disclosure Policies §§ 401, 402, 3 Fed. Sec. L. Rep. (CCH) ¶¶ 23,124A-124B (1977).

1934.[48] Form 8K requires timely disclosure of certain material events, including the acquisition or disposition of substantial assets or changes in control.[49] It also requires disclosure upon the consummation of the transaction.[50] Thus, form 8K does not mandate disclosure of negotiations, at least until they have been completed and the deal has been finalized.

The apparent absence of an affirmative disclosure obligation imposed by rule 10b-5 and the correlative rule of no liability for mere nondisclosure presents its own safe harbor: silence or no comment. In the typical merger negotiation situation, management is responding to a question and, thus, can avoid 10b-5 scrutiny only by silence, which can take the form of a "no comment" statement.

C. *Section 17(a) of the Securities Act of 1933*

In addition to rule 10b-5, which has the broadest application, there are other securities law provisions that may come into play on appropriate facts. Section 17(a) of the Securities Act of 1933,[51] which was the model for SEC rule 10b-5, prohibits material misstatements "in the offer or sale" of securities.[52] Although the courts are divided as to the existence of a private remedy under section 17(a),[53] the Supreme Court has held that a showing of negligence is sufficient to support a finding that a material misstatement is in violation thereof.[54] Under the broadest reading of section 17(a)'s "in connection with" requirement, its proscriptions would apply whenever a statement is reasonably calculated to affect decisions made in connection with sales of securities. Under such a reading, section 17(a) would have the same application as rule 10b-5 to management statements issued in connection with merger negotiations, corpo-

48. *See* 17 C.F.R. § 240.13a-11 (1986).

49. Other required form 8K disclosures include director resignations and changes in the issuer's certified public accountant acting as auditor. In addition to the required disclosures, an issuer may use form 8K to disclose any other information that it deems material and worthy of disclosure. Form 8K, item 5. The item 5 disclosures are purely voluntary.

50. Form 8K provides in relevant part: "If the registrant or any of its majority-owned subsidiaries *has acquired or disposed of* a significant amount of assets, otherwise in the ordinary course of business, [it must] furnish the following information . . . ." Form 8K, item 2 (emphasis added).

51. 15 U.S.C. § 77q(a) (1982).

52. The Supreme Court has indicated that § 17(a)'s "in the offer or sale" language is equivalent to rule 10b-5's "in connection with" requirement. United States v. Naftalin, 441 U.S. 768, 773 n.4 (1979).

53. *See* T. HAZEN, *supra* note 3, at § 13.13.

54. Aaron v. SEC, 446 U.S. 680, 697 (1980).

rate restructuring, going private, or rumor control; section 17(a) would arguably be applicable since such statements are likely to affect investment decisions. Such a broad reading arguably is inappropriate, however, since it would negate the impact of rule 10b-5's scienter requirement. Perhaps a more acceptable reading of section 17(a)'s "in connection with" requirement would be to limit its applicability to management statements reasonably calculated to affect offers or sales of securities by management or by the corporation. Under this reading, section 17(a) would have a relatively narrow application to disclosure issues relating to merger negotiations or rumor control.

D. *Section 14(e) of the Williams Act and the Proxy Rules*

When preliminary merger negotiations are undertaken in conjunction with or in response to a third-party tender offer, section 14(e) of the Exchange Act[55] may come into play. Section 14(e) applies 10b-5 type disclosure requirements to statements made in connection with a tender offer. As is the case with rule 10b-5, section 14(e) applies regardless of whether or not the target corporation is a reporting company. Thus, once a tender offer has been commenced, any statement made by the target company's management (or anyone else, for that matter) will be subject to section 14(e) scrutiny. While it is clear that competing tender offerors do not have standing to bring private damage suits under section 14(e),[56] it remains to be resolved whether such an action can be maintained by a shareholder of the target company.

Finally, in the relatively unlikely event that merger negotiations are taking place contemporaneously with a proxy solicitation for a company subject to the Exchange Act's reporting requirements, the full disclosure requirements of the proxy rules would come into play.[57] The weight of authority favors the view that negligence is sufficient to prove a violation of the federal proxy rules.[58] Additionally, the Supreme Court has recognized a private damage remedy in favor of a shareholder injured by misleading proxy solicitation

55. 15 U.S.C. § 78n(e) (1982).

56. Piper v. Chris-Craft Indus., 430 U.S. 1, 46 (1977).

57. 15 U.S.C. § 78n(a) (1982); 17 C.F.R. § 240.14a-9 (1986).

