The Basic Rules of Disclosure

Joyce Shulman-Kanciper

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THE BASIC RULES OF DISCLOSURE

The Securities Act of 1933\(^1\) ("1933 Act") and the Securities Exchange Act of 1934\(^2\) ("1934 Act") were enacted principally to

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\(^1\) Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (1982 & Supp. IV 1986)) [hereinafter "1933 Act"]). The 1933 Act requires the initial registration of all publicly traded securities, see id. § 77e, and broadly defines a "security" as:

[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, . . . any interest or instrument commonly known as a "security," . . . [any] warrant or right to subscribe to or purchase, any of the foregoing.

Id. § 77b(1).


\(^2\) 15 U.S.C. §§ 78a-78kk (1982 & Supp. IV 1986). The 1934 Act requires continuing corporate compliance with disclosure rules following initial registration of their securities pursuant to the 1933 Act. See Knauss, supra note 1, at 608. This responsibility continues as long as the company's securities are traded on a national exchange. See id. Commentators have suggested that the sporadic disclosure requirements of the 1933 Act should be superseded by the continuous disclosure requirements of the 1934 Act, and that the two acts should be coordinated into a comprehensive disclosure law. See Cohen, "Truth in Securities" Revisited, 79 Harv. L. Rev. 1340, 1402-08 (1966); Knauss, supra note 1, at 628-30.

Prior to the 1934 Act, corporate disclosure was governed by the rules of the various exchanges, and arguments were enunciated against passage of the 1934 Act. See Seligman, The Historical Need for a Mandatory Corporate Disclosure System, 9 J. Corp. L. 1 (1983),
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protect investors in registered securities. The primary vehicle for this protection has been full and accurate disclosure of all "material" facts relating to such securities, as required, in part, by section 10(b) of the 1934 Act and rule 10b-5 promulgated thereunder.

See Wolfson & Russo, supra note 1, at 1147. The 1934 Act contains approximately fifty references to the goal of protecting investors. Id. The legislative history of the securities law is replete with references to the protection of investors. See, e.g., H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933) (broad purpose of securities legislation is to protect investors); S. Rep. No. 792, 73d Cong., 2d Sess. 2 (1934) (providing regulation of exchanges for protection of investors) (President Franklin D. Roosevelt). The Supreme Court has also recognized this fundamental goal of the securities laws. See, e.g., Herman & MacLean v. Huddleston, 459 U.S. 375, 383 (1983) (purpose of 1933 Act to protect investors in registered securities); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976) (purpose of 1933 Act to protect investors and to promote honesty and fair dealing); see also Bauman, Rule 10b-5 and the Corporation's Affirmative Duty to Disclose, 67 Geo. L.J. 935, 942 (1979) (principal purpose of securities laws to protect investors).


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—
der.

Over the years, courts have struggled to define materiality so as to best satisfy the inapposite needs of corporations for silence and of investors for information. The courts have sought to establish a flexible but clear rule in order to provide a standard for

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

Id.

See 17 C.F.R. § 240.10b-5 (1987). Rule 10b-5 was promulgated by the SEC pursuant to the express grant of authority in section 10(b). See supra note 5 (text of § 10(b)). Rule 10b-5 provides, inter alia:

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

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

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .

in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5.

Section 10(b) and rule 10b-5 have been the source of voluminous and significant litigation. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) ("[w]hen we deal with . . . Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn"); SEC v. National Sec., Inc., 393 U.S. 453, 465 (1969) (§ 10(b) and rule 10b-5 may be the most litigated provisions of federal securities law); see also Jacobs, What is a Misleading Statement or Omission Under Rule 10b-5?, 42 FORDHAM L. REV. 243, 243 (1973) (rule 10b-5 is most powerful and widely used instrument of federal securities remedies). See generally Note, Insider Trading and the Misappropriation Theory: Has the Second Circuit Gone Too Far?, 61 ST. JOHN'S L. REV. 78, 88-90 (1986) (discussing history, enactment, and interpretation of rule 10b-5); Note, SEC Rule 10b-5: A Recent Profile, 13 WM. & MARY L. REV. 860, 864-67 (1972) (historical background of rule 10b-5).

Some limitations have been imposed on actions brought pursuant to rule 10b-5. See, e.g., Santa Fe Indus. v. Green, 430 U.S. 462, 473-74 (1977) (breach of fiduciary duty, absent deception, does not give rise to 10b-5 claim); Ernst & Ernst, 425 U.S. at 201 (scienter necessary element of 10b-5 claim); Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir.) (only actual purchasers and sellers have standing to sue under rule 10b-5), cert. denied, 343 U.S. 956 (1952); see also Blue Chip Stamps, 421 U.S. at 731 (affirming Birnbaum rule).

See infra notes 16-22 and accompanying text.

