

# Structure and Price: Striking a Delicate Balance in Tender Offer Negotiations

*The proper time for disclosing tender offer negotiations continues to elude both companies and investors. This Comment advocates adopting a strict definition of materiality in the tender offer context. Until the target and acquiring companies agree on a transaction's structure and price, the negotiations are immaterial as a matter of law, and neither company should have any disclosure obligations under the Securities Acts. With this definition investors are most able to maximize profits. Simultaneously, companies are able to preserve confidentiality in legitimate business transactions.*

## INTRODUCTION

Considerable controversy surrounds disclosure obligations under the federal securities laws.<sup>1</sup> Presently, this conflict focuses on tender offers.<sup>2</sup>

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<sup>1</sup> The Federal Securities laws include the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act) (collectively, Securities Acts). *See* Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982 & Supp. III 1986); Securities Exchange Act of 1934, 15 U.S.C. §§ 77b-77e, 77j-77k, 77m, 77o, 77s, 78a-78o, 78o(3)-(4), 78p-78q(1), 78r-78dd(2), 77e-78hh, 78ii and 78jj notes, 78kk (1982). Congress created the Securities and Exchange Commission to enforce the Securities Acts.

The 1933 Act "truth in securities" law has two basic objectives: (1) to provide investors with material financial information and other information concerning securities offered for public sale; and (2) to prohibit misrepresentation, deceit and other fraudulent acts and practices in the sale of securities generally. *See generally* L. SODERQUIST, *SECURITIES REGULATION: A PROBLEM APPROACH* (1982). Through the 1934 Act, Congress extended the "disclosure" doctrine of investor protection to securities listed and registered on our national and over-the-counter securities exchanges. *Id.* at 8-9.

The SEC regulates the initial purchase, intermediate trading, and ultimate sale of securities in the stock market. *Id.* at 5-8 (laws administered by SEC seek to provide protection for investors and public in their securities transactions); *see infra* text accompanying notes 13-24.

<sup>2</sup> The term tender offer refers to a technique of acquiring control of a corporation by making a public offer to purchase a part of a corporation's stock at a fixed price — usually in cash and representing a premium above market price. Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, in *SELECTED ARTICLES ON FEDERAL*

Tender offers generally shift corporate control from one shareholder group to another group or individual.<sup>3</sup>

Courts and securities practitioners differ as to when target companies'<sup>4</sup> disclosure obligations arise. Recent decisions disagree over when preliminary tender offer negotiations become material corporate events<sup>5</sup>

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SECURITIES LAWS 815 (ABA 1986). The dramatic increase in the dollar value of mergers and acquisitions in the tender offer area over the last twenty years contributes to the controversy. D. COMMONS, *TENDER OFFER: THE SNEAK ATTACK IN CORPORATE TAKEOVERS* xi-xii (1985) (6,017 in 1969 compared with 2,533 in 1983; however, dollar value steadily increasing from \$58.8 billion in 1969, \$73.1 billion in 1983, to \$132.6 billion in 1984); INVESTMENT DEALER'S DIGEST — CORPORATE FINANCING DIRECTORY 78-79 (Aug. 15, 1966) (32 in first six months of 1966); Cohen, *A Note On Takeover Bids and Corporate Purchases of Stock*, 22 BUS. LAW. 149 (1966) (merely eight in 1960); Fleischer & Mundheim, *supra* (29 cash tenders regarding companies listed on the NYSE and 15 involving companies listed on the ASE in 1965). Furthermore, acquisition practices have undergone fundamental changes since Congress promulgated the Williams Act in 1968. *See infra* text accompanying notes 25-40; *see also* A. SOMMER, *UNTENDER TENDER OFFERS: TIME TO CALL A HALT* (1984) (noting three recent developments encouraging takeovers: (1) ready availability of money for takeovers; (2) recent invalidation of state anti-takeover laws; and (3) tax laws permitting asset write-off by target owner); Garay, *Takeover Contests and Saving Institutions: Part I - The Takeover Phenomenon*, 51 LEG. BULL. 149 (May 1985) (reviewing effect of tender offers in shaping and structuring public companies in recent years).

<sup>3</sup> *See infra* note 26.

<sup>4</sup> Target companies are those companies from which another individual or entity seeks to acquire control. L. SODERQUIST, *supra* note 1, at 481-89.

<sup>5</sup> The concept of "materiality" generally defines the standard for imposing disclosure obligations under the Securities Acts. The seminal case imposing liability on a company for failing to disclose material information was *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969). *Texas Gulf Sulphur* promulgated the first comprehensive test for determining materiality: "whether a reasonable man would attach importance [to the information] in determining his choice of action in the transaction in question . . . and that encompasses any fact which in reasonable and objective contemplation might affect the value of [a] corporation's stock or securities." *Id.* at 849 (citing *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir. 1965)). Thus, until information becomes material, disclosure obligations do not generally arise under the Securities Acts. *Id.*; *see also infra* text accompanying notes 49-63.

The facts and circumstances of a particular case determine the materiality of the information. *See generally* Lowenfels, *The Case Against the Proposed Federal Securities Code*, 65 VA. L. REV. 615 (1979) (suggesting that what is *material* depends on context and sophistication of given transaction).

Courts continue to proffer additional materiality standards. *See TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (misstatement of a character that would be considered important to a reasonable investor in deciding whether to buy); *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 571 (E.D.N.Y. 1971) (material fact exists whenever a rational relation is present between its disclosure and a

requiring the target to completely and accurately disclose merger possibilities.<sup>6</sup> A specific question arises when stock prices of a publicly-traded company<sup>7</sup> involved in merger negotiations dramatically fluctuate and someone asks the company to explain the volatility.<sup>8</sup> Courts must resolve this question to eliminate companies' confusion in deciding when to disclose negotiations and what to say when they choose to disclose.<sup>9</sup>

Two competing interests explain this controversy. An investor's primary interest is in maximizing potential profits by obtaining all information relevant to valuing a company's stock when making an investment decision.<sup>10</sup> Simultaneously, companies have an interest in

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viable alternative course of action by any appreciable number of shareholders); *see also* *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643, 681 (S.D.N.Y. 1968), which established three separate materiality standards: (1) those "matters as to which an average prudent investor ought reasonably to be informed" before purchasing the security, *id.* at 681; (2) "matters which . . . an investor needs to know before he can make an intelligent, informed [investment] decision . . .," *id.*; and (3) "facts which have an important bearing upon the nature or condition of the issuing corporation or its business," *id.*

<sup>6</sup> One must determine when tender offer negotiations become material for purposes of triggering liability under the Securities Acts' antifraud provisions. *See infra* text accompanying notes 49-63. The standard itself is fairly clear. *See supra* note 5. However, interpreting the standard in the factual context of tender offers creates confusion and is the primary focus of this Comment. *See infra* notes 64-128 and accompanying text.

<sup>7</sup> A publicly-traded company trades its stock on a national or regional securities exchange. *See* L. SODERQUIST, *supra* note 1, at 86-97. The 1933 and 1934 Acts regulate these companies. *Id.*

<sup>8</sup> *See, e.g.,* *Schlanger v. Four-Phase Sys.*, 582 F. Supp. 128 (S.D.N.Y. 1984); *Greenfield v. Heublein, Inc.*, 575 F. Supp. 1325, *aff'd*, 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985); *see also infra* text accompanying notes 64-93.

<sup>9</sup> *See supra* note 8.

<sup>10</sup> Congress and the SEC designed the Securities Acts primarily to protect investment decisions. SEC, *THE WORK OF THE SECURITIES AND EXCHANGE COMMISSION* (1974), [hereafter *WORK OF THE SEC*] ("securities laws designed to facilitate informed investment analyses and prudent and discriminating investment decisions"); *AMERICAN STOCK EXCHANGE COMPANY GUIDE* §§ 401-05 ("the conduct of a fair and orderly market requires every listed company to make available to the public information necessary for informed investing"); *see also supra* note 1.

Premature disclosure of merger negotiations threatens investors' profit potential. *See infra* note 52; *see also* Bleakley, *The Perils of the Takeover Game*, N.Y. Times, Jan. 15, 1984, § 3, at 10, col. 2 (stating that when merger negotiations terminate as a result of premature disclosure, the stock price frequently drops well below the pre-merger discussion price). Consummated mergers often provide gains to target shareholders in excess of 20%. Jensen & Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 7-15 (1983).

protecting the confidentiality of legitimate business transactions.<sup>11</sup> For example, target companies engaged in tender offer negotiations have a particularly strong interest in relinquishing corporate control at the most advantageous price. This benefits both shareholders and the company.

To adequately protect investors while preserving their own interests, target companies need precise guidelines defining their disclosure obligations. Unfortunately, the federal securities laws fail to define when and what target companies must disclose. Similarly, recent decisions interpreting the Securities Act disclosure obligations reach inconsistent results.<sup>12</sup>

This Comment provides target companies with useful guidelines for analyzing disclosure obligations in typical tender offer situations. Part I provides an historical background of tender offer regulation and describes the positive economic effect that clarifying tender offer disclosure obligations will have on the stock market. Part II examines the timing of disclosure and the materiality standard's application in the tender offer context. Part III defines and describes the factual background of the tender offer negotiation issue. Part IV presents an analysis that balances an investor's desire for information with the target company's need for privacy. This part also proposes adopting a structure and price threshold for defining materiality in tender offer situations to achieve this balance. The Comment concludes by describing the structure and price test's practical and economic advantages.

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<sup>11</sup> A recent student note described the target's concerns in the merger context:

An important reason for corporate management's concern for confidentiality is management's fear that disclosure may trigger a bidding contest for the target corporation. In general, target management will prefer negotiated mergers to bidding contests, because in a negotiated merger management is better able to select a "compatible" merger partner and/or negotiate an attractive severance package. Management's decision to enter into merger negotiations is discretionary, and an increased likelihood of public disclosure of preliminary merger negotiations will reduce management's incentive to enter into negotiations in the first place, thereby resulting in lost merger opportunities for shareholders.

Note, *Rule 10b-5 and the Duty to Disclose Merger Negotiations in Corporate Statements*, 96 YALE L.J. 547 (1987) [hereafter Note, *Rule 10b-5*]; see also *infra* note 52.

<sup>12</sup> See *infra* text accompanying notes 64-93.

