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Disclosing the White Knight-When Does the Duty Arise?

DISCLOSING THE WHITE KNIGHT— WHEN DOES THE DUTY ARISE?

A tender offer is a limited public offer to a target corporation's shareholders to purchase or exchange some or all of the target corporation's securities at a premium over the prevailing market value.[1] Over the past twenty-five years, the use of tender offers has become the method of choice for effectuating a hostile takeover of a publicly held corporation.[2] A "raider," or unsolicited third party purchaser, typically launches a takeover attempt by purchasing a small block of the target corporation's securities.[3] A raider

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1. *See* Polinsky v. MCA Inc., 680 F.2d 1286, 1291 (9th Cir. 1982) (citing Wellman v. Dickinson, 475 F. Supp. 783, 823-24 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983)). The common characteristics of a tender offer include a widespread solicitation of public shareholders for a substantial percentage of the issuer's securities and a firm offer to purchase the shares at a premium over market value contingent only on the tender of a fixed number of shares. *Id.* In addition, the offeror typically leaves the offer open for only a limited time period, thus pressuring shareholders in making the tender decision. *Id.*

While the federal securities laws do not define the term "tender offer," the Securities and Exchange Commission (SEC) once proposed a two-tier definition. *See* 44 Fed. Reg. 70,349, 70,349-52 (1979) (proposed rule 14d-1(b)(1) under the Securities Exchange Act of 1934 ('34 Act)). Under the first of the two independent tiers, a tender offer had to propose to purchase or sell more than 5% of a class of securities from more than 10 persons within a 45-day period. *Id.* at 70,350. The second tier required that an offer be made in a widespread manner at a premium over market price of either 5% or $2 per share and not provide for negotiation of the price and terms. *Id.* at 70,351. The SEC, however, apparently has retreated from its attempt to define tender offer more precisely. *See* Note, *Developments in Corporate Takeover Techniques: Creeping Tender Offers*, 39 WASH. & LEE L. REV. 1095, 1101 n.36 (1982) (SEC apparently returning to position that defining tender offer would unduly restrict flexibility needed to respond to new forms of corporate takeover) [hereinafter cited as Note, *Developments in Corporate Takeovers*]; *SEC Reconsiders Rules on Tender Offers*, Wall St. J., July 17, 1980, at 4, col. 1 (SEC dropping pursuit of either rule change or legislative revision to define tender offer). *See generally* Note, *What is a Tender Offer?*, 37 WASH. & LEE L. REV. 908 (1980) (general overview of definition of tender offer).

2. *See* Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228, 228 (1984) (tender offer is method of choice for acquiring large corporations). The number of cash tender offers involving corporations listed on a major stock exchange has grown from 8 in 1960 to 123 in 1981. *Id.* at n.2; *see* 113 Cong. Rec. 24,664 (1967) (comments of Sen. Harrison A. Williams, Jr., on increased use of cash tender offers in corporate takeovers); Austin & Boucher, *Tender Offer Update: 1982*, 16 MERGERS & ACQUISITIONS 48, 48-49 (1982) (statistical overview of tender offers issued in 1981-82).

3. *See* Note, *Developments in Corporate Takeovers*, *supra* note 1, at 1096-97 (description of conventional multistep corporate takeovers); Greenwald, *High Times for T. Boone Pickens*, TIME, March 4, 1985, at 52 (description of typical raider takeover). Raiders are opportunity hunters who threaten the managements of undervalued corporations with tactics ranging from large, speculative stock purchases to hostile tender offers. Toy, *The Raiders*, BUS. WK., March 4, 1985, at 80. An undervalued corporation is a corporation in which the liquidation value of the company's assets exceeds the aggregate trading value in the company's stock. *Id.* at 83. The fear of a takeover by a raider forces the management of an underperforming company to find ways to deliver fuller stock value from the company's assets. *Id.* By first purchasing a block of the

then makes an unsolicited tender offer for the number of shares sufficient to obtain control of the target corporation.[4] By dealing directly with the shareholders, a raider using a tender offer can avoid having to seek the approval of the target corporation's management and thus may consummate the acquisition more quickly than by engaging in traditional takeover methods.[5]

A corporate takeover by a raider through the use of a hostile tender offer often results in substantial changes in the target corporation's management structure, policies, or operations.[6] Consequently, the managements of target corporations have developed a variety of techniques to resist hostile tender offers.[7] By employing defensive tactics, the management of a target

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target's securities, a raider obtains a bargaining position with the target's management, dissuades others from bidding for the target corporation, and tests the market in the target's securities to determine the proper pricing of a subsequent tender offer. Note, *Developments in Corporate Takeovers, supra* note 1, at 1097 n.10. If the raider purchases more than 5% of the target corporation's securities, federal securities laws requires disclosure of the purchase to the SEC and target corporation. *See* Securities Exchange Act of 1934 § 13(d), 15 U.S.C. § 78m(d) (1982) (anyone acquiring beneficial ownership of more than 5% of any registered corporation's securities must file public disclosure statement). Thus, the raider calls attention to the undervalued company and may profit from the increased market value of the target's shares, even if the raider fails to acquire the company. *Toy, supra,* at 83.

4. Comment, *Antitakeover Maneuvers: Developments in Defense Tactics and Target Actions for Injunctive Relief,* 35 Sw. L.J. 617, 618 n.5 (1981). A raider may attempt to acquire a target corporation for numerous reasons. *Id.* at 617-18. For example, a raider may desire a merger because acquisition of the target corporation may improve the raider's overall earnings position or secure a captive supplier of goods needed for the raider's own productivity. *Id.*

Any corporate acquisition usually involves numerous stages or steps. *See* 3 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 7.4(4)(b), at 173 (1982). First, corporate management typically expresses a desire to merge and perhaps receives limited authorization to proceed by the corporation's board of directors. *Id.* Next, management begins a preliminary investigation and analysis of the potential target. *Id.* Following an initial valuation of the target, the acquiring corporation may open negotiations with the target. *Id.* The next step is an agreement in principle by the executives of the two corporations fixing the terms of the acquisition. *Id.* After the parties sign a formal agreement, the corporations submit the plan to their shareholders for approval. *Id.* Finally, the corporations implement the acquisition. *Id.* A tender offer typically skips the shareholder approval stage because corporate ownership effectively changes hands when the tender offeror acquires a controlling interest in the target. *Id.* at 173 n.140. In addition, hostile tender offers generally bypass the negotiation stage as well as the agreement in principle and formal agreement stages.

5. *See* Note, *supra* note 2, at 228 n.3 (crucial advantage of tender offers over conventional acquisitions and proxy contests is speed of consummation); *see also supra* note 4 (hostile tender offers usually skip negotiation, agreement in principle, formal agreement, and shareholder approval stages of typical corporate acquisition).

6. Comment, *supra* note 4, at 618 (corporate management must be concerned with takeover laws and options available in responding to hostile tender offers).

7. *Id.* Common defensive tactics employed by target corporations in resisting hostile takeover attempts include shark repellants, poison pills, scorched earth policies, and white knight mergers. *See Them's Fightin' Words,* TIME, March 4, 1985, at 55. Shark repellants are any measures taken by a target corporation to make it more difficult for a raider to gain control. *Id.* A typical shark repellant is a charter and bylaw provision requiring a 70% to 80%

corporation ideally seeks to force the raider to withdraw the tender offer.[8] Alternatively, a target corporation may hope to defeat the tender offer or to trigger a bidding war to improve the terms of any eventual takeover.[9] In contrast, the raider making the tender offer and the shareholders of a target corporation often oppose the management's use of defensive tactics and may have a cause of action against the management for improperly resisting the hostile tender offer, especially when a higher offering price for the shares fails to develop.[10]

One of the most popular and effective defensive techniques a target corporation can use when faced with a hostile tender offer is the solicitation of a takeover offer from a friendly third party, or "white knight."[11] A white knight merger can enable a target corporation to continue its operations in a relatively independent fashion under more favorable terms and working relationships because the target corporation is choosing the merger partner.[12] In addition, even if the hostile tender offer eventually succeeds, the use of a white knight might secure a higher offering price for the target corporation's

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supermajority shareholder approval of acquisitions not favored by management. *Id.* Poison pills are devices, such as securities held by the shareholders of the target corporation, which automatically convert to cash if a hostile takeover attempt succeeds, that make successful takeovers more expensive for the raider. *Id.* A scorched earth policy is an attempt by the target corporation to make itself less attractive for a takeover by measures such as selling off the corporation's most valued assets. *Id.* A white knight merger occurs when the target corporation agrees to merge with a friendly third party on better terms than the raider would provide to avoid having the raider obtain control. *Id.; see infra* notes 11-13 and accompanying text (description of white knight mergers). Ultimately, a corporation's best defense is a high stock price and satisfied shareholders nurtured by a strong management team and shareholder relations program. Toy, *supra* note 3, at 89. *See generally* Lipton, *Takeover Bids in the Target's Boardroom,* 35 BUS. LAW. 101 (1979) (analysis of propriety under business judgment rule of common defensive tactics); Comment, *supra* note 4, at 619-32 (overview of target corporations' common defense techniques to avoid hostile takeovers).

8. *See* Comment, *supra* note 4, at 629-30. (description of corporations' general purposes for using white knight merger).

9. *See id.*

10. *See* Note, *supra* note 2, at 229-30. Raiders and shareholders who oppose a target corporation's use of defensive tactics in resisting a hostile takeover use federal securities laws and state fiduciary duty laws to seek injunctive relief against the target's management. *Id.* The dissenting shareholders typically assert that by resisting a raider's attempt to buy out a corporation's shareholders at a premium, the management of the target corporation is acting contrary to the fundamental tenet of corporate law that corporations exist primarily to maximize profits for shareholders. *See* Dodge v. Ford Motor Co., 204 Mich. 459, ____, 170 N.W. 668, 684 (1919) (primary purpose for organization and operation of business corporations is to provide profit to shareholders); *see also* Toy, *supra* note 3, at 81 (resisting premium takeover offers is contrary to maximizing shareholders' interests).