See Starkman v. Marathon Oil Co., 772 F.2d 231, 238 (6th Cir. 1985) ("adherence to [a materiality standard will ensure] management's disclosure obligations will strike the correct balance between the competing costs and benefits of disclosure"), cert. denied, 475 U.S. 1015 (1986); see also Bauman, supra note 3, at 988 (corporation's duty to disclose "requires balancing corporation's need for silence against investors' need for disclosure"); Note, Rule 10b-5 and the Corporation's Duty to Disclose Merger Negotiations: A Proposal for a Safe Harbor from the Storm of Uncertainty, 55 FORDHAM L. REV. 731, 732 (1987) (disclosure policy must balance competing interests of corporations and investors).

corporate disclosure upon which both corporations and courts could rely. These conflicting goals have resulted in inconsistent rules of disclosure, particularly in the context of early corporate merger negotiations. In Basic Inc. v. Levinson, the Supreme Court set forth the appropriate treatment of the materiality issue in 10b-5 actions. The Court rejected a number of circuit court decisions which had found certain preliminary merger negotiations "immaterial as a matter of law," holding instead that such a determination required an inquiry into the particular facts and circumstances of the case. It is submitted that by relying on a case by case approach, and by declining to reach the timing of disclosure issue, the Court has left corporations without a reliable method by which to ascertain when a legal duty to disclose certain facts arises. It is further suggested that the Court inadvertently impaired the application of summary judgment to section 10(b)/rule 10b-5 disclosure actions. This Note will review the development of the materiality standard and the ensuing conflict among the circuits, discuss the Supreme Court's attempt to settle this conflict, and suggest several questions regarding corporate responsibility to disclose that remain unanswered after Basic.

DEVELOPMENT OF THE MATERIALITY STANDARD

Prior to the Supreme Court's 1976 decision in TSC Industries v. Northway, Inc., various standards of materiality had been enunciated and applied by courts. In TSC, the Supreme Court

11 See infra notes 23-41 and accompanying text.
13 See id. at 983-84.
14 See infra notes 43-50 and accompanying text.
15 See infra notes 51-58 and accompanying text.
17 See, e.g., Mills v. Electric Auto-Lite Co., 396 U.S. 375, 384-85 (1970) (suggesting "might" test to determine materiality). A misstatement or omission in a proxy statement was considered material if "the defect was of such a character that it might have been considered important by a reasonable shareholder . . . in the process of deciding how to vote." Id. (emphasis added); see also Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972) (applying Mills test in rule 10b-5 case). However, the "might" test has been criticized as an inaccurate interpretation of Mills, see Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1301 (2d Cir. 1973) ("might" was "not in fact intended to establish a definition of materiality"), cited with approval in TSC, 426 U.S. at 448-49, and as providing too low a threshold,
considered earlier standards and concluded that in order for a fact to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Although TSC discussed the issue of materiality in the context of a proxy solicitation, it provided the test generally adopted by courts in a variety of securities settings.

Previously, with regard to future contingent events, the Second Circuit had defined materiality as involving a balancing of the "probability that the event will occur and the anticipated magnitude of the event." Whatever the test and whatever the context, however, courts have been aware that too low a materiality threshold could threaten the stability of the securities markets and undermine the fundamental purpose of disclosure. In TSC, the Su-
preme Court recognized this potential problem and cautioned that the standard of materiality must be high enough to avoid the possibility that management might bury shareholders in an “avalanche of trivial information.”

Prior to Basic Inc. v. Levinson, some courts had developed a threshold before which facts concerning preliminary merger negotiations were “immaterial as a matter of law” and challenges of allegedly improper nondisclosure of these negotiations were summarily dismissed. The rationale for this approach was based primarily on three theories: first, the negotiations were considered too speculative and premature disclosure might mislead investors; second, premature disclosure could frustrate completion of a transaction because investor activity following disclosure might rule 10b-5 and the Duty to Disclose Merger Negotiations in Corporate Statements, 96 Yale L.J. 547, 547 (1987) (“[p]remature disclosure . . . poses a substantial threat to investors”).

22 TSC, 426 U.S. at 448. The Court also said that “the disclosure policy embodied in the . . . regulations is not without limit” and that “[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good.” Id.; see also Greenapple v. Detroit Edison Co., 618 F.2d 198, 210 (2d Cir. 1980) (“disclosure . . . must steer a middle course, neither submerging a material fact in a flood of collateral data, nor slighting its importance through . . . cavalier treatment”). The Greenapple court illustrated the conflicting interests of disclosure by comparing the policies underlying “Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1297 (2d Cir. 1973) (‘it is not sufficient that overtones might have been picked up by the sensitive antennae of investment analysts’) [with] Richland v. Crandall, 262 F. Supp. 538, 554 [(S.D.N.Y. 1967)] (‘corporations are not required to address their stockholders as if they were children in kindergarten”). Greenapple, 618 F.2d at 210.