## I. HISTORICAL BACKGROUND

### A. An Historical Look at Securities Regulation

The historical development and composition of the Securities Acts highlights the compelling need to regulate tender offers.<sup>13</sup> The 1929 stock market crash<sup>14</sup> precipitated Congress' adoption of the first formal set of securities regulations in 1933.<sup>15</sup> Through a series of disclosure obligations, the 1933 Act focuses on preventing the rampant use of false information from escalating the price of new stock issues.<sup>16</sup> The 1933

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<sup>13</sup> The legal antecedents of the disclosure philosophy embodied in the Securities Acts originated in ancient partnership, trust, and corporate law. Manne, *Economic Aspects of Required Disclosure Under Federal Securities Laws*, in WALL STREET IN TRANSITION: THE EMERGING SYSTEM AND ITS IMPACT ON OUR ECONOMY 23 (1974) [hereafter WALL STREET IN TRANSITION] (noting that Securities Acts' concept of disclosure evolved over centuries of informal and rudimentary business transactions).

Early forms of disclosure protected narrow, finely focused interests. See generally *id.* Partnership agreements require partners to fully disclose information pertinent to the partnership, its agents, and principals. *Id.* at 23. Similarly, a trustee of an express trust can only deal with the *cestui que* trust after fully disclosing all relevant information. *Id.* Corporations, too, must adhere to certain disclosure requirements in their articles of incorporation concerning capitalization. *Id.* at 24. Corporation statutes also require that corporations keep books and records. *Id.* The economic costs of conforming to these disclosures generally were quite small and the law fairly easy to understand. *Id.*

Because no administrative organization existed, enforcing disclosure prescriptions was inconsistent and infrequent. See Katz, *The Philosophy of Midcentury Corporation Statutes*, 23 LAW & CONTEMP. PROBS. 177, 177-81 (1958) (due to ad hoc manner of enforcing disclosure, analysts of era generally refer to it as "laissez faire" period).

<sup>14</sup> Beginning in 1929, tales of fraud, manipulation, and embezzlement began pervading the market. REPORT OF COMMISSION ON BANKING AND CURRENCY, STOCK EXCHANGE PRACTICES, S. REP. NO. 1455, 73d Cong., 2d Sess. (1934) [hereafter STOCK EXCHANGE PRACTICES] (Senate designed "Pecora" Hearings to fully illustrate "parade of horrors" and to pave the way for adoption of extensive securities regulation). These abuses were thought to artificially inflate stock prices, creating an inherently unfair trading market. *Id.* Therefore, Congress eventually adopted the 1933 Act. *Id.* Soon thereafter, Congress enacted the 1934 Act to ensure full disclosure. *Id.* The movement continues today with a constant flow of new rules and regulations from the Securities and Exchange Commission. WORK OF THE SEC, *supra* note 10.

<sup>15</sup> Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982 and Supp. III 1986); see also *supra* note 1.

<sup>16</sup> See *supra* note 1. Disclosure under the 1933 Act generally requires publicly traded companies to file a registration statement and prospectus with the SEC prior to offering the securities for sale:

It shall be unlawful for any person, directly or indirectly, to make use of any means . . . to offer to sell . . . through the use . . . of any prospectus . . . any security, unless a registration statement has been filed as to such security.

Act requires disclosure of certain types of material information.<sup>17</sup> Typically, facts are material if an investor would consider them important in deciding whether to purchase a security.<sup>18</sup>

Congress enacted this legislation to regulate the initial sale of securities to the public, but neglected to provide a system for continuing regulations following registration.<sup>19</sup> Because companies continued to interact with investors after initial registration, companies could continue to manipulate and deceive the investing public with impunity.<sup>20</sup> Consequently, in 1934 Congress passed additional legislation to prevent these abuses, thus completing the project begun in 1933.<sup>21</sup>

The 1934 Act imposes continuing disclosure obligations on companies trading stock registered under the 1933 Act.<sup>22</sup> Congress formulated

Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly . . . to sell such security through the use . . . of any prospectus or otherwise.

15 U.S.C. § 77e (1982 & Supp. III 1986). A *registration statement* is the document used to register securities with the SEC. *Id.* § 77b(8).

The term *prospectus* means: the document that offers any security for sale or confirms the sale of any security. *Id.* § 77b(10). The prospectus contains considerable information about the company, the securities being offered, and factors making the prospective investment speculative or uncertain. *See generally* Securities Act of 1933, Regulation S-K (including information concerning risk factors, company management, capitalization, and the company's business as some items requiring disclosure).

<sup>17</sup> No rigid rule or definition of materiality exists. In 1970, the SEC held that information is material if it is "of such importance that it could be expected to affect the judgment of investors [in determining] whether to buy, sell, or hold . . . stock . . . [and if] generally known . . . to affect materially the market price of the stock." In the Matter of Investors Management Co., [1970 Transfer Binder], FED. SEC. L. REP. (CCH) § 77,832 (June 26, 1970); *see also supra* note 5 and accompanying text (*BarChris* and *Leasco* courts espoused four completely distinct materiality standards).

<sup>18</sup> *See supra* note 5. The materiality standard itself is not the focus of this Comment. Rather, this Comment focuses on the standard's application in the tender offer context. *See infra* notes 64-128 and accompanying text.

<sup>19</sup> Because the 1933 Act applied only to sales of new securities, this initial disclosure scheme was inadequate in two respects. 3 H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW 2A-2 (1986). First, disclosure obligations under the 1933 Act depended on the fortuitous circumstance of a company making a public offering. *Id.* Second, the 1933 Act failed to require the updating of the information. *Id.*

<sup>20</sup> Until adoption of the 1934 Act, insider trading continued without penalty. *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied sub nom.* *Coates v. SEC*, 394 U.S. 976 (1969).

<sup>21</sup> Securities Exchange Act of 1934, 15 U.S.C. §§ 77-78kk (1982 and Supp. III 1986).

<sup>22</sup> Section 13(a) of the 1934 Act imposes periodic reporting obligations on companies with publicly-traded stock. *Id.* § 78a-78c (1934 Act requires all companies listing securities on national exchanges to register listed security and file annual and periodic

these additional requirements in an effort to devise a comprehensive system providing investors with a continual, minimum degree of protection.<sup>23</sup> The rules most germane to this Comment are the 1934 Act provisions regulating tender offers.<sup>24</sup>

### B. *The Genesis of Tender Offer Regulation*

In 1968, Congress promulgated the Williams Act,<sup>25</sup> as part of the 1934 Act, to correct abuses inherent in cash tender offers<sup>26</sup> and various

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reports with SEC; unlisted companies with \$1 million in total assets and 500 or more shareholders also must register). Pursuant to this section, the SEC promulgated rules requiring companies to file annual reports on form 10-K, quarterly reports on form 10-Q, and current reports on form 8-K. *See* 17 C.F.R. §§ 240.13a, 240.12b (1986).

<sup>23</sup> For instance, the proxy solicitation rules contained in § 14 of the 1934 Act govern shareholder voting. 15 U.S.C. § 78n(c) (1982 & Supp. III 1986). The proxy rules require the dissemination of a proxy or information statement in connection with the election of directors and other shareholder actions. *Id.* § 78n(c)(1).

In any solicitation, a company must disclose all material facts concerning matters upon which the shareholders are voting. *See* L. SODERQUIST, *supra* note 1, at 9. Companies must file proxy statements with the SEC in advance of shareholder meetings to ensure compliance with the applicable disclosure regulations by requiring insiders to disgorge any profits from the sale and purchase (or purchase and sale) of any security within a six-month period. *Id.* at 10.

Congress, through the 1934 Act, even chose to regulate margin trading. 15 U.S.C. § 78g (1982 & Supp. III 1986). The statute allows the federal reserve system to limit the amount of credit extended to purchase or carry securities. *See* L. SODERQUIST, *supra* note 1, at 10.

The 1934 Act also provides a system for regulating securities trading practices and requires registration of exchanges, brokers, and dealers. 15 U.S.C. § 78o (1982 & Supp. III 1986). These provisions "seek to curb misrepresentations and deceit, market manipulation, and other fraudulent acts and practices and to maintain an open, fair, and orderly market." *See* L. SODERQUIST, *supra* note 1, at 10.

<sup>24</sup> 15 U.S.C. § 78m (1982 & Supp. III 1986); *see also infra* notes 25-40 and accompanying text.

<sup>25</sup> Williams Act of 1968, Pub. L. No. 90-439, 82 Stat. 454 (codified at 15 U.S.C. §§ 78l-78n (1982 & Supp. III 1986)). Congress named the bill after Senator Harrison Williams, the bill's principal advocate. *See infra* note 28.

<sup>26</sup> Tender offers generally involve a concerted program of purchasing securities in the open market to obtain majority stock ownership and control. *See* L. SODERQUIST, *supra* note 1, at 482. Potential acquirers usually achieve the takeover through negotiated transactions with the target company's shareholders. *Id.* Publicity may or may not accompany the offer. *Id.* at 483. The acquirer is generally not content with being a passive investor. Fleischman & Mundheim, *supra* note 2, at 816.

At the time of the tender offer hearings, the SEC found it inappropriate and unnecessary to precisely define the term "tender offer." Einhorn & Blackburn, *The Developing Concept of "Tender Offer": An Analysis of the Judicial and Administrative Interpretations of the Term*, 23 N.Y.L. SCH. L. REV. 379 (1978). *Contra* Securities Act

other forms of corporate takeovers.<sup>27</sup> Until 1968, the proliferation of cash tenders escaped the disclosure obligations of the 1933 Act.<sup>28</sup> The Williams Act regulates the conduct of both the offeror<sup>29</sup> and the target company.<sup>30</sup>

The Williams Act imposes affirmative disclosure obligations on offerors. It requires takeover bidders (the offerors) or any individual or entity owning more than five percent of a corporation's stock to file a statement with the SEC.<sup>31</sup> The statement must reveal the offeror's

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Release No. 16,385 (November 29, 1979), wherein the SEC proposed (but never adopted) the following definition of tender offer:

The term 'tender offer' includes a 'request or invitation for tenders' and means one or more offers to purchase or solicitations of offers to sell securities of a single class, whether or not all or any portion of the securities sought are purchased, which

(i) during any 45-day period are directed to more than 10 persons and seek the acquisition of more than 5% of the class of securities . . . ; or

(ii) are not otherwise a tender offer. . . but which (A) are disseminated in a widespread manner, (B) provide for a price which represents a premium in excess of the greater of 5% of or \$2 above the current market price and (C) do not provide for a meaningful opportunity to negotiate the price and terms.

