Maryland Law Review

Volume 46 | Issue 4 Article 3

Introduction

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INTRODUCTION

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I am delighted to author the Introduction to this timely and important Symposium principally focusing on issuer disclosure obligations under the securities laws. With this issue, the *Maryland Law Review* once again demonstrates why it has become one of the premier legal periodicals in the United States. During the recent past, the Review has published contributions by the leading academicians and jurists in this country on a wide variety of significant legal subjects.[1] This Symposium continues that tradition,[2] as will future is-

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1. Although I could have included several additional contributions to illustrate this point, the following twelve *Maryland Law Review* articles provide ample support: Clark, *Why Does Health Care Regulation Fail?*, 41 MD. L. REV. 1 (1981); Coffee, *Rescuing the Private Attorney General: Why the Model of the Lawyer As Bounty Hunter Is Not Working*, 42 MD. L. REV. 215 (1983); Fletcher, *The Case for Treason*, 41 MD. L. REV. 193 (1982); Galanter, *The Day After the Litigation Explosion*, 46 MD. L. REV. 3 (1986); Getman, *Labor Law and Free Speech: The Curious Policy of Limited Expression*, 43 MD. L. REV. 4 (1984); Goldberg, *Regulation of Hostile Tender Offers: A Dissenting View and Recommended Reforms*, 43 MD. L. REV. 225 (1984); Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563 (1982); O'Connell, *From Doctor Johnson to Justice Holmes to Professor Laski*, 46 MD. L. REV. 320 (1987); Simon, *The Invention and Reinvention of Welfare Rights*, 44 MD. L. REV. 1 (1985); Stewart, *Reconstitutive Law*, 46 MD. L. REV. 86 (1986); Wald, *The Problem with the Courts: Black-Robed Bureaucracy, or Collegiality Under Challenge?*, 42 MD. L. REV. 766 (1983); Zimring & Hawkins, *A Punishment in Search of a Crime: Standards for Capital Punishment in the Law of Criminal Homicide*, 46 MD. L. REV. 115 (1986).

2. The contributors to this Symposium include a federal district court judge, respected academicians, and top-level Securities and Exchange Commission staff. Previous publications by the contributing authors include, for example: T. HAZEN, THE LAW OF SECURITIES REGULATION (1985 & Supp. 1987); M. STEINBERG, SECURITIES REGULATION (1986); Branson, *Securities Regulation After Entering the Competitive Era: The Securities Industry, SEC Policy, and the Individual Investor*, 75 NW. U.L. REV. 857 (1980); Dennis, *Valuing the Firm and the Development of Delaware Corporate Law*, 17 RUTGERS L.J. 1 (1985); Goelzer, *The Accounting Provisions of the Foreign Corrupt Practices Act—The Federalization of Corporate Recordkeeping and Internal Control*, 5 J. CORP. L. 1 (1979); 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); Hiler, *Dirks v. SEC—A Study in Cause and Effect*, 43 MD. L. REV. 292 (1984); Kerr, *Suitability Standards: A New Look at Economic Theory and Current SEC Disclosure Policy*, 16 PAC. L.J. 805 (1985); Sargent, *On the Validity of State Takeover Regulation: State Responses to MITE and Kidwell*, 42 OHIO ST. L.J. 689 (1981); Sporkin, *SEC Enforcement and the Corporate Board Room*, 61 N.C.L. REV. 455 (1983); Steinberg, *The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws*, 67 CORNELL L. REV. 557 (1982); Warren, *Reflections on Dual Regulation of Securities: A Case Against Preemption*, 25 B.C.L. REV. 495 (1984).

sues of the Review.[3]

The subjects addressed by the contributions in this Symposium are critically important to publicly-held enterprises, the investing public, and the securities bar. Issuer disclosure practices have an impact on the perceived safety and fairness of the American capital markets. The tension exists between promulgating disclosure obligations that facilitate investor and market confidence, yet are not unduly burdensome to issuers. The accommodation of these sometimes conflicting interests within an equitable framework is a vital component underlying the objectives sought to be achieved by the federal securities laws.[4]