11. *See* Comment, *supra* note 4, at 629 (corporate merger with friendly offeror is popular defensive tactic against undesired takeovers by third party); *see also* Note, *Tender Offer Defensive Tactics and the Business Judgment Rule,* 58 N.Y.U. L. REV. 621, 621 (1983) (white knight merger highly effective defensive tactic).

12. *See* Comment, *supra* note 4, at 629 (description of typical purposes for solicitation of white knight mergers in responding to hostile tender offers).

securities by triggering competitive bidding between the raider and white knight.[13]

Knowledge that a target corporation is seeking a white knight merger is of critical importance to both a raider and the target corporation's shareholders.[14] A raider obviously wants the hostile tender offer to succeed and would like disclosure of white knight merger activities as early as possible in order to prepare a prompt and effective response.[15] The target corporation's shareholders typically seek to maximize short-term profits by benefiting from the highest premium over market value for their securities.[16] Therefore, the shareholders also may desire information concerning a potential white knight merger before tendering securities to a raider during the limited tender offer period.[17] On the other hand, both the target corporation and its white knight typically desire to avoid premature disclosures that may jeopardize the inchoate merger plans and mislead the investing public about a merger that may never materialize.[18]

A target corporation voluntarily may choose to disclose information concerning an attempt to arrange a white knight merger at any point during the acquisition process.[19] Nevertheless, a general duty to disclose material corporate events to the investing public may force a target corporation into an early disclosure of white knight merger activities.[20] A more specific duty

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13. *See id.* (soliciting white knight merger may trigger competitive bidding for target corporation's securities).

14. *See infra* notes 15-17 and accompanying text (discussion of reasons why knowledge of white knight merger activities is important to raiders and target's shareholders); *supra* note 10 and accompanying text (raiders and other shareholders often oppose use of defensive tactics by target corporation in resisting takeover attempts); *see also* Note, *supra* note 2, at 229 (raider and shareholders may have interests opposed to target corporation's use of defensive tactics).

15. *See* Note, *supra* note 2, at 229 & n.7 (raider seeks to obtain benefits from target corporation that led raider to make its tender offer). The earlier a raider discovers that a target corporation's management intends to seek a white knight merger, the sooner the raider can respond by seeking injunctive relief or by increasing the value of the hostile tender offer before it expires. *See id.* at 229-30 (parties objecting to use of defensive tactics often seek judicial remedies to constrain target corporation's actions).

16. *Id.* at 229 (shareholders of target corporation often seek quick profit of large premiums over market value in tender offers).

17. *Cf.* 17 C.F.R. § 240.14e-1(a), .14d-7(a) (1984). The SEC requires tender offers to remain open for at least 20 days. *Id.* § 240.14e-1(a). The SEC also provides shareholders with only limited rights to withdraw tendered shares. *See id.* § 240.14d-7(a) (shareholders tendering securities may withdraw tenders during first 15 days of original offer and within 10 days from commencement of another bidder's tender offer). Thus, shareholders would benefit from an early disclosure of a possible white knight merger before making a potentially irreversible decision to tender, since the white knight may be offering a higher premium.

18. *See* Greenfield v. Heublein, Inc., 742 F.2d 751, 756-57 (3d Cir. 1984) (premature disclosures of merger talks would have disruptive effect on stock market and might inhibit all forms of corporate acquisitions), *cert. denied,* 105 S. Ct. 1189 (1985); Reiss v. Pan American World Airways, Inc., 711 F.2d 11, 14 (2d Cir. 1983) (disclosure of uncertain merger negotiations may be more misleading to shareholders than secrecy).

19. *See supra* note 4 (description of steps in typical acquisition process).

20. *See infra* notes 23-26 and accompanying text (discussing potential sources of duty to

to disclose white knight merger activities could arise from several sources.[21] First, corporations must comply with the formal disclosure requirements of the Securities Act of 1933 ('33 Act) and the Securities Exchange Act of 1934 ('34 Act).[22] Corporations also may have to disclose white knight merger activities to avoid liability under the general antifraud provisions of the '34 Act.[23] In addition, the major stock exchanges subject listed corporations to certain disclosure policies.[24]

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disclose white knight merger activity). One additional source for a potential duty to disclose white knight merger activities is state common law on fiduciary duty. *See* Note, *supra* note 2, at 231-32 (analysis of limited use of state fiduciary duty law to restrict defensive conduct by target corporations in responding to hostile tender offers).

21. *See infra* note 23-26 and accompanying text (discussing potential sources of duty to disclose white knight merger activity).

22. *See* Securities Act of 1933 §§ 7, 10, Schedule A, 15 U.S.C. §§ 77g, 77j, 77aa (1982) (requiring certain disclosures in registration statements and prospectuses, including every material contract not in ordinary course of corporation's business); Securities Exchange Act of 1934 §§ 13-14, 15 U.S.C. §§ 78m-78n (1982) (requiring periodic reports to Securities Exchange Commission (SEC) and certain disclosures in proxy statements and tender offer materials, including contracts to merge); *see also infra* notes 66-69 and accompanying text (analysis of effectiveness of formal disclosure requirements to force early disclosure of white knight merger activities).

The formal disclosure requirements for corporations most pertinent to white knight merger situations include §§ 13 and 14 of the '34 Act and the rules adopted by the SEC to implement those sections. *See* Securities Exchange Act of 1934 §§ 13-14, 15 U.S.C. §§ 77m-78n (1982); 17 C.F.R. § 240.13a-1 to .14f-1 (1984). Section 13 of the '34 Act requires corporations registered under the '34 Act to file periodic reports with the SEC. Securities Exchange Act of 1934 § 13, 15 U.S.C. § 78m (1982). The rules promulgated pursuant to § 13 require registered corporations to file annual, current, and quarterly reports. *See* 17 C.F.R. §§ 240.13a-1, .13a-11, .13a-13 (1984). For example, rule 13a-11 requires a registered corporation to file a current report on Form 8-K within 15 days after the occurrence of certain specified corporate events. *Id.* § 240.13a-11. When corporate control changes in a registrant, Form 8-K discloses information such as the identity of the person acquiring control, the basis of control, the date and description of the transaction, and the amount and source of the consideration used in the transaction. *Id.* § 249.308. Section 14(d) of the '34 Act requires both the tender offeror and target corporation to make certain disclosures concerning the tender offer. Securities Exchange Act of 1934 § 14(d), 15 U.S.C. § 78n(d) (1982). A target corporation must make two statements in response to a tender offer. *See* 17 C.F.R. § 240.14d-101, .14e-2 (1984). First, under rule 14d-101, the target corporation must file with the SEC a Schedule 14D-9 for the purpose of stating the corporation's recommendation concerning the offer and its reasoning, and describing any negotiations the target corporation is conducting in response. *Id.* § 240.14d-101. Second, the target corporation also must distribute to its shareholders a statement indicating the target corporation's management's position on the offer. *Id.* § 240.14e-2.

23. *See* Securities Exchange Act of 1934 §§ 10(b), 14(e), 15 U.S.C. §§ 78j(b), 78n(e) (1982) (proscribing use of manipulation, misstatements, and omissions in connection with securities transactions and tender offers); *see also* 17 C.F.R. § 240.10b-5 (1984) (SEC rule implementing § 10(b)); *infra* note 38 (discussing breadth of rule 10b-5); *infra* notes 71-87 & 103-09 and accompanying text (analysis of various disclosure duties generated by rule 10b-5).

24. *See* AMERICAN STOCK EXCHANGE COMPANY GUIDE §§ 401, 402, *reprinted in* 2 FED. SEC. L. REP. (CCH) ¶¶ 23,124A-B (June 29, 1983) (requiring immediate public disclosure of material information with certain limited exceptions) [hereinafter cited AMEX GUIDE]; NEW YORK STOCK EXCHANGE COMPANY MANUAL, A-18, *reprinted in* 2 FED. SEC. L. REP. (CCH) ¶ 23,121 (FEB. 11, 1981) (generally requiring prompt disclosure of all material corporate information) [hereinafter cited as NYSE MANUAL]; *see also* notes 88-94 & 111-14 and accompanying

Relevant case law suggests analyzing a target corporation's duty to disclose white knight merger activities under three common factual situations.[25] One situation in which the duty to disclose clearly arises is when formal disclosure requirements mandate certain disclosure filings or when insider trading occurs.[26] In contrast, a target corporation apparently is under no enforceable affirmative duty to disclose white knight merger activities in the absence of insider trading, issuance of prior inaccurate or misleading public statements, and stock market rumors affecting the trading activity in the target's securities.[27] Between these two extremes, the point at which the duty to disclose arises is unclear.[28] In addition, the proper form of disclosure, especially when the target corporation is responding to stock market rumors, is not clear.[29] Despite the lack of clarity in the parameters of the duty, raiders and other shareholders are able to bring a cause of action against the target corporation for breaching the duty to disclose white knight merger activities.[30]

Raiders and the target corporation's shareholders generally base causes of action for fraudulently failing to disclose white knight merger activities on violations of sections 10(b) and 14(e) of the '34 Act and Securities Exchange Commission (SEC) rule 10b-5.[31] While the '33 and '34 Acts provide express remedies for violations of the formal disclosure requirements, the general antifraud provisions in sections 10(b) and 14(e) provide more inclusive protection.[32] The formal disclosure requirements of the '33 and '34 Acts only prohibit misstatements or omissions concerning material corporate informa-

text (analysis of timely disclosure policies of New York Stock Exchange (NYSE) and American Stock Exchange (AMEX)).

25. *See infra* notes 26-28 and accompanying text (overview of common factual situations in which issue of target corporation's duty to disclose white knight merger activities arises).