<sup>27</sup> See L. SODERQUIST, *supra* note 1, at 482 (stating that the Williams Act regulates various forms of corporate takeovers including mergers, acquisitions and corporate combinations).

<sup>28</sup> The Supreme Court's opinion in *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 22 (1977) provides perhaps the best short sketch of the background surrounding the Williams Act:

[T]he Williams Act . . . was adopted in 1968 in response to the growing use of cash tender offers as a means for achieving corporate takeovers. Prior to the 1960's, corporate takeover attempts had typically involved either proxy solicitations, regulated under § 14 of the [1934 Act], or exchange offers of securities, subject to the registration requirements of the [1933 Act]. The proliferation of cash tender offers, in which publicized requests are made and intensive campaigns conducted for tenders of shares of stock at a fixed price, removed a substantial number of corporate control contests from the reach of existing disclosure requirements of the federal securities laws.

To remedy this gap in federal regulation, Senator Harrison Williams introduced a bill in October 1965 to subject tender offerors to advance disclosure requirements. The original proposal . . . evolved over the next two years in response to positions expressed by the SEC and other interested parties from private industry and the New York Stock Exchange.

<sup>29</sup> The offeror is the individual or entity seeking to acquire control of the target company. See L. SODERQUIST, *supra* note 1, at 481-89.

<sup>30</sup> See *supra* note 4.

<sup>31</sup> 15 U.S.C. § 78m(d)(1) (1982); see *infra* note 32.



*background and identity*, as well as the offeror's plans to acquire additional shares in the target.<sup>32</sup> In addition to these disclosure requirements, the Williams Act provides additional benefits for target shareholders who tender their stock.<sup>33</sup>

The Williams Act also contains a broad antifraud provision.<sup>34</sup> Section 14(e) imposes liability on anyone (target companies as well as offerors) who misstates *material* facts or acts in a manipulative or decep-

<sup>32</sup> 15 U.S.C. § 78m(d)(1) (1982 & Supp. III 1986). The statute states that:

Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to . . . this title . . . is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security . . . and file with the Commission, a statement containing such of the following information . . .

(A) the background, and identity . . . and the nature of such beneficial ownership . . . ;

(B) the source and amount of the funds or other consideration used or to be used in making the purchases. . . ;

(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporate structure;

(D) the number of shares of such security which are beneficially owned . . . ; and

(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer . . . .

*Id.*

<sup>33</sup> First, shareholders who accept the tender offer may withdraw their shares during the first seven days of the tender offer and at any time after sixty days from commencement of the offer. *Id.* § 78m(d)(5). Second, when the tender offer is for less than all outstanding shares and shareholders tender more than the requested number, the Williams Act requires that the offeror purchase the tendered securities pro rata during the first ten days of the offer. *Id.* § 78m(d)(6). Finally, the Williams Act provides that if, during the course of the offer, the amount paid for the target shares increases, all tendering shareholders will receive additional consideration, even if they tendered their stock before the price increase. *Id.* § 78m(d)(7).

<sup>34</sup> Section 14(e) of the 1934 Act reads in pertinent part:

It shall be unlawful for any person to make any untrue statement of a *material* fact or omit to state any *material* fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer . . . or any solicitation of security holders in opposition to or in favor of any such offer. . . .

*Id.* § 78n(e)(7) (emphasis added).

tive manner in connection with a tender offer.<sup>35</sup> This is the only way liability will attach to target companies under the Williams Act for fraud in connection with tender offers.<sup>36</sup> Interestingly, however, the Williams Act does not impose any affirmative duty on target companies to disclose tender offer negotiations.<sup>37</sup> Nevertheless, once a target company chooses to disclose, any statement made concerning a material fact must be complete and accurate.<sup>38</sup>

The Williams Act neglects to describe precisely when tender offer negotiations become material, thereby triggering target companies' disclosure obligations. Moreover, the SEC has never issued guidelines defining materiality in the tender offer context, or suggested the appropriate time and contents of tender offer negotiation disclosures.<sup>39</sup> Thus, courts interpreting the Williams Act continue to formulate inconsistent definitions of materiality.<sup>40</sup> Clarifying target companies' disclosure obligations will also help stabilize the stock market.

### C. *The Economics of Disclosure*

Clarifying tender offer disclosure obligations will have a significant positive economic effect.<sup>41</sup> The primary economic justification for disclosure is that the information is necessary for efficient stock market operation.<sup>42</sup> Disclosure and dissemination of relevant corporate infor-

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<sup>35</sup> See *id.*

<sup>36</sup> See generally *supra* note 25. In addition to the Williams Act, the target also faces liability under Rule 10b-5 of the 1934 Act. See *infra* note 50 and accompanying text. The language of Rule 10b-5 closely tracks that of § 14(e). *Id.*; see also *infra* note 51. To establish liability under Rule 10b-5, the plaintiff must be a purchaser or seller of the target's securities. *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461, 468 (2d Cir. 1952), *aff'd*, 421 U.S. 723 (1975).

<sup>37</sup> See generally *supra* note 25; *infra* note 54.

<sup>38</sup> See *infra* text accompanying note 59.

<sup>39</sup> See *infra* notes 49-63 and accompanying text.

<sup>40</sup> See *infra* notes 64-93 and accompanying text.

<sup>41</sup> For a full discussion of the arguments and in-depth analysis of stock market economics, see generally WALL STREET IN TRANSITION, *supra* note 13. Until the late 1960's the entire area of securities regulation had escaped in-depth economic scrutiny. *Id.* Several well-known authorities have since commented extensively on the general utility of the Securities Acts from an economic standpoint. *Id.*

<sup>42</sup> See generally Manne, WALL STREET IN TRANSITION, *supra* note 13, at 23. Proponents of disclosure argue that it will ultimately make the market more efficient. *Id.* This will ensure that stock prices rapidly integrate and reflect new information. *Id.* at 27. Proponents further claim disclosure does not interfere with legitimate business decisions. *Id.* To the contrary, they argue, disclosure enables the market to function more, not less, effectively. *Id.* But see J. MOFSKY, BLUE SKY RESTRICTIONS ON NEW BUSINESS PROMOTIONS (1971) (opponents claim disclosure necessarily forces behavior that

mation protects investors from fraud and deception.<sup>43</sup> Consequently, economists say this process of distributing information, known as allocational efficiency,<sup>44</sup> stabilizes stock prices and trading volume in the markets.<sup>45</sup> Thus, advising target companies about when to disclose tender offer negotiations and what to say when they disclose will enhance the stabilizing effect of the Securities Acts' disclosure obligations.

While disclosure furnishes investors with a greater amount of information,<sup>46</sup> the Securities Acts do not assist target companies in satisfying

differs substantially from what would occur in absence of disclosure rules).

Interestingly, economists continue to debate the positive and negative effects of the Securities Acts' disclosure obligations. *See infra* text accompanying notes 43-48; *see also* ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES (H. Manne ed. 1969) [hereafter ECONOMIC POLICY] (containing articles from several recognized economists focusing on the economic advantages and disadvantages of securities regulation). They disagree on whether the enactment of the Securities Acts created a more or less efficient trading market. *See* Manne, WALL STREET IN TRANSITION, *supra* note 13, at 25.

<sup>43</sup> With full disclosure we would expect less dramatic shifts in estimates of expected profitability of a given issue as a result of the greater initial level of economic information . . . , a greater scope for scientific investment analysis, a diminished reliance on and use of rumors, and a reduction in the scale of manipulative practices.

Friend & Herman, *The S.E.C. Through A Glass Darkly*, 27 J. BUS. L. 382 (1964).

<sup>44</sup> For an in-depth analysis of the allocational efficiency arguments, *see generally* Friend, *The S.E.C. and The Economic Performance of Securities Markets*, in ECONOMIC POLICY, *supra* note 42, at 185.

<sup>45</sup> *See supra* note 42.

<sup>46</sup> *See* Manne, WALL STREET IN TRANSITION, *supra* note 13, at 24. For instance, the SEC's disclosure requirements are powerful enforcement devices that encourage honesty and integrity among companies. *Id.* at 38. In addition, the disclosure required in registration statements also can be a tremendous boon to competitors. *Id.* Finally, securities analysts benefit from the library of data available, as all disclosures become public record upon filing with the SEC. *Id.* Disclosure also encourages honesty and integrity in trading, promotes competition, and provides relatively inexpensive information to investors. Friend, *supra* note 44, at 197-99 (author avers that regulations' improvement of stock price structure suggests, and is consistent with, expectations of improved information and a reduction in manipulative activity).

Economists also identify negative effects of disclosure. *Id.* at 188. One criticism suggests that registration has introduced undesirable impediments into the competitive forces of the market. *Id.* at 192. For example, disclosure costs will completely prohibit some issuers from entering the market. *Id.* at 193. Specifically, public capital markets are less accessible to small firms desiring to enter a particular industry or expand operations than for large established companies in a similar field. Manne, WALL STREET IN TRANSITION, *supra* note 13, at 49; *see also* Securities Act of 1933, Regulation S-K (disclosure regulations themselves particularly onerous).

Other economists argue that Congress only intended for disclosure to prevent fraud and deception. *See generally* Kripke, *The S.E.C., The Accountants, Some Myths and*

*Some Realities*, 45 N.Y.U. L. REV. 1151 (1970) (according to SEC, fraud and deception, not financial losses, drove public out of market after 1929 and would do so again regardless of shareholder returns on stock investments).

In 1964, George Stigler evaluated the effect of the Securities Acts on investors. His unrefuted findings suggest neither shareholders nor investors have benefited from the 1933 and 1934 Acts. *See Stigler, Public Regulation of Securities Markets*, 37 J. BUS. L. 117 (1964).

