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TSC Industries Inc. v. Northway, Inc.

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in Sept. prior to Sept 29 Conference

CA7's requirement is unreasonable.

There is a conflict

Clear split in Circuits as to standard of materiality of a statement or omission in a Reg. statement or proxy statement.

The Reply Brief adds nothing important chm

DISCUSS

Case presents an impt. Q of Securities Acts law.

CA7 (reversing Judge McLaren) & refusing to follow CA2 (Friendly), held that any omitted fact that "might" be considered "important by a reasonable shareholder" constituted a violation of Act.

An unrealistic standard

PRELIMINARY MEMO

Deny? See my note on last page. penny

Summer List 1, Sheet 3

No. 74-1471

TSC INDUSTRIES, INC.

v.

NORTHWAY, INC.

Cert to CA

(Swygert, Cummings, Pell)

Federal/Civil (Securities)

CA7 also granted summary judgment, holding omissions here were misleading as matter of law.

Timely

SUMMARY: Resp Northway, plaintiff below, is a holder of the securities of TSC Industries, petr here and defendant below. Petr TSC was acquired by petr National Industries, Inc., in a stock-for-stock purchase. Resp filed suit under § 14(a) of the Securities Exchange Act of 1934, alleging that the joint proxy statement filed by TSC and National Industries in connection with the exchange offer was materially misleading in its omission of certain details of the interrelationship of the merger

partners.[1/] On resp's motion for summary judgment on the issue of liability, USDC (N. D. Ill) (McLaren) denied the motion since materiality of the omissions was not established as a matter of law and was a jury question. On § 1292 appeal, the 7th Circuit reversed, holding that certain omissions were material as a matter of law since they were "of such a character that [they] might have been considered important by a reasonable shareholder." Petrs now seek review by cert of CA 7's decision arguing:

> (a) the standard for materiality expounded by CA 7 is in direct conflict with the "significant propensity" test adopted in Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), and with the decisions of various CA's;
> (b) CA 7 erred in holding the omissions involved in this case to be material as a matter of law.

FACTS: After acquiring 34% of TSC's stock and placing five of its nominees on TSC's board of directors, National Industries proposed that TSC sell its assets to National in exchange for National stock. This sale of assets and liquidation required a shareholder vote under state corporate law and, as required by § 14(a) of the 1934 Act, TSC and National distributed a proxy statement to their shareholders. The non-National nominees on the TSC board unanimously approved the proposed asset acquisition and liquidation as did the TSC shareholders. After the merger was culminated, resp Northway brought this suit, alleging, inter alia, certain material omissions in the proxy statement.

1/ Resp also filed certain claims against the controlling shareholders of TSC which are not here in issue.

First, resp noted that the proxy statement failed to note that TSC and National had filed Schedule 13d's with the SEC as required by § 13d of the 1934 Act stating that National could be deemed the "parent" of TSC within the meaning of that provision by reason of its 33% of TSC. Beyond this, although the proxy statement did note that 5 out of the 10 TSC directors were National nominees, it failed to note that National's President and Vice-President were respectively Chairmen of the TSC board of directors and executive committee. Without substantial explanation, CA 7 held these omissions to be material as a matter of law. Petn at 13a-14a.

Second, although the proxy statement revealed the current market value of the shares of National to be received by TSC shareholders [$16.19 per common share of TSC], it failed to include the "prediction" of an underwriter that the received shares would bring only $14.50 per TSC share after the exchange due to a ~~diminution~~ diminution in value of certain National warrants included in the package. The predicted change in value would reduce the premium over present value received by the TSC shareholders from $3.23 per TSC share to $1.48 per share. CA 7 held the materiality of this omission to be obvious. Petn at 18a.

Finally CA 7 found it a material omission to fail to disclose the fact that National had retained as a $12,000 a year consultant the President of a mutual fund which had purchased substantial quantities of National stock amounting to about 8% of the yearly float in National. This was true since some shareholders might have drawn an inference of collusion from these facts.

CONTENTIONS: (1) CA 7 at some length expounds its view of materiality for purposes of § 14(a) and Rule 14a-9. It concludes that the correct test is "whether the omitted fact is of such a character that it might have been considered important by

a reasonable shareholder who was in the process of determining how to vote." Petn at 5a-12a. Drawing support from Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54, and Mills v. Electric Auto-Lite, 396 U.S. at 384, while specifically rejecting Judge Friendly's opinion in Gerstle v. Gamble-Skogmo, Inc., 478 F. 2d 1281 (2nd Cir. 1973), and Smallwood v. Pearl Brewing Co., 489 F. 2d 579, 604 (5th Cir. 1974), cert denied, _____ U.S. _____ (1975), the CA stated that relevancy alone is the only test of materiality [Petn. at 10a, n. 13]. It specifically rejected the significant propensity test adopted by the USDC as well as other CA.

Petr understandably argues that the Circuits are badly split on the question of the standard for materiality for purposes of the federal securities disclosure laws [Cases collected in petn at 8-9] as well as finding the "significant propensity" test supported by Mills. It notes that the omitted facts are not required by any SEC guideline on disclosure. A proxy statement is not formulated in a laboratory, as CA 7 assumes, but in the real world by fallible draftsmen and any proxy statement or other disclosure statement omits material which might have been considered important by some shareholder, at least when viewed retrospectively.

Resp generally renews the CA's holding, arguing that it merely repeats the Mills test. It argues that petr seeks to create a conflict out of a mere ethereal difference in wording. Under any standard these omissions were material as a matter of law. And for the Court to consider this question would be shoveling smoke. It also urges that CA 7's decision can be supported on the alternate grounds of governing state law and Rule 14a-3 -- neither of which were considered below.

(2) Petr urges that CA 7 clearly misused its summary judgment power in foreclosing this issue from jury consideration -- no matter what standard is applied.

How, for example, could the failure to disclose the fact that National officials, named in the proxy as TSC directors as well as officers of National, were chairmen of the TSC board and executive committee possibly be material as a matter of law in light of the disclosures in the proxy that National controlled 33% of TSC's stock as well as 5 of 10 directors.

Resp urges that summary judgment was clearly correct.

DISCUSSION: The case appears to be an outside candidate for cert. The granting of summary judgment is difficult to defend and perhaps completely untenable on all questions save omission of the underwriter's prediction. This issue would not appear to be independently certworthy.

There is a clear split in circuits on the standard for materiality. It surely must be something more than mere relevancy unless filings, prospectuses, and proxy statements are to become encyclopedias. On the other hand, as Judge Friendly's opinion in Gerstle indicated, the particular verbal formula utilized by a court may be more smoke than essence.

There is a response.

O'Neill Ops in petn

7/1/75

AF

There does appear to be a conflict, but one of the two omissions charged here would be material under either standard. The materiality of the other omission would not affect the result of this case, as damages (or injunctive relief) should be the same if there is one material omission or two, but the case still could be used to resolve the conflict over the standard. I suppose the major consideration governing the vote to grant or deny must be the likelihood that articulation of a formula ("mere relevance" as against something that would be important to a reasonable shareholder) is not determinative of these fact-specific cases. Penny

Court ..... Voted on....., 19...

Argued ....., 19... Assigned ....., 19... No. 74-1471

Submitted ....., 19... Announced ....., 19...

TSC INDUSTRIES, INC., ET AL., Petitioners

vs.

NORTHWAY, INC.

5/23/75 Cert. filed.