26. *See infra* notes 66-72 and accompanying text (analysis of corporation's duty to disclose white knight merger activity under formal disclosure rules of '33 and '34 Acts and rule 10b-5 prohibition of insider trading).

27. *See infra* notes 73-94 and accompanying text (analysis of duty to disclose white knight merger activity in absence of insider trading, prior misstatements, and stock market rumors).

28. *See infra* notes 95-143 and accompanying text (analysis of duty to disclose white knight merger activity when target corporation has issued public statements and when stock market rumors affect trading activity in target's securities).

29. *See infra* notes 109-43 and accompanying text (analysis of target corporation's various duties when responding to stock market rumors).

30. *See, e.g.,* Greenfield v. Heublein, Inc., 742 F.2d 751, 755 (3d Cir. 1984) (plaintiffs alleged that target corporation violated §§ 10(b) and 14(e) of '34 Act and rule 10b-5 by illegally withholding material information concerning merger discussions with raider and white knight), *cert. denied,* 105 S. Ct. 1189 (1985); Staffin v. Greenberg, 672 F.2d 1196, 1201 (3d Cir. 1982) (plaintiffs alleged that target corporation violated §§ 10(b) and 14(e) of '34 Act and rule 10b-5 by fraudulently concealing white knight merger plans); American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 728 (E.D. Va. 1980) (raider alleged that executives of target corporation violated § 10(b) of '34 Act and rule 10b-5 by failing to disclose existence of substantive white knight merger negotiations).

31. *See supra* note 30 (list of cases involving fraudulent failure to disclose white knight merger activity).

32. *See infra* notes 33-34 and accompanying text (comparison of items proscribed by formal disclosure requirements and §§ 10(b) and 14(e)).

tion in required SEC filings and reports.[33] In contrast, sections 10(b) and 14(e) proscribe any form of fraudulent, deceptive, or manipulative conduct in connection with the sale or purchase of any security or tender offer.[34] Despite its similarity with section 10(b) and rule 10b-5, however, section 14(e) may not provide standing for a nonstockholder raider to challenge the nondisclosure.[35] While neither section 10(b) nor section 14(e) expressly provides for a private cause of action for nondisclosure, courts generally have implied a private right of action from section 10(b).[36] However, the United States Supreme Court explicitly has refused to imply a private cause of action for damages from section 14(e) for a plaintiff suing in the capacity of a defeated tender offeror.[37] As a result, section 10(b) and rule 10b-5 may

33. *See* Securities Act of 1933 §§ 11(a), 12(2), 15 U.S.C. §§ 77k(a), 77l(2) (1982) (proscribing untruths and omissions by corporations of material information in registration statements, prospectuses, and oral communications concerning offer or sale of securities); Securities Exchange Act of 1934 § 18(a), 15 U.S.C. § 78r(a) (1982) (proscribing false or misleading statements in all SEC filings, reports, or documents).

34. *See* Securities Exchange Act of 1934 §§ 10(b), 14(e), 15 U.S.C. §§ 78j(b), 78n(e) (1982) (proscribing any manipulative or deceptive device or contrivance in purchase or sale of any security or tender offer).

35. *See infra* notes 36-38 and accompanying text (discussion of raider's standing problems under § 14(e) of '34 Act); *see also* Berman v. Gerber Products Co., 454 F. Supp. 1310, 1316 (W.D. Mich. 1978) (§ 14(e) of '34 Act brings rule 10b-5 requirements into area of tender offers); 2 A. BROMBERG & L. LOWENFELS, *supra* note 4, § 6.3(211), at 116.7 (comparison of relationship between § 14(e) and rule 10b-5).

36. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971). The United States Supreme Court in *Bankers Life* expressly recognized an implied private right of action under section 10(b). *Id.*; *see* Kardon v. National Gypsum Co., 73 F. Supp. 798, 800 (E.D. Pa.) (first court to imply private right of action from § 10(b) of '34 Act and rule 10b-5), *modified on other grounds*, 83 F. Supp. 613 (E.D. Pa 1947).

37. *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 42 (1977) (holding that plaintiff as defeated tender offeror has no private right of action for damages under § 14(e)). In *Piper v. Chris-Craft Industries, Inc.*, a raider sued the target corporation's management, among others, after the raider's takeover attempt failed. *Id.* at 4. The raider alleged that the defendants violated § 14(e) and the '34 Act by allowing a white knight to obtain control of the target corporation. *See id.* at 4-5 (asserting white knight gained control of target corporation because of defendants' alleged securities laws violations). The *Piper* Court analyzed whether the raider had a cause of action for damages against the target corporation under § 14(e) on the theory that antifraud violations by the target and white knight prevented the raider's hostile tender offer from succeeding. *Id.* at 24-42. Noting that § 14(e) makes no explicit provision for a private cause of action, the United States Supreme Court looked to legislative history and policy considerations for support in implying a private cause of action. *Id.* at 25-42. The *Piper* Court described the legislative purpose of the Williams Act, which added § 14(e) of the '34 Act, as providing protection to shareholders who must decide how to respond to a tender offer. *Id.* at 35; *see* Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982) (adding §§ 13(d)-(e) and 14(d)-(f) to the '34 Act). The Court noted that the raider as a defeated tender offeror was not within the class protected by the Williams Act. 430 U.S. at 35, 37. The *Piper* Court also noted that policy considerations weighed against implying a private right of action under § 14(e). *Id.* at 39-41. The Court asserted that the threat of an action for damages by a defeated tender offeror would not provide significant additional protection to investors. *Id.* at 39-40. Moreover, the Court suggested that injunctive relief provides a more effective remedy than does a claim for damages after the takeover battle. *Id.* at 40. Finally, the Court observed that the target

provide shareholders with the broadest remedy when a target corporation fails to disclose white knight merger activities.[38]

In the context of nondisclosure of white knight merger activities, a plaintiff must prove several key elements before a court will find that a target corporation violated section 10(b) and rule 10b-5.[39] First, a plaintiff must prove that the target corporation's nondisclosure of white knight merger activities while under a duty to disclose constitutes either the manipulation or deception necessary for finding fraud under rule 10b-5.[40] A plaintiff also must prove scienter before a court may find liability under rule 10b-5.[41] The United States Supreme Court has defined scienter as an intent to deceive, manipulate, or defraud.[42] In a nondisclosure case, a court can infer scienter whenever the target corporation had actual knowledge of material information and failed to disclose.[43] In addition, a section 10(b) and rule 10b-5 cause

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corporation's shareholders rather than the target's management and white knight would have to bear the cost of satisfying any damages recovered by the raiders. *Id.* at 39. Accordingly, the Court held that the raider, suing in its capacity as a defeated tender offeror, did not have standing to sue for damages under § 14(e). *Id.* at 42. The *Piper* Court, however, limited its holding to a defeated tender offeror suing for damages, thus suggesting that shareholder-offerees and competing tender offerors may have an implied action under § 14(e) for injunctive relief and under § 10(b) for damages for violations of the federal securities laws. *Id.* at 42 n.28; *see* Humana, Inc. v. American Medicorp, Inc., 445 F. Supp 613, 616 (S.D.N.Y. 1977) (granting tender offeror standing to sue another corporation seeking to acquire target corporation for injunctive relief). *But see* Crane Co. v. American Standard, Inc., 603 F. 2d 244, 251 (2d Cir. 1979) (holding that raider did not have standing to sue for damages under § 10(b), even though raider was also shareholder of target corporation).

38. *See supra* notes 31-37 and accompanying text (comparison of common statutory grounds for claims alleging target corporation of fraudulently failing to disclose white knight merger activities). Since the SEC adopted rule 10b-5 in 1942, the scope of the rule has broadened to encompass a variety of fraudulent activity. SODERQUIST, SECURITIES REGULATION 531-32 (1982). As a catch-all provision, rule 10b-5 has risen to the preeminent position among the antifraud provisions in the '33 and '34 Acts. *Id.*

39. *See* American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 741-47 (E.D. Va. 1980) (explicit application of each requisite element in § 10(b) nondisclosure action); Bromberg, *10b-5 Liabilities for Non-Disclosure,* 1 INTRODUCTION TO SECURITIES LAWS DISCLOSURE 225, 246-52 (P.L.I. 1976) (general discussion of elements in rule 10b-5 nondisclosure cases); *see also infra* notes 40-46 and accompanying text (overview of key elements in rule 10b-5 nondisclosure cases).

40. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473-74, 475 n.15 (1977) (Court refused to find rule 10b-5 violation when corporate management's conduct did not constitute deception or manipulation); *see also* Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose,* 67 GEO. L.J. 935, 943-45 (1979) (failure to disclose information when under duty to disclose constitutes both manipulation and deception under rule 10b-5).

41. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976) (plaintiff must prove scienter to recover damages for breach of duty to disclose under rule 10b-5). *See generally* Allen, *The Disclosure Obligation of Publicly Held Corporations in the Absence of Insider Trading,* 25 MERCER L. REV. 479, 484-87 (1974) (discussion of scienter requirement prior to *Ernst & Ernst v. Hochfelder);* Bauman, *supra* note 40, at 960-62 (overview of scienter requirement in rule 10b-5 claims in terms of requisite standard of management's conduct).

42. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 194 n.12 (1976).

43. *See* Allen, *supra* note 41, at 485 (scienter established if plaintiff proves defendant knew material facts were misstated or omitted from public statements); Bauman, *supra* note

of action requires a plaintiff to show a connection between the fraudulent conduct and the securities transaction.[44] The "in connection with" element encompasses the notions of causation and reliance required in a common-law fraud action.[45] This requirement presents no problem for a plaintiff asserting that a target corporation fraudulently failed to disclose white knight merger activity because the Supreme Court, realizing the impossibility of proving reliance on information never disclosed, allows a presumption of causation in nondisclosure cases if the information withheld is material.[46]

Materiality is the most important element that a plaintiff must prove in claiming that a target corporation fraudulently failed to disclose white knight merger activities.[47] A target corporation is not liable under rule 10b-5 unless the undisclosed information was material.[48] The United States Supreme Court held in *TSC Industries v. Northway, Inc.*[49] that undisclosed information is material if a substantial likelihood exists that a reasonable shareholder would

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40, at 961 (courts should infer scienter in duty to disclose cases when corporation had knowledge of materiality of information and did not disclose).

44. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971) (§ 10(b) requires deceptive practice to touch sale or purchase of securities); Ketchum v. Green, 557 F.2d 1022, 1027 (3d Cir.) (dictum) (in connection with requirement does not encompass all intra-corporate management disputes which only tangentially relate to securities), *cert. denied,* 434 U.S. 940 (1977); *see also* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1982) (proscribing use of manipulation and contrivances in connection with purchase or sale of securities); 17 C.F.R. § 240.10b-5 (1984) (SEC rule implementing § 10(b), proscribing fraud, misstatements, and omissions in connection with purchase or sale of securities).

In addition to satisfying the in connection with requirement, a plaintiff must be a purchaser or seller of the securities in order to establish a § 10(b) claim. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 749 (1975) (recognizing buyer-seller requirement in § 10(b) actions). In contrast to § 10(b), however, a § 14(e) action does not have a buyer-seller requirement. *Compare* Securities Exchange Act of 1934 § 14(e), 15 U.S.C. § 78n(e) (1982) (proscribing fraudulent conduct in connection with tender offers) *with id.* § 10(b), 15 U.S.C. § 78j(b) (proscribing fraudulent conduct in connection with purchase or sale of securities).

45. *See* Bauman, *supra* note 40, at 941 n.17 (noting relationship of causation and reliance in discussion of in connection with requirement in rule 10b-5 nondisclosure cases).

46. *See* Affiliated Ute Citizens v. United States, 406 U.S. 128, 154 (1972) (withholding material fact when under obligation to disclose constitutes causation in fact); *see also* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 447 n.9 (1976) (dictum) (positive proof of reliance unnecessary when plaintiff establishes materiality).

47. *See* Sheffey, *Securities Law Responsibilities of Issuers to Respond to Rumors and Other Publicity: Reexamination of a Continuing Problem,* 57 NOTRE DAME LAW. 755, 757 (1982) (disclosure of corporate information is effectively useless without materiality requirement because investors could not otherwise determine relevance of information supplied). *See generally* Hewitt, *Developing Concepts of Materiality and Disclosure,* 32 BUS. LAW. 887 (1977) (overview of question of materiality in corporate disclosures).

48. *See* Greenfield v. Heublein, Inc., 742 F.2d 751, 756-57 (3d Cir. 1984) (target corporation not liable under rule 10b-5 for failing to disclose white knight merger activities until parties have reached agreement in principle on price and terms of merger), *cert. denied,* 105 S. Ct. 1189 (1985); Staffin v. Greenberg, 672 F.2d 1196, 1205-07 (3d Cir. 1982) (analyzing materiality of preliminary merger discussions); *see also* 17 C.F.R. § 240.10b-5(b) (1982) (proscribes corporations from making untrue statements or omissions of material facts).

49. 426 U.S. 438 (1976).

consider it important in making decisions concerning the securities involved.[50] Although *TSC Industries* involved false and misleading proxy statements in violation of section 14(a) of the '34 Act, courts have applied the same standard of materiality in rule 10b-5 actions.[51] While the *TSC Industries* Court set the requisite standard of materiality, whether information is material depends upon the context in which the alleged cause of action arose.[52]

The importance of the factual context in determining materiality is evident in cases which have analyzed when merger activities become material enough to trigger a duty to disclose under federal securities laws.[53] For example, in *SEC v. Geon Industries, Inc.*,[54] the United States Court of Appeals for the Second Circuit noted that the proposed conventional merger activities involved were sufficiently material for rule 10b-5 to prohibit insider trading without full public disclosure, but not material enough to have been

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50. *See id.* at 449.

51. *See id.* at 439-40 (plaintiff alleged defendant issued false and misleading proxy statements); *see also id.* at 449 (omitted information is material if substantial likelihood exists that reasonable shareholder would consider omitted information important in making proxy voting decision). Since the United States Supreme Court's decision in *TSC Industries v. Northway, Inc.*, other courts have judged the materiality in rule 10b-5 nondisclosure cases by considering whether a substantial likelihood exists that reasonable shareholders would consider the omitted information important in making investment decisions. *See, e.g.*, Sharp v. Coopers & Lybrand, 649 F.2d 175, 187 (3d Cir. 1981) (applying *TSC Industries* objective standard of materiality in rule 10b-5 case), *cert. denied*, 455 U.S. 938 (1982); Panter v. Marshall Field & Co., 646 F.2d 271, 289 (7th Cir.) (adopting *TSC Industries* definition of materiality), *cert. denied*, 454 U.S. 1092 (1981); Harkavy v. Apparel Indus., Inc., 571 F.2d 737, 741 n.5 (2d Cir. 1978) (applying *TSC Industries* standard of materiality). The SEC apparently also has adopted the *TSC Industries* objective standard of materiality. *See* 17 C.F.R. § 230.405 (1984) (defining "material" in connection with information required in registration statements under '33 Act); 17 C.F.R. § 240.12b-2 (1984) (defining "material" in connection with information required in registration and reporting statements under '34 Act).

52. *See* SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1233 (S.D.N.Y. 1976) (courts cannot determine materiality in factual vacuum), *aff'd*, 565 F.2d 8 (2d Cir. 1977); *see also* Bauman, *supra* note 40, at 938 n.11 (noting how SEC and courts have recognized that factual context of case alters determination of materiality). *See generally* Hewitt, *supra* note 47, at 898 (changes in factual context of case may affect determination of whether particular fact is material).

53. *See* Missouri Portland Cement Co. v. H.K. Porter Co., 535 F.2d 388, 398 (8th Cir. 1976) (implying that target corporation's agreement in principle to merge with white knight was not necessarily material information); SEC v. Geon Indus., Inc., 531 F.2d 39, 47-48 (2d Cir. 1976) (information concerning potential merger deemed material enough to impose duty to abstain from tipping, but not necessarily material enough for disclosure in SEC filings); *see also* Thomas v. Duralite Co., 524 F.2d 577, 584-85 (3d Cir. 1975) (for closely held corporation, preliminary discussions that established likelihood of subsequent merger deemed material information to foreclose insider trading without disclosure); SEC v. Shapiro, 494 F.2d 1301, 1307 (2d Cir. 1974) (negotiations reaching point in which merger was not remote possibility deemed material information); Bucher v. Shumway, [1979-80 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 97,142, at 96,302 (S.D.N.Y. 1979) (mere inquiries or contacts made by parties interested in possible merger were not material), *aff'd*, 622 F.2d 572 (2d Cir.), *cert. denied*, 449 U.S. 841 (1980).

54. 531 F. 2d 39 (2d Cir. 1976).

included in required SEC filings.[55] When the corporate president in *Geon* tipped a friend about a potential merger, the extent of the merger activities consisted only of the exchange of some specially prepared financial reports and a continuing expression of interest from the prospective merger partner.[56] In affirming the district court's finding that the president had improperly disclosed the potential merger,[57] the Second Circuit indicated that the materiality of inside information depends on both the probability that the event will occur and the anticipated impact of the event on the company.[58] The factual context also was important in the determination of materiality by the United States Court of Appeals for the Eighth Circuit in *Missouri Portland Cement v. H.K. Porter Co.*[59] The *Missouri Portland Cement* court implied that white knight merger activity can even reach the point of an agreement in principle to merge without becoming material enough to require disclosure.[60] The target corporation in *Missouri Portland Cement* accused the raider of improperly making incomplete disclosure of the target's white knight merger activity in the raider's hostile tender offer filings.[61] After questioning whether the raider was under a duty to disclose the terms of a proposed merger to which the raider was not a party, the Eighth Circuit analyzed whether the incomplete disclosure misled the target corporation's shareholders.[62] The target corporation and white knight had reached an agreement in principle to merge, subject only to certain standard conditions.[63] Nevertheless, the Eighth Circuit characterized the proposed white knight merger plans as tentative and stated that parties are not required to disclose contingent or indefinite plans.[64] Thus, the *Missouri Portland Cement* court implied that the lack of materiality in the target's proposed merger plans vitiated any potential duty to disclose the white knight merger activities.[65]

A target corporation's duty to disclose white knight merger activities clearly arises under both the specific formal disclosure requirements of the

55. *Id.* at 47-48.

56. *Id.* at 48.

57. *Id.* at 49.

58. *Id.* at 47 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).

59. *See* 535 F.2d 388, 398 (8th Cir. 1976) (affirming district court's decision that there was not reasonable probability that raider's failure to disclose fully target's white knight merger plans would mislead target's shareholders).

60. *Id.* at 398.

61. *Id.* at 391-92.

62. *Id.* at 397-98.

63. *See id.* at 398. In *Missouri Portland Cement Co. v. H.K. Porter*, the agreement in principle to merge referred to a formal agreement that the merging companies would sign conditioned on shareholder and director approval, the effectiveness of registration statement filed with the SEC, the listing of the merged corporation securities on the NYSE, the absence of materially adverse changes in either merging company, and a complete investigation of each company's business. *Id.*

64. *See id.* (citing Susquehanna Corp. v. Pan American Sulphur Co., 423 F.2d 1075, 1084-86 (5th Cir. 1970)).

65. *See id.* (concluding that reasonable probability existed that plaintiff would not prevail on its contention that defendant's failure to disclose merger plans would mislead investors).