Some economists espouse various economic theories when criticizing the effect of the Securities Acts' disclosure policies on stock prices and market efficiency. *See generally* Kripke, *supra*, at 1154. One allegedly negative result of the Securities Acts is their impact on market liquidity. Manne, *WALL STREET IN TRANSITION*, *supra* note 13, at 53. Market liquidity involves the ability to freely buy and sell securities in the open market. *Id.* The requirements of Rule 144 under the 1933 Act provide the most obvious example of inhibiting market liquidity. This rule restricts the resale of certain "restricted" and "control" shares. In this way, any such securities are not freely tradeable. *See generally* Securities Act of 1933, Rule 144, *codified at* 17 C.F.R. § 240.144 (1981); *see also* Manne, *WALL STREET IN TRANSITION*, *supra* note 13, at 53-55. Restricting the sale of large amounts of securities affects the market's functional efficiency. *Id.* at 54-55. These restrictions affect the availability of securities in the market and, thus, the shares' relative price. *Id.* at 53. Furthermore, the restriction may also grossly inhibit the process of integrating and assimilating additional information into the stock price. *Id.* at 55. Restricted stockholders are often the most knowledgeable traders (*i.e.*, officers, directors, and large shareholders). *Id.* Economically, we should not preclude these persons or entities from entering the market. *Id.*

Using the public goods model, economists demonstrate how various kinds of information affect a security's price well before public announcement of the information. *See* discussion by Manne & Solomon, *WALL STREET IN TRANSITION*, *supra* note 13, at 40-43. In its purest form, the public-goods doctrine defines a range of economic goods (in this case, information) that any one individual can consume without diminishing enjoyment of the same economic good by others. *Id.* at 40-41. Consequently, a user charge for goods possessing this characteristic is sub-optimal. *Id.* Unless the goods are freely available, "the good will be under consumed and total social welfare will be less[ened]." *Id.*

Information contained in prospectuses and registration statements involve such a public good. However, in applying the public goods doctrine in this context, several errors become apparent. *Id.* First, although there may be some savings in allowing additional persons to use the information free of charge, production incentives are lacking. *Id.* "If the producer of an economic good [fails to receive] at least a market rate of return for his efforts and resources, he will have no incentive to produce the good." *Id.* at 42. However, one might argue that securities registration laws push disclosure closer to the optimum level since an issuer must disclose the "correct" amount of information or suffer the civil and criminal sanctions provided in the federal securities laws (the "incentive"). *Id.*

The traditional public goods argument assumes that one individual's use of an economic good will not impair its usefulness to another. *Id.* This is not the case with stock market information. *Id.* Traders with access to specific information concerning traded securities rapidly exploit the information's economic value. *Id.* Thus, "the information will *not* have the same value to subsequent recipients of the information with its total

disclosure obligations.<sup>47</sup> Neither the SEC nor the courts provide any guidelines suggesting the appropriate time for disclosing tender offer negotiations. Consequently, the Securities Acts' antifraud provisions create confusion and controversy for target companies involved in negotiations.<sup>48</sup> These deficiencies in the Securities Acts' disclosure requirements illustrate the tension created in the tender offer area.

## II. COMPLIANCE: THE CONCEPTS OF DISCLOSURE AND MATERIALITY

Deciding when to disclose tender offer negotiations is a recurring problem for target companies. Timely disclosure provides investors with valuable information and enhances confidence in the securities markets.<sup>49</sup> Moreover, failure to promptly and accurately disclose tender offer negotiations may subject a target company to liability under the antifraud provisions of the Securities Acts, particularly Rule 10b-5<sup>50</sup>

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value already realized in the market." *Id.* at 42-43. "[A] second person cannot receive the same positive utility as the first without loss to the latter." *Id.* One solution would be to require investors to bear disclosure costs. *Id.* at 41. Since most individuals are generally risk-averse, any disclosure of valuable information lessens risk. *Id.* at 50.

Economists use the random walk theory to make a similar argument. *See generally* W. BAUMOL, *THE STOCK MARKET AND ECONOMIC EFFICIENCY* (1965); THE RANDOM CHARACTER OF STOCK MARKET PRICES (P.H. Cootner ed. 1964); Wu, *An Economist Looks At Section 16 Of the Securities Exchange Act of 1934*, 68 COLUM. L. REV. 260 (1968). Proponents of the random-walk theory contend that nothing in the previous history of the securities markets provides useful information for predicting future prices. Manne, *WALL STREET IN TRANSITION*, *supra* note 13, at 67. Stock prices typically follow a random walk pattern. *Id.* Thus, no one acquiring "known" information could use it to realize a greater than normal rate of return in the market. *Id.* at 68. This assumes that the market is efficient at assimilating and integrating new information. *Id.* Arguably, there is nothing left to influence present price changes except exogenous circumstances that presumably will occur at random intervals with random intensities. *Id.* at 69.

<sup>47</sup> *See supra* text accompanying notes 1-12.

<sup>48</sup> *Id.*

<sup>49</sup> *See generally* Wander & Schwartzman, *Timely Disclosure*, 17 REV. OF SEC. REG. No. 14, at 861 (S & P Aug. 22, 1984) (describing how fruits of disclosure improve investor confidence).

<sup>50</sup> The regulation provides:

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 any material fact or 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, or

and section 14(e).<sup>51</sup> Conversely, a target company that prematurely discloses tender offer negotiations may harm its business position or unintentionally issue a misleading press release because of incomplete, inaccurate information.<sup>52</sup> Thus, target companies must strike a delicate balance between investors' need for information and the companies' need for silence.<sup>53</sup>

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(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit on any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1986).

To establish liability under Rule 10b-5, a plaintiff must allege either a duty to disclose or a material misstatement or omission. *Chiarella v. United States*, 445 U.S. 222, 229 (1980) ("[t]he party charged with failing to disclose market information must be under a duty to disclose it," and must be an insider, fiduciary, or tippee). Additionally, the corporation need not itself be trading to incur liability. *Id.* at 229 (citing *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied sub nom.*, 394 U.S. 976 (1969)).

<sup>51</sup> See *supra* text accompanying notes 25-40 for a full discussion of the Williams Act antifraud provisions. For all practical purposes, Rule 10b-5 and § 14(e) are the same standard. However, a plaintiff may invoke Rule 10b-5 for general fraudulent practices involving the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (1986). Conversely, a plaintiff may only invoke § 14(e) of the Williams Act for fraud in connection with tender offers. See *supra* note 34.

<sup>52</sup> For example, premature disclosure of preliminary merger negotiations could cause the market price of the target's stock to rise prematurely toward, or beyond, the expected tender price, leading to the collapse of negotiations. See *Staffin v. Greenberg*, 672 F.2d 1196, 1206 (3d Cir. 1982) (disclosure of merger negotiations themselves may be misleading — "[i]f word of the impending tender offer becomes public, the price of the stock will rise . . . . Thus, the primary inducement to [share]holders . . . — to [sell] their shares . . . above market — is lost, and the offeror may be forced to abandon its plans."); *Greenfield v. Heublein, Inc.*, 575 F. Supp. 1325, 1336 (E.D. Pa. 1983) (premature disclosure of merger negotiations may be misleading and "do more harm than good"; if merger negotiations collapsed, a shareholder could easily pursue action on grounds that disclosure of negotiations was materially misleading), *aff'd*, 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985). In addition, merger negotiations are inherently fluid and uncertain. *Reiss v. Pan Am. World Airways*, 711 F.2d 11, 14 (2d Cir. 1983).

<sup>53</sup> In defining materiality, the *Schlanger* and *Greenfield* courts attempted to balance the competing interests of protecting investors and preserving confidentiality in legitimate business transactions. *Schlanger v. Four-Phase Sys.*, 582 F. Supp. 128, 132 (S.D.N.Y. 1984); *Greenfield*, 575 F. Supp. at 1336. Balancing these interests, both courts enunciated the policy reasons for requiring or not requiring a target company to disclose preliminary tender offer negotiations. *Id.*

These competing interests are best summarized as follows. Congress enacted the Securities Acts primarily to protect investors from fraudulent and deceptive practices. See *supra* note 1. With comprehensive regulations, Congress encouraged public companies to diligently disclose information concerning its securities. *S.E.C. v. Texas Gulf*

An analysis of the relevant case law reveals some general rules about the disclosure of tender offer negotiations. Generally, the Securities Acts only require target companies to affirmatively disclose negotiations in specifically defined situations.<sup>54</sup> Absent bad faith, insider trading, previous inaccurate disclosures, or objective indications of information leaks, courts permit companies to use discretion in determining when to disclose tender offer negotiations.<sup>55</sup> Several cases have held that "current or future" plans that are "uncertain or contingent in nature" do

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Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc) (central goal of securities laws is "to ensure that buyers and sellers of securities will be adequately informed [of all relevant information] affecting the value of securities . . ."), *cert. denied sub nom.*, 394 U.S. 976 (1969). Furthermore, the Securities Acts strive to eliminate and prevent the "hiding and secreting of important information [because it] obstructs the markets as indices of real value." H.R. REP. NO. 1383, 73d Cong., 2d Sess. 11, *reprinted in* 1934 U.S. CODE CONG. & AD. NEWS 2307, 2310 (1933).

However, premature disclosure of tender offer negotiations is likely to effect a rise in the trading price. *Greenfield*, 575 F. Supp. at 1336. The price could rise to a level equalling or exceeding the tender offer price, thus destroying the negotiations. *Id.* Therefore, a shareholder who purchased shares at a price inflated by disclosure of merger discussions suffers an economic loss when the stock price collapses to its pre-disclosure price. *Id.*; *see also Staffin*, 672 F.2d at 1207 ("Those persons who would buy stock on the basis of the occurrence of preliminary merger discussions preceding a merger which never occurs, are left 'holding the bag' on a stock whose value was inflated by an inchoate hope."). Once this occurs, a shareholder could easily file an action under Rule 10b-5 or § 14(e) for providing materially misleading information. *See Reiss v. Pan Am. World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983).

<sup>54</sup> *See Staffin*, 672 F.2d at 1204 (holding that Securities Acts do not impose duty to affirmatively disclose material facts when not trading in own stock); *see also* Wander & Schwartzman, *supra* note 49, at 862-64 (reviewing recent case law affirming that absent insider trading, prior inconsistent statements, or disclosures mandated by the Securities Acts, companies do not have affirmative disclosure obligations). In the context of tender offers, the Williams Act also only compels disclosure of *material* information. 15 U.S.C. § 78n(e)(7) (1981); *see also supra* note 34.