58. *See* Gould v. American-Hawaiian S.S. Co., 535 F.2d 761, 777-78 (3d Cir. 1976); Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1299-1301 (2d Cir. 1973); Fradkin v. Ernst, 571 F. Supp. 829, 843 (N.D. Ohio 1983). *But see* Adams v. Standard Knitting Mills, Inc., 623 F.2d 422, 428-31 (6th Cir. 1980), *cert. denied*, 449 U.S. 1067 (1981). *See generally* T. HAZEN, *supra* note 3, at § 11.3.

materials.[59]

In sum, there are various provisions of the federal securities laws that have potential impact in regulating management statements concerning preliminary merger negotiations or statements issued in response to reporters' or analysts' questions. In most cases, when a question is raised, SEC rule 10b-5 will be the appropriate provision. Regardless of which provision is applicable, however, the question of whether there has been an actionable misstatement depends upon a finding of materiality. Materiality is discussed directly below.

V. MATERIALITY, PRELIMINARY MERGER NEGOTIATIONS, CORPORATE RESTRUCTURING, GOING PRIVATE, AND RUMOR CONTROL

As is the case with any issue regarding disclosure under the securities laws, " 'materiality' is the name of the game."[60] Thus, it is necessary to take at least a brief look at the definition of materiality, as developed by the courts, in order to understand the particulars of the merger negotiation and rumor response issues.[61] In its second attempt to define materiality, the Supreme Court in *TSC Industries v. Northway, Inc.*[62] declared that materiality of a particular item depends upon a finding of "a substantial likelihood that a reasonable shareholder would consider it important . . . ." The Court further explained that materiality is to be determined according to the "total mix" of information.[63] The *TSC Industries* ruling was decided under the rules relating to full disclosure in the solicitation of proxies.[64] Nonetheless, the Court's test has equal applicability to cases brought under rule 10b-5's general disclosure requirements,[65] as

59. J.I. Case Co. v. Borak, 377 U.S. 426, 430-31 (1964).

60. R. JENNINGS & H. MARSH, SECURITIES REGULATION: CASES AND MATERIALS 1023 (5th ed. 1982).

61. *See generally* T. HAZEN, *supra* note 3, at §§ 11.4, 13.5; Hewitt, *Developing Concepts of Materialilty and Disclosure*, 32 BUS. LAW. 887 (1977); Kripke, *Rule 10b-5 Liability and "Material" "Facts,"* 46 N.Y.U. L. REV. 1061 (1971). *See also*, Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 WM. & MARY L. REV. 373 (1984).

62. 426 U.S. 438, 449 (1976). In its first attempt, the Court stated that materiality "embodies a conclusion that the defect was of such character that it *might* have been considered important by a reasonable shareholder . . . ." Mills v. Electric Auto-Lite Co., 396 U.S. 375, 384 (1970) (emphasis added).

63. 426 U.S. at 450. *See also* Beebe v. Pacific Realty Trust, 578 F. Supp. 1128, 1138 (D. Or. 1984); Unicorp Fin. Corp. v. First Union Real Estate Equity & Mortgage Inv., 515 F. Supp. 249, 257-59 (S.D. Ohio 1981).

64. 15 U.S.C. § 78n(a) (1982); 17 C.F.R. § 240.14a-9 (1986).

65. 17 C.F.R. § 240.10b-5 (1986). *See* T. HAZEN, *supra* note 3, at § 13.5. The same

well as for disclosures scrutinized under the Williams Act provisions relating to tender offers.[66] The SEC has, by use of its rulemaking power, adopted the same test for materiality with regard to other required disclosures under the Securities Exchange Act of 1934.[67]

As the foregoing very brief overview of the history of the materiality question demonstrates, the determination of the materiality of a particular statement and whether it is materially misleading is a highly factual inquiry. In the words of the Supreme Court: "[M]ateriality may be characterized as a *mixed question of law and fact*, involving as it does the application of legal standards to a particular set of facts."[68] In light of the law-and-fact character of materiality, it would appear that a safe-harbor alternative to full disclosure beyond the suggested "no comment" would not be feasible without changing the existing law. A brief examination of the leading recent merger and rumor control cases further bears this out.