Although not addressing disclosure problems in particular, Judge Stanley Sporkin appropriately leads off the Symposium with a call for a new special study of the securities and financial markets. In recent years deregulation, the boom in mergers and related acquisitions, and the growth of trading in options and indexes have led to rapid, dramatic changes in America's securities and financial markets. In addition, the development of a global market for securities poses competitive challenges to this country's market system. Citing these and other changes, Judge Sporkin calls for a new study similar to the 1962 study that was commissioned by Congress and directed by Mr. Milton H. Cohen.[5]

The 1962 study, which, among other things, was instrumental in integrating the 1933 and 1934 Acts' disclosure standards, largely focused on the internal workings of the market system. By contrast, today's problems, according to Judge Sporkin, are primarily external. To avoid the fate that has befallen other American industries, and to preserve America's preeminent position in the global securities marketplace, he asserts that our securities markets must continue to command investor confidence; this is possible only if the markets continue to ensure financial and disclosure integrity.

Judge Sporkin outlines several problems that demand serious study. These problems include: the relationships between brokers, bankers, and other players in the various financial sectors; the fi-

3. For example, the Fall 1987 issue of the *Maryland Law Review* will include articles on constitutional law by Archibald Cox, Charles Mathias, Carl Rowan, Arthur Schlesinger, and James Boyd White.

4. The Supreme Court's grant of certiorari in Levinson v. Basic Inc., 786 F.2d 741 (6th Cir. 1986), *cert. granted*, 107 S. Ct. 1284 (1987), scheduled to be decided in the forthcoming term, highlights the importance of this subject.

5. *Report of the Special Study of Securities Markets of the Securities and Exchange Commission*, H.R. Doc. No. 95, 88th Cong., 1st Sess. (5 vols. 1963). *See also* Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340 (1966).

nancing of takeovers through the issuance of debt securities of less than investment grade; issues of corporate governance, especially the role that allegedly inept corporate management has played in the decline of American industry; the suitability of the current market structure to new trading vehicles, such as options and indexes; and the respective roles that the federal government and the states should play in policing the markets. A broad-range study of these issues, Judge Sporkin concludes, is timely and necessary.

The Symposium thereafter turns to issuer disclosure obligations. An article which I coauthor with Mr. Robin Goldman provides an examination of certain situations relating to an issuer's affirmative duty to disclose material nonpublic information. In particular, the subjects addressed focus on an issuer's obligation to disclose merger negotiations, "soft" information, and "bad" financial news.

Questions relating to an issuer's affirmative duty to disclose frequently present the corporate lawyer with difficult counseling decisions. These situations are not resolved by referring to specific SEC disclosure rules, and the few judicial decisions rendered lack uniformity. This contribution provides a synthesis of the divergent viewpoints and seeks to present a viable framework for analysis.

The next article by Professor Thomas Hazen argues that a safe harbor rule allowing some degree of disclosure between "no comment" and full disclosure is not acceptable in rumor control and merger negotiation situations. As he points out, the current speculative market environment, in which investors seek out "deals" that will lead to quick profits, demands that companies follow a responsible disclosure policy to avoid the injection of misinformation into the market.

Starting from the premise that the federal securities laws generally impose no affirmative disclosure obligation in the absence of an SEC-mandated rule, a statement, or other affirmative conduct, Professor Hazen observes that nondisclosure presents its own safe harbor: silence or "no comment." The formulation of a workable safe harbor rule, permitting some disclosure short of full disclosure, he asserts, would be impractical to devise because of the fact-specific nature of materiality determinations. As importantly, such a rule would necessarily redefine the traditional concepts of disclosure and materiality. Professor Hazen concludes that the imposition of such a mandated rule would permit the introduction of half-truths into the marketplace and, thus, would serve merely to exacerbate current market inefficiencies.