<sup>55</sup> *See supra* note 54; *see also* Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514, 518 (10th Cir. 1972) (no duty to disclose material information in absence of trading or prior statements if corporate purpose advanced by nondisclosure), *cert. denied*, 414 U.S. 874 (1973); *Texas Gulf Sulphur*, 401 F.2d at 833 (finding that nondisclosure served valuable corporate purpose until land acquisition complete); *Matarese v. Aero Chantillon Corp.*, [1971 Transfer Binder], FED. SEC. L. REP. (CCH) § 93,322 (S.D.N.Y. Dec. 22, 1971) (nondisclosure until approval of merger by target corporation's shareholders is valid business reason). The National Association of Securities Dealers [hereafter NASD] agrees with the commentators. NYSE LISTED COMPANY MANUAL § 202.01 (1985) (permits delaying disclosure for legitimate business reasons; recognized legitimate business reasons include negotiations leading to mergers and acquisitions under the NASD rules).

not require disclosure.<sup>56</sup>

Target companies, however, may not completely rely on these general rules, for several reasons. For example, some commentators advocate that absent a legitimate business reason, all companies should have an affirmative duty to disclose material information.<sup>57</sup> Additionally, recent decisions contain warnings implying that in future cases, companies that unreasonably delay disclosures will be held liable.<sup>58</sup>

All courts agree that once made, statements concerning pending tender offer negotiations must be complete and accurate.<sup>59</sup> This applies whether the target company spoke voluntarily or in response to outside solicitations.<sup>60</sup> The rule applies to all statements made in registration statements, proxies, press releases, or annual reports.<sup>61</sup>

Taken together, the general rules, commentators' criticisms, and repeated judicial warnings create considerable confusion. With increased litigation in the tender offer area in the last five years,<sup>62</sup> target compa-

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<sup>56</sup> *Reiss v. Pan Am. World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983) (Securities Acts do not impose affirmative duty to disclose information regarding uncertain or contingent business plans); *see also* *Warner Communications Inc. v. Murdoch*, [1984 Transfer Binder], FED. SEC. L. REP. (CCH) § 91,435 (D. Del. Mar. 16, 1984) (strong presumption against requiring disclosure of contemplated transactions).

<sup>57</sup> *See* Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 GEO. L.J. 935, 957 (1979); Sheffey, *Securities Law Responsibilities of Issuers to Respond to Rumors and Other Publicity: Reexamination of a Continuing Problem*, 57 NOTRE DAME L. REV. 755, 763 (1982).

<sup>58</sup> Although neither the SEC nor the courts have ever expressly required ongoing affirmative disclosure of all material information, the judiciary's warnings have nevertheless encouraged such action. *Financial Indus. Fund, Inc.*, 474 F.2d at 519 (undue delay in revealing facts, not in good faith, can be deceptive, misleading, or viewed as device to defraud under Rule 10b-5). This warning closely approximates an affirmative disclosure duty in all situations. *See supra* text accompanying notes 49-63.

<sup>59</sup> *See Greenfield*, 742 F.2d at 751 ("If [a] corporation . . . voluntarily chooses to make a public statement . . . reasonably calculated to influence the investing public, . . . [there is a] duty to disclose sufficient information so that [sic] statement made is not false or misleading or so incomplete as to mislead."); *Texas Gulf Sulphur*, 401 F.2d at 862-64 (if issuer makes statement "reasonably calculated to influence the investing public," it must make diligent efforts to ensure statement is not false or misleading); *Schlanger*, 582 F. Supp. at 128 (once statement of fact made, issuer has duty to disclose all material facts "necessary in order to make statements made, in light of circumstances under which they were made, not misleading").

<sup>60</sup> *See supra* note 59.

<sup>61</sup> *Texas Gulf Sulphur*, 401 F.2d at 863-64.

<sup>62</sup> Since 1982, shareholders of public companies filed over 3,765 class actions claiming violations of the Securities Acts involving misrepresentations or omissions to state material facts in connection with tender offers. REPORT OF COMMISSION ON BANKING AND CURRENCY, SECURITIES LITIGATION REPORT, S. REP. NO. 24,765, 99th Cong.,



nies are beginning to worry about the timing of disclosure.<sup>63</sup>

### III. THE IMPORTANCE OF MANDATING DISCLOSURE: THE DISCLOSURE OBLIGATION — WHEN DOES IT ARISE?

Courts disagree about a target company's disclosure obligations in the tender offer context. Recently, a federal district court and the Third Circuit, with virtually identical fact situations, reached opposite conclusions when evaluating target companies' responsibility to disclose tender offer negotiations.<sup>64</sup>

#### 1. Pending Negotiations — Immaterial As a Matter of Law

In *Greenfield v. Heublein, Inc.*<sup>65</sup> a shareholder of Heublein sold his shares shortly before "white knight"<sup>66</sup> Reynolds Industries acquired Heublein.<sup>67</sup> The price and trading volume of Heublein's stock had been fluctuating dramatically.<sup>68</sup> When questioned about the volatility, a Heublein spokesman issued a press release saying Heublein was "aware of no reason that would explain" the recent stock activity.<sup>69</sup> Soon after, Reynolds announced the merger.<sup>70</sup> Following plaintiff's

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1st Sess. (1985).

<sup>63</sup> See *supra* notes 52-53. Target companies are afraid to disclose tender offer negotiations before final agreement for fear they will be incomplete or inaccurate. They are also afraid not to speak for fear that a court will determine that they acted unreasonably by not disclosing. See *supra* note 58. Companies deserve protection. Resolving this dispute benefits both companies and the investing public. See *supra* text accompanying notes 1-12. Companies receive needed guidance and protection. *Id.* The investing public is also notified of what company statements or actions they can reasonably rely on. *Id.*

<sup>64</sup> *Schlanger v. Four-Phase Sys.*, 582 F. Supp. 128 (S.D.N.Y. 1984); *Greenfield v. Heublein, Inc.*, 575 F. Supp. 1325 (E.D. Pa. 1983), *aff'd*, 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

<sup>65</sup> 575 F. Supp. 1325 (E.D. Pa. 1983), *aff'd*, 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985).

<sup>66</sup> The term "white knight" generally denotes an entity that helps prevent a successful hostile takeover attempt. See L. SODERQUIST, *supra* note 1, at 784.

<sup>67</sup> See generally *Greenfield*, 575 F. Supp. 1325.

<sup>68</sup> Plaintiff decided to sell his stock because he believed that the stock's price had peaked. *Greenfield*, 575 F. Supp. at 1328. He made the decision after analyzing the press release and the healthy market then existing. *Id.* Plaintiff sold his stock for \$45.25 per share. *Id.* Reynolds subsequently purchased the outstanding shares at a range from \$56.83 to \$63.00 per share. *Id.* Plaintiff subsequently sued under the general antifraud provisions of Rule 10b-5 and § 14(e) of the Williams Act. *Id.* at 1336.

<sup>69</sup> *Id.* at 1332. This language closely parallels the language of the *Schlanger* press release. *Schlanger*, 582 F. Supp. at 129.

<sup>70</sup> *Greenfield*, 575 F. Supp. at 1328.

claim that the press release was false and misleading, the court held that Heublein had no duty "as a matter of law" to respond to the inquiry and to disclose the forthcoming merger.<sup>71</sup> Furthermore, even though the company chose to respond to the inquiry, no duty to disclose the merger negotiations arose because Heublein and Reynolds had not yet determined the structure and price of the tender offer.<sup>72</sup> The court concluded that the merger negotiations were too tentative to be a material corporate event; therefore, the press release was not inaccurate or incomplete.<sup>73</sup>

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<sup>71</sup> *Id.* at 1336. The court held "as a matter of law, 'preliminary merger negotiations' are not material corporate developments, and thus need not be disclosed. A duty to disclose only arises when there is an 'agreement in principle' to merge." *Id.* (citing *Staffin v. Greenberg*, 672 F.2d 1196, 1205-07 (3d Cir. 1982)).

<sup>72</sup> The court defined the *agreement in principle* as consisting of a *structure and price*. *See id.* at 1337 ("Without fundamental agreement on the structure and price of a merger, a merger is simply *too tentative* to give rise to a duty of disclosure." emphasis added).

<sup>73</sup> In other words, the Heublein spokesman did not misrepresent the truth and thus could not be liable under Rule 10b-5 or § 14(e). *Id.* at 1338. However, if an insider traded as a result of the negotiations, the target would have a separate and distinct duty to disclose. *See infra* note 106. This is because the insider (an agent of the target company) has directly influenced the investing public. *Id.*

This Comment does not address the question of materiality for purposes of *insider trading* after preliminary negotiations have begun. Presumably, in that instance, the company should disclose merger negotiations before the insider trades, or at the very least, when asked to explain market volatility. *See infra* note 106. The mere fact that the insider trades is probative of materiality. *Accord* *S.E.C. v. Shapiro*, 494 F.2d 1301, 1307 (2d Cir. 1974) (fact that corporate officials purchased substantial amounts of stock immediately following merger proposal "highly pertinent" to materiality of the "inside information"); *S.E.C. v. Lund*, 570 F. Supp. 1397, 1401 (C.D. Cal. 1983) (fact that Lund purchased stock following meeting concerning proposed joint venture indicates that information was material). However, the fact that an insider trades is not conclusive of materiality. *See Elkind v. Liggett & Myers*, 635 F.2d 156, 166 (2d Cir. 1980) (relevant question in determining materiality is "whether the tipped information, if divulged to the public, would have . . . likely [affected] the decision of potential buyers and sellers"); *S.E.C. v. Bausch & Lomb, Inc.*, 565 F.2d 8, 14-15 (2d Cir. 1977) (inside information leaked must be "extraordinary in nature" to create general duty to disclose); *Chelsea v. Rabanos*, 527 F.2d 1266, 1270 (6th Cir. 1975); *see also* *List v. Fashion Park, Inc.*, 340 F.2d 457, 463 (2d Cir. 1965) (insiders need not "search out details . . . that would not influence [the public's] judgment . . .").

## 2. Possible Leaks are Material Facts Creating an Affirmative Duty to Disclose

*Schlanger v. Four-Phase Systems, Inc.*,<sup>74</sup> involved facts similar to *Greenfield*. In *Schlanger*, shareholders brought an action against Four-Phase and its officers alleging a violation of Rule 10b-5.<sup>75</sup> The shareholders alleged that Four-Phase failed to disclose a forthcoming merger that raised the stock's market value and trading volume.<sup>76</sup> Four-Phase received several unsolicited inquiries concerning the reasons for the stock's sudden activity.<sup>77</sup> Four-Phase issued an announcement claiming that the company was unaware "of any corporate developments which would affect the market of its stock."<sup>78</sup> Two days later, Four-Phase announced its plans to merge with Motorola.<sup>79</sup> The plaintiffs argued that merger negotiations had leaked, causing the substantial change in trading volume.<sup>80</sup> This alleged leak triggered disclosure obligations.<sup>81</sup>

The court only superficially discussed Four-Phase's general affirmative disclosure obligations, concluding that it had none.<sup>82</sup> The court concluded, however, that the presence of a *potential* leak triggered disclosure obligations.<sup>83</sup> Therefore, because Four-Phase officials chose to

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<sup>74</sup> 582 F. Supp. 128 (S.D.N.Y. 1984).

