DISCLOSURE PROGRAMS FOR PUBLICLY HELD COMPANIES—A PRACTICAL GUIDE†

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† This article is based in part on a speech delivered before the Corporate Counsel Institute and appears with the permission of the Institute. The speech is published in PROCEEDINGS OF THE EIGHTH ANNUAL CORPORATE COUNSEL INSTITUTE 325-58 (O'Byrne ed. 1970).

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Companies whose securities are actively traded face complex problems in handling information about their affairs; increased emphasis is currently being placed on quick, complete, and accurate disclosure. The main propulsion for such disclosure is from the antifraud provisions of the federal securities laws as construed by the Second Circuit in *SEC v. Texas Gulf Sulphur Co.*[1] The court there stated for the securities laws a broad purpose: to equalize investors' access to information so that no one in the market has an advantage over another by virtue of inside information.[2]

This article sketches the legal developments as a background and then presents the necessary operational and organizational elements for a corporate disclosure program designed to satisfy both legal and practical requirements.

I. Objectives of Disclosure Programs

A disclosure compliance program has at least five objectives or reasons for its existence: avoiding law violations; avoiding sanctions for violations; meeting stock exchange and other trading market requirements; protecting corporate information against competitive use; and coordinating with other corporate goals. These objectives are considered in the following sections.

A. Avoidance of Securities Violations

The first objective of any disclosure compliance program is to avoid legal violations for many acts, most of which have only recently been classed as offenses. They include insider trading with undisclosed material information, tipping of material inside information, trading by tippees, misrepresentation of material information, and failure to correct previously-released information which was incorrect when released or which has become incorrect by virtue of later developments.

1. *Insider Trading.* Insider trading—face to face or in the impersonal market—with undisclosed or nonpublic material information is a violation of SEC rule 10b-5.[3] Such trading in the

1. 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

2. *Id.* at 848, 851-52.

3. SEC Securities Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (1970):

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

(a) To employ any device, scheme or artifice to defraud, public market has violated rule 10b-5 at least since *Cady, Roberts*,[4] the SEC's 1961 decision which received resounding confirmation by the Second Circuit in *Texas Gulf Sulphur*.[5]

Although rule 10b-5 is not the only provision violated by insider trading with material information, it is the most generally applicable. The rule, like most other provisions which may govern insider trading,[6] speaks in terms of fraud or deceit and does not specifically mention insiders.[7] For rule 10b-5 purposes, an insider is anyone who has access to corporate information for a corporate purpose.[8] A check list of possible insiders should include:[9] (a) the company itself; (b) directors, officers, and major security holders; (c) outside professional advisers including lawyers, accountants, financial advisers, management counselors, public relations consultants, engineers, and testing laboratories; (d) business connections including lenders, underwriters, proposed merger partners, customers, and suppliers; (e) personnel of the press, wire services, and other communication media; and (f) personnel of stock exchanges, self-

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

(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

For a discussion of the extensive litigation generated under rule 10b-5, see A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10b-5 § 2.5(6) (1969) [hereinafter cited as BROMBERG].

4. Cady, Roberts & Co., 40 S.E.C. 907 (1961).

5. 401 F.2d 833 (2d Cir. 1968). *See also* Astor v. Texas Gulf Sulphur Co., 306 F. Supp. 1333, 1339-42, 1344-45 (S.D.N.Y. 1969) (denying summary judgments for insider traders in private suits).

6. Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1964), may be violated in sales. Cady, Roberts & Co., 40 S.E.C. 907 (1961). But that section, by its own terms, is inapplicable to purchases. And while SEC Securities Exchange Act rule 15c1-2, 17 C.F.R. § 240.15c1-2 (1970), governs purchases as well as sales, it applies only to broker-dealers and only to over-the-counter (unlisted) securities. *See, e.g.*, Van Alstyne, Noel & Co., SEC Securities Exchange Act Release No. 8511 (Jan. 31, 1969), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,656 (1969). For further discussion, see BROMBERG § 2.3.