White thinks there is conflict bet. CA7 & CA2 standards. Utter irrelevant, says Henry.

Grant

	HOLD FOR	CERT. G	CERT. D	JURISDICTIONAL STATEMENT N	JURISDICTIONAL STATEMENT POST	JURISDICTIONAL STATEMENT DIS	JURISDICTIONAL STATEMENT AFF	MERITS REV	MERITS AFF	MOTION G	MOTION D	ABSENT	NOT VOTING	
.....		✓												
Rehnquist, J.		✓												
Powell, J.		✓												
Blackmun, J.			✓		Join		3							
Marshall, J.		✓												
White, J.		✓												
Stewart, J.		✓			~~Prob. noted, 6/6~~									
Brennan, J.			✓											
Douglas, J.			✓											
Burger, Ch. J.		✓												

DISCUSS

DEN 4
Hunt

Agreed.
Carl
(Maybe someone should also contact Stintz and tell him he can be shorter next time.)

November 7, 1975 Conference
List 3, Sheet 3

No. 74-1471

Motion of Respondent to Dispense with Printing Appendix

TSC INDUSTRIES, INC.

v.

NORTHWAY, INC.

On October 6, the Court granted cert to CA 7 in this case to consider the standard for materiality under §14(a) of the Securities Exchange Act.

Respondent (joined by petr in a separate reply) moves to dispense with printing an appendix and to permit the case to be heard on the original record together with nine letter size xeroxed sets of relevant parts of the record. Petr initially designated about 1,500 pages to be printed as the Appendix. Resp, apparently concerned that it may have to bear such costs if the case is reversed, see Rules 36(3) and 57(2) and (3), attempted to persuade petr to include less. Unsuccessful, resp files this motion, suggesting as an alternative that the Court

permit xeroxed copies of the record to be filed. Resp sent the Clerk for his inspection a set of the xeroxed appendix used in the CA. The reproductions are clear and the letter sized volumes are firmly bound. Petr, in a reply brief, joins resp in this motion. Both cite the high costs of printing--$20-25,000, as compared to the relatively low cost of xeroxing, about $3,500.

DISCUSSION: As noted in my memorandum on the motion in Drew Municipal Separate School Dist. v. Andrews, No. 74-1318, List 3, Sheet 3 this Conference, there have been a few of these motions filed this term. As set out in the Drew memorandum, the clear intent of Rule 36 is to discourage voluminous appendices, that an appendix should set out only relevant docket entries, etc. and only those other parts of the record to which the parties wish to direct the Court's particular attention. As with counsel in Drew, the members of the bar in this case have likewise failed "to discern" the purpose of Rule 36.

Again, the parties may be just putting their motion badly. (As in Drew, the cert petition in this case contains the opinion below, as well as the relevant portion of the proxy statement, the Exchange Act and certain Rules of the S. E. C.). However, to grant the motion on the ground given--cost--would only encourage further motions of this type, and verbose and xeroxed appendices.

The provision of Rule 36(8) that the Court may by order dispense with the requirement of an appendix and may permit cases to be heard on the original record, "with such copies of the record, or relevant parts thereof, as the Court may require" should be reserved only for extraordinary situations such as in the Calley motion, see List 3, Sheet 4, October 10 Conference, where the opinions (required by Rule 36(1)) ran several hundred pages.

Also, Rule 36(3) provides protection to resp:

"The cost of producing the appendix shall be taxed as costs in the case, but if either party shall cause matter to be included in the appendix unnecessarily the Court may impose the cost of producing such parts on the party."

The motion probably should be denied and the Clerk advised to contact the parties and discuss the matter with them.

There is a reply.

11/5/75 Ginty

PJN

Court ..... *Voted on* ....., 19...

Argued ....., 19... *Assigned* ....., 19... No. 74-1471

Submitted ....., 19... *Announced* ....., 19...

TSC Industries, Inc.

vs.

Northway, Inc.

Cert
Mike
to discuss
with allys.

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING	
		G	D	N	POST	DIS	AFF	REV	AFF	G	D			
.....														
Rehnquist, J.														
Powell, J.														
Blackmun, J.														
Marshall, J.														
White, J.														
Stewart, J.														
Brennan, J.														
Douglas, J.														
Burger, Ch. J.														

Stroke suit

74-1471 - TSC Industries v Northway

Rule 14a-9 requires (i) that the omitted fact (here only omissions are alleged) be "material", and (ii) that such omitted fact makes the disclosures in the P/S statement "false or misleading".

Mills teaches that liability turns solely on whether the omission (or false statement) is "material".

Standard of materiality:

CA7 - omissions are material as a matter of law if they are "of such a character that [they] might have been considered important by a reasonable shareholder"

No

CA2 (Gerstle v. Gamble-Skogmo) - if "a reasonable man would attach importance [to the omission] in determining his choice of action in the transaction in question"

Substitute "substantial likelihood" for "would"

Suggested modification of CA2 - an omission is material if there is a "significant likelihood that a reasonable investor would consider the information important in arriving at his choice of action." (Mills uses "significant likelihood")

Key reason for a middle-of-road, ~~a~~ standard:

As Friendly noted in Gerstle, altho language of 14a + Rule do not suggest requirement of scienter, we have here a judicially created remedy.

About Congressional action, courts should avoid extreme standards either of laxity or liability.

Moreover, if standard of materiality is too open-ended, corp. mgt. will supply busy stockholders* w an avalanche of details. This would defeat purposes of ~~the~~ 14a.

---

* I've advised management then is only safe course to pursue

[redacted].

The alleged material omissions:

1. [redacted] Control & Conflict of Interest

The P/S did not show that Yarmuth was chairman of TSC and pres of Natl, ~~president of both cos.~~, + that Simonelli was also was an officer of both.

But P/S showed that (i) National then owned 34% of equity of TSC; (ii) that Yarmuth + Simonelli, & two other nominees of Nat. were on TSC Bd. P/S also showed that 5 of 10 directors were "not affiliated with National".

SEC had been advised.

2. Hornblower's Op. on Warrants

It's favorable op. on the merger was stated in P/S (p 6) - identifying five factors considered in reaching op.

CAT & SEC ignore that op. was based on several factors + rely on a single factor - ~~an arguably~~ a difference bet. "intrinsic value" (not disclosed in P/S) & "market value" which Rule ~~requires~~ required be disclosed. (See Reply Brief - CAT's view is [redacted] wholly unrealistic)

Noyes - director + substantial stockholder of TSC (2000 shs vs 200 owned by TI)

3. Buying-in Own Stock

During 19 mo. prior to merger, National & a mutual fund (Madison Fund) had bought in market 8.5% of National's common shares.

The Chairman of National's Bd was a director of Madison, & Pres. of Madison was a consultant of National. But no ev. of collusion or intent to manipulate stock of National to make it more attractive in a future merger.

Probably not material, but was not disclosed.

?

4. Error by CAT

(a) The "might" be material standard

(b) The holding as matter of law that these omissions were material.

5. Disposition

Articulate a correct standard.

Reverse + remand for jury trial

business now conducted by General Outdoor": Robbins was an outdoor advertising man, not a real estate salesman. Indeed, at a later point the Statement explicitly noted that General Outdoor would transfer to this Skogmo subsidiary "its entire outdoor advertising business", which would "continue to be managed by the same officers and substantially the same directors as General Outdoor". Moreover, many, probably most, of the GOA stockholders receiving the Proxy Statement of September 11, 1963, had received, only five months earlier, GOA's quarterly letter of April 11, 1963, quoting the resolution, adopted by its directors on that day, announcing that GOA would continue to operate its outdoor advertising plants with the sole exception of Oklahoma City. While, according to Robbins, this resolution was passed to improve employee morale, the combination of it with the lack of further plant sales (save the closing of the Oklahoma City sale) contributed to the misleading character of the statement of intention in the Proxy Statement.