The Third Circuit in *Greenfield v. Heublein, Inc.*[69] has adopted a most questionable "price and structure" threshold of materiality in the context of takeover negotiations. Under this test—even in the face of market rumors and in the context of responding to questions—there is no duty to disclose the existence of negotiations before there has been an agreement on the price and structure of the deal.[70] Accordingly, the court in *Greenfield* found no violation based on the issuer's denial of knowledge of any reason for price increases in its stock, while undisclosed merger negotiations were in fact taking place.[71]

Applying both the Supreme Court's and SEC's test of materiality to the facts of *Greenfield*, however, there can be no doubt that there is a substantial likelihood that the reasonable investor would

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test of materiality also applies with regard to § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982).

66. 15 U.S.C. § 78n(e) (1982). *See* T. HAZEN, *supra* note 3, at § 11.15.

67. 17 C.F.R. § 240.12b-2 (1986) provides: "The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered."

68. TSC Indus. v. Northway, Inc., 426 U.S. 438, 450 (1976) (emphasis added).

69. 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

70. *Id.* at 757. *Accord* Flamm v. Eberstadt, 814 F.2d 1169, 1178 (7th Cir. 1987). *See also* Reiss v. Pan Am. World Airways, 711 F.2d 11, 14 (2d Cir. 1983)(time of disclosure a matter of corporate discretion where legally material facts not involved); Staffin v. Greenberg, 672 F.2d 1196, 1206 (3d Cir. 1982)(no duty to disclose preliminary merger discussions during tender offer to shareholder).

71. 742 F.2d at 759.

consider the existence of such negotiations important in determining whether to buy or sell the stock. Similarly, there is no doubt that confirmation of the market rumors, as opposed to the apparent denial given by the issuer, would have affected the market price. I refer to this as an apparent denial, because as Commissioner Grundfest has pointed out, the majority opinion in *Greenfield* took the position that the statement provided merely a denial of knowledge of any leak to the market that would justify the price rise, rather than a denial of the existence of the negotiations.[72] Commissioner Grundfest has noted, however, that the majority's analysis can be viewed as "too cute."[73] As a district court decision has observed in a similar situation, when no facts other than pending negotiations can be identified as the source of unusual market activity, then management should assume that there has been a leak.[74]

Accordingly, a denial of knowledge of facts accounting for the market activity could be actionable under rule 10b-5, if made with scienter.[75] Another court has indicated, however, that when there is no evidence that the leak, if any, originated from the company, a denial of knowledge of "corporate developments that would account for the surge in trading" will not be in violation of rule 10b-5, although private merger negotiations were in fact taking place.[76] The foregoing rumor control cases point out the highly factual nature of the inquiry, which may result in apparent inconsistencies by the courts. Since materiality requires each case to be determined according to its own facts, though, any attempt to strive for certainty through a safe harbor rule for disclosures would have unfortunate results. It is contrary to an efficient market to permit denials in the face of facts known by management to be of significance to investors. Knowing dissemination of misinformation cannot be justified on the basis that merger negotiations are preliminary, and there has not yet been an agreement as to price and structure.

The price and structure threshold thus seems to be a less stringent test of materiality than the one provided by relevant precedent.

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72. *See Grundfest, supra* note 25, at 13.

73. *Id.* (referring to Judge Higgenbotham's dissenting opinion). *Accord* Etshokin v. Texasgulf, Inc., 612 F. Supp. 1212 (N.D. Ill. 1984).

74. Schlanger v. Four-Phase Sys., Inc., 582 F. Supp. 128, 135 (S.D.N.Y. 1984).

75. *Id.* at 134.

76. Zuckerman v. Harnischfeger Corp., 591 F. Supp. 112, 114 (S.D.N.Y. 1984). *See also Etshokin*, 612 F. Supp. at 1217 (stating that there was no duty "to determine whether there actually was a reason for the trading activity in its stock apart from reasons of which the company knew"); Weintraub v. Texasgulf, Inc., 564 F. Supp. 1466, 1470 (S.D.N.Y. 1983) (finding no duty to investigate source of unusual trading).

It must be remembered that the issue here is not the higher threshold that is necessary to find a violation of an affirmative duty to disclose,[77] but rather the accuracy of a disclosure once made—that is, the materially misleading nature of the issuer's apparent denial of the existence of negotiations.[78]

The Third Circuit's price and structure test does, of course, present a safe harbor. As pointed out above, however, it does so at the sacrifice of the existing law on materiality. The overly lenient approach of the Third Circuit has led a number of courts and the SEC to seek an alternative test. Shortly after the Third Circuit's pronouncement, the SEC took the position that the case was "wrongly decided,"[79] a position that has been reaffirmed in subsequent SEC amicus briefs.[80]