7. By contrast, section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1964), was enacted for the express purpose of preventing the unfair use of information by designated classes of insiders. But section 16(b) requires a purchase *and* a sale within a six-month period and is therefore easily evaded, while rule 10b-5 applies to a single purchase or sale. It may be fair to say that section 16(b) is for stupid insiders and rule 10b-5 for smart ones.

8. *See* 401 F.2d at 848; 40 S.E.C. at 912.

9. *See generally* BROMBERG § 7.4(6)(b) for a more complete discussion and citations to relevant cases and other authorities.

regulatory agencies, and government agencies. Others who may be insiders, but are more likely to be tippees, include: financial analysts, institutional investors, and firms and associates; families, brokers, or tippees of anyone above. While such a list is necessarily incomplete, because of the open-ended "access test" for defining insiders, the list is clearly much broader than the class defined for the short-swing insider trading provisions of section 16 of the Securities Exchange Act.[10]

Insider trading is not solely a violation of federal law but has been condemned at common law in New York[11] and legislated against in California in 1968.[12] Moreover the twenty-odd states which have passed the Uniform Securities Act have adopted language almost identical to rule 10b-5[13] and subject to the same interpretation.[14]

2. *Tipping.* A second violation to be prevented by compliance programs is the tipping of material inside information. Not yet sharply defined, tipping involves giving information to third persons for use in their stock market trading—or for any other non-corporate purpose—or recommending trades on the basis of such information even without divulging the information in detail. Tipping has also been recognized as a violation of the federal securities laws.[15]

3. *Tippee Trading.* Another closely related violation is trading by tippees who have received material nonpublic information.[16] The

10. See note 7 *supra*.

11. Diamond v. Oreamuno, 24 N.Y.2d 494, 348 N.E.2d 910, 301 N.Y.S.2d 78 (1969). *See also* Brophy v. Cities Serv. Co., 31 Del. Ch. 241, 70 A.2d 5 (1949).

12. CAL. CORP. CODE §§ 25402, 25502 (West Supp. 1970).

13. UNIFORM SECURITIES ACT § 101. For lists of adopting states, see 1 CCH BLUE SKY L. REP. 701-02; 9C UNIFORM LAWS ANN. 71 (Supp. 1967). By also adopting Uniform Securities Act section 410(h), most of these states have confined section 101 to state enforcement actions, denying private suits under the provision.

14. L. LOSS & E. COWETT, BLUE SKY LAW 250-52 (1958).

15. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 852, 856 n.23 (2d Cir. 1968), *followed on remand*, 312 F. Supp. 77, 94-96 (S.D.N.Y. 1970); SEC v. Glen Alden Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,280 (S.D.N.Y. 1968) (consent injunction); Mates Financial Services, SEC Securities Exchange Act Release No. 8836 (March 9, 1970); *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,790 (1970); Van Alstyne, Noel & Co., SEC Securities Exchange Act Release No. 8511 (Jan. 31, 1969), *reprinted at* CCH FED. SEC. L. REP. ¶ 77,656 (1969); Merrill Lynch, Pierce, Fenner & Smith, Inc., SEC Securities Exchange Act Release No. 8459 (Nov. 25, 1968), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,629 (1968). *See also* Complaint For Injunction ¶ 25 (filed Oct. 16, 1969), SEC v. Parvin/Dohrmann Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,500 (S.D.N.Y. 1969); Astor v. Texas Gulf Sulphur, 306 F. Supp. 1333, 1339-45 (S.D.N.Y. 1969) (denying summary judgments for defendant-insider-tippers in private suits). For further discussion, see BROMBERG §§ 7.5(1)-(4).