24 See Flamm v. Eberstadt, 814 F.2d 1169, 1175 (7th Cir. 1987), cert. denied, 108 S. Ct. 157 (1987); see also Reiss, 711 F.2d at 14 (uncertainty surrounding merger negotiations may cause disclosure to be more misleading than secrecy); Staffin v. Greenberg, 672 F.2d 1196, 1206 (3d Cir. 1982) (disclosure of preliminary merger discussions immaterial because disclosure may be misleading); Susquehanna Corp. v. Pan Am. Sulphur Co., 423 F.2d 1075, 1084-85 (5th Cir. 1970) (misleading to stockholders and investing public to indicate a plan or proposal to merge which never got off the ground); American Stock Exchange Company Gums § 402(a), reprinted in 3 Fed. Sec. L. Rep. (CCH) ¶ 23,124B, at 17,097-11 (1985) (“Occasionally, corporate developments give rise to information which, although material, is subject to rapid change. . . . [I]t may be proper to withhold public disclosure until a firm announcement can be made, since successive public statements . . . may confuse or mislead the public rather than enlighten it.”). However, the validity of this justification for nondisclosure has been criticized. See Basic, 108 S. Ct. at 984-85 (rejecting confusion of investors as rationale for nondisclosure); Flamm, 814 F.2d at 1175 (notion that disclosure may be misleading “assumes that investors are nitwits”).
change circumstances so as to make completion of the transaction economically infeasible; and third, a corporation could be subject to liability for premature disclosure of contingencies which fail to come to fruition. Even those circuits accepting one of these theories, however, disagreed as to the development and implementation of the “immaterial as a matter of law” standard.

**Conflict in “Immaterial as a Matter of Law”**

One disagreement that emerged among the circuits acknowledging the applicability of an immateriality threshold concerned the point at which that threshold was met. In Staffin v. Greenberg the Third Circuit provided a test pursuant to which all preliminary merger negotiations were immaterial prior to an “agreement in principle” or the “functional equivalent” of such an agreement. Two years later, in the sharply criticized case of

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26 See Flamm, 814 F.2d at 1175-76; Note, supra note 8, at 739-40 (public knowledge or suspicion of merger negotiations precipitates trading, which forces market price towards tender offer); see also Easterbrook & Fischel, Mandatory Disclosure and the Protection of Investors, 70 Va. L. Rev. 669, 708-09 (1984) (mandatory disclosure may terminate merger negotiations and reduce shareholder returns). This concern is most evident in the merger context because disclosure of merger negotiations often raises the market price of stock towards the expected tender price, see, e.g., Schlanger v. Four-Phase Sys., Inc., 582 F. Supp. 128, 130 (S.D.N.Y. 1984) (merger rumors caused market activity), and the offeror may be forced to abandon his plans. See Staffin, 672 F.2d at 1206 (quoting Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 72 (1967) (statement of Mr. Calvin on behalf of New York Stock Exchange, suggesting disclosure of preliminary merger discussions would do more harm than good)).

27 See Reiss, 711 F.2d at 14 (had corporation disclosed negotiations, and had they failed, corporation would be liable for such disclosure); Susquehanna Corp., 423 F.2d at 1086 (“next case may well be one in which exaggeration and overstatement is the basis of attack”); Guy v. Duff & Phelps, Inc., 628 F. Supp. 252, 256 (N.D. Ill. 1985) (disclosure of preliminary negotiations makes corporation vulnerable to lawsuit charging the disclosure was misleading). For an example of an action brought for disclosure of affirmative predictions which failed to materialize, see Goldman v. Belden, 754 F.2d 1059, 1069 (2d Cir. 1985). But see Brown, Corporate Secrecy, the Federal Securities Laws, and the Disclosure of Ongoing Negotiations, 36 Cath. U.L. Rev. 93, 95 (1986) (criticizing rationale justifying nondisclosure).

28 See infra notes 28-42 and accompanying text.


30 672 F.2d 1196 (3d Cir. 1982).

31 Id. at 1207. The court found that under the facts, such an agreement had not been
Greenfield v. Heublein, Inc., the same court defined an “agreement in principle” as one in which the parties had reached agreement as to the price and structure of the transaction. A four-prong rationale was offered to support this “bright line” price and structure rule: first, price and structure are two critical factors of any merger; second, agreement as to price and structure provides concrete evidence of a “mature understanding between the negotiating corporations”; third, the price and structure rule provides a usable and definite measure for deciding the time for disclosure; and fourth, once price and structure are agreed upon, there is minimal chance that disclosure will disrupt the transaction or mislead the investing public. This “bright line” price and structure rule was subsequently adopted by a number of courts and found support in the rules of the exchanges. However, the price and struc-

reached and affirmed the district court’s grant of summary judgment. Id.