<sup>75</sup> *Schlanger*, 582 F. Supp. at 129.

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* For a discussion of the Third Circuit's opposite interpretation of a virtually identical announcement, see also *supra* text accompanying notes 65-73.

<sup>79</sup> *Schlanger*, 582 F. Supp. at 130.

<sup>80</sup> Plaintiffs brought suit under the general antifraud provisions of Rule 10b-5. *Id.* According to plaintiffs, the assumed leak created the substantial changes in trading. *Id.* Therefore, the press release was false and contained a material omission. *Id.* Plaintiffs further alleged that the statement "artificially depressed" the market price of Four-Phase stock, thus affecting the market's "integrity." *Id.*

<sup>81</sup> To plaintiffs, the *possibility* of a leak was a de facto disclosure requiring the target to fully disclose the negotiations. *Id.* at 133; see also *infra* text accompanying notes 118-28.

<sup>82</sup> The court conceded that the Securities Acts do not impose any general duty upon a company to disclose material facts or new developments when not trading in its own securities. See *id.* at 133; see also *supra* note 54.

<sup>83</sup> The court noted: "[A] company could be liable under 10b-5 for failing to disclose merger negotiations in a press release when unusual market activity indicated that there had been leaks of inside information about the negotiations." *Schlanger*, 582 F. Supp. at 134. Conversely, *Greenfield* reached the opposite conclusion. See *Greenfield*, 742 F.2d at 759. The court specifically recognized that "Heublein clearly knew of information that might [account] for the increase in trading." Notwithstanding the volatile market, the court concluded that "because of the confidential nature of these discussions, there was no basis for [Heublein] to believe . . . that any of the details of these

speak, they had a duty to ensure that any statement made was accurate and complete.<sup>84</sup> In denying defendant's motion for summary judgment, the court implied that Four-Phase made an insufficient statement.<sup>85</sup> The court also specifically rejected the *Greenfield* holding.<sup>86</sup> However,

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discussions, not previously known to the public, had been recently leaked." *Id.* (footnote omitted). This position parallels the weight of the authority suggesting that no affirmative disclosure obligation exists absent objective indications of a leak or rumors *attributable to the company*. See *infra* text accompanying notes 94-128.

<sup>84</sup> The court noted, in the event a statement is made, a duty arises to ensure that the statements made are "truthful and complete and do not materially misrepresent the facts existing at the time of the announcement." *Schlanger*, 582 F. Supp. at 133; *accord* *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860-62 (2d Cir. 1968) (en banc) (when and what to disclose is matter of sound business discretion; however, statement, when made, cannot be false or misleading), *cert. denied sub nom.*, 394 U.S. 976 (1969). In this way the court implies that the existence of a potential leak made the negotiations material. *Schlanger*, 582 F. Supp. at 133. Such an imposition opposes existing authority. See *infra* note 123.

<sup>85</sup> Since this action involved the denial of defendant's motion for summary judgment, the court did not reach the issue on the merits. *Schlanger*, 582 F. Supp. at 133. The court determined that with respect to the duty and materiality issues, triable issues of fact existed. *Id.* Therefore, the court indicated that liability could attach if the trial court determined that Four-Phase acted recklessly or intentionally in issuing the statement. *Id.* at 134.

<sup>86</sup> *Schlanger*, 582 F. Supp. at 132 ("[i]n this court's view, the *Greenfield* decision is wrong, essentially because it fails to distinguish between cases involving false or misleading statements, and situations involving a decision merely to remain silent . . ."). Other courts also reject *Greenfield*. See *Levinson v. Basic, Inc.*, 786 F.2d 741 (6th Cir. 1986); *In re Carnation Co.*, [1984-85 Transfer Binder], FED. SEC. L. REP. (CCH) § 83,801 (July 8, 1985).

*Levinson* dealt with the eventual consummation of a merger between Basic and Combustion Engineering. *Levinson*, 786 F.2d at 741. On four separate occasions, Basic officials made statements in an effort to allay investor interest resulting from sudden rises in Basic stock. *Id.* at 744-45. The four statements spanned a period of fourteen months. *Id.* Discussions regarding the possible acquisition of Basic by Combustion continued throughout this fourteen month period. *Id.* at 743-45. The first of the four statements categorically denied that "negotiations were under way with any company for a merger." *Id.* at 744. The second statement was a direct response to an inquiry by an SEC official, James Dolan. *Id.* at 745. Dolan specifically asked whether there were any "undisclosed merger or acquisition" plans . . . [or] any developments relating to a possible 'tender offer.'" *Id.* A Basic spokesman replied with a "no corporate developments" statement similar to that issued in *Greenfield*. *Id.*

The statements made in *Levinson* and the court's holding relative to them are actually consistent with the position adopted in this Comment. See *infra* text accompanying notes 95-129. The first statement specifically denied the existence of merger negotiations. *Levinson*, 786 F.2d at 744. At that time, however, only very elementary discussions regarding a possible acquisition had ensued. *Id.*

Thus, although the release was arguably false, it was not *material* for purposes of

the court neglected to describe when the tender offer negotiations became material.<sup>87</sup> The court did not elaborate on what Four-Phase should have said or when it should have disclosed the pending merger.

The split these decisions created remains unresolved.<sup>88</sup> *Greenfield* and *Schlanger* illustrate target companies' confusion in determining when tender offer negotiations become material corporate events requiring disclosure. More importantly, these cases illustrate the courts' confusion in defining materiality. Both *Greenfield* and *Schlanger* emphasize the lack of direction given to target companies when they disclose.

The courts in *Schlanger* and *Greenfield* agree that any response to inquiries concerning material information must be accurate and complete.<sup>89</sup> Unless the tender offer negotiations constitute material information, a court cannot find the target liable under the 1934 Act antifraud

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disclosure under the Securities Acts. Therefore liability could not attach under Rule 10b-5. *Id.* at 748 (since the "merger discussions were not [yet] material and, therefore, their omission could not have been an '[omission] of a material fact' as prohibited by Rule 10b-5" (citing *Greenfield*, 742 F.2d 751)), *cert. denied*, 469 U.S. 1215 (1985).

More importantly, the second statement constituted an outright rejection of an inquiry concerning merger negotiations. *Levinson*, 786 F.2d at 745. Basic officials categorically denied that merger discussions could possibly explain its stock price's volatility. *Id.* Such an inquiry amounts to an objective indication of a leak, mandating disclosure. *See infra* note 121.

The SEC also rejected *Greenfield* as "wrongly decided" without discussion in *In re Carnation*, FED. SEC. L. REP. § 87,596 n.8. The *Carnation* release arose from an SEC investigation conducted because of unusual trading activity during preliminary merger discussions between Nestle and Carnation. *Id.* § 87,593. Carnation made a no corporate developments statement in response to press inquiries. *Id.* § 87,594 ("There is no news from the company and no corporate developments that would account for the stock action."). The SEC determined that the statement made while engaged in preliminary acquisition discussions *may* be misleading. *Id.* § 87,596.

Again, *Carnation* is distinguishable from *Greenfield*. Unlike *Greenfield*, the public statement in *Carnation* followed several articles disclosing rumors about a possible sale of Carnation. *Id.* § 87,593. Reports speculated that Nestle was a possible acquirer. *Id.* § 87,594. This amounts to an objective indication of a leak requiring full disclosure. *See infra* text accompanying notes 94-128.

<sup>87</sup> *See infra* note 111.

<sup>88</sup> Clarifying disclosure obligations in the tender offer area will settle the controversy from several perspectives. *See supra* text accompanying notes 1-12. Defining disclosure obligations eliminates the need for already overworked courts to determine disclosure issues. *Id.* Similarly, target companies benefit from guidelines telling them when tender offer negotiations become material corporate events for purposes of triggering disclosure obligations. *Id.* Finally, investors receive adequate protection because they have notice of when they can or cannot rely on target company representations. *Id.*

<sup>89</sup> *See supra* text accompanying notes 64-93.

provisions.<sup>90</sup> However, courts disagree about when preliminary merger negotiations become material corporate events mandating disclosure under the Securities Acts.<sup>91</sup>

To reconcile *Schlanger* and *Greenfield*, the courts must precisely define material tender offer negotiations. The *Greenfield* structure and price test establishes a workable test for defining materiality in the tender offer context.<sup>92</sup> This test determines the point at which tender offer negotiations compel disclosure in every conceivable situation. In essence, until the structure and price are agreed upon, tender offer negotiations are too tentative to warrant disclosure.<sup>93</sup>

#### IV. SOLUTION — THE GREENFIELD STRUCTURE AND PRICE TEST

In an effort to allay the confusion in balancing the competing interests of disclosure and confidentiality, *Greenfield* developed an understandable and easily-applied bright line structure and price test<sup>94</sup> for

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<sup>90</sup> See *supra* notes 49-63. Because the Securities Acts only require disclosure of material information, requiring a company to disclose a pending tender offer makes the negotiations material by definition. Therefore, unless statements made in response to inquiries regarding market volatility constitute material information, liability could not attach under the Williams Act or Rule 10b-5. *Id.* This does not mean that the target could not be liable to its shareholders under a general fraud cause of action, but only that a cause of action under the antifraud provisions of the Securities Acts could not arise.

<sup>91</sup> In both cases, the parties made an announcement. See *Schlanger*, 582 F. Supp. at 133; *Greenfield*, 575 F. Supp. at 1335. However, the courts disagree as to whether the information was material. *Id.*

In rejecting the *Greenfield* test, the *Schlanger* court implied that the statement amounted to material information even though the parties had not consummated the merger. *Schlanger*, 582 F. Supp. at 133. Therefore, Four-Phase had a duty to make a statement that was both truthful and not misleading. *Id.*

Conversely, the *Greenfield* court held, "as a matter of law 'preliminary merger discussions' are *not* material corporate developments, and thus need not be disclosed." 575 F. Supp. at 1336 (emphasis added). The *Greenfield* holding legally implies that investors can no longer rely on such premature information. *Id.*; see also *supra* notes 49-63 and accompanying text. Such reliance is "unreasonable as a matter of law." *Greenfield*, 575 F. Supp. at 1336. Although this might initially appear to be exactly the type of information investors would want to know, the *Greenfield* approach makes sound practical sense. See *supra* notes 52-53 for the competing arguments.

<sup>92</sup> See *infra* note 95 and accompanying text.