16. Investors Management Co., CCH FED. SEC. L. REP. ¶ 77,832 (June 26, 1970) (Initial

elements which determine tippee violations are complex, still developing, and not highly significant for the purposes of this article.[17]

4. *Misleading Releases.* A fourth potential violation is the misrepresentation of, or omissions in, material information disclosed to the public. Because it misleads investors, misrepresentation or omission of material information has the necessary "connection" with the "purchase or sale" requirement of rule 10b-5 to violate that rule even if no insider is trading with knowledge of the truth.[18] The

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Decision of SEC Hearing Examiner); Mates Financial Services, SEC Securities Exchange Act Release No. 8836 (March 9, 1970), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,790 (1970); Wunsch, SEC Securities Exchange Act Release No. 8713 (Oct. 7, 1969), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,749 (1969); Van Alstyne, Noel & Co., SEC Securities Exchange Act Release No. 8511 (Jan. 31, 1969), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,656 (1969), City Associates, SEC Securities Exchange Act Release No. 8509 (Jan. 31, 1969), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,657 (1969); Blyth & Co., SEC Securities Exchange Act Release No. 8499 (Jan. 17, 1969), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,647 (1969); Cady, Roberts & Co., 40 S.E.C. 907 (1961); Herbert L. Honohan, 13 S.E.C. 754, 757-58 (1943), *modified in other respects,* 16 S.E.C. 297 (1944). *See also* SEC v. Dott, 302 F. Supp. 169 (S.D.N.Y. 1969).

17. For a full discussion, see BROMBERG §§ 7.5(5)-(7); Bromberg, *Tippee Risks and Liabilities,* 3 REV. OF SECURITIES REGULATION 875 (1970).

18. 401 F.2d at 860. The *Texas Gulf Sulphur* court later reaffirmed this position in SEC v. Great Am. Indus., Inc., 407 F.2d 453, 455 (2d Cir. 1968), *cert. denied,* 395 U.S. 920 (1969), and Heit v. Weitzen, 402 F.2d 909, 913 (2d Cir. 1968), *cert. denied,* 395 U.S. 903 (1969). *See also* SEC v. Parvin/Dohrmann Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,500 (S.D.N.Y. 1969). While the reported consent injunction in *Parvin/Dohrmann* generally forbids violations of rule 10b-5 and other provisions, it was based on a complaint which charged several specific examples of misleading publicity. Complaint for Preliminary Injunction ¶¶ 22(b), (d), 26, 28(c), (d), (f) (filed Oct. 16, 1969), *id.*

Significant pending litigation on misleading company communications includes Stull v. Baker, [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,644 (S.D.N.Y. Apr. 23, 1970) (motion to transfer denied; the case involves publicity on the Lockheed C-5A contract discussed in notes 75 and 82 *infra*); SEC v. Liberty Equities Corp., Civil No. 2351-70 (D.D.C., filed Aug. 6, 1970). *See also* The Wall St. Journal, Aug. 14, 1970, at 12, col. 4 (SEC seeks injunction against allegedly misleading publicity, released by RIC International Industries, Inc. to brokers, which discusses results of oil spill cleanup chemical without disclosing insignificant testing used). A press release concerning a reorganization was held not to be misleading in Kohn v. American Metal Climax, Inc., 313 F. Supp. 1251, 1261 (E.D. Pa. 1970) (preliminary injunction denied). Although the court is presumably on firm ground in finding that the release contained no misstatements of facts, *id.* at 1260, it is much less cogent in saying that omissions from the press release did not violate rule 10b-5 because a later proxy statement would supply the missing information. If the omitted information was material—on which the court makes no finding—it should have been released to the investing public along with the other data. Later documents could not cure this deficiency retroactively.

For another case involving the unsuccessful allegation of omissions in reorganization press releases, see Stedman v. Storer, 308 F. Supp. 881 (S.D.N.Y. 1969) (preliminary injunction denied).

corollary is that public releases should be complete, accurate, and free of distortion or error.

5. *Failure to Correct Information.* A final violation that should be eliminated is the failure to correct information which has already been published. Company spokesmen have a duty to correct information released by the company itself[19] although such a duty might not be imposed in connection with information not attributable to the company.[20] The need for correction may arise either from later events which alter the facts previously given or from a later discovery of error in the original statement.