31 742 F.2d 751 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985). Greenfield has been criticized as having confused the issue of nondisclosure and materiality with the wrongful issuance of a “no corporate development” statement. See, e.g., Basic, 786 F.2d at 748-49 (“Greenfield court’s reliance on Staffin was clearly misplaced”); Schlanger v. Four-Phase Sys., Inc., 582 F. Supp. 128, 132 (S.D.N.Y. 1984) (“Greenfield . . . is wrong, essentially because it fails to distinguish between cases involving false or misleading statements, and situations involving a decision merely to remain silent”); In re Carnation Co., Exchange Act Release No. 22,214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 n.8 (July 8, 1985) (SEC stated that Greenfield wrongly decided and issuance of “no corporate development statement” was violation of rule 10b-5 when corporation engaged in merger negotiations); see also Comment, Corporate Disclosure of Merger Negotiations—When Does the Investor Have a Right to Know?: Greenfield v. Heublein, Inc., 36 Syracuse L. Rev. 1155, 1174 (1985) (suggesting it was error to find Heublein had not breached duty not to mislead).

32 Greenfield, 742 F.2d at 757.

33 Id.

34 See, e.g., Flamm v. Eberstadt, 814 F.2d 1169, 1177 (7th Cir.) (price and structure rule best alternative), cert. denied, 108 S. Ct. 157 (1987); Reiss v. Pan Am. World Airways, 711 F.2d 11, 14 (2d Cir. 1983) (citing Staffin but finding agreement in principle once price and structure agreed upon); Guy v. Duff & Phelps, Inc., 628 F. Supp. 252, 258 (N.D. Ill 1985) (litmus test for duty to disclose is agreement in principle); see also Comment, The Duty Not to Disclose v. The Duty Not to Mislead During Merger Negotiations, 23 Wake Forest L. Rev. 143, 162 (1988) (nondisclosure prior to price and structure is correct rule). But see Note, supra note 8, at 745 (price and structure cannot provide for disclosure of all necessary information).

35 See New York Stock Exchange Listed Company Manual § 202.01, reprinted in 3 Fed. Sec. L. Rep. (CCH) ¶ 23,515, at 17,210 (1985) (“[f]requently [various preliminary negotiations] require extensive discussion and study by corporate officials before final decisions can be made, . . . [w]here adequate security can be maintained, premature public announcement may properly be avoided”); American Stock Exchange Company Guide § 402(a), reprinted in 3 Fed. Sec. L. Rep. (CCH) ¶ 23,124, at 17,097-11 (1985) (“Occasionally, corporate developments give rise to information which, although material, is subject to rapid change. . . . [T]he may be proper to withhold public disclosure until a firm announcement can
ture rule encountered strong opposition from the SEC\textsuperscript{36} and was ultimately rejected by the Supreme Court.\textsuperscript{37}

A sharper conflict arose concerning the appropriate issuing of "no corporate development" statements. These statements are issued pursuant to rules of the major stock exchanges requiring corporations to explain unusual trading activity in their stocks.\textsuperscript{38} Three approaches were employed to determine whether or not the issuing of a "no corporate development" statement was a violation of rule 10b-5. One approach held that since negotiations were immaterial as a matter of law prior to an agreement as to price and structure, the corporation was under no obligation to disclose them.\textsuperscript{39} In contrast, a second approach advocated that a corporation violated rule 10b-5 by issuing a "no corporate development" statement while engaged in preliminary merger negotiations.\textsuperscript{40} Advocating a third approach, the Sixth Circuit held that once a corporation issues any statement, the failure to disclose ongoing merger negotiations is a violation of rule 10b-5.\textsuperscript{41}

**Basic Inc. v. Levinson**

In light of the existing conflict among the circuits and the SEC, the Supreme Court granted certiorari in *Basic Inc. v. Levinson*.\textsuperscript{42}

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\textsuperscript{36} See Basic Inc. v. Levinson, 108 S. Ct. 978, 987 n.16 (1988) (quoting Brief for SEC as amicus curiae at 10; possibility of merger may be material); In re Carnation Co., Exchange Release No. 22,214, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801 (July 8, 1985) (Heublein wrongly decided); Commission Submits Amicus Memorandum on Materiality of Merger Talks, SEC News Digest (July 29, 1985) (SEC reiterated long-standing view that materiality may arise well before agreement as to price and structure).

\textsuperscript{37} Basic, 108 S. Ct. at 986.


\textsuperscript{39} See Greenfield, 742 F.2d at 755-57; see also Note, supra note 21, at 548 (arguing "no corporate development statements" issued while engaged in preliminary merger negotiations do not violate rule 10b-5).