'33 and '34 Acts and the rule 10b-5 prohibition of insider trading.[66] Although the duty to disclose is certain, the formal disclosure requirements often do not force a target corporation into making timely or effective disclosures of white knight merger activities.[67] For example, a target corporation typically would not have to reveal a white knight merger pursuant to the periodic reporting requirements of the '34 Act until fifteen days after the consummation of the merger.[68] In addition, the use of boilerplate language by target corporations reduces the effectiveness of the formal disclosures imposed by the tender offer requirements.[69] Moreover, the combination of judicial willingness to excuse noncompliance and remedies for violations typically limited to curative disclosures further dilutes the effectiveness of a target corporation's disclosure duties under the tender offer requirements.[70] The parameters of the duty to disclose white knight merger activity when a target corporation or corporate insiders are trading in the target's securities also are reasonably clear.[71] The dispositive issue in most cases involving the duty

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66. *See* Staffin v. Greenberg, 672 F.2d 1196, 1205 (2d Cir. 1982) (no question existed that target corporation was under duty to disclose material corporate information during target's stock repurchase tender offer); American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 742-44 (E.D. Va. 1980) (analyzing duty to disclose owed by corporate insider trading on nonpublic information); Securities Act of 1933 §§ 7, 10, Schedule A, 15 U.S.C. §§ 77g, 77j, 77aa (1982) (requiring certain disclosures in registration statements and prospectuses, including every material contract not in ordinary course of corporation's business); Securities Exchange Act of 1934 §§ 13, 14, 15 U.S.C. §§ 78m, 78n (1982) (requiring periodic reports to SEC and certain disclosures in proxy statements and tender offer materials, including contracts to merge).

67. *See infra* notes 68-70 and accompanying text (examples of ineffectiveness of formal disclosure requirements in forcing target corporations into early disclosure of white knight merger activities).

68. *See* 17 C.F.R. § 240.13a-11 (1984) (corporation must file Form 8-K current report with SEC within 15 days after change in corporate control); *see also supra* note 22 (general description of Form 8-K filing responsibilities under rule 13a-11 of '34 Act).

69. *See supra* note 22 (describing responses target corporation required to make under tender offer regulations); *see also* Note, *supra* 2, at 231 & n.19 (target corporations seek to minimize restrictions that federal securities laws impose on target's response to hostile tender offers by artfully drafting required disclosures).

70. *See* Electronic Speciality Co. v. International Controls Corp., 409 F.2d 937, 948 (2d Cir. 1969) (accepting less than full compliance with tender offer disclosure requirements by suggesting that Congress did not intend to impose unrealistic requirements on corporations involved in tender offers); Note, *supra* note 2, at 231 & nn.20-21 (effectiveness of tender offer disclosure requirements weakened by judicial willingness to excuse noncompliance and by curative disclosures being likely remedy for violations).

71. *See* American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 742-44 (E.D. Va. 1980) (dictum) (careful analysis of duty of target corporation executives to abstain from insider trading while engaging in undisclosed white knight merger negotiations). A target corporation or corporate insider trading in the target's securities by using nonpublic information is under a duty to disclose all material facts to the prospective purchaser or seller. *See* Chiarella v. United States, 445 U.S. 222, 227 (1980). The existence of a relationship providing access to nonpublic information and the inherent unfairness of allowing a corporate insider or fiduciary to take advantage of that information without disclosure establishes a rule 10b-5 violation. *In re* Cady, Roberts & Co., 40 S.E.C. 907, 911-12 (1961); *see* Dirks v. SEC, 463 U.S. 646, 653-54 (1983); *Chiarella*, 445 U.S. at 227.

to disclose before trading on inside information is the materiality of the white knight merger plans under the given facts and circumstances.[72]

In another common factual situation, a target corporation is under no enforceable affirmative duty to disclose white knight merger activities in cases involving no insider trading, issuance of prior inaccurate or misleading public statements, and stock market rumors.[73] With the philosophy of full disclosure permeating all federal securities laws,[74] a court may find a general affirmative duty to disclose white knight mergers arising from the legislative history and underlying policies of the '34 Act and rule 10b-5.[75] However, the language of rule 10b-5 does not deal with nondisclosures aside from prohibiting omissions of material facts when such omissions make previously disclosed information misleading.[76] Accordingly, as the United States Court of Appeals for the Third Circuit in *Staffin v. Greenberg*[77] noted, no court clearly has imposed an affirmative duty on a corporation to disclose all

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72. *See* Staffin v. Greenberg, 672 F.2d 1196, 1205-07 (2d Cir. 1982) (despite being under duty to disclose while trading in its own securities, target corporation not liable under rule 10b-5 because court deemed white knight merger activities immaterial); *accord* Thomas v. Duralite Co., 524 F.2d 577, 584-85 (3d Cir. 1975) (shareholders in closely held corporation violated rule 10b-5 for inside trading without disclosing material information concerning possible merger plans).

73. *See infra* notes 74-94 and accompanying text (analysis of possible sources of general affirmative duty to disclose white knight merger activities).

74. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977) (fundamental purpose of '34 Act was to implement philosophy of full disclosure); Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 563 (E.D.N.Y. 1971) (full disclosure is foundation of '33 Act and entire legislative scheme of federal securities laws). Congress designed the federal securities laws to facilitate informed investment analyses and discriminating investment decisions by the investing public by encouraging full disclosure of material corporate information. *See* 78 CONG. REC. 7704-05 (1934) (Congress indicated in debates concerning '34 Act that no investor can safely trade securities without intelligent basis for forming judgment as to value of securities investor is trading).

75. *See* Bauman, *supra* note 40, at 943-48 (general affirmative duty to disclose material corporate information consistent with legislative history and underlying policies of '34 Act and rule 10b-5); *see also* 78 CONG. REC. 7861-62 (1934) (Congress intends '34 Act to require corporations registering stock on national securities exchanges to make full disclosure of all facts that materially could affect listed securities).

The Supreme Court has indicated that in interpreting the federal securities laws courts should first examine the language of the statute. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 472 (1977) (statutory interpretation of federal securities laws begins with language of statute); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976) (same). Only if the statutory language is not clear should a court then examine the legislative history and underlying policy considerations. *See* Santa *Fe Indus., Inc.*, 430 U.S. at 473, 476-77; *Hochfelder*, 425 U.S. at 201, 214 n.33.

76. *See* 17 C.F.R. § 240.10b-5 (1984). Neither the first clause nor the third clause of rule 10b-5 deals explicitly with nondisclosures of material information. *Id.* Moreover, the second clause of rule 10b-5 prohibits omissions of material facts only in the limited situation in which omissions make previously disclosed information misleading. *Id.* One commentator argues that the more specific reference to omissions in the second clause precludes interpreting the first or third clauses to cover broader and more general omission cases. Sheffey, *supra* note 47, at 769.

77. 672 F.2d 1196 (3d Cir. 1982).

material corporate events in the absence of insider trading or prior inaccurate disclosures.[78] In *Staffin,* the target corporation issued several press releases during the struggle for corporate control by a raider.[79] After obtaining control, the raider had the target corporation issue a tender offer to repurchase a portion of the target's shares to allow shareholders dissatisfied with the new management to liquidate their interests in the target.[80] The target corporation subsequently merged with a white knight solicited by the target's former management.[81] After the merger, the shareholders who had sold their shares back to the target corporation at a price lower than the price offered by the white knight sued the target corporation.[82] The shareholders alleged that the target corporation violated sections 10(b) and 14(e) of the '34 Act for failing to disclose the full extent of the white knight merger plans before and after the target corporation's stock repurchase tender offer.[83] The *Staffin* court held that the target corporation had no general affirmative duty to disclose the white knight merger activities prior to the time when the target corporation began issuing the press releases.[84] The *Staffin* court also held that a duty to disclose arose when the target corporation began trading in its own securities during the stock repurchase tender offer.[85] The Third Circuit, however, held as a matter of law that the merger plans were not material enough to require disclosure.[86] The *Staffin* court noted that disclo-

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78. *Id.* at 1204; *see* Allen, *supra* note 41, at 488 (courts have been reluctant to impose rule 10b-5 violations for total nondisclosure of material corporate events); Sheffey, *supra* note 47, at 762 (no consensus among commentators as to whether rule 10b-5 imposes general affirmative duty to disclose).

79. 672 F.2d at 1199. In *Staffin v. Greenberg,* a raider slowly made open market purchases of a target corporation's stock over a six year period. *Id.* at 1198. The target's management decided to seek a white knight after the raider indicated in a Schedule 13D statement that the raider may attempt to obtain control of the target. *Id.* at 1198-99; *see supra* note 3 (§ 13(d) of '34 Act requires purchasers of 5% interest in single corporation to file disclosure statement). Fearing that the target corporation might not find a white knight in time, the target's controlling shareholder sold his shares at a substantial premium over market value to the raider in a privately negotiated agreement. 672 F.2d at 1199. The target corporation issued press releases to announce the sale of the controlling interest in the corporation to the raider. *Id.*

80. 672 F.2d at 1199. After the raider in *Staffin* refused to buy any additional shares, the target issued a partial stock repurchase tender offer to allow dissenting shareholders to liquidate their interests in the target. *Id.*

81. *Id.* at 1201.

82. *Id.* at 1198, 1201. The plaintiffs in *Staffin* sued the target corporation after the target agreed to merge with a white knight at nearly $15 per share only a month after the plaintiffs had sold some of their shares back to the target at $10 per share. *Id.*

83. *Id.* at 1203.