B. Avoidance of Sanctions for Violations

1. *Damages.* Monetary liability for the violations just described is still in the formative stage. While many cases are pending,[21] only a few have been decided. But they do demonstrate that monetary damages are a very real possibility as direct relief in suits by public investors in the open market[22] and as ancillary relief in SEC

19. Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc., 425 F.2d 842 (2d Cir. 1970) (in the context of a tender offer); Cochran v. Channing Corp., 211 F. Supp. 239, 243 (S.D.N.Y. 1962) (dictum). *See* SEC v. Shattuck Denn Mining Corp., 297 F. Supp. 470, 475-76 (S.D.N.Y. 1968) (in the context of trading by the president); *cf.* Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967) (refusing to dismiss claim against accountants for failure to disclose errors discovered by them in report previously certified by them). A professional duty has been decreed in the latter instance. COMMITTEE ON AUDITING PROCEDURE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, STATEMENT ON AUDITING PROCEDURE NO. 41 (1969).

20. Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 949 (2d Cir. 1969) (in the context of a tender offer). *See also* notes 86-87 *infra* and accompanying text.

21. *E.g.*, Astor v. Texas Gulf Sulphur Co., 306 F. Supp. 1333 (S.D.N.Y. 1969) (sixty class actions).

22. *See* Reynolds v. Texas Gulf Sulphur Co., 309 F. Supp. 548 (D. Utah 1970) (three former shareholders who sold their shares after misleading pessimistic press release awarded damages equal to the difference between their selling prices and the average of the daily high market prices during the twenty days after a corrected release; judgment was against the company and also, apparently, against a top executive responsible for issuing the release). For argnments against subjecting the company to damages for misrepresentation, see 401 F.2d at 866-68 (concurring opinion).

Numerous private suits based on the misrepresentations in SEC v. Great Am. Indus., Inc., 407 F.2d 453 (2d Cir. 1968), *cert. denied*, 395 U.S. 1770 (1969), were held maintainable as class actions in Berland v. Mack, 48 F.R.D. 121 (S.D.N.Y. 1969). Notice has been given of a proposed settlement in which the company would issue up to 300,000 warrants to purchasers of its shares during the period of misrepresentation, and the then-chairman of the company would serve as a consultant to the company for five years at $1 per year. N.Y. Times, July 30, 1970, at 51, col. 5. The use of warrants permits compensation of injured security holders without cash cost to the company and—if the exercise price of the warrants is above the current market price—without immediate dilution cost to existing security holders. This technique is well suited to settlements and may even be adopted by courts awarding damages.

injunction suits.[23]

Even though a disclosure program is not completely successful, it may have beneficial results. Thus, issuance of a misleading release does not constitute a violation if due diligence was used in its preparation.[24] Perhaps courts will not formulate the standards quite this way in the future, but it seems probable that the degree of care manifested by a thoughtful and demonstrable disclosure program will always be of some help in reducing the severity of damage awards and perhaps eliminating them entirely. If damages are imposed on the company, the existence of a well designed program may protect individual members of management from shareholder derivative suits seeking to force them to reimburse the company for its losses.

A compliance program may also be useful in curing violations before compensable damage is caused. For example, in *Schy v. Susquehanna Corp.*[25] the plaintiff contended that he had been damaged as a result of an allegedly misleading proxy statement. Ruling that plaintiff's shares were actually issued pursuant to a second, complete and fair proxy statement, the court denied recovery on the ground that the second proxy broke the chain of causation between the earlier proxy and any damage allegedly caused by it.[26]

2. *Injunction.* The present era of disclosure requirements began with the SEC injunction suit against the Texas Gulf Sulphur Company.[27] It remains to be seen whether the SEC will continue to seek injunctions now that it has established important law in the area. Perhaps the Commission will be content to leave enforcement to

23. SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 90-97 (S.D.N.Y. 1970) (judgment against insiders who bought with or "tipped" material nonpublic information; the measure of damages was the difference between their purchase prices—and those of their immediate tippees—and the average market price the day after disclosure of the information; award to be held in escrow by company for five years subject to disposition by order of the court, presumably available first to satisfy any judgment in private suits based on the same transactions); SEC v. Golconda Mining Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,504 (S.D.N.Y. 1969) (*semble*). Damages in the latter case were measured against the closing market prices on the day of disclosure. Letter from David Ferber, Solicitor, SEC, to Alan R. Bromberg, Feb. 2, 1970. For a thoughtful critique of the damage problem, see Ruder, Texas Gulf Sulphur—*The Second Round: Privity and State of Mind in Rule 10b-5 Purchase and Sale Cases*, 63 NW. U.L. REV. 423 (1968).

24. 401 F.2d at 863.

25. 419 F.2d 1112 (7th Cir. 1970).

26. The role of causation was greatly weakened two weeks later by Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), thereby partially undermining the *Schy* rationale. *But cf.* Kohn v. American Metal Climax, 313 F. Supp. 1251 (E.D. Pa. 1970).

27. 401 F.2d 833 (2d Cir. 1968) (brought under Securities Exchange Act § 21(e), 15 U.S.C. § 78u (1964)).

private suits, although it may still feel in some instances that the publicity and fact disclosure of its injunction cases and related investigations are necessary aids to private suits. In any event, when an injunction is sought by the SEC—or probably by a private party[28]—the existence of a compliance program is a factor to be considered by the court in deciding whether to grant the injunction.[29]

C. *Satisfying Trading Market Requirements*

Another objective of any compliance program is to obey the prompt disclosure requirements of the stock exchange on which the company is listed.[30] Violation may lead to trading suspension by the exchange or even delisting.[31] Although the over-the-counter market has similar disclosure requirements, they are less detailed and less easily enforceable.[32]

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28. *See, e.g.*, Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967).

29. *See* SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 84-88 (S.D.N.Y. 1970) (denying injunction, despite finding of lack of due diligence, because repetition of violation unlikely. The court notes that issuance of an injunction would be inappropriate "absent a showing of lack of good faith." *Id.* at 88.). In the arguments preceding this decision, the SEC urged that Texas Gulf's failure to adopt a disclosure compliance policy until the eve of the remand hearings—and more than a year after the decision in the Second Circuit—justified the injunction. Post-Hearing Brief for SEC at 31-32, SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77 (S.D.N.Y. 1970); The Wall St. Journal, Oct. 8, 1969, at 15, col. 1 (Sw. ed.). Texas Gulf's present disclosure compliance policy appears in Appendix C *infra*.

30. AMERICAN STOCK EXCHANGE, COMPANY GUIDE §§ 401-06, at 101-14 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶¶ 23,124-124E (1970); MIDWEST STOCK EXCHANGE, Supp. to rule 8, art. XXII, CCH MIDWEST STOCK EXCHANGE GUIDE ¶ 2448.10 (1970); N.Y. STOCK EXCHANGE COMPANY MANUAL A-18 to A-27 (1968), 2 CCH FED. SEC. L. REP. ¶ 23,121 (1968).

A New York Stock Exchange vice president has expressed the Exchange's rule of thumb in the most basic terms: "When in doubt—disclose." West, *Timely Disclosure—The View from 11 Wall Street*, 24 Sw. L.J. 241, 242 (1970). *SEC v. Texas Gulf Sulphur* hinted that the disclosure requirements of the exchanges might have the force of law. 401 F.2d at 850 n.12. But the same court gave primacy to federal securities registration law when it seemed to conflict with exchange requirements. *See* Chris-Craft Indus. Inc. v. Bangor Punta Corp., 426 F.2d 569 (2d Cir. 1970) (en banc, 6-2 on this poiut) (disclosure of value of proposed exchange offer, before filing of registration statement, violated Securities Act § 5(c), 15 U.S.C. § 77e(c) (1964) and SEC Securities Act rule 135, 17 C.F.R. § 230.135 (1970)).