\textsuperscript{41} See Levinson v. Basic Inc., 786 F.2d 741, 748 (6th Cir. 1986) (rejected price and structure rule but held information regarding merger negotiations "becomes material by virtue of a statement denying their existence"), vac'd, 108 S. Ct. 978 (1988); see also Schlanger v. Four-Phase Sys., Inc., 582 F. Supp. 128, 134 (S.D.N.Y. 1984) (once corporation chose to speak, duty to disclose otherwise immaterial merger negotiations arose).
son. The plaintiffs in Basic were former Basic shareholders who had sold their stock following Basic's public announcement denying its involvement in merger negotiations. Plaintiffs alleged that they had sustained a loss through sale of their Basic stock as a result of a market artificially depressed by Basic's public denial of merger negotiations. The Court of Appeals for the Sixth Circuit had rejected the district court's ruling that merger negotiations were immaterial as a matter of law, holding instead that negotiations, which may have been immaterial prior to any disclosure, are rendered material by virtue of a statement denying their existence.

Writing for the Supreme Court, Justice Blackmun purported to settle the existing conflict by expressly adopting the TSC test for all questions of materiality arising under section 10(b)/rule 10b-5 claims. The Court approved the Texas Gulf Sulphur balancing test and its underlying policy as the appropriate test in determining the materiality of preliminary merger negotiations. The Court endorsed a case by case, fact intensive materiality inquiry, rejecting a “bright line” test and the rationale that led to its development. The Court further rejected the Sixth Circuit's contention that otherwise immaterial factors become material upon issuing a statement denying their existence. Finally, the Supreme Court distinguished between the materiality of the information and the timing of the duty to disclose it, declaring that the Basic case did not concern the timing of disclosure issue. It is submitted that while the Supreme Court may have closed the door on the

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43 Basic Inc. v. Levinson, 108 S. Ct. 978, 981 (1988). Prior to the announcement of the merger, Basic had issued three public statements denying involvement in any merger negotiations, and professing that the corporation could not explain the unusually high volume trading of its stock. Id. at 981 & n.4.
44 Id. at 981. Plaintiffs sold their stock after Basic's first denial of merger negotiations.
45 Id. at 981. Plaintiffs sold their stock after Basic's first denial of merger negotiations.
46 Basic, 108 S. Ct. at 983; see supra notes 17-19 and accompanying text.
47 SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969); see supra note 20 and accompanying text.
48 Basic, 108 S. Ct. at 987.
49 Id. at 986, 987-88.
50 Id. at 986. The Court found that adoption of the Sixth Circuit's rule “would be . . . insensitive” to plaintiff's burden in a 10b-5 claim to show that statements were misleading regarding a material fact. Id.
51 Id. at 985 (“[a]rguments . . . that some disclosure would be 'premature' . . . are more properly considered under the rubric of an issuer's duty to disclose”).
"bright line" test for materiality, it failed to provide a standard by which corporations may appropriately structure their disclosure policies.

The Unanswered Questions

Timing of the Duty to Disclose

The Supreme Court in Basic distinguished the question of materiality of information from the question of when disclosure of such material information is required, but failed to address the latter issue. The distinction between the duty to disclose and materiality in a 10b-5 claim has been frequently noted. Some courts and commentators have suggested that once the materiality of a fact is ascertained, the requirement of disclosure necessarily follows. While under the generally accepted rule corporations do not have an affirmative duty to disclose, this general rule is subject to certain exceptions. In applying the rule to early merger negotia-

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52 Id.
53 See, e.g., Starkman v. Marathon Oil Co., 772 F.2d 231, 238 (6th Cir. 1985) (established view that rule 10b-5 requires both duty to disclose and material facts), cert. denied, 475 U.S. 1015 (1986); Flynn v. Bass Bros., 744 F.2d 978, 984 (3d Cir. 1984) (material facts must be disclosed only if "duty to speak exists").

54 See Bauman, supra note 3, at 937 (urging adoption of affirmative duty to disclose). A few courts have also suggested that an affirmative duty to disclose exists generally. See, e.g., Zweig v. Hearst Corp., 594 F.2d 1261, 1266 (9th Cir. 1979) (rule 10b-5 makes no distinction between materiality and duty to disclose, and unless "some doctrine limits [corporations'] duty to disclose" they will be liable for nondisclosure); Financial Indus. Fund v. McDonnell Douglas Corp., 474 F.2d 514, 519 (10th Cir.)(absent valid business purpose for nondisclosure, duty to disclose arises provided information is "ripe"), cert. denied, 414 U.S. 874 (1973); Issen v. GSC Enters., 538 F. Supp. 745, 751 (N.D. Ill. 1982) (broadly interpreting Chiarella v. United States, 445 U.S. 222 (1980), to find an affirmative duty to disclose all material facts arising out of special relationship between corporation and shareholder). See generally Talesmick, Corporate Silence and Rule 10b-5: Does a Publicly Held Corporation Have an Affirmative Obligation to Disclose?, 49 Denver L.J. 369 (1973) (discussing basis for affirmative duty to disclose, but suggesting breach gives rise only to injunctive relief).