84. *Id.* at 1204. Until the target corporation chose to issue a public statement, the *Staffin* court held that the target had no duty to disclose the raider's takeover attempt and the target's search for a white knight. *Id.*

85. *Id.* at 1205. The *Staffin* court stated that there was no question that the target corporation was under a duty to disclose material corporate information during the stock repurchase tender offer. *Id.*

86. *Id.* at 1207. The *Staffin* court found no evidence that the target's white knight merger negotiations had reached an agreement in principle to merge. *Id.* The court noted that target

sure of merger activity before the merger plans ripen into an agreement in principle may mislead investors into purchasing stock on the basis of preliminary discussions preceding a merger which may never occur.[87]

Another potential source of a general affirmative duty to disclose material corporate information including white knight mergers are the timely disclosure policies of the major stock exchanges.[88] The rules of the New York Stock Exchange (NYSE) and of the American Stock Exchange (AMEX) require listed companies to disclose promptly and fully any material information that may affect the market in a company's securities.[89] In the context of white knight mergers, however, this affirmative duty to disclose is ineffective and unenforceable. First, only a small percentage of all publicly held companies list their securities on either exchange.[90] Also, both the NYSE and the AMEX allow a company discretion to withhold disclosure temporarily when immediate disclosure would jeopardize legitimate corporate objectives, or when the corporate information is subject to change and a more appropriate time for disclosure is imminent.[91] Significantly, white

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corporations do not have to disclose preliminary merger discussions. *Id.* at 1205-06. Accordingly, the *Staffin* court affirmed the district court's summary judgment in favor of the defendants. *Id.* at 1207.

87. *Id.* The United States Court of Appeals for the Third Circuit noted in *Staffin* that disclosure of preliminary merger discussions may temporarily inflate the market value of a target corporation's stock in reliance on a merger that may never occur. *Id.; see* Susquehanna Corp. v. Pan American Sulphur Co., 423 F.2d 1075, 1084-85 (5th Cir. 1970) (reason that preliminary merger discussions are immaterial is that premature disclosure may be misleading). The *Staffin* court refused to state the circumstances in which a court may find a target corporation liable under rule 10b-5 for failing to disclose merger negotiations which have not reached an agreement in principle. 672 F.2d at 1207. The *Staffin* court asserted that withholding disclosure of merger negotiations until an agreement in principle is reached strikes the best balance between the interests of the target corporation and investing public. 672 F.2d at 1207; *see* AMEX GUIDE, *supra* note 2, at ¶ 23,124B (assuming maintenance of confidentiality, listed company need not disclose merger negotiations before parties reach agreement in principle on specific terms of the merger); NYSE MANUAL, *supra* note 24, at ¶ 23,123 (in exercising judgment as to timing of public release, managements of listed companies should weigh interests of listed company and investing public).

88. *See* AMEX GUIDE, *supra* note 24, at ¶ 23,124A (listed company required to make immediate disclosure of all material corporate information); NYSE MANUAL, *supra* note 24, at ¶ 23,121 (listed companies required to release promptly any information likely to affect market of company's securities); *see also* Bauman, *supra* note 40, at 976-77 (discussion of stock exchange rules as source of general affirmative duty to disclose all material corporate information); Sheffey, *supra* note 47, at 757-60 (discussion of disclosure requirements for companies listed on NYSE or AMEX, or on National Association of Securities Dealers Automated Quotation System for over-the-counter securities).

89. *See* AMEX GUIDE, *supra* note 24, at ¶ 23,124A (requiring immediate public disclosure of material information with certain limited exceptions); NYSE MANUAL, *supra* note 24, at ¶ 23,121 (generally requiring prompt disclosure of all material corporate information).

90. *See* Bauman, *supra* note 40, at 936-37 (number of companies listed on major stock exchanges is only small fraction of publicly held corporations).

91. *See* AMEX GUIDE, *supra* note 24, at ¶ 23,124B (listed company may withhold material information when immediate disclosure would harm company's ability to pursue valid corporate

knight merger activities would qualify under either test.[92] Moreover, the exchanges' enforcement tools, which include placing a freeze on trading and delisting a nondisclosing company's securities, provide no deterrence for a target corporation seeking additional time to finalize a white knight merger because the merger typically would result in the raider's securities replacing the target's securities on the trading market.[93] In addition, even if a target corporation did break the exchanges' timely disclosure requirements, an investor would have difficulty in establishing a cause of action against the target corporation because the exchanges' requirements may not meet the criteria necessary to imply a private right of action under the federal securities laws or under state law third party beneficiary contract principles.[94]

The task of determining when the duty arises to disclose white knight merger activities becomes more complex when market rumors begin to circulate and to affect the trading activity in a target corporation's securities. Generally, courts have held that a corporation is under no duty to respond to any type of rumor not attributable to the corporation.[95] In contrast, the

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objectives, or when corporate activity is in state of flux and more appropriate time for disclosure in imminent); NYSE MANUAL, *supra* note 24, at ¶ 23,123 (listed company can exercise judgment in determining proper timing of disclosure when premature disclosure would harm listed company's goals or provide helpful information to competitors).

92. *See supra* note 89 (both NYSE MANUAL and AMEX GUIDE use merger negotiations as examples of valid reasons for temporarily withholding disclosure of corporate activities).

93. *See* Talesnick, *Corporate Silence and Rule 10b-5: Does a Publicly Held Corporation Have an Affirmative Obligation to Disclose?*, 49 DENVER L.J. 369, 369 (1973) (because merger would delist target corporation's securities, target corporation could avoid making unwanted disclosure of white knight merger activities). *But see* Sheffey, *supra* note 47, at 760 n.23 (asserting that delisting securities to avoid making unwanted disclosures is unrealistic for most listed companies).

94. *See* Bauman, *supra* note 40, at 977-88 (analysis of theories of liability for breach of stock exchange disclosure requirements based on private implied rights of action under federal securities laws). The stock exchange disclosure requirements may not qualify as a sufficient substitute for SEC regulations in meeting the requirements for an implied private right of action under the federal securities laws. *Id.* at 983-84; *see* Colonial Realty Corp. v. Bache & Co., 358 F.2d 178, 181-82 (2d Cir.) (establishing criteria for recognizing implied right of action for breach of certain stock exchange rules), *cert. denied,* 385 U.S. 817 (1966); *see also* Sheffey, *supra* note 47, at 760 n.23 (Supreme Court not likely to imply private cause of action for breach of stock exchange disclosure requirements). In trying to establish a third party beneficiary contract claim, investors may have difficulty in proving that they were the intended beneficiary of the listed company's contract with the stock exchange. *See* Bauman, *supra* note 40, at 986-88 (analysis of theory of liability for violating exchanges' disclosure requirements premised on state law third party beneficiary contract principles).

95. *See, e.g.,* State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981) (company has no duty to correct or verify market rumors unless those rumors are attributable to company); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 949 (2d Cir. 1969) (securities laws do not require company to correct misstatements that are not attributable to company); SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 85 (S.D.N.Y. 1970) (suggests that company need not respond to spreading rumors concerning any activity of corporation), *modified,* 466 F.2d 1301 (2d Cir.), *cert. denied,* 404 U.S. 1005 (1971). *See generally* Sheffey, *supra* note 47 (comprehensive analysis of corporation's responsibilities to correct or respond to inaccurate publicly disseminated information concerning corporation).

stock exchanges' timely disclosure requirements mandate a prompt and explicit response to any rumor, even if the rumor is not attributable to the listed company.[96] In *Staffin,* one of the press releases issued by the target corporation was in response to a dramatic increase in the trading activity of the target corporation's securities.[97] By finding that the target corporation was under no duty to make any disclosures about the white knight merger activities prior to the issuance of the press releases or insider trading, the Third Circuit in *Staffin* also implicity held that the target corporation had no duty to respond to the rumors affecting the trading activity in the target's securities.[98] The Third Circuit further elaborated the position it took in *Staffin* by explicitly stating in *Greenfield v. Heublein, Inc.*[99] that a target corporation did not have a duty to disclose its white knight merger activities, even though the NYSE requested the target corporation to respond to market rumors.[100] Thus, the *Staffin* and *Greenfield* decisions suggest that a target corporation is under no duty to respond to rumors not attributable to the target concerning white knight merger activities.[101]

The reasoning of the Third Circuit in the *Staffin* and *Greenfield* decisions also implies that a target corporation may respond voluntarily to market rumors without making specific substantive disclosures concerning its white knight merger activities.[102] The antifraud provisions of the federal securities laws, however, impose several duties on corporations that choose to make public statements.[103] As indicated by the United States Court of Appeals for

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96. AMEX GUIDE, *supra* note 24, at ¶¶ 23,124A-23,124B, NYSE MANUAL, *supra* note 24, at ¶ 23,123.

97. Staffin v. Greenberg, 672 F.2d 1196, 1201 (3d Cir. 1982).

98. *See id.* at 1204 (target corporation had no duty to disclose takeover struggle or white knight merger activities before target corporation chose to make public statement).

99. 742 F.2d 751 (3d Cir. 1984)

100. *See id.* at 759 (target corporation under no duty to respond to inquiry concerning upswing in trading activity in target corporation's securities).

101. *See* Greenfield v. Heublein, Inc., 742 F.2d 751, 759 (3d Cir. 1984) (target corporation had no duty to reply to stock exchange inquiries concerning market rumors affecting trading activity in target's securities), *cert. denied,* 105 S. Ct. 1189 (1985); Staffin v. Greenberg, 672 F. 2d 1196, 1204 (3d Cir. 1982) (target corporation had no duty to disclose white knight merger activities prior to issuing public statements concerning raider obtaining control of target).

102. *See Greenfield,* 742 F.2d at 757-59 (no duty to disclose white knight merger activities until parties reach agreement in principle); *Staffin,* 672 F.2d at 1204 (target corporation under no duty to disclose white knight merger activities prior to issuing public statements). Because the target corporation was under no duty to disclose the substance of its white knight merger activities until the parties reached an agreement in principle, the United States Court of Appeals for the Second Circuit in *Greenfield v. Heublein* implied that the target corporation voluntarily could respond to stock exchange inquiries without fully disclosing the extent of the merger activities. *See Greenfield,* 742 F.2d at 757-59.