31. Intercontinental Indus., Inc., SEC Securities Exchange Act Release No. 8858 (Apr. 3, 1970), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,827 (1970). For the SEC injunction against the same company, see the last paragraph of note 83 *infra*.

32. NATIONAL ASSOCIATION OF SECURITIES DEALERS, NATIONAL PROCEDURES FOR OVER-THE-COUNTER QUOTATIONS DISTRIBUTED IN THE PRESS, RADIO OR TELEVISION AS A PUBLIC SERVICE ¶ (7), CCH NASD MANUAL 2073 (1970). The difficulties of enforcement derive partly from the decentralized character of the over-the-counter market. In addition, the NASD rules bind only members (brokers) who gather the quotations. Unlike the stock exchanges, the NASD has no contract with the companies whose securities are traded in its markets.

D. *Protecting Corporate Information Against Competitive Use*

Still another objective of a compliance program is to control inside information in order to safeguard it against competitive use by business rivals or by present or past employees.[33]

E. *Coordination with Other Corporate Goals*

The last general objective in designing a compliance program is to make sure that information activities are coordinated with, and supportive of, other corporate goals, whether these goals involve general public relations, financial public relations, shareholder relations, an acquisition program, product promotion efforts, or other objectives.

F. *Possible Conflicts Among Objectives*

One disclosure objective may conflict with another or with a different principle of law. A few examples will suffice. Prevention of insider trading, tipping, and tippee trading may be accomplished by early release of information or by controls on the actions of individuals having access to the information.[34] However, early release of information may hurt the company in acquisition negotiations, for instance, by driving up the market price of the assets or securities sought, thereby raising the price which the company must pay. Perhaps mindful of this, the courts have recognized that a company may withhold information when it has good business reasons to do so,[35] although such reasons do not excuse insider trading, tipping, or tippee trading.[36] But controls tight enough to forestall the latter may themselves be a tip that something important is in the wind.

Early release of material information may conflict with other parts of the securities laws, particularly if the company is in

33. See note 47 *infra* and accompanying text.

34. See section II(B) of text *infra.*

35. 401 F.2d at 850 n.12; Reynolds v. Texas Gulf Sulphur Co., 309 F. Supp. 548, 558 (D. Utah 1970) (dictum concerning corporation's duty to acquire mineral interests); Astor v. Texas Gulf Sulphur Co., 306 F. Supp. 1333, 1338-39 (S.D.N.Y. 1969) (granting summary judgment for the company on claims by shareholders who sold before the company completed its land acquisition program). For a more specific discussion of possible good business reasons for withholding information, see section II(A)(4) of text *infra.*

36. 401 F.2d at 848 n.12. The rule is applied in Astor v. Texas Gulf Sulphur Co., 306 F. Supp. 1333, 1339-42 (S.D.N..Y 1969) (refusing summary judgment for insiders who traded or tipped before the company completed its land acquisition program).

registration under the 1933 Securities Act.[37] Leaving registration aside, a dilemma arises if the material information involves an expectation of much higher or lower earnings. If the "forecast" information is released, it may turn out to be wrong, leading to charges of misrepresentation and manipulation. If it is not released, there may be insider trading and tipping.[38]

A company may have highly favorable financial information that develops in the course of a tough labor negotiation. The last thing the company wants to do in its bargaining is to flaunt a new high in profitability or a major discovery that will enhance the corporate finances. Yet rule 10b-5 or the stock exchange policies may compel it to do so in some circumstances.

Or, a very unfavorable development may appear at a time when the company is attempting to strengthen itself and its reputation after a management change, or after a decline in the company's stock prices on the market, or during negotiations with creditors who are feeling insecure and ready to exercise default rights. Nevertheless, disclosure may be required.

G. *Special Instances of Disclosure*

Disclosure compliance takes on special significance in proxy solicitations, offerings of a company's own securities through a registration statement or otherwise, purchases of a company's own securities, making a tender offer for another company's securities, and combating a tender offer for the company's securities. These are generally not covered in this article.[39]

37. *See* the discussion in the last paragraph of note 30 *supra*. *But see* SEC Securities Act Release No. 5009 (Oct. 7, 1969), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,744 (1969) (permitting purely factual disclosure of material events during registration but not predictions or opinions).