<sup>93</sup> *Id.*

<sup>94</sup> This structure and price test provides the best available method for determining when a company must disclose tender offer negotiations. Other courts have suggested adopting an agreement-in-principle approach or ripeness test. See *Staffin v. Greenberg*, 672 F.2d 1196, 1207 (3d Cir. 1932) (holding that "[w]here an 'agreement in principle' has been reached, a duty to disclose *does* exist" emphasis in original); *Financial Indus.*

determining materiality in tender offer cases.<sup>95</sup> This test can determine when companies should disclose cash tender offers in any context.<sup>96</sup> Under this test, a company need not disclose tender offer negotiations until the structure and price are agreed upon, even when asked to explain market volatility.<sup>97</sup>

The *Schlanger* court specifically rejected the structure and price test, but failed to offer an alternative, workable test or method for determin-

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Fund Inc. v. McDonnell Douglas Corp., 474 F.2d 514, 519 (10th Cir. 1972) (court suggested information must be "available and ripe" for publication before duty to disclose arises; information must be sufficiently verified to permit officers and directors to have full confidence in information's accuracy), *cert. denied*, 414 U.S. 874 (1973).

The original agreement in principle approach failed to establish a workable standard for defining when a company reached such an agreement. *Id.* at 890. Consequently, it was too subjective a measurement, incapable of application to a broad range of transactions. *Id.* *Greenfield* subsequently refined the agreement in principle approach to include the structure and price test. *See infra* note 95.

<sup>95</sup> In discussing the time for disclosing preliminary negotiations, the *Greenfield* court held:

[An] agreement on the fundamental terms . . . must be reached before merger negotiations become a material corporate development that must be disclosed to the investing public. Without fundamental agreement on the *structure and price* of a merger, the merger is simply too tentative to give rise to a duty of disclosure.

*Greenfield*, 575 F. Supp. at 1337 (emphasis added). Concededly, literal adherence to the structure and price test creates enormous possibilities for abuse. Rigidly following the test could effectively relieve the target of disclosure obligations until the very last minute. Arguably misleading statements could be made for some time with no legal recourse against the target. Certainly fact situations will arise enabling courts to confidently imply that the structure and price test is met — a "constructive structure and price." The target would thus be liable for attempting to thwart the Securities Acts' disclosure obligations, for effectively issuing incomplete, incorrect, or misleading statements. A typical scenario consists of merger negotiations that had progressed to the point of both the target and acquiring companies being contractually committed. In such a case, "there is only a minimal chance that a public announcement would *quash* the deal." *Greenfield*, 742 F.2d at 757 (emphasis added). Moreover, the precise time for determining the structure and price will vary considerably from case to case. Defining the time when *all* merger negotiations reach the structure and price threshold is likely impossible. *Levinson v. Basic, Inc.*, 786 F.2d 741 (6th Cir. 1986) (27 months from initial contact with Combustion until consummation of the merger); *Schlanger*, 582 F. Supp. 128 (at *least* 14 days); *Greenfield*, 575 F. Supp. 1325 (15 days); *In re Carnation Co.*, [1984-85 Transfer Binder], FED. SEC. L. REP. (CCH) § 83,801 (July 8, 1985) (approximately three months). Hence, courts must remain flexible and agree to determine structure and price on a case by case basis.

<sup>96</sup> *See supra* note 95.

<sup>97</sup> Both courts agree that "no comment" would always suffice. *See infra* text accompanying notes 101-28.

ing materiality.<sup>98</sup> *Schlanger* seems to assume that even the most tentative discussions constitute material information.<sup>99</sup> If this were true, courts could conceivably force target companies to disclose an array of corporate information concerning product development and management decisions.<sup>100</sup>

By defining materiality, the *Greenfield* structure and price test provides workable disclosure guidelines in a variety of situations involving tender offer negotiations. For example, absent a volatile trading market, if a company voluntarily makes a public statement, the *Greenfield* test indicates whether the company must disclose the pending tender offer.<sup>101</sup> If the company does not meet the *Greenfield* test, it need not disclose the tender offer.<sup>102</sup> If the company does meet the structure and price threshold, the merger negotiations constitute material information.<sup>103</sup> Therefore, any statements, whether voluntarily made or not, that mentioned the pending tender offer negotiations must then satisfy the complete and accurate criteria of the antifraud provisions of the Williams Act and Rule 10b-5.<sup>104</sup>

The *Greenfield* test also provides guidelines when a volatile trading market exists. Consider three situations. In the first situation, no one requests information from the target company. Regardless of whether a target company's tender offer negotiations reach the *Greenfield* structure and price threshold, a company would not have to disclose.<sup>105</sup> Disclosure obligations do not arise because the Securities Acts do not generally require target companies to affirmatively disclose tender offer negotiations.<sup>106</sup>

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<sup>98</sup> See *infra* note 111.

<sup>99</sup> See *Schlanger*, 582 F. Supp. at 134; *supra* note 83.

<sup>100</sup> This requirement could quickly escalate to compelling affirmative disclosure of all information. See *supra* notes 51-52.

<sup>101</sup> See *supra* notes 49-63 and accompanying text.

<sup>102</sup> *Greenfield*, 575 F. Supp. at 1337. This Comment does not argue that the target company could lie with impunity by flatly denying the existence of negotiations. Nor does it advocate inaccurately or incompletely reporting the status of negotiations that it voluntarily discloses. However, for purposes of liability under the Securities Act antifraud provisions, the negotiations do not constitute *material* information. See *supra* notes 34 & 50. Therefore, liability could not attach under Rule 10b-5 or § 14(e).

<sup>103</sup> See *supra* note 95.

<sup>104</sup> *Id.*

<sup>105</sup> See *supra* note 54.

<sup>106</sup> See *supra* notes 64-93 and accompanying text. However, if a company reaches the structure and price threshold, it would probably choose to make a public statement at that time. The acquiring company (offeror) would be ready to institute formal tender offer procedures that necessitate a public statement anyway. 15 U.S.C. § 78m(d)(1)



Next, an outsider, such as a securities analyst, asks a target company to explain the volatility in its stock price and trading volume. The target could respond in one of two ways. The target could say the equivalent of no comment, or it could adopt the posture chosen by the defendants in *Greenfield* and *Schlanger* — business as usual.<sup>107</sup>

If the target company responds by saying “no comment” or “the company has a policy of not responding to factual inquiries from the press,” liability would not attach.<sup>108</sup> The company has, in effect, disclosed nothing, or, at the very most, nothing material. Hence, the company has not made any error or omission triggering liability under the antifraud provisions of the Securities Acts.<sup>109</sup> This is analagous to the situation in which no one inquires about the target company.<sup>110</sup>

If a target company responds to inquiries in a manner similar to the defendants in *Greenfield* and *Schlanger*, the analysis changes slightly. Presumably, this type of disclosure implies that a company is conducting “business as usual.” A reasonable investor could rely on such a statement and buy or sell the company’s stock. Such an investor arguably believes that strong public interest in the company (and nothing else) has caused the volatility.<sup>111</sup> Thus, the statement could mislead po-

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(1982 & Supp. III 1986); see *supra* note 32. Consequently, when a company announces the tender offer (now material information), the statement is subject to the “complete and accurate” test of the antifraud provisions of the Securities Acts. See *supra* notes 34 & 50.

Additionally, as a general principle, if a target corporation is trading in its own stock or has reason to know of or suspect insider trading, it has an affirmative duty to disclose preliminary tender offer negotiations whether or not someone asks it to explain existing market volatility. See *supra* note 54. However, in situations in which the source of market volatility is unclear, courts and legal scholars fail to precisely define this duty, when it arises, and what it consists of in the tender offer context. See *supra* text accompanying notes 64-93.

<sup>107</sup> See *supra* text accompanying notes 64-93.

<sup>108</sup> Both courts agree that “no comment” would always suffice. See *Greenfield*, 575 F. Supp. at 1328; *Schlanger*, 575 F. Supp. at 130.

<sup>109</sup> See *supra* text accompanying notes 49-63.

<sup>110</sup> See *supra* text accompanying notes 105-06.

<sup>111</sup> Consider *Schlanger* and *Greenfield*, in which active tender offer negotiations were taking place. See *supra* text accompanying notes 64-93. In both cases, the companies announced the merger within days of making their respective statements. *Id.* The *Schlanger* court commented that investors would reasonably rely on a statement that implied business was progressing as usual. *Schlanger*, 582 F. Supp. at 130. Therefore, Four-Phase, choosing to speak, had an obligation to make a statement that was both accurate and complete. *Id.* at 133. This position, however, is untenable. One can interpret *Schlanger* as implying that merger negotiations, at any stage, constitute material corporate events, an inconsistent and absurd proposition. *Id.* The *Schlanger* court also

tential investors into thinking that business was routine, when in fact tender offer negotiations were in progress.<sup>112</sup>

Even in this situation, the *Greenfield* structure and price test provides target companies with the necessary direction. The structure and price test defines the point at which responses to factual inquiries compel disclosure.<sup>113</sup> Once a target company meets the structure and price threshold and chooses to either voluntarily initiate or respond to inquiries surrounding a volatile trading market, it has the duty to disclose those negotiations.<sup>114</sup> However, until the structure and price threshold is met, the tender offer negotiations are, by the *Greenfield* definition, "too tentative" to be material.<sup>115</sup> If the structure and price of the tender offer remain unresolved, a statement implying business as usual would not be inaccurate or incomplete.<sup>116</sup> Therefore, the statement would not trigger liability under the Williams Act or Rule 10b-5.<sup>117</sup>

Finally, the *Greenfield* structure and price test also is useful if an information leak exists.<sup>118</sup> One argument suggests that tremendous mar-

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failed to provide target companies with any direction regarding when tender offer negotiations become material corporate developments. *See generally id.* In addition, while intimating that Four-Phase made an inaccurate and incomplete statement, the court failed to inform Four-Phase of what to say to ensure that it made an accurate statement. *Id.*

<sup>112</sup> *See generally Schlanger*, 582 F. Supp. 128.

<sup>113</sup> *Greenfield*, 575 F. Supp. at 1328 (finding that General Cinema Corporation was commencing hostile takeover of Heublein); *Schlanger*, 582 F. Supp. at 130 (finding Four-Phase involved in merger discussion with Motorola). Adopting the structure and price test as the threshold for determining materiality would cure any future reliance by investors. Since companies would not have a duty to disclose merger negotiations until discussions reach the structure and price threshold, an investor can no longer reasonably rely on bald "no corporate development" statements when choosing whether to buy or sell a company's stock. Any reliance would, in fact, be per se unreasonable. Although this might seem like a harsh result, in the aggregate, more good would result. *See supra* text accompanying notes 94-128.