In the next contribution, SEC General Counsel Daniel Goelzer addresses when, if ever, confidential merger negotiations must be disclosed if those negotiations have not yet resulted, and may never result, in a definitive agreement as to the price and structure of the transaction. The article first discusses the various securities law and exchange listing requirements that give rise to a duty to disclose. Next, Mr. Goelzer analyzes the split in the federal circuits, specifically discussing the bright-line, price and structure test adopted by the Third Circuit[6] and the rejection of that test in the Sixth Circuit.[7] He particularly examines the holding in *Levinson v. Basic Inc.*,[8] a case that will be decided by the Supreme Court during the 1987 term. Following this discussion, Mr. Goelzer explains the SEC's position as set forth in its amicus curiae brief in *Levinson*.[9]

Thereafter, Professor Douglas Branson combines an analysis and critique of the SEC's response to the Third Circuit's decision in *Heublein*[10] with suggestions for the proper role of the Commission in this area and possible courses of conduct for issuers in light of the SEC's *Carnation* release.[11] Professor Branson agrees with the *Heublein* decision both on the question of when negotiations become material, and on the issue of whether literally-true but incomplete statements are misleading. He asserts that companies should be free to make truthful, noncommittal responses in order to "test the acquisition waters." Alternatively, some realistic limits should be placed on damage awards to reflect more closely the culpability of subject companies and their managements in light of the tremendous pressures at play in this context.

The next contribution, authored by Professor Mark Sargent, focuses on the complex relationship of merit and disclosure regulation under state "blue sky" law, emphasizing their functional interdependence rather than their philosophical differences. He goes on to demonstrate that the increasing importance of state disclosure regulation has generated new tensions in the relationship of

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6. Greenfield v. Heublein, Inc., 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

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

8. *Id.*

9. For a summary of the SEC's amicus curiae brief, see *Materiality of Premerger Negotiations Involves Balancing Test, SEC Tells Court*, 19 Sec. Reg. & L. Rep. (BNA) 781 (1987).

10. Greenfield v. Heublein, Inc., 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

11. In the Matter of Carnation Co., Exchange Act Release No. 22,214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801 (July 8, 1985).

federal and state securities regulation, with those tensions reflecting fundamental problems in the allocation of regulatory responsibilities between the states and the SEC. Professor Sargent concludes with an analysis of possible solutions to this regulatory dilemma.

Professor Janet Kerr's article surveys "the legal mine field" of soft information disclosure. Initially, her contribution examines the SEC's policy on soft information disclosure in transition from prohibitive to permissive. The Commission's approach in this area may be viewed as fairly clear. The federal circuits' reactions to SEC policy, however, are diverse. Professor Kerr reviews each circuit that has an established position on soft information disclosure. In the course of this review, she brings order to the various views by setting forth the fact patterns and legal reasoning of the major decisions in this area. As she details, the circuits do indeed run the gamut in their responses to the Commission's policy on soft information disclosure.

In the Symposium's next article, Mr. Bruce Hiler, an SEC Assistant Enforcement Director, explores the Commission's changing policy concerning disclosure of soft information, focusing particularly on earnings projections and asset appraisals, and the courts' response to that policy. As Mr. Hiler points out, after initially barring the inclusion of such information on grounds of unreliability, the SEC presently encourages the disclosure of soft information, recognizing that market professionals and investors alike often view such information as essential to informed decisions. In the second part of the article, Mr. Hiler discusses the various sources of a duty to disclose soft information and presents a proposed standard for determining the materiality of such information. He bases this standard on the user-oriented approach enunciated by the Supreme Court in *TSC Industries*[12] and the Second Circuit's probability/magnitude test in *Texas Gulf Sulphur.*[13]

Professor Roger Dennis in his article also focuses on disclosure of soft information. After reviewing the pertinent SEC and judicial approaches, Professor Dennis examines the utility of the mandatory disclosure framework, including the feasibility of applying this framework to management projections. Upon analysis, he proposes a limited mandatory disclosure system in this context. Projections, whether positive or negative, he asserts should only be required to

12. TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976).

13. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

be disclosed in control transaction situations. In these settings management's incentive for selective disclosure is reduced, and the need for the information (and its processing through securities analysis) is high. In the negative projection case, Professor Dennis concludes that unless a control transaction is pending, the benefits of a mandatory system would not outweigh the costs, and thus the requirement should not be imposed.