We recognize that, in thus branding the Proxy Statement as misleading, the district judge and we possess an advantage of hindsight that was not available to the draftsman. It would not have been proper to say that Skogmo *was going to sell* all the remaining plants, when, even with the encouragement that had been received, there was no assurance that it could do this on satisfactory terms. But the English language has sufficient resources that the draftsman could have done better than he did and more accurately expressed Skogmo's true intention to the stockholders. If only the first sentence of the fateful paragraph had said something like "including a policy of aggressively seeking to dispose of the remaining outdoor advertising branches or subsidiaries of General Outdoor through sales to acceptable prospective purchasers on advantageous terms in the range of those that have been achieved in the past," we would at least have had a very different case.

B. *What Is the Standard of Culpability in Suits for Damages for Violation of Rule 14a–9?*

In contrast to the large quantity of ink that has been spilled on the issue whether a plaintiff seeking damages under Rule 10b–5 must make some showing of "scienter" and, if so, what, there has been little discussion of what a plaintiff alleging damage because of a violation of Rule 14a–9(a) must show in the way of culpability on the part of a defendant.[16] Neither of the Supreme Court decisions concerning private actions under section 14(a), J. I. Case Co. v. Borak, *supra*, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423, or Mills v. Electric Auto-Lite Co., 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970), casts light on the problem.

Judge Bartels held, 298 F.Supp. at 97, that "the basis for incorporating scienter into a Rule 10b–5 action does not exist in a Rule 14a–9 suit," and that "Negligence alone either in making a misrepresentation or in failing to disclose a material fact in connection with proxy solicitation is sufficient to warrant recovery." The judge agreed in substance with Judge Mansfield's analysis in Richland v. Crandall, *supra*, 262 F.Supp. at 558 n.12, to the effect that one strong ground for holding that Rule 10b–5 re-

16. Our discussion of this point is limited to the rights of persons who were invited by a proxy statement to participate in the taking of corporate action involving a change in the character of their securities, as in a sale of assets or a consolidation or merger. It does not include persons who have traded because of information in such a proxy statement, for whom the statement would seem to stand no differently from, say, an annual report to stockholders. We likewise do not pass on the principles that should govern liability of directors and other individuals having some responsibility for such a statement, as distinguished from a controlling corporation which has been the beneficiary of the action that was induced. See Jennings & Marsh, Securities Regulation: Cases and Materials 1358–59 (3d ed. 1972).

quires a showing of something more than negligence in an action for damages is that the statutory authority for the Rule, section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j, is addressed to "any manipulative or deceptive device or contrivance," a point later stressed in the writer's concurring opinion in SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 868 (2 Cir. 1968), cert. denied, 394 U.S. 976, 89 S.Ct. 1454, 22 L.Ed.2d 756 (1969), whereas section 14(a) contains no such evil-sounding language.

We think there is much force in this. See Gould v. American Hawaiian S. S. Co., 351 F.Supp. 853, 861–863 (D.Del. 1972); 5 Loss, Securities Regulation 2864–65 (2d ed. supp.1969). Although the language of Rule 14a–9(a) closely parallels that of Rule 10b–5, and neither says in so many words that scienter should be a requirement, one of the primary reasons that this court has held that this is required in a private action under Rule 10b–5, Shemtob v. Shearson, Hammill & Co., 448 F.2d 442, 445 (2 Cir. 1971); Lanza v. Drexel & Co., 479 F.2d 1277, 1304, 1305 (2 Cir. 1973), is a concern that without some such requirement the Rule might be invalid as exceeding the Commission's authority under section 10(b) to regulate "manipulative or deceptive devices." See SEC v. Texas Gulf Sulphur Co., *supra*, 401 F.2d at 868 (Friendly, J., concurring); Lanza v. Drexel & Co., *supra*, 479 F.2d at 1305; 3 Loss, *supra*, at 1766 (2d ed. 1962); 6 *id.* at 3883–85 (Supp.1969). In contrast, the scope of the rulemaking authority granted under section 14(a) is broad, extending to all proxy regulation "necessary or appropriate in the public interest or for the protection of investors" and not limited by any words connoting fraud or deception. This language suggests that rather than emphasizing the prohibition of fraudulent conduct on the part of insiders to a securities transaction, as we think section 10(b) does, in section 14(a) Congress was somewhat more concerned with protection of the outsider whose proxy is being solicited. Indeed, it was this aspect of the statute that the Supreme Court emphasized in recognizing a private right of action for violation of section 14(a) in *Borak*, 377 U.S. at 431–432, 84 S.Ct. 1555.[17] We note also that while an open-ended reading of Rule 10b–5 would render the express civil liability provisions of the securities acts largely superfluous, and be inconsistent with the limitations Congress built into these sections, see SEC v. Texas Gulf Sulphur Co., *supra*, 401 F.2d at 867–868; 3 Loss, *supra*, at 1785, a reading of Rule 14a–9 as imposing liability without scienter in a case like the present is completely compatible with the statutory scheme.[18]

17. For similar reasons, we do not think that this court's recent holding in Chris-Craft Industries, Inc. v. Piper Aircraft Corp., *supra*, 480 F.2d at 362, that scienter must be proved in a private action under section 14(e) of the Securities Exchange Act, in which Congress in 1968 adopted the language of Rule 10b–5 and applied it to tender offers, is inconsistent with the result we reach here. In that connection Judge Mansfield noted, 480 F.2d at 397:

> Congress' use of the words "fraudulent," "deceptive" and "manipulative" in § 14(e), when coupled with the partially similar language and the legislative history of the earlier-enacted § 10(b), indicates that its purpose was not to punish mere negligence . . . .

18. It has been argued that imposing liability for negligent misrepresentations or omissions under Rule 14a–9 would be inconsistent with the congressional intent in enacting section 18 of the 1934 Act, 15 U.S.C. § 78r, which expressly creates liability in a private civil action for making materially false or misleading statements in any document filed with the Commission but provides that no liability shall be imposed if the defendant "acted in good faith and had no knowledge that such statement was false and misleading." See Gould v. American Hawaiian S.S. Co., *supra*, 351 F.Supp. at 863. But section 18 applies broadly to any document filed with the Commission, whereas section 14 was specifically directed at proxy regulation. Moreover, most of the documents within the scope of section 18 are not distributed to stockholders for the purpose of inducing action; we see nothing anomalous about applying a different

by Judge Bartels, 298 F.Supp. 66 (E.D. N.Y.1969), 332 F.Supp. 644 (E.D.N.Y. 1971), and 348 F.Supp. 979 (E.D.N.Y. 1972), along with two elaborate reports by the special master, Arthur H. Schwartz, Esq., on the amount of damages, attest to the problems which the recognition of a private right of action for violation of § 14(a) in J. I. Case Co. v. Borak, 377 U.S. 426, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964), have thrust upon the federal courts, and also the assiduity with which the judge and the special master tackled them.