103. *See* Securities Exchange Act of 1934 §§ 10(b), 14(e), 15 U.S.C. §§ 78j(b), 78n(e) (1982) (proscribing corporations from issuing public statements with misstatements or omissions of material facts); *see also* 17 C.F.R. § 240.10b-5 (1984) (SEC rule implementing § 10(b)); *infra* notes 104-08 and accompanying text (discussing duties imposed by rule 10b-5 on corporations issuing public statements).

the Second Circuit in *SEC v. Texas Gulf Sulphur Co.*,[104] rule 10b-5 proscribes corporations from issuing false statements of material fact, or incomplete statements that mislead the investing public.[105] Other courts have noted that a corporation also could commit a fraud by failing to correct a misleading impression left by prior statements.[106] Moreover, at least one federal district court has stated that the duty to correct or revise prior statements lasts as long as investors reasonably could rely on the statements.[107] Thus, in voluntarily responding to rumors concerning a possible white knight merger, a target corporation may have to disclose the full extent of the merger activities even though the target corporation would not otherwise have the duty to disclose.[108]

Target corporations commonly make voluntary statements in response to stock exchange inquiries concerning unusual trading activity in the target's securities.[109] These voluntary responses are an example of the nexus between the target corporation's duty to disclose white knight mergers and duty not to issue misleading statements.[110] In an attempt to enforce their respective timely disclosure policies, both the NYSE and AMEX carefully monitor the trading activity in listed securities to detect situations in which some investors

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104. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

105. *Id.* at 862 (corporations violate rule 10b-5 if assertions made in manner reasonably calculated to influence investing public convey false impression to public).

106. *See* SEC v. Century Investment Transfer Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,232, at 91,443 (S.D.N.Y. 1971) (failure to disclose abandonment of merger plans following public announcement of proposed merger violated rule 10b-5); Cochran v. Channing Corp., 211 F. Supp. 239, 243 (S.D.N.Y. 1962) (dictum) (failure to correct misleading impression left by prior statements can constitute fraud).

107. *See* Ross v. A.H. Robins Co., 465 F. Supp. 904, 908 (S.D.N.Y.) (duty to correct or revise prior statement exists so long as investing public reasonably could rely on statement), *rev'd on other grounds*, 607 F.2d 545 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980).

108. *See* Greenfield v. Heublein, Inc., 742 F.2d 751, 762 (3d Cir. 1984) (Higginbotham, J., dissenting) (target corporation may have duty not to issue misleading statements concerning merger activities irrespective of whether agreement in principle to merge has been reached), *cert. denied*, 105 S. Ct. 1189 (1985); *see also supra* notes 103-07 and accompanying text (discussing duty not to mislead and duty to correct or revise imposed by rule 10b-5 on corporations issuing public statement). Judge Higginbotham's dissent in *Greenfield* is even more persuasive considing Judge Higginbotham also drafted the Third Circuit's decision in *Staffin*. *See* Staffin v. Greenberg, 672 F.2d 1196, 1198 (3d Cir. 1982).

109. *See, e.g.*, Greenfield v. Heublein, Inc., 742 F.2d 751, 754, 758 (3d Cir. 1984) (target corporation issued no corporate development statement in response to NYSE inquiry concerning increase in trading activity in target's securities), *cert. denied*, 105 S. Ct. 1189 (1985); Schlanger v. Four-Phase Systems, Inc., 582 F. Supp. 128, 129 (S.D.N.Y. 1984) (target corporation issued no corporate development statement in response to NYSE inquiry concerning unusual fluctuations in market price of target's securities); American Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 736-37, 744-45 (E.D. Va. 1980) (target corporation denied rumors of potential white knight merger in press releases, oral representations, and contract warranty provision).

110. *See* Greenfield v. Heublein, Inc., 742 F.2d 751, 758-60 (3d Cir. 1984) (discussing target corporation's duty not to mislead when target not under duty to disclose white knight merger activities), *cert. denied*, 105 S. Ct. 1189 (1985).

are trading on information not generally known to the investing public.[111] Sudden unexplained changes in the trading volume or price of securities may indicate rumors or insider trading.[112] Accordingly, the exchange asks the listed company to disclose any information that would explain the unusual trading activity.[113] When the listed company has no explanation for the unusual trading, the company typically issues to the public a "no corporate development" statement indicating that the company is aware of no corporate development that would explain the activity in its securities.[114]

Recent case law has not determined clearly whether a target corporation violates rule 10b-5 by issuing a no corporate development statement or other public response to rumors about a possible merger while simultaneously engaging in undisclosed white knight merger activities.[115] The Third Circuit in *Greenfield v. Heublein, Inc.*[116] held that the target corporation's no corporate development statement was not misleading when the target corporation's management had no indication other than unusual trading activity in the target's stock that someone had leaked information to the public concerning the target's white knight merger activities.[117] The target corpora-

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111. *See* AMEX GUIDE, *supra* note 24, at ¶ 23,124D; NYSE MANUAL, *supra* note 24, at ¶ 23,121. Both the AMEX and NYSE maintain a continuous market surveillance program. *See supra* note 24. With the use of computers, the stock watch programs monitor the trading activity of every listed security to detect large unexplained changes in trading volume and price. *Id.* The effectiveness of the disclosure policies of the exchanges depends on the stock watch programs. West, *Timely Disclosure—The View From 11 Wall Street,* 3 SEC. L. REV. 155, 155 (1971).

112. *See* AMEX GUIDE, *supra* note 24, at ¶ 23,124D (unusual fluctuations in trading activity in listed security may indicate trading on inside information or rumors); NYSE MANUAL, *supra* note 24, at ¶ 23,121 (unusual trading activity in listed security may indicate that market is reflecting selectively disclosed information or rumors).

113. *See* AMEX GUIDE, *supra* note 24, at ¶ 23,124D (listed company requested to make public disclosure when market appears to be reflecting undisclosed information); NYSE MANUAL, *supra* note 24, at ¶ 23,121 (listed company requested to make public disclosure when market appears to be reflecting undisclosed information).

114. *Id.; see* Greenfield v. Heublein, Inc., 742 F.2d 751, 754, 758 (3d Cir. 1984) (example of typical no corporate development statement), *cert. denied,* S. Ct. 1189 (1985).

115. *Compare Greenfield,* 742 F.2d at 758-59 (holding that no corporate development statement was not materially misleading), *cert. denied,* 105 S. Ct. 1189 (1985) *and Staffin,* 672 F.2d at 1204 (finding that target corporation's press releases were not false, misleading, or so incomplete as to mislead) *with* Schlanger v. Four-Phase Systems, Inc., 582 F. Supp. 123, 132-34 (S.D.N.Y. 1984) (substantial fact issues as to corporation's duty when responding to market rumors precluded summary judgment in corporation's favor) *and* American Gen. Ins. Co. v. Equitable Gen. Corp., 443 F. Supp. 721, 747 (E.D. Va. 1980) (finding target corporation and officers liable under rule 10b-5 for issuing false and misleading press releases in responding to market rumors).

116. 742 F.2d 751 (1984).

117. *Id.* at 759. In *Greenfield,* the target corporation began seeking a white knight when merger negotiations with another corporation started to deteriorate and the other corporation threatened to attempt a hostile takeover attempt. *Id.* at 753-54. Prior to the consummation of the white knight merger, the target corporation issued a no corporate development statement in response to an inquiry from the NYSE concerning a dramatic increase in the trading activity of the target's securities. *Id.* at 754.

tion's no corporate development statement disavowed knowledge of any reason that would explain the unusual stock trading activity.[118] The Third Circuit suggested that the statement was not misleading because the white knight merger had not reached an agreement in principle and thus was not information a reasonable investor would consider important.[119] However, the *Greenfield* court also noted that knowledge of the merger activities was information the target corporation clearly knew could have explained the unusual trading activity.[120] Nevertheless, because the target corporation had no other indication that someone had breached the confidentiality of the white knight merger plans, the Third Circuit held that the target corporation's statement denying knowledge of any reason that would explain the stock activity was not false, inaccurate, or misleading.[121]

The dissent in *Greenfield* questioned the majority's finding that the target corporation was not liable for issuing a no corporate development statement while engaging in half-secret white knight merger negotiations.[122] The dissent asserted that the target corporation's duty not to mislead applied to any public statement reasonably calculated to influence investors, irrespective of whether the information concerning the white knight merger was material enough to otherwise trigger disclosure.[123] The dissent argued that the *Greenfield* majority effectively used the absence of a general duty to disclose to avoid recognizing that the target corporation had a duty not to mislead the investing public and to update any public statement voluntarily made.[124] The dissent noted that the Third Circuit's decision suggested that the target corporation's statement would have been false or misleading only if the target corporation had known that someone had leaked information concerning the white knight merger activities.[125] The dissent argued that in judging whether the target corporation's statement was misleading, the proper standard should be whether the target corporation had knowledge of infor-

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118. *Id.* at 754, 758.

119. *See id.* at 756-57, 759. The *Greenfield* court held that the target corporation was under no duty to disclose its white knight merger activities when the NYSE requested the no corporate development statement because the merger negotiations were immaterial. *Id.* at 756-57. The court considered an agreement in principle on the price and structure of a merger a useful measure for determining when the merger activities have become material enough to require disclosure. *Id.* at 757.