Similarly, a number of courts have either rejected or seriously questioned the Third Circuit's price and structure threshold of materiality. The Sixth Circuit has rejected the threshold because such a rule disregards the highly factual nature of any materiality inquiry.[81] The Ninth Circuit has observed that the materiality of preliminary merger negotiations depends upon the facts of each particular situation rather than upon a per se rule.[82] The court also noted that it is significant whether the statements were made with regard to face-to-face transactions as opposed to open market transactions.[83] Additionally, the Seventh Circuit has held that the price and structure threshold will not be applied as a per se rule in the context of a closely held corporation.[84] The Third Circuit's per se

77. The threshold for triggering an affirmative duty to disclose is much higher. *See, e.g.*, Levinson v. Basic Inc., 786 F.2d 741, 746 (6th Cir. 1986), *cert. granted*, 107 S. Ct. 1284 (1987); Starkman v. Marathon Oil Co., 772 F.2d 231, 238 (6th Cir. 1985). *See also* T. HAZEN, *supra* note 3, at §§ 11.15, 13.10; Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 GEO. L.J. 935 (1979); Block, Barton & Garfield, *Affirmative Duty to Disclose Material Information Concerning Issuer's Financial Condition and Business Plans*, 40 BUS. LAW. 1243 (1985). *See supra* text accompanying note 36.

78. *See, e.g.*, *Levinson*, 786 F.2d at 747-48 (finding statement that management was unaware of merger negotiations when in fact some were taking place, albeit of a preliminary nature, to be materially misleading).

79. In the Matter of Carnation Co., Exchange Act Release No. 22,214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 n.8 (July 8, 1985). Commissioner Grundfest obviously is correct in his support of the Commission's ability (and, perhaps, even obligation) to question what it believes to be a questionable circuit or district court interpretation of the securities laws. *See* Grundfest, *supra* note 25, at 7-8.

80. *See* Grundfest, *supra* note 25, at 6.

81. *See Levinson*, 786 F.2d at 748.

82. Grigsby v. CMI Corp., 765 F.2d 1369, 1373 (9th Cir. 1985).

83. *Id.* (citing Thomas v. Duralite Co., 524 F.2d 577, 584-85 (3d Cir. 1975)).

84. Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 434 (7th Cir. 1987); Michaels v. Michaels, 767 F.2d 1185, 1196 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 797 (1986).

price and structure threshold has thus been far from universally accepted. However, in its most recent decision, the Seventh Circuit has adopted the Third Circuit's price and structure threshold outside of the closely-held context.[85] The Supreme Court's granting of certiorari in the *Levinson* case[86] presents the opportunity for resolving the conflict between the circuits.

The SEC's opinion in *In the Matter of Carnation Co.*[87] is neither a drastic new development nor does it present a *bright-line* solution to the problem.[88] The *Carnation* opinion merely reaffirms the traditional approach to materiality. The view expressed in *Carnation*, which has been adopted by some courts,[89] suggests the wisdom of a "no comment" response. Then, after the essence of the proposed transaction has been agreed upon by both sides, or after management has in the exercise of its business judgment determined that negotiations are sufficiently advanced, full disclosure is appropriate.

VI. FULL DISCLOSURE OR "NO COMMENT"—THE ONLY VIABLE ALTERNATIVES

Commissioner Grundfest has suggested that "even a little bit of accurate information—as long as it is not part of a plan to deceive or mislead the market—is better than a deafening 'no comment.' "[90] Seventh Circuit Court of Appeals Judge Easterbrook has taken the same approach.[91] There can be no doubt as to the truth of this view so far as it goes. In most cases, however, a statement that has the effect of disguising or hiding preliminary negotiations is designed to deceive. Typically, the person speaking on the issuer's behalf is not making the denial out of ignorance of the true facts,[92] but rather because of a determination that the negotiations taking place are in

85. Flamm v. Eberstadt, 814 F.2d 1169,1177-78 (7th Cir. 1987).

86. Basic Inc. v. Levinson, 107 S. Ct. 1284 (1987).

87. Exchange Act Release No. 22,214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801 (July 8, 1985).

88. Grundfest, *supra* note 25, at 4-6.

89. Levinson v. Basic Inc., 786 F.2d 741 (6th Cir. 1986), *cert. granted*, 107 S. Ct. 1284 (1987).

90. Grundfest, *supra* note 25, at 14.

91. "If by hypothesis silence is the best course for investors, then it may be necessary to condone evasive answers, as the Third Circuit did in *Greenfield*, to put pursuers off the scent for a time." *Flamm*, 814 F.2d at 1178.