I. *The Facts*

The facts are stated in such detail in Judge Bartels' first opinion, 298 F.Supp. at 74–89, that we can limit ourselves to those that are vital for understanding the issues on appeal. In order to make the following summary more enlightening, it will be well to state at the outset that the gravamen of plaintiffs' complaint concerning the Proxy Statement sent to GOA's stockholders was that its disclosure that Skogmo expected to realize large profits from the disposition of such of GOA's advertising plants as had not been sold at the date of the merger was inadequate.

GOA had been the largest company in the outdoor advertising business in the United States. It had also acquired over 96% of the stock of Claude Neon Advertising, Limited, the largest outdoor advertising company in Canada, and all the stock of Vendor, S.A., the largest such company in Mexico. Skogmo was a company engaged in wholesale and retail merchandising of durable and soft goods through subsidiaries, franchised dealers, and discount centers in the United States and Canada, and related activities.

Between April, 1961 and March, 1962, Skogmo acquired 50.12% of GOA's common stock. Bertin C. Gamble, chairman of the board of directors and controlling stockholder of Skogmo, was elected to GOA's board in October, 1961. He was followed by Roy N. Gesme, a former consultant to Skogmo, who was to act as liaison between the two companies. Two Skogmo vice presidents were added to the GOA board in April, 1962. In the same month Gamble engaged Donald E. Ryan, who had no previous experience in the outdoor advertising business, as an officer of GOA, primarily in charge of the sale of plants, and had him elected as a member of the board and executive vice president of GOA; the district court found, 298 F.Supp. at 75, that "Ryan was indisputably Skogmo's man at General and was expected to evaluate General's prospects and make recommendations to Skogmo for the future." There were seven other directors. Four, including Burr L. Robbins, the president of GOA, had been associated with GOA before Skogmo's acquisition of control; three were outsiders. Despite the fact that only five of the twelve directors were Skogmo men, Skogmo does not dispute that it had effective control of GOA.

Beginning in 1961 the outdoor advertising business began to encounter serious difficulties. Disappointing reports, indicating that income from advertising plants had fallen off substantially during 1961 and that the expected rate of return in the business was declining, were made to Gesme by the management in the early months of 1962. Upon assuming his duties in May 1962, Ryan, after an intensive study, reported to Gamble that GOA's advertising plants could not be operated profitably and should be sold. A strong impulse in that direction had been furnished by the sale, in January 1962, of GOA's St. Louis plant to a competitor at a price described as "fantastic".[1] After this sale, Gesme had prepared a detailed report on the property and earnings of each of GOA's plants, referred to as the "Green Book", which listed sales prices for the plants, apparently calculated on

1. The price was $2,953,000, of which $653,000 was in cash and the balance in notes, as against a book value of $879,000.

74-1471 TSC v. NORTHWAY Cert to CA 7 Argued 3/3/76

We took this case to resolve conflict as to standard applicable to disclosure required on proxy statements by §14a + Rule 14a-9

Morency (Petr).

CA 7, on summary judg., found as matter of law that omission of four matters ~~invalidated~~ violated 14a 9.

DC (McLaurin) found there were issues as to material facts & rejected S/judg.

CA 7 redefined "materiality" — in relation to possible relevancy to any stockholders.

SEC Release ( ) states standard but SEC Brief does not mention its Release

Reese (for Rehnquist)

Rehnquist asks whether jury is not proper body to decide materiality — it is matter of fact

"Facts" are not disputed here, but Rehnquist says jury - not judge - should be allowed to draw inferences from them: whether facts are material.

Stewart noted that Miller addressed "casualties" - not "materiality". (CA2 said Miller did not establish standard)

gp/ss 3/4/76

MEMORANDUM

TO: Mr. Justice Powell DATE: March 4, 1976

FROM: Greg Palm

No. 74-1471 TSC Industries, Inc. v. Northway, Inc.

I. Appropriate Standard of Materiality under § 14(a).

The purpose of § 14(a) is "to promote 'the free exercise of the voting rights of stockholders' by insuring that proxies would be solicited with 'explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought.'" Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970), quoting H.R. Rep. No. 1385 73d Cong., 2d Sess. 14 S. Rep. No. 792, 73d Cong., 2d Sess. 12. See J.I. Case Co. v. Borak, 377 U.S. 426 (1964). Section 14(a) was thus intended to promote "[f]air corporate suffrage" H.R. Rep., supra, at 13, by conveying information to shareholders that should be important in the decisionmaking process. SEC Rule 14a-9 thus proscribes solicitations "containing any statement which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary to make the statements therein not false or misleading. . . ." In Borak the Court recognized a private cause of action for violations of the rule and in Mills liability was made to turn solely upon the question whether the statement or omission was "material". The reasoning of

the Mills Court essentially was that the section and rule are designed to insure that all information that may be significant in the decisionmaking process is conveyed to the shareholders. The concern of the rule is fair corporate suffrage, not the inherent fairness or unfairness of a particular deal.

The central question in this case is how to define the concept of materiality. CA7 defines material as including "all facts which a reasonable investor might consider important." (emphasis supplied). For the reasons elaborated by Judge Friendly in Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281 (2d Cir. 1973), I think that this "might" test is inappropriate because it is "too suggestive of mere possibility, however unlikely." The Gerstle court cited with favor two alternative formulations of what appears* to be a more stringent standard: (1) whether "a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question, id. (emphasis supplied); (2) whether "taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a

*I say "appears" only because much of the difference here may properly be characterized as alternative word choice for the same concept. CA7, for example, thought that the use of the word "reasonable" properly circumscribed the materiality test, noting that it "will not reach 'trivial' and 'unrelated' facts; neither will it fail to reach facts which may be relevant for some, but not for others." Pet. A.9.

stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course." Id. (emphasis supplied). Although either of these formulations would point to the same conclusion in most cases, I prefer formulation (1) since when applied by lower courts formulation (2) may become tangled up in the notion of causality that was rejected in Mills.** I would, however, perhaps modify formulation (1) to the extent of requiring only that there be a "significant likelihood" that a "reasonable investor" "would" consider the information "important" in arriving at a decision. The addition of the "significant likelihood" language would be consistent with Mills and the broad disclosure purpose of § 14(a). (I'm somewhat ambivalent about the addition of this language. I think that it is sound law, but am not sure that lower courts would not run away with it.)

All that the Court can do in this case is to state the standard, and then elaborate upon it (i.e., by indicating that an important fact is not a fact which necessarily would have been controlling in a reasonable shareholder's mind in arriving at a decision; on the other hand it must be a fact which necessarily would have been controlling in a reasonable

**Either formulation, however, is probably acceptable. The SEC argues the test should be: "whether the misstatement or omission has a significant propensity to affect the judgment of a reasonable shareholder in the process of deciding how to vote." SEC Brief 4. This standard is close to formulation (2).

shareholder's mind in arriving at a decision; on the other hand it must be a fact that a reasonable (rational) investor would have considered significant facts that only a few investors would consider important, or which even the hypothetical reasonable man might consider important are not material). None of the cases which I have read contain any totally satisfactory method of elaborating on the test. Thus, much of the elaboration will have to come in terms of the Court's discussion of the various material deficiencies that CA7 identified in the TSC Proxy.

As a matter of "policy" I think that Judge Friendly identified the key reason for requiring a standard of materiality higher than that required by CA7. As he notes in Gerstle the language and purpose of § 14(a) and Rule 14a-9 strongly suggest that there should be no requirement of scienter to establish a violation. But if one is going to impose civil liability (a judicially created remedy) for misstatements or omissions it is appropriate that one impose a fairly high standard of relevance. In view of the purposes of the section and rule it is also important that the standard of materiality not be made too broad for the shareholders will be buried in an avalanche of information making it more difficult for the average investor to make reasoned decisions.