120. *Id.* at 759. The corporate executives of the target in *Greenfield* clearly understood that knowledge of the target's white knight merger activities might have accounted for the increased trading activity. *Id.*

121. *Id.*

122. *See id.* at 760 (Higginbotham, J., dissenting). The dissent in *Greenfield* stated that it was false or misleading for a target corporation to issue a public statement disavowing knowledge of any explanation for the unusual trading activity in the target's securities when the target knew of information that might have accounted for trading activity. *Id.*

123. *See id.* at 762. The *Greenfield* dissent distinguished the duty not to mislead and the duty to disclose as two separate duties imposed by rule 10b-5. *Id.*

124. *Id.*

125. *Id.* at 763-64.

mation that if leaked would explain the unusual trading activity.[126] Thus, the *Greenfield* dissent concluded that given the majority's finding that the target corporation had information that might have accounted for the unusual trading activity and the existence of a possibility that someone could have leaked such information, the statement that the target corporation was unaware of any possible explanation for the unusual trading activity necessarily violated section l0(b) and rule l0b-5.[127]

Two federal district court decisions support the *Greenfield* dissent's position that target corporations can issue, in response to rumors, public statements which are so incomplete that the statements fraudulently mislead investors.[128] The United States District Court for the Southern District of New York in *Schlanger v. Four Phase Systems, Inc.*[129] considered and rejected the majority view in *Greenfield* that a target corporation's failure to acknowledge the existence of white knight merger activity in responding to market rumors was not a false or misleading statement.[130] In *Schlanger,* the target corporation issued a standard no corporate development statement in response to an NYSE inquiry, although the corporation was engaged in serious merger negotiations.[131] Finding that the target corporation knew of no other fact apart from leaks about possible merger activity, which could have explained the unusually heavy stock trading,[132] the *Schlanger* court held that

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126. *See id.* The dissent in *Greenfield* argued that courts should not allow a target corporation to falsely assure the public that no corporate changes had taken place when the target knew potentially damaging information. *Id.* Noting the near impossibility of maintaining confidentiality of merger plans until the parties reach an agreement in principle, the dissent asserted that the no corporate development statement in *Greenfield* was misleading because the target corporation knew about information that if leaked would have explained the increase in the trading activity of the target's stock. *Id.*

127. *Id.* at 765.

128. *See* Schlanger v. Four-Phase Systems, Inc., 582 F. Supp. 128, 132-34 (S.D.N.Y. 1984) (substantial fact issues as to corporation's duty when responding to market rumors precluded summary judgment in corporation's favor); American Gen. Ins. Co. v. Equitable Gen. Corp., 443 F. Supp. 721, 747 (E.D. Va. 1980) (finding target corporation and officers liable under rule 10b-5 for issuing false and misleading press releases in responding to market rumors).

129. 582 F. Supp. 128 (S.D.N.Y. 1984).

130. *Id.* at 132. In *Schlanger v. Four-Phase Systems, Inc.*, the United States District Court for the Southern District of New York analyzed the federal district court decision in *Greenfield v. Heublein, Inc. Id.; see* Greenfield v. Heublein, Inc., 575 F. Supp. 1325, 1337 (E.D. Pa. 1983) (holding target corporation was under no duty to disclose preliminary merger activities until parties reach agreement in principle), *aff'd,* 742 F.2d 751 (3d Cir. 1984). The *Schlanger* court asserted that the *Greenfield* court erred by failing to distinguish the duty not to mislead from the general duty to disclose. 582 F. Supp. at 132.

131. 582 F. Supp. at 129. In *Schlanger,* a target corporation was engaging in serious conventional merger negotiations when the NYSE requested the target to issue a no corporate development statement in response to an unusual fluctuation in the market price of the target's securities. *Id.* at 129-31. The market price of the target corporation's securities dropped after the target issued a statement disavowing knowledge of any corporate developments which could have affected the market in the target's stock. *Id.* at 129-30. The target corporation announced eight days later that it had entered into a merger agreement with another company. *Id.* at 130.

132. *Id.* at 132-33.

the evidence raised issues of fact regarding the target corporation's duty not to mislead and the materiality of the merger negotiations.[133] Consequently, the court denied the target corporation's motion for summary judgment.[134]

The United States District Court for the Eastern District of Virginia in *American General Insurance Co. v. Equitable General Corp.*[135] also supported the position taken in the *Greenfield* dissent by holding the target corporation liable under rule l0b-5 for material misrepresentations made in two press releases.[136] In *American General,* as the momentum behind the raider's takeover attempt waned, the target corporation nevertheless actively continued to solicit white knight merger offers.[137] At the time of the closing of a stock repurchase agreement with the raider that liquidated the raider's interest in the target, the target corporation's white knight merger activities with at least two other companies had reached the point just short of agreements in principle to merge.[138] In signing the stock repurchase agreement, the raider relied in part on two prior press releases.[139] The first press release failed to disclose the existence of any new merger negotiations and the later press release characterized the merger activities as very preliminary and exploratory.[140] The *American General* court noted that, regardless of whether a duty to disclose the merger activities initially was present, rule l0b-5 prohibited the corporation from making affirmative misrepresentations in the course of consummating the stock repurchase.[141] Determining that information about the white knight merger negotiations was material, the court proceeded to find the press releases false and misleading.[142] Accordingly, the court found the target corporation, the target's president, and two directors liable for violating rule l0b-5.[143]

A target corporation's duty to disclose white knight merger activities appears to vary under the three common factual situations.[144] A target corporation clearly must disclose its white knight merger activities when

133. *Id.* at 135.

134. *Id.*

135. 493 F. Supp. 721 (E.D. Va. 1980).

136. *Id.* at 747. In *American General Insurance Co. v. Equitable General Corp.*, the United States District Court for the Eastern District of Virginia found the target corporation vicariously liable for the § 10(b) violations of the target's officers. *Id.*

137. *Id.* at 732-33.

138. *Id.* at 736. After the failure of the raider's takeover attempt in *American General,* the raider agreed to sell back to the target corporation the shares the raider had acquired. *Id.*

139. *Id.* at 744-45. In *American General,* the target corporation misrepresented the extent of the target's merger activities in oral representations and press releases. *Id.*

140. *Id.* at 744.

141. *Id.* (citing First Va. Bankshares v. Renson, 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied,* 435 U.S. 952 (1978)).

142. *Id.* at 744-45.

143. *Id.* at 747.

144. *See infra* notes 145-51 and accompanying text (discussing target corporation's duty to disclose white knight merger activities in three common factual situations).

subject to the formal disclosure requirements of the federal securities laws[145] and when trading in the targets' own securities.[146] While the formal disclosure requirements appear ineffective in forcing early disclosure, the rules nevertheless eventually force a target corporation into revealing information about the white knight merger activities.[147] Another common factual situation involves the target corporation's duty to disclose white knight merger activity in the absence of insider trading, prior inaccurate or misleading public statements, or stock market rumors.[148] In this situation, a target corporation is under no enforceable general affirmative duty to unveil the white knight until the duty arises under the formal disclosure requirements.[149] The final common factual situation involves the target corporation's duty to disclose white knight merger activities when issuing public statements, especially in response to stock market rumors.[150] If a target corporation voluntarily issues a public statement, courts have not recognized consistently that the duty not to mislead the investing public continues to apply and that this duty may force a target corporation into indirectly disclosing the existence of potential white knight merger activities.[151]

The *Greenfield* dissent and the district court decisions in *Schlanger* and *American General* properly question whether a target corporation engaged in white knight merger activities, not yet otherwise subject to full disclosure, can issue no corporate development statements without violating rule 10b-5.[152] Case law indicates that a target corporation cannot issue any public statement reasonably calculated to influence investors that is false, misleading, or so incomplete as to mislead.[153] Accordingly, courts should not allow target corporations to hide behind no corporate development statements while engaging in any significant white knight merger activities. Courts could

145. *See supra* notes 66-70 and accompanying text (discussing applicability of formal disclosure requirements of '33 and '34 Acts in context of white knight mergers).

146. *See supra* notes 71-72 and accompanying text (discussing target corporation's duty to disclose inside information such as white knight merger activities while trading target corporation's securities).

147. *See supra* note 67-70 and accompanying text (discussing ineffectiveness of formal disclosure requirements).

148. *See supra* notes 73-94 and accompanying text (discussing potential sources of general affirmative duty to disclose white knight merger activities).

149. *See id.*

150. *See supra* notes 95-143 and accompanying text (discussing target corporation's duties under rule 10b-5 when issuing public statements).

151. *See supra* notes 103-10 and 122-27 and accompanying text (discussing nexus between target corporation's duty to disclose white knight merger activity and duty not to issue misleading public statements).

152. *See supra* notes 122-43 and accompanying text (analyzing *Greenfield* dissent and federal district court decisions in *Schlanger* and *American General).*

153. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir. 1968) (assertions by corporations made in manner reasonably calculated to influence public violate rule 10b-5 if assertions are false or misleading or are so incomplete as to mislead), *cert. denied,* 394 U.S. 976 (1969).

strike the needed balance between the legitimate informational needs of investors and the equally valid need of corporations to seek business objectives with a modicum of secrecy by requiring target corporations engaged in white knight merger activities to give either specific denials of incorrect rumors or "no comment" replies to stock exchange inquiries about the target's merger activities.[154]

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154. *See* Staffin v. Greenberg, 672 F.2d 1196, 1207 & n.12 (3d Cir. 1982) (one must balance target's needs and public's needs in determining when duty arises for target corporations to disclose white knight merger activities); NYSE MANUAL, *supra* note 24, at ¶ 23,123 (weighing fairness to both present and potential shareholders is helpful in determining proper timing of disclosure of corporate developments). If a stock exchange requests a target corporation engaged in white knight merger negotiations to respond to unusual trading activity, the target corporation could protect the delicate nature of the negotiations and avoid misleading the investing public by issuing specific denials of erroneous rumors or "no comment" replies to substantially correct rumors. *See* Greenfield v. Heublein, Inc., 742 F.2d 751, 760 & n.1 (3d Cir. 1984) (Higginbotham, J., dissenting) ("no comment" response carries no legal significance when target corporation is under no legal obligation to respond to stock exchange inquiries), *cert. denied*, 105 S. Ct. 1189 (1985); AMEX GUIDE, *supra* note 24, at ¶ 23,124A (proper response to erroneous rumors includes denying rumor and setting forth sufficient facts to clarify misleading aspects).