Consequently, the only subjective analysis involved would be in determining precisely when the negotiations reach the structure and price threshold. *See supra* note 95. This takes the guess work out of determining materiality. *See supra* text accompanying notes 94-128.

<sup>114</sup> *See supra* notes 94-97 and accompanying text.

<sup>115</sup> *See supra* note 72.

<sup>116</sup> *Id.*; *see also supra* text accompanying note 102.

<sup>117</sup> *See supra* notes 49-63 and accompanying text.

<sup>118</sup> *See supra* text accompanying note 80; *see also infra* text accompanying notes 119-28. The *Schlanger* court commented that the volatile trading market created a substantial likelihood of an information leak to the public. *Schlanger*, 582 F. Supp. at 135. Four-Phase consequently had a separate and distinct duty to disclose the negotiations because they should have known the information had leaked. *Id.*

ket volatility alone creates an inference of a leak, triggering disclosure obligations.<sup>119</sup> If one accepts this argument, market volatility would always create the presumption of a leak. Therefore, a volatile market would always trigger a duty to disclose.<sup>120</sup> However, the only authority supporting this assumption involves inquiry into specific merger negotiations.<sup>121</sup>

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<sup>119</sup> In *Schlanger*, the presence of a potential leak triggered disclosure obligations. See *Schlanger*, 582 F. Supp. at 134. The NASD appears to side with *Schlanger*:

Negotiations leading to mergers and acquisitions . . . are the type of development where the risk of untimely and inadvertent disclosure of corporate plans are [sic] most likely to occur. Frequently, these matters require extensive discussion and study by corporate officials before final decisions can be made. Accordingly, extreme care must be used in order to keep the information on a confidential basis.

Where it is possible to confine formal or informal discussions to a small group of the top management of the company or companies involved, and their individual confidential advisors where adequate security can be maintained, premature public announcement may properly be avoided. In this regard, the market action of a company's securities should be closely watched at a time when consideration is being given to important corporate matters. *If unusual market activity should arise, the company should be prepared to make an immediate public announcement* of the matter.

NYSE LISTED COMPANY MANUAL § 202.01 (1985) (emphasis added). However, the NYSE continues by explicitly delineating those factual situations that mandate disclosure:

If rumors or unusual market activity indicate that information on impending developments has been leaked out, a frank and explicit announcement is clearly required. If rumors are in fact false or inaccurate, they should be promptly denied or clarified. A statement to the effect that the company knows of no corporate developments to account for the unusual market activity can have a salutary effect . . . . If rumors are correct or there are developments, an immediate candid statement to the public as to the state of negotiations or of development of corporate plans in the rumored area must be made directly and openly.

*Id.* § 202.03. When this occurs, an exchange official typically contacts the company and requests an explanation. *Id.* § 202.04.

<sup>120</sup> Hence, one reading of *Schlanger* suggests that the volatile market (not the tender offer negotiations) created the possibility of a leak (a material fact) triggering disclosure obligations under the Securities Acts. See *Schlanger*, 582 F. Supp. at 134.

<sup>121</sup> The only authority *Schlanger* cited to support this contention is distinguishable. The court cites *In Re Spartek, Inc.*, [1979 Transfer Binder], FED. SEC. L. REP. (CCH) § 81,961 (Feb. 14, 1979). *Spartek* is distinguishable because it involved a statement implying business as usual (like those at issue here) made in response to a *specific* inquiry about the status of *particular* preliminary merger negotiations. *Id.* A company must disclose in that instance because the inquiry amounts to an objective indication of a leak. *Id.* The company must explain these *rumors*, apparently emanating from it. *Id.*; see also *infra* note 123.

Market volatility is too subjective a measurement to presume the occurrence of a leak.<sup>122</sup> Thus, *objective* indications of a leak, such as rumors attributable to the company,<sup>123</sup> must arguably be present before a target company must consider the materiality question. For example, assume that the inquiry directed at Four-Phase specifically addressed the tender offer negotiations, rather than just the volatile market. The former argument would have merit because the inquiry would objectively indicate a leak.<sup>124</sup> The Securities Acts would then require the target company to confirm or deny the rumors.<sup>125</sup>

Even with objective indications of a leak, the structure and price test is useful. If the target company and offeror agree to the structure and price, the target company must fully disclose the pending merger.<sup>126</sup> If not, the rumors apparently emanating from the company warrant an explanation,<sup>127</sup> but something less than full disclosure would suffice.<sup>128</sup> Thus, the *Greenfield* structure and price test provides target companies with necessary direction. The test establishes a workable means for determining the existence of material information and consequent disclosure obligations when and if it chooses to speak.

### CONCLUSION

Target companies deserve a realistic conception of when preliminary tender offer negotiations become material, thus triggering disclosure obligations under the antifraud provisions of the Williams Act and Rule

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<sup>122</sup> See *Greenfield*, 742 F.2d at 756 ("a 'no corporate developments' press release . . . [was] not misleading because there was no [objective] indication that the information had been leaked"); see also *Levinson v. Basic, Inc.*, [1984 Transfer Binder], FED. SEC. L. REP. (CCH) § 91,801 (N.D. Ohio Aug. 3, 1984) ("no corporate development" statement not misleading because company unaware of any information leaking).

<sup>123</sup> Accord *State Teachers Retirement Bd. v. Fluor Corp.*, 654 F.2d 843, 851 (2d Cir. 1981) (no duty to correct rumors or make statement concerning market volatility or stock volume and price unless attributable to the company); *Electronic Specialty Co., v. International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969) (duty to correct rumors exists only if source attributable to the company); *Zuckerman v. Harneschfeger Corp.*, [1984 Transfer Binder], FED. SEC. L. REP. (CCH) § 91,470 (S.D.N.Y. Apr. 26, 1984) (no duty to disclose merger negotiations except in response to allegations that market-place rumors about negotiations had emanated from the company).

<sup>124</sup> See *supra* note 122.

<sup>125</sup> See *supra* note 123.

<sup>126</sup> *Greenfield*, 575 F. Supp. at 1336.

<sup>127</sup> See *supra* note 123.

<sup>128</sup> However, what would constitute complete and accurate disclosure in this instance remains undetermined. See *supra* note 123.

10b-5.<sup>129</sup> The *Greenfield* structure and price test precisely defines materiality in the tender offer area.<sup>130</sup> Unlike the *Schlanger* approach, this test takes the guesswork out of determining materiality. Under the *Greenfield* approach, negotiations simply *are not* material until the acquiring and target companies agree on the structure and price of the tender offer.<sup>131</sup>

In addition, the *Greenfield* structure and price test provides appropriate disclosure guidelines for target companies engaged in tender offer negotiations that have not reached an agreement in principle (as defined by the *Greenfield* structure and price test). This rule implies that when, during tender offer negotiations, tremendous market volatility occurs, without any objective indication of a leak, "no comment" or "business as usual" statements are appropriate responses to an outsider's inquiry concerning market volatility.

Adopting the *Greenfield* approach is also economically advantageous. The relationship between tender price and market price is critical in a tender offer.<sup>132</sup> A tender offer must usually be made at a premium above the market price in order to induce shareholders to tender their shares.<sup>133</sup> Disclosure of negotiations before a target company meets the *Greenfield* structure and price test could drive up the market price and, therefore, have a major impact on the tender price.<sup>134</sup> This situation

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<sup>129</sup> Once a company makes a statement, it must be complete and accurate. *See supra* note 59. In order to make a complete and accurate statement, a company must determine what types of information constitute material information, thereby triggering disclosure obligations under the Securities Acts. *See supra* text accompanying notes 64-93. In doing so, companies must continue to balance the investor's desire for information and the company's need for confidentiality. *Id.* This is often a difficult task. *Id.*

A real problem exists with the *Schlanger* decision and other inadequate disclosure cases decided subsequent to *Greenfield*. In each case, when a court deemed disclosure inadequate, the court failed to provide companies with guidance about when information becomes material for purposes of triggering disclosure obligations. *See supra* text accompanying notes 64-93.

<sup>130</sup> *See supra* note 95.

<sup>131</sup> *Id.* If insider trading was involved, liability would attach to the target under a separate theory. *See supra* notes 73 & 106. The focus would then move away from the materiality question and concentrate on general fiduciary liability principles. *Id.*

<sup>132</sup> *Greenfield*, 575 F. Supp. at 1337; *see also supra* note 53.

<sup>133</sup> *Id.* at 1336. Therefore, any rise in market price will up the amount that the offeror must offer to make the tender offer attractive to the target shareholders. *Id.* This may cause the offeror to lose interest in the acquisition. *Id.* Thus, shareholders who purchase shares at an inflated rate following disclosure of the negotiations, suffer an economic loss. *Id.*

<sup>134</sup> *Id.* at 1337 (disclosure of preliminary merger negotiations before agreement on price could effect market price and have great deal of impact on tender price).

could lead to the collapse of tender offer negotiations.<sup>135</sup> Consequently, premature disclosure could harm investors more than nondisclosure.<sup>136</sup> Investors who purchased shares at an inflated rate in reliance on the information could suffer an economic loss if the price of the stock collapsed to its predisclosure price.<sup>137</sup>

Withholding disclosure until parties reach the structure and price threshold promotes the greatest good for the greatest number. Target companies now have realistic guidelines for determining when to disclose tender offer negotiations, thus protecting confidentiality in legitimate business transactions.<sup>138</sup> If the merger occurs, all of the company's shareholders will usually benefit.<sup>139</sup> Conversely, if the parties fail to reach an agreement, the stock's performance remains unaffected and no injury results.

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<sup>135</sup> *Id.* at 1336.

<sup>136</sup> *Id.*; see also *supra* note 53.

<sup>137</sup> *Greenfield*, 575 F. Supp. at 1336.

<sup>138</sup> See *supra* text accompanying notes 1-12.

<sup>139</sup> A recent student Note captures the "greatest good for the greatest number" argument:

This refers to shareholders in the aggregate. Those shareholders who sell their shares during the pendency of preliminary merger negotiations would arguably be better off with early disclosure, and shareholders of acquiring firms might also desire early disclosure so as to discourage mergers which do not maximize their individual wealth. The potential losses which these groups might suffer, however, are small in comparison with the gains realizable by target shareholders who do not sell their shares prior to the announcement of a merger.

Note, *Rule 10b-5*, *supra* note 11, at 549 n.47 (citations omitted).