II. Application of the Test

CA7 granted summary judgment based on three sets of facts. I will discuss them separately below. It is my conclusion that only one of the sets of facts relied on is even arguably material as a matter of law. Moreover, several of the facts relied on are clearly not material under any reasonable test.

A. Indicia of Control.

CA7 initially focused on two sets of acts relating to Northway's potential influence over TSC management. First, three reports that National and TSC had filed with the SEC it was stated that under SEC regulations National may be deemed a "parent" of TSC. Second, the statement also failed to show that at the time the TSC board considered the proposed merger transaction the chairman was Stanley Yarmuth, National's president, and the chairman of the TSC executive committee was Charles Simonelli, National's executive vice president. CA7 found both these facts to be material as a matter of law. I disagree. The proxy statement indicated quite clearly that five of TSC's ten directors were [redacted] nominees. Moreover, it indicated that [redacted] owned 34% of TSC's stock and that no other shareholder owned over 10%. Given the disclosure of these facts which clearly suggest the possibility of control of TSC by [redacted] I think that the omission of the existence of the "parent" filings certainly

is not material. Although a closer question I also do not believe that the omission of Yarmuth's and Simonelli's positions at TSC is material. The proxy statements revealed their positions at Northway and that they were on the TSC board. My current view is that the additional information regarding their TSC board positions is merely cummulative evidence of control and arguably not material as a matter of law. (The contrary view would emphasize the substantially greater influence directors in these positions presumably would have on board decisions).

B. Hornblower Opinion on Value of National's Warrants.

Petitioner's Reply Brief contains an excellent discussion of why the omission of the letter referring to the value of the Northway warrants is not a material omission from the proxy statement. See pp. 23-32. CA7's view essentially is that the statement by Hornblower that TSC shareholders were being offered a "substantial premium over current market values" coupled with the tables containing the market prices of the Northway warrants on given dates makes the omission of a letter from Hornblower indicating that the "value" of the warrants was less than their market price (at least in comparison to the figures in the proxy statement) a material omission. CA7's view is silly. The proxy statement indicates only that the shareholders will be receiving a substantial premium over current market values. Moreover, it indicates that market

prices were only one factor considered in reaching the conclusion that the market prices given in the statement are an accurate barometer of value or of the size of the premium. The SEC requires that the market prices be included in the statement. Northway correctly points out that the true "premium" must be calculated after filtering out any appreciation in the value of TSC common shares because of the announcement of the exchange offer. My current view is that the omission of the information contained in this letter was not material as a matter of law. It is evident that the investment bankers properly considered many factors other than current market prices in giving their opinion and a proxy statement cannot be expected to define their chain of reasoning in detail.

C. Purchases of National Securities

CA7 also found material as a matter of law the omission of the fact that both National and the Madison Fund, Inc., had acquired a substantial number of National convertible debentures and common stock during the 19-month interval preceding the proxy solicitation. Their transactions amounted to about 8.5% of the total National common shares traded. CA7 considered Madison purchases to be material because the chairman of National's board is a director of Madison and because the president of Madison is a consultant of National ($12,000 annual retainer). The implication that CA7 considered derivable from this information was that National

and Madison were coordinating their purchases to artifically raise the price of National stock. The argument is that even if there in fact was no coordination of purchases this information should have been revealed to the shareholders to that they could make their own informed decision. I suppose that it might not be wholly unreasonable to require the Madison purchases to be revealed. But if in fact there was no co-ordination then it is quite likely that National never considered this a material fact. Moreover, even if they did reveal these purchases they would also have to state their view that there was no coordinated purchase plan since if in fact there was no such plan then the unexplained information would mislead the shareholders in the opposite way. All this drives home the point that there may be some real value in not forcing the proxy solicitor to go through the silly exercise of transmitting facts only to say that because of other facts they are not material and may be disregarded. There is, however, a strong reason for requiring the purchases here to be disclosed since it is a somewhat subjective judgment whether Madison in fact did not continue its purchases in order to bolster National stock for purposes of the TSC deal (after all, if they were successful in "puffing" the value of the shares the "puff" might in part become real once they had acquired TSC at a bargain rate), and this is the type of judgment § 14(a) and Rule 14a-9 arguably have left to the shareholders. (As you can tell, I am somewhat uncertain about what to do

about this last set of information. Imposing civil liability for nondisclosure does seem rather harsh on these facts.)

[redacted] National's own purchases similarly are not clearly material. Many corporations do purchase their shares on a regular basis. [redacted] If that is the reason for the purchases here and they can be expected to continue unabated in the future then there may be no reason to require disclosure. Petitioners do not make this argument, however, and I'm not yet certain why Northway was purchasing its shares (I intend to look further tonight).

A final question to be asked as to these facts is whether, as a matter of law, 8.5% is a "material" amount of purchases. To be sure these purchases would affect market prices, but I am not certain that the "effect" (i.e., depending on the market prices may have been raised several percent) is per se material". I think that it probably is, but want to think further on the subject tonight.

III. Remand

A remand will be necessary in any case since CA7 declined to pass on respondents' argument that the proposal was never legally approved under Delaware law because only 4 of 10 directors voted. CA7 should be given an opportunity to consider this question first.

G.P.

ss

No. _____

74-1471 TSC v. NORTHWAY Reverse 6-2 Conf. 3/5/76

The Chief Justice Reverse

Not care for summary judg. in any event.
CA 7 standard ("might") improper. We should clarify.
CA 2 standard OK

Remand for trial in light of proper standard.

xxxxxxxx Stevens, J.

Out

Brennan, J. Pass

Teker SEC formula.

Stewart, J. Reverse

What we do is more imp. than how standard is expressed
DC was right in denying summary judg. CA was wrong.
As to standard like "would" ~~as~~ formulation is best — as CA 2.

Affirm

CA 7 may have been wrong but agree with SEC. Actually, very little difference. Issue as to summary judg is close.

Reverse

CA 7's use of "might" opens door too widely. Agree with CA 2 language (Must 9 read) Summary judg, was error.

Blackmun, J. Reverse

Only issue is standard. Quote from Utes was out of context. Prefer SEC standard ~~not~~

Powell, J. Reverse

See my yellow page notes

Rehnquist, J. Reverse

Agree with me.

Renewed
LFP 6/3
Good opinion. I'll
join. But I'll circle
& talk to TM about
Notes 7 & 11

To: The Chief Justice
Mr. Justice Brennan
Mr. Justice Stewart
Mr. Justice White
Mr. Justice Blackmun
Mr. Justice Powell
Mr. Justice Rehnquist
Mr. Justice Stevens

From: Mr. Justice Marshall

Circulated: JUN 2 1976

Recirculated: _____

No. 74-1471 -- TSC Industries, Inc. v. Northway, Inc.

MR. JUSTICE MARSHALL delivered the opinion of the Court.

The proxy rules promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 bar the use of proxy statements that are false or misleading with respect to the presentation or omission of material facts. We are called upon to consider the definition of a material fact under those rules, and the appropriateness of resolving the question of materiality by summary judgment in this case.