55 See Staffin v. Greenberg, 672 F.2d 1196, 1204 (3d Cir. 1982) (generally no affirmative duty to disclose); see also Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir. 1976) (corporation has alternative "to disclose or abstain from trading" its own stock), cert. denied, 429 U.S. 1053 (1977).

56 See, e.g., Chiarella v. United States, 445 U.S. 222, 229 (1980) (duty to disclose arising from insider trading); Greenfield v. Heublein, Inc., 742 F.2d 751, 756 (3d Cir. 1984) (duty to disclose if corporation is trading its own securities), cert. denied, 469 U.S. 1215 (1985); State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 848, 850 (2d Cir. 1981) (duty to disclose if company is source of rumors concerning it); see also Block, Barton & Garfield, Affirmative Duty to Disclose Material Information Concerning Issuer’s Financial Condition and Business Plans, 40 Bus. Law. 1243, 1250 (1985) (even if general rule is that affirmative disclosure is not necessary, exceptions have "eat[en] up the general rule").
tions, courts and the SEC have blurred the distinction between materiality of the information and the duty to disclose it by holding that once the materiality of preliminary merger negotiations is established the duty to disclose arises. It is suggested, therefore, that courts have implicitly linked the questions of materiality and of the appropriate timing of disclosure in developing their policies for the required disclosure of preliminary merger negotiations. Thus, by failing to address the question of when the duty to disclose material information arises, the Supreme Court answered only one-half of the issue actually presented. This incomplete disposition will precipitate situations where a fact may be concededly “material,” yet there will remain an issue as to whether or not the corporation has a duty to disclose it. It is asserted that the Court’s incomplete disposition will serve only to focus the inquiry concerning corporate disclosure upon the issue of duty to disclose, rather than materiality. This is a dubious result considering that regardless of whether the inquiry is termed “duty to disclose” or materiality, the salient factors will likely be identical.

The Corporate Quandary

The need for the establishment of a time for disclosure on which corporations may rely has been recognized. The Basic court quickly dismissed this concern by emphasizing that the securities laws’ fundamental purpose of complete disclosure is paramount to considerations of managerial comfort and ease of application of a disclosure policy. It is submitted, however, that these two concerns are not mutually exclusive, but instead, are intrinsically dependent on one another. Corporations, left with a tenuous

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87 See, e.g., Greenfield, 742 F.2d at 756 (no obligation to disclose until agreement as to price and structure); Staffin, 672 F.2d at 1207 (duty to disclose exists once agreement in principle has been reached); In re Revlon, Inc., Exchange Act Release No. 23,320, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,006 (June 16, 1986) (duty to disclose in Tender Offer Recommendation Statement once agreement in principle is reached); see also Block, Barton & Garfield, supra note 56, at 1259-62 (courts require affirmative disclosure once preliminary merger negotiations deemed material); Note, supra note 8, at 737 n.36 (affirmative duty to disclose merger negotiations once agreement in principle is reached departs from long-standing view of no affirmative duty to disclose).

88 See, e.g., Flamm v. Eberstadt, 814 F.2d 1169, 1178 (7th Cir.) (time for disclosure should be readily ascertainable), cert. denied, 108 S. Ct. 157 (1987).

89 Basic, 108 S. Ct. at 985. The Court recognized that a “bright line” test would be easier to apply than a case-by-case approach, but in rejecting this approach the Court declared that “ease of application alone is not an excuse for ignoring the purpose of the securities acts and Congress’ policy decisions.” Id.
standard upon which to formulate their disclosure policy, are likely to adopt either an over-expansive or an under-expansive disclosure policy in an attempt to protect themselves. The risks of overly broad disclosure are threefold. First, by adopting such a disclosure policy, corporations risk liability for the premature disclosure of contingencies that never come to fruition. Additionally, by disclosing preliminary plans, a corporation may incur an ongoing duty to update that information when circumstances change in order to prevent the previous disclosure from becoming misleading. Finally, a substantial risk exists to the investing public that corporations will "bury [investors] in an avalanche of trivial information," thereby defeating the very purpose of disclosure.

In the alternative, corporations could opt for a more restrictive disclosure policy based on their "business judgment" as to what a reasonable shareholder would consider important. This alternative, however, leaves the corporation vulnerable to lengthy and costly litigation, with little hope of disposition prior to a full trial. It is submitted that courts have improvidently failed to provide corporations with the necessary and safe middle ground between these two unsatisfactory disclosure policies.