Rather than examining issuer disclosure obligations, Professor Manning Warren in the next article in the Symposium addresses a topical "insider trading" issue: namely, that of investment bankers who allegedly, in breach of their clients' confidences, reap large profits by trading on nonpublic information concerning their clients' acquisition plans. Professor Warren specifically focuses on the question of whether the client in this situation has a private cause of action for deception under section 10(b) of the Securities Exchange Act[14] and rule 10b-5 promulgated by the SEC thereunder.[15] Upon analysis of judicial precedent, he asserts that there exist several obstacles to the invocation of a private remedy in this setting. Professor Warren concludes that the misappropriation theory as formulated by the lower federal courts[16] works a serious distortion of section 10(b) jurisprudence, and that congressional action is necessary to provide private litigants with effective recourse under the federal securities laws for damages based on misappropriation of nonpublic information.[17]

The Symposium concludes with two Comments.[18] The first

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14. 15 U.S.C. § 78j(b) (1982).

15. 17 C.F.R. § 240.10b-5 (1986).

16. *See, e.g.*, United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983).

17. In the 1987 term, the Supreme Court is scheduled to rule on the validity of the misappropriation theory under section 10(b) jurisprudence, at least to a certain degree. *See* United States v. Carpenter, 791 F.2d 1024 (2d Cir.), *cert. granted*, 107 S. Ct. 666 (1986).

18. The first Comment is authored by Mr. F. Philip Manns and the second by Mr. Ronald B. Lee. I am pleased that both of these Comments were initiated in my securities regulation seminar held in the fall semester 1986 at the Law School. A third Comment authored by Mr. Lee Applebaum also was written in the seminar and has been published in 46 MD. L. REV. 339 (1987). Mr. Applebaum's Comment was cited on three separate occasions in Justice Blackmun's opinion in Shearson/American Express, Inc. v. McMahon, 55 U.S.L.W. 4757, 4763 (1987) (Blackmun, J., concurring in part and dissenting in part). In addition, four other superb papers written in the seminar will appear in a forthcoming book. *See* CONTEMPORARY ISSUES IN SECURITIES REGULATION (M. Steinberg ed., to be published by Butterworth Legal Publishers, 1988).

At a time in which law student writing has been subject to extensive criticism, these papers provide ample support that there are many bright students whose written work is excellent.

contribution, after generally reviewing issuer affirmative disclosure obligations, analyzes an issuer's "duty to correct." As the author observes, the central problem in this context involves the attribution of unauthorized statements by corporate and extra-corporate parties to the issuer. Such attribution is necessary for liability to attach to the issuer under section 10(b) of the Exchange Act and rule 10b-5. The author suggests that the courts should use tort liability principles to attribute statements by unauthorized parties to issuers in any case in which the public might reasonably believe that the spokesperson speaks for the issuer. The author suggests a framework for determining liability due to the attribution based on the agency status of the speaker and the affirmative steps that a company has taken to inform the public as to who is authorized to speak.

The second Comment provides an overview of the various measures of damages used by the courts when compensating a plaintiff under the securities laws' antifraud provisions. As section 10(b) does not expressly provide for a precise measure of damages, the courts must determine for themselves the appropriate measure to be applied when a violation occurs. In the author's view, this has resulted in a great deal of confusion, with a multiplicity of formulations being used by the courts. Still, he maintains that such a case-by-case approach may be necessary due to the complexity of the area. Additionally, the author explores other issues such as timing of valuation, determination of fair value, and consequential damages in relation to these measures. The ramifications and the pros and cons of each measure are analyzed, and the author provides two hypotheticals in an effort to clarify this area.

The provocative articles contained in this Symposium should be a valuable resource for many years to come. The subjects addressed are important to American business, our capital markets, and investor protection. I am pleased to be associated with this excellent Symposium and I commend the Law Review and the contributors for their productive efforts.