I

The dispute in this case centers about the acquisition of petitioner TSC Industries, Inc. by petitioner National Industries, Inc. In February 1969 National acquired 34% of TSC's voting securities by purchase from Charles E. Schmidt and his family. Schmidt, who had been TSC's founder and principal shareholder, promptly resigned along with his son from TSC's board of directors.

Thereafter, five National nominees were placed on TSC's board, Stanley R. Yarmuth, National's president and chief executive officer, became chairman of the TSC board, and Charles F. Simonelli, National's executive vice president, became chairman of the TSC executive committee. On October 16, 1969, the TSC board, with the attending National nominees abstaining, approved a proposal to liquidate and sell all of TSC's assets to National. The proposal in substance provided for the exchange of TSC Common and Series 1 Preferred Stock for National Series B Preferred Stock and Warrants.[1/] On November 12, 1969, TSC and National issued a joint proxy statement to their shareholders, recommending approval of the proposal. The proxy solicitation was successful, TSC was placed in liquidation and dissolution, and the exchange of shares was effected.

This is an action brought by respondent Northway, a TSC shareholder, against TSC and National, claiming that their joint proxy statement was incomplete and materially misleading in violation of § 14a of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a),[2/] and Rules 14a-3 and 14a-9 promulgated thereunder. 17 CFR §§ 240. 14a-3, 240. 14a-9 (1975).[3/] The basis of Northway's claim under Rule 14a-3 is that TSC and National failed to state in the proxy statement that the transfer of the Schmidt interests in

TSC to National had given National control of TSC.[4] The Rule 14a-9 claim, insofar as it concerns us,[5] is that TSC and National omitted from the proxy statement material facts relating to the degree of National's control over TSC and the favorability of the terms of the proposal to TSC shareholders.[6]

Northway filed its complaint in the United States District Court for the Northern District of Illinois on December 4, 1969, the day before the shareholder meeting on the proposed transaction, but while it requested injunctive relief it never so moved. In 1972 Northway amended its complaint to seek money damages, restitution, and other equitable relief. Shortly thereafter, Northway moved for summary judgment on the issue of TSC's and National's liability. The District Court denied the motion, but granted leave to appeal pursuant to 28 U.S.C. § 1292(b). The Court of Appeals for the Seventh Circuit agreed with the District Court that there existed a genuine issue of fact as to whether National's acquisition of the Schmidt interests in TSC had resulted in a change of control, and that summary judgment was therefore inappropriate on the Rule 14a-3 claim. But the Court of Appeals reversed the District Court's denial of summary judgment to Northway on its 14a-9 claims, holding that certain omissions of fact were material as a matter of law. 512 F.2d 324 (CA 7 1975).

We granted certiorari because the standard applied by the Court of Appeals in resolving the question of materiality appeared to conflict with the standard applied by other Courts of Appeals. 423 U.S. 820 (1975). We now hold that the Court of Appeals erred in ordering that partial summary judgment be granted to Northway.

II

A.

As we have noted on more than one occasion, § 14a of the Exchange Act "was intended to promote 'the free exercise of the voting rights of stockholders' by ensuring that proxies would be solicited with 'explanation to the stockholder of the real nature of the questions for which authority to cast his vote is sought.'" Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970), quoting H. R. Rep. No. 1383, 73d Cong., 2d Sess., 13. See also J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964); S. Rep. No. 792, 73d Cong., 2d Sess., 12. In Borak, the Court held that § 14a's broad remedial purposes required recognition under § 27 of the Exchange Act, 15 U.S.C. § 78aa, of an implied private right of action for violations of the provision. And in Mills, we attempted to clarify to some extent the elements of a private cause of action for violation of § 14a. In a suit challenging the sufficiency under § 14a and Rule 14a-9 of a proxy statement soliciting votes in favor of a merger, we held that there was no need to demonstrate that the alleged defect in the

proxy statement actually had a decisive effect on the voting. So long as the misstatement or omission was material, it is sufficient to show the causal relation between violation and injury, we concluded, that "the proxy solicitation itself . . . was an "essential link in the accomplishment of the transaction." 396 U.S., at 385. After Mills, then, the content given to the notion of materiality assumes heightened significance.[7/]

B.

The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor. Variations in the formulation of a general test of materiality occur in the articulation of just how significant a fact must be or, put another way, how certain it must be that the fact would affect a reasonable investor's judgment.

The Court of Appeals in this case concluded that material facts include "all facts which a reasonable shareholder might consider important." 512 F.2d, at 330 (emphasis added). This formulation of the test of materiality has been explicitly rejected by at least two courts as setting too low a threshold for the imposition of liability under Rule 14a-9. Gerstle v. Gamble-Skogmo, Inc., 478 F.2d 1281, 1301-1302 (CA 2 1973); Smallwood v. Pearl Brewing Co., 489 F. 2d 579, 603-604 (CA 5 1974). In these cases, panels of the Second and Fifth

Circuits opted for the conventional tort test of materiality -- whether a reasonable man would attach importance to the fact misrepresented or omitted in determining his course of action. See Restatement, Torts § 538(2)(a). See also ALI Federal Securities Code §256(a), Tent. Draft No. 2 (1973).[8/] Gerstle v. Gamble-Skogmo, supra, at 1302, also approved the following standard, which had been formulated with reference to statements issued in a contested election: "whether, taking a properly realistic view, there is a substantial likelihood that the misstatement or omission may have led a stockholder to grant a proxy to the solicitor or to withhold one from the other side, whereas in the absence of this he would have taken a contrary course." General Time Corp. v. Talley Industries, Inc., 403 F.2d 159, 162 (CA 2 1968), cert. denied, 393 U.S. 1026 (1969).

In arriving at its broad definition of a material fact as one that a reasonable shareholder might consider important, the Court of Appeals in this case relied heavily upon language of this Court in Mills v. Electric Auto-Lite Co., supra. This reliance was misplaced. The Mills Court did characterize a determination of materiality as at least "embod[ying] a conclusion that the defect was of such a character that it might have been considered important by a reasonable shareholder who was in the process of deciding how to

to ensure by judicial means that the transaction, when judged by its real terms, is fair and otherwise adequate, but to ensure disclosures by corporate management in order to enable the shareholders to make an informed choice. See Mills, supra, at 381. As an abstract proposition, the most desirable role for a court in a suit of this sort, coming after the consummation of the proposed transaction, would perhaps be to determine whether in fact the proposal would have been favored by the shareholders and consummated in the absence of any misstatement or omission. But as we recognized in Mills, supra, at 382 n. 5, such matters are not subject to determination with certainty. Doubts as to the critical nature of information misstated or omitted will be commonplace. And particularly in view of the prophylactic purpose of the Rule and the fact that the content of the proxy statement is within management's control, it is appropriate that these doubts be resolved in favor of those the statute is designed to protect. Mills, supra, at 385.

We are aware, however, that the disclosure policy embodied in the proxy regulations is not without limit. See id., at 384. Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may corporations and their

managements be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholder in an avalanche of trivial information -- a result that is hardly conducive to informed decisionmaking. Precisely these dangers are presented, we think, by the definition of a material fact adopted by the Court of Appeals in this case -- a fact which a reasonable shareholder might consider important. We agree with Judge Friendly, speaking for the Court of Appeals in Gerstle, that the "might" formulation is "too suggestive of mere possibility, however unlikely." 478 F.2d., at 1302.