**Summary Judgment**

A holding that misstatements or omissions are "immaterial as a matter of law" is essentially an application of summary judgment to the issue of disclosure in the context of the securities laws. The Court in *Basic* implicitly endorsed the application of summary judgment to disclosure questions by remanding the case for a de-
termination of "whether a grant of summary judgment [was] appropriate on the record."\textsuperscript{68} Summary judgment in federal courts is to be granted if there exists "no genuine issue as to any material fact."\textsuperscript{67} The Supreme Court recently spoke on the appropriate application of summary judgment in both \textit{Matsushita Electric Industrial Co. v. Zenith Radio Corp.}\textsuperscript{68} and \textit{Anderson v. Liberty Lobby, Inc.}\textsuperscript{69} The Court set forth a two step inquiry to determine whether summary judgment is warranted: first, the fact in issue must be "material," interpreted to mean potentially determinative;\textsuperscript{70} and second, the issue regarding that fact must be "genuine," interpreted to mean one on which a reasonable jury could differ.\textsuperscript{71}

Substantive law determines whether a given fact is "material" for purposes of summary judgment.\textsuperscript{72} Since liability pursuant to 10(b)/10b-5 requires a showing that the misstatement or omission

\textsuperscript{66} \textit{Basic}, 108 S. Ct. at 988.

\textsuperscript{67} Fed. R. Civ. P. 56(c). The rule provides, \textit{inter alia:} "[T]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file . . . show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." \textit{Id.}


\textsuperscript{69} 477 U.S. 242 (1986). \textit{Anderson} is critical in that it requires a court evaluating a motion for summary judgment to consider the standard of proof which would be applied at trial. \textit{Id.} at 252; \textit{see also Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986) (judge must consider burdens of proof).}

For our purposes, \textit{Anderson} is most important for its definition of the standard to be applied to motions for summary judgment. \textit{See The Supreme Court—Leading Cases, Summary Judgment, 100 Harv. L. Rev. 250, 256 (1986) (Anderson is important for providing framework upon which to analyze summary judgment motions); see also Calkins, Summary Judgment, Motions to Dismiss, and Other Examples of Equilibrating Tendencies in the Antitrust System, 74 Geo. L.J. 1065, 1114 (1986) (Anderson and Matsushita do little more than endorse summary judgment standard already applied by "thoughtful courts").

\textsuperscript{70} \textit{Anderson}, 477 U.S. at 248; \textit{see infra} notes 73-74 and accompanying text.

\textsuperscript{71} \textit{Anderson}, 477 U.S. at 250; \textit{see infra} notes 75-79 and accompanying text.

\textsuperscript{72} \textit{Anderson}, 477 U.S. at 248.
was material,\textsuperscript{73} the materiality of the misstatement or omission will always be determinative.\textsuperscript{74} Therefore, it is submitted that the materiality of a misstatement or omission in section 10(b)/rule 10b-5 actions will always be “material” so as to defeat the first step towards summary judgment.

However, summary judgment is still appropriate if the moving party establishes that no “genuine issue” regarding that material fact exists.\textsuperscript{75} In providing the standard for genuineness, the Anderson Court analogized summary judgment motions to motions for a directed verdict and applied the test of whether a reasonable jury could return a verdict for the non-moving party.\textsuperscript{76} In applying such a test, all “inferences to be drawn from the underlying facts . . . must be viewed in the light most favorable to the party opposing the motion.”\textsuperscript{77} The mere possibility that a jury may infer that a fact is material is sufficient to defeat a summary judgment motion.\textsuperscript{78} In section 10(b)/rule 10b-5 actions, the materiality of misstatements or omissions is based on whether or not a reasonable

\textsuperscript{73} See Starkman v. Marathon Oil Co., 772 F.2d 231, 238 (6th Cir. 1985), cert. denied, 475 U.S. 1015 (1986). For a discussion of the necessary elements of a 10(b)/10b-5 action, see 3A H. Bloomenthal, Securities and Federal Corporate Law § 9.91 (1973); Bauman, supra note 3, at 943.

\textsuperscript{74} See supra note 73.

\textsuperscript{75} Fed. R. Civ. P. 56(c); see Anderson, 477 U.S. at 248 (summary judgment appropriate only if no genuine issue exists regarding any material fact); see also Adickes v. S.H. Kress & Co., 398 U.S. 144, 157 (1970) (moving party has burden of showing absence of genuine issue of material fact); Dreyer v. Sielesoff, 636 F.2d 1141, 1143 n.4 (7th Cir. 1980) (same) (citing Rose v. Bridgeport Brass Co., 487 F.2d 804, 808 (7th Cir. 1973)); Louis, Federal Summary Judgment Doctrine: A Critical Analysis, 83 Yale L.J. 745, 748 (1974) (generally accepted that movant has burden of establishing absence of genuine issue). Courts have had difficulty defining what is genuine. See Note, supra note 68, at 491; see also Louis, supra, at 746 (insufficiencies in standard courts apply to determine whether to grant summary judgment).