92. Thus, the typical merger negotiation or rumor denial situation is quite different from Commissioner Grundfest's "Baby Doc" example. *See* Grundfest, *supra* note 25, at 10. Furthermore, even in the absence of scienter, negligence may form the basis of liability under § 17(a)(2)-(3) of the 1933 Act and § 14(a) of the 1934 Act. *See supra* notes 51-59 and accompanying text.

too early a stage to be material. Accordingly, in such a case the speaker knowingly withholds information from the market and, therefore, does so with the requisite scienter.[93] Even beyond such omissions made with scienter, a materially misleading statement that has been negligently prepared, under appropriate facts, may be the basis for liability under other provisions of the securities laws.

As noted above, sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933[94] are violated by negligently made, material misstatements issued in connection with the offer or sale of securities.[95] In the context of a rumored takeover or pending merger negotiations, however, section 17(a)'s "in connection with" requirement may be more difficult to satisfy than under rule 10b-5, which applies to purchases or sales.[96] In addition to the negligence standard under section 17(a), negligence is sufficient for a violation of the proxy rules' general antifraud provision.[97] It should further be noted that, although the few cases on point have indicated otherwise, there is an argument that negligence can form the basis of a violation of the Williams Act's general antifraud provision—section 14(e)[98]—which applies to statements issued in connection with a tender offer.[99]

Even aside from the scienter issue, any safe harbor short of the alternatives of "no comment" or full disclosure of the negotiations, regardless of how preliminary, would encourage premature disclosure, which in turn would be likely to mislead, add to rumors, and thus act against an informed and efficient market. Silence or "no comment" may lead to lack of information, but rumors with cryptic issuer responses are likely to lead to a market fueled by speculation rather than accurate information. Accordingly, any alternative to "no comment" or full disclosure is undesirable as it would be likely to hamper the market's attempt to be an efficient filter and evaluator of information. When an inquiry emanates from a securities

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93. *See supra* note 33 and accompanying text.

94. 15 U.S.C. § 77q(a)(2)-(3) (1982).

95. *See generally* Hazen, *A Look Beyond the Pruning of Rule 10b-5: Implied Remedies and Section 17(a) of the Securities Act of 1933*, 64 VA. L. REV. 641 (1978); Steinberg, *Section 17(a) of the Securities Act of 1933 After Naftalin and Reddington*, 68 GEO. L.J. 163 (1979). *See supra* text accompanying notes 51-54.

96. For discussion of the "in connection with" requirement, see T. HAZEN, *supra* note 3, at § 13.6.

97. *See* sources cited *supra* note 58.

98. 15 U.S.C. § 78n(e) (1982).

99. Clearly, many rumors and merger negotiations do not arise in connection with a tender offer. Section 14(e), however, would apply to merger negotiations with a "white knight" sought out to save the target from a hostile tender offer.

exchange, "no comment" may not be appropriate[100] and full disclosure may then be the only option.[101] In such a case the exchange officials may elect to permit public silence if the negotiations are still preliminary.

VII. CONCLUSION

Full and fair disclosure fuels investor confidence in securities. The disclosure and antifraud provisions of the federal securities laws are designed to strengthen the integrity of the marketplace. Furthermore, under the currently in-vogue efficient capital market hypothesis,[102] stock prices reflect expert analysts' evaluation of the totality of information available. A more efficient market would have a significant impact in controlling the volatile price swings frequently taking place in today's securities markets. The volatility infused into the market by the quest for takeover and other deal candidates is exacerbated by disclosure rules that tolerate the injection of half-truths and misinformation into the market. In the face of rumors or pending negotiations, any response other than full disclosure or "no comment" will add to, rather than correct, the current market inefficiencies.

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100. In the words of Judge Easterbrook:

> Suppose a firm is engaged in negotiations that are best kept quiet, and the Exchange asks whether new developments account for activity in its stock. If the firm says yes and says why, the cat is out of the bag; if the firm says no, it faces liability for fraud; if the firm says "no comment" that is the same thing as saying "yes" because investors will deduce the truth. No corporation follows the CIA's policy of saying "no comment" to *every* inquiry; every firm regularly confirms or denies rumors, as the securities laws and the stock exchanges' rules require. The exchanges' rule require a response, not a refusal to respond, to inquiries.

Flamm, 814 F.2d at 1178.

101. *See id.*

102. *See* authorities cited *supra* notes 7-8.