The general standard of materiality that we think best comports with the policies of Rule 14a-9 is as follows: an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with Mills' general description of materiality as a requirement that "the defect have a significant propensity to affect the voting process."[10/] It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have

assumed actual significance in the deliberations of the reasonable shareholder. Put another way, 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.[11/]

D.

The issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to particular set of facts. In considering whether summary judgment on the issue is appropriate,[12/] we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires a delicate assessment of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact.[13/] Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality

exchange with National. It then concluded that the omitted facts were material because they were "persuasive indicators that the TSC board was in fact under the control of National, and that National thus 'sat on both sides of the table' in setting the terms of the exchange." 512 F. 2d, at 333.

We do not agree that the omission of these facts, when viewed against the disclosures contained in the proxy statement, warrants the entry of summary judgment against TSC and National on this record. Our conclusion is the same whether the omissions are considered separately or together.

The proxy statement prominently displayed the facts that National owned 34% of the outstanding shares in TSC, and that no other person owned more than 10%. App. 262-263, 267. It also prominently revealed that five out of ten TSC directors were National nominees, and it recited the positions of those National nominees with National -- indicating, among other things, that Stanley Yarmuth was president and a director of National, and that Charles Simonelli was executive vice president and a director of National. App. 267. These disclosures clearly revealed the nature of National's relationship with TSC and alerted the reasonable shareholder to the fact that National exercised a degree of influence over TSC. In view of these disclosures, we certainly cannot say that the

additional facts that Yarmuth was chairman of the TSC board of directors and Simonelli chairman of its executive committee were, on this record, so obviously important that reasonable minds could not differ on their materiality.

Nor can we say that it was materially misleading as a matter of law for TSC and National to have omitted reference to SEC filings indicating that National "may be deemed to be a parent of TSC." As we have already noted, both the District Court and the Court of Appeals concluded, in denying summary judgment on the Rule 14a-3 claim, that there was a genuine issue of fact as to whether National actually controlled TSC at the time of the proxy solicitation. We must assume for present purposes, then, that National did not control TSC. On that assumption, TSC and National obviously had no duty to state without qualification that control did exist. If the proxy statements were to disclose the conclusory statements in the SEC filings that National "may be deemed to be a parent of TSC," then it would have been appropriate, if not necessary, for the statement to have included a disclaimer of National control over TSC or a disclaimer of knowledge as to whether National controlled TSC.[15/] The net contribution of including the contents of the SEC filings accompanied by such

disclaimers is not of such obvious significance, in view of the other facts contained in the proxy statement, that their exclusion renders the statement materially misleading as a matter of law.[16/]

B. Favorability of the Terms to TSC Shareholders

The Court of Appeals also found that the failure to disclose two sets of facts rendered the proxy statement materially deficient in its presentation of the favorability of the terms of the proposed transaction to TSC shareholders. The first omission was of information, described by the Court of Appeals as "bad news" for TSC shareholders, contained in a letter from an investment banking firm whose earlier favorable opinion of the fairness of the proposed transaction was reported in the proxy statement. The second omission related to purchases of National common stock by National and by Madison Fund, Inc., a large mutual fund, during the two years prior to the issuance of the proxy statement.

1.

The proxy statement revealed that the investment banking firm of Hornblower & Weeks-Hemphill, Noyes had rendered a favorable opinion on the fairness to TSC shareholders of the terms for the exchange of TSC shares for National securities. In that opinion, the proxy statement explained, the firm had considered, "among other things, the current market prices of the securities

of both corporations, the high redemption price of the National Series B Preferred Stock, the dividend and debt service requirements of both corporations, the substantial premium over current market values represented by the securities being offered to TSC stockholders, and the increased dividend income." App. 267.

The Court of Appeals focused upon the reference to the "substantial premium over current market values represented by the securities being offered to TSC stockholders," and noted that any TSC shareholder could calculate the apparent premium by reference to the table of current market prices that appeared four pages later in the proxy statement. App. 271. On the basis of the recited closing prices for November 7, 1969, five days before the issuance of the proxy statement, the apparent premiums were as follows. Each share of TSC Series 1 Preferred, which closed at $12.00, would bring National Series B Preferred Stock and National Warrants worth $15.23 -- for a premium of $3.23, or 27% of the market value of the TSC Series 1 Preferred. Each share of TSC Common Stock, which closed at $13.25, would bring National Series B Preferred Stock and National Warrants worth $16.19 -- for a premium of $2.94, or 22% of the market value of TSC Common.[17/]

The closing price of the National Warrants on November 7, 1969, was, as indicated in the proxy statement, $5.25. The TSC shareholders

were misled, the Court of Appeals concluded, by the proxy statement's failure to disclose that in a communication two weeks after its favorable opinion letter, the Hornblower firm revealed that its determination of the fairness of the offer to TSC was based on the conclusion that the value of the Warrants involved in the transaction would not be their current market price, but approximately $3.50. If the Warrants were valued at $3.50 rather than $5.25, and the other securities valued at the November 7 closing price, the Court figured, the apparent premium would be substantially reduced -- from $3.23 (27%) to $1.48 (12%) in the case of TSC Preferred, and from $2.94 (22%) to $.31 (2%) in the case of TSC Common. "In simple terms," the Court concluded, "TSC and National had received some good news and some bad news from the Hornblower firm. They chose to publish the good news and omit the bad news." 512 F.2d, at 335.

It would appear, however, that the subsequent communication from the Hornblower firm, which the Court of Appeals felt contained "bad news," contained nothing new at all. At the TSC board of directors meeting held on October 16, 1969, the date of the initial Hornblower opinion letter, Blancke Noyes, a TSC director and a partner in the Hornblower firm, had pointed out the likelihood of a decline in the market price of National Warrants with the issuance of the additional Warrants involved in the exchange, and reaffirmed his

conclusion that the exchange offer was a fair one nevertheless. The subsequent Hornblower letter, signed by Mr. Noyes, purported merely to explain the basis of the calculations underlying the favorable opinion rendered in the October 16th letter. "In advising TSC as to the fairness of the offer from [National], Mr. Noyes wrote, "we concluded that the warrants in question had a value of approximately $3.50." 18/ On its face, then, the subsequent letter from Hornblower does not appear to have contained anything to alter the favorable opinion rendered in the October 16th letter -- including the conclusion that the securities being offered to TSC shareholders represented a "substantial premium over current market values."

The real question, though, is not whether the subsequent Hornblower letter contained anything that altered the Hornblower opinion in any way. It is rather whether the advice given at the October 16th meeting, and reduced to more precise terms in the subsequent Hornblower letter -- that there may be a decline in the market price of the National Warrants -- had to be disclosed in order to clarify the import of the proxy statement's reference to "the substantial premium over current market values represented by the securities being offered to TSC stockholders." We note initially

that the proxy statement referred to the substantial premium as but one of several factors considered by Hornblower in rendering its favorable opinion of the terms of exchange. Still, we cannot assume that a TSC shareholder would focus only on the "bottom line" of the opinion to the exclusion of the considerations that produced it.