\textsuperscript{76} See Anderson, 477 U.S. at 250-51. The Court declared that the primary difference between summary judgment and a directed verdict is procedural. Id.; see also United States v. General Motors Corp., 518 F.2d 420, 441-42 (D.C. Cir. 1975) (moving party entitled to summary judgment if established facts and presumptions would have entitled him to directed verdict); Childress, supra note 68, at 186 (Supreme Court intends summary judgment motion to parallel directed verdict motion); Sonenshein, State of Mind and Credibility in the Summary Judgment Context: A Better Approach, 78 Nw. U.L. Rev. 774, 783 (1983) (standard for summary judgment should be same as that applied to motion for directed verdict).

\textsuperscript{77} Matsushita, 475 U.S. at 587 (quoting United States v. Diebold, Inc., 369 U.S. 654, 655 (1962)); see, e.g., Adickes, 398 U.S. at 157 (evidence of moving party construed in light most favorable to opposing party); Cole v. Cole, 633 F.2d 1083, 1089 (4th Cir. 1980) (“party opposing summary judgment is entitled to ‘the benefit of all reasonable doubts’ ” (quoting 10 C. Wright & A. Miller, Federal Practice & Procedure § 2727, at 551 (1973))).

\textsuperscript{78} See Adickes, 398 U.S. at 159.
investor would have considered them important.\textsuperscript{79} It is asserted
that since these actions are frequently instituted by disgruntled
shareholders, a jury may infer that the plaintiff considered the
omitted or misstated fact important. Therefore, since minimal evi-
dence is necessary to give rise to a "genuine issue," and the action
was commenced by either a presumably reasonable shareholder or
the SEC, materiality will consistently present a "genuine issue"
within the meaning of the rules for summary judgment.

Thus, it is submitted that \textit{Basic Inc. v. Levinson}, read in con-
junction with \textit{Anderson v. Liberty Lobby, Inc.}, sets forth a test for
the disposition of section 10(b)/rule 10b-5 actions which will virtu-
ally preclude courts from granting summary judgment in such ac-
tions. Since section 10(b) and rule 10b-5 may be the most litigated
provisions of all the securities laws,\textsuperscript{80} curtailing the use of summary
judgment in such actions will unnecessarily burden the judicial
system with time-consuming and costly litigation.\textsuperscript{81}

\textbf{CONCLUSION}

In \textit{Basic Inc. v. Levinson}, the Supreme Court confronted the
question of a corporation's duty to disclose preliminary merger ne-
gotiations but addressed only one facet of this duty, the materi-
ality issue. In reaffirming the TSC materiality test, the Court pur-
ported to settle the existing conflict among the circuits; however,
the case by case, fact intensive approach endorsed by the Court
fails to provide corporations with an effective means of establish-
ing disclosure policies and virtually precludes application of sum-

\textsuperscript{79} \textit{See supra} notes 17-18 and accompanying text.

\textsuperscript{80} \textit{See Blue Chip Stamps v. Manor Drug Stores}, 421 U.S. 723, 737 (1975) ("Rule 10b-5
... is a judicial oak which has grown from little more than a legislative acorn"); \textit{SEC v. National Sec., Inc.}, 393 U.S. 453, 465 (1969) ("§ 10(b) and Rule 10b-5 may well be the most
litigated provisions in the federal securities laws"); \textit{see also} Jacobs, \textit{supra} note 6, at 243
(rule 10b-5 is "most powerful and most widely-used tool in the federal arsenal of securities
remedies").

\textsuperscript{81} \textit{See}, e.g., \textit{Catrett v. Johns-Manville Sales Corp.}, 756 F.2d 181, 187 (D.C. Cir. 1985)
(Bork, J., dissenting) (limiting trial judges' authority to grant summary judgment will waste
court time and increase cost and procedural burdens), \textit{rev'd sub nom. Celotex Corp. v. Cat-
trett}, 477 U.S. 317 (1986); \textit{Cole}, 633 F.2d at 1092 (court of appeals expressing sympathy to
overburdened district court compelled by precedent to deny summary judgment); \textit{United
States v. General Motors Corp.}, 518 F.2d 420, 441 (D.C. Cir. 1975) (summary judgment
important to avoid long and expensive litigation); \textit{see also} Lambros, \textit{The Summary Jury
(recent explosion of litigation resulted in overburdened courts and increased costs); Sonen-
schein, \textit{supra} note 76, at 810 (rule 56 designed to be applied to every type of case).
mary judgment. Although ease of application is not the Court’s primary concern, a rule that corporations cannot effectively employ fails to serve the interests of all those involved, particularly those of the investor.

Joyce Shulman-Kanciper