TSC and National insist that the reference to a substantial premium required no clarification or supplementation, for the reason that there was a substantial premium even if the National Warrants are assumed to have been worth $3.50. In reaching the contrary conclusion, the Court of Appeals, they contend, ignored the rise in price of TSC securities between the early October 1969 reference point for the Hornblower opinion and November 7, 1969 -- a rise in price that they suggest was a result of the favorable exchange ratio's becoming public knowledge. When the proxy statement was mailed, TSC and National contend, the market price of TSC securities already reflected a protion of the premium to which Hornblower had referred in rendering its favorable opinion of the terms of exchange. Thus, they note that Hornblower assessed the fairness of the proposed transaction by reference to early October market prices of TSC Preferred, TSC Common, and National Preferred. On the basis of those prices and a $3.50 value for the National Warrants involved in the exchange, TSC and National contend that the premium was substantial. Each share of TSC Preferred, selling in early October

at $11, would bring National Preferred Stock and Warrants worth $13.50 -- for a premium of $2.10, or 19%. And each share of TSC Common, selling in early October at $11.63, would bring National Preferred Stock and Warrants worth $13.25 -- for a premium of $1.62, or 14%.[19/] We certainly cannot say as a matter of law that these premiums were not substantial. And if, as we must assume in considering the appropriateness of summary judgment, the increase in price of TSC's securities from early October to November 7 reflected in large part the market's reaction to the terms of the proposed exchange, it was not materially misleading as a matter of law for the proxy statement to refer to the existence of a substantial premium.

There remains the possibility, however, that although TSC and National may be correct in urging the existence of a substantial premium based upon a $3.50 value for the National Warrants and the early October market prices of the other securities involved in the transaction, the proxy statement misled the TSC shareholder to calculate a premium substantially in excess of that premium. The premiums apparent from early October market prices and a $3.50 value for the National Warrants -- 19% on TSC Preferred and 14% on TSC Common -- were certainly less than those that would have been derived through use of the November 7 closing prices listed

in the proxy statement -- 27% on TSC Preferred and 22% on TSC Common. But we are unwilling to sustain a grant of summary judgment to Northway on that basis. To do so we would have to conclude as a matter of law, first, that the proxy statement would have misled the TSC shareholder to calculate his premium on the basis of November 7 market prices, and second, that the difference between that premium and that which would be apparent from early October prices and a $3.50 value for the National Warrants was material. These are questions we think best left to the trier of fact.

2.

The final omission that concerns us relates to purchases of National Common Stock by National and by Madison Fund, Inc., a mutual fund. Northway notes that National's board chairman was a director of Madison, and that Madison's president and chief executive, Edward Merkle, was employed by National pursuant to an agreement obligating him to provide at least one day per month for such duties as National might request.[20/] Northway contends that the proxy statement, having called the TSC shareholder's attention to the market prices of the securities involved in the proposed transaction, should have revealed substantial purchases of National Common Stock made by National and Madison during the two years prior to the issuance of the proxy statement.[21/] In particular, Northway contends that

the TSC shareholders should, as a matter of law, have been informed that National and Madison purchases accounted for 8.5% of all reported transactions in National Common Stock during the period between National's acquisition of the Schmidt interests and the proxy solicitation. The theory behind Northway's contention is that disclosure of these purchases would have pointed to the existence, or at least the possible existence, of conspiratorial manipulation of the price of National Common Stock, which would have had an effect on the market price of the National Preferred Stock and Warrants involved in the proposed transaction.[22/]

Before the District Court, Northway attempted to demonstrate that the National and Madison purchases were coordinated. The District Court concluded, however, that there was a genuine issue of fact as to whether there was coordination. Finding that a showing of coordination was essential to Northway's theory, the District Court denied summary judgment.

The Court of Appeals agreed with the District Court that "collusion is not conclusively established." 512 F. 2d, at 336. But observing that "it is certainly suggested," ibid., the Court concluded that the failure to disclose the purchases was materially misleading as a matter of law. The Court explained:

> "Stockholders contemplating an offer involving preferred shares convertible to common stock and warrants for the purchase of common stock must be informed of circumstances which tend to indicate that the current selling price of the common stock involved may be affected by apparent market manipulations. It was for the shareholders to determine whether the market price of the common shares was relevant to their evaluation of the convertible preferred shares and warrants, or whether the activities of Madison and National actually amounted to manipulation at all." Ibid.

In short, while the Court of Appeals viewed the purchases as significant only insofar as they suggested manipulation of the price of National securities, and acknowledged the existence of a genuine issue of fact as to whether there was any manipulation, the Court nevertheless required disclosure to enable the shareholders to decide whether there was manipulation or not.

The Court of Appeals' approach would sanction the imposition of civil liability on a theory that undisclosed information may suggest the existence of market manipulation, even if the responsible corporate officials knew that there was in fact no market manipulation. We do

not agree that Rule 14a-9 requires such a result. Rule 14a-9 is concerned only with whether a proxy statement is misleading with respect to its presentation of material facts. If, as we must assume on a motion for summary judgment, there was no collusion or manipulation whatsoever in the National and Madison purchases -- that is, if the purchases were made wholly independently for proper corporate and investment purposes, then by Northway's implicit acknowledgment they had no bearing on the soundness and reliability of the market prices listed in the proxy statement,[23/] and it cannot have been materially misleading to fail to disclose them.[24/]

That is not to say, of course, that the SEC could not enact a rule specifically requiring the disclosure of purchases such as were involved in this case, without regard to whether the purchases can be shown to have been collusive or manipulative. We simply hold that if liability is to be imposed upon a theory that it was misleading to fail to disclose purchases suggestive of market manipulation, there must be some showing that there was in fact market manipulation.[25/]

IV

In summary, none of the omissions claimed to have been in violation of Rule 14a-9 were, so far as the record reveals, materially misleading as a matter of law, and Northway was not entitled to

partial summary judgment. The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

Mr. Justice Stevens took no part in the consideration or decision of this case.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

June 9, 1976

Re: 74-1471 - TSC Industries, Inc. v. Northway, Inc.

Dear Thurgood:

I join your proposed opinion dated June 2.

Regards,

WEB

Mr. Justice Marshall

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

June 9, 1976

Re: No. 74-1471 - TSC Industries, Inc. v. Northway

Dear Thurgood:

Please join me.

Sincerely,

Mr. Justice Marshall

Copies to Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

June 9, 1976

Re: No. 74-1471 - TSC Industries, Inc. v. Northway

Dear Thurgood:

It is my understanding that footnote 11 will be withdrawn. On that understanding, I am glad to join your opinion.

Sincerely,

Harry

Mr. Justice Marshall

cc: The Conference

June 7, 1976

No. 74-1471 TSC Industries v. Northway

Dear Thurgood:

Please join me in your excellent opinion.

Sincerely,

Mr. Justice Marshall

lfp/ss

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE POTTER STEWART

June 7, 1976

No. 74-1471, TSC Industries v. Northway

Dear Thurgood,

I am glad to join your opinion for the Court in this case.

Sincerely yours,

P.S.

Mr. Justice Marshall

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

June 7, 1976

RE: No. 74-1471 TSC Industries v. Northway

Dear Thurgood:

I agree.

Sincerely,

Mr. Justice Marshall

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

June 7, 1976

Re: No. 74-1471 - TSC Industries v. Northway

Dear Thurgood:

Please join me.

Sincerely,

WHR

Mr. Justice Marshall

Copies to the Conference

JPS

THE C. J.	[redacted]	W. J. B.	P. S.	B. R. W.	T. M.	H. A. B.	L. F. P.	W. H. R.
					3/8/76			
join TM 6/9/76		agree with TM 6/7/76	join TM 6/7/76	join TM 6/9/76	typed draft 6/2/76 1st draft 6/9/76 2nd draft 6/10/76	join TM 6/9/76	join TM 6/7/76	join TM 6/7/76
					74-1471 TSC Industries v. Northway			