38. *See* section II(A)(4) of text *infra*.

39. For examples of recently intensified disclosure requirements in some of these areas, see Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970) (insufficient disclosure of conflict of interest in proxy statement for merger); Swanson v. American Consumer Indus., Inc., 415 F.2d 1326 (7th Cir. 1969) (*semble*); Gerstle v. Gamble Skogmo, Inc., 298 F. Supp. 66 (E.D.N.Y. 1969) (insufficient disclosure of asset values in proxy statement for merger). On disclosure in tender offers, see BROMBERG §§ 6.3(400)-(470), (630)-(635), (700)-(850); Bromberg, *The Securities Law of Tender Offers*, 15 N.Y.L.F. 462, 482-503, 519-22, 531-46 (1969). On disclosure in exchange offers, see Bromberg, *Exchange Offers*, 2 REV. OF SECURITIES REGULATION 805, 808-10, 812-13 (1969), *reprinted at* 12 CORP. PRACTICE COMMENTATOR 1, 12-15, 23-27 (1970); MacLean, *SEC Registration and Filing Requirements for Mergers and Acquisitions*, 4 MERGERS & ACQUISITIONS 33 (No. 2, Mar.-Apr. 1969).

II. COMPONENTS OF A COMPLIANCE PROGRAM

To attain the objectives stated above, two kinds of controls are necessary. I call them "information controls" and "people controls," and they overlap to some extent.

A. *Information Controls*

"Information controls" fall into these general categories: gathering information, particularly early detection of material information; monitoring and limiting access to the information; deciding when it is material; deciding whether it is to be released; preparing for and timing the release; phrasing and releasing the information; and taking certain actions after release.

1. *Early Detection of Material Information*

Techniques. The information control phase of a good disclosure program depends on the company's ability to anticipate the development of material information. Methods of anticipating or detecting material information will differ greatly according to the corporate structures and personalities.[40] At the minimum the company should establish clear reporting obligations on developing information and provide channels by which that information reaches the proper destination. In a well-managed company, information of this kind should be coming to top management continually. However, even this process does not necessarily guarantee that the information reaches the person who has to deal with the legal questions of whether it will be released, when, and how. Some two-way communication channel needs to be established between top management and the Information Officer recommended in the next section. This Information Officer will need to make frequent inquiries in parts of the company likely to spawn material information—for example, the accounting, research, and corporate finance or acquisitions departments[41]—as well as to control the collection and release of such information.

Responsibility and Authority—Information Officer. The company should have someone designated to act as an information

40. For some of the informal means of gathering information, see W. MOORE, THE CONDUCT OF THE CORPORATION ch. V (1962); Choka, *The Role of Corporate Counsel*, 25 BUS. LAW. 1011, 1019-20 (1970).

41. *See* DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS 216-17 (J. Flom, B. Garfinkel, & J. Freund eds. 1967) (house counsel should review intra-company correspondence, participate in meetings, quiz operating chiefs).

officer. If there are house counsel, one of them is the logical choice. The Information Officer may, however, be someone else such as a member of the public relations staff or an executive officer. He may also be an outside legal or public relations counsel, although this sacrifices something in intimacy and accessibility. The choice of the person is not as important as that person's understanding of his responsibilities and a clear grant of authority to him to gain access to all information and to perform the necessary acts to fulfill those responsibilities. If he is to consult before acting—as he usually should[42]—this too should be spelled out.

In large companies several Information Officers may be necessary. Even in a small company, it is wise to have an alternate who can act if the primary person is unavailable.

Examples of Material Information. The Information Officer should be alert for all of the items in the following check list.[43] Tested by the criteria discussed below,[44] any of them may become material information: (a) financial results, especially profits (total and by line of business); (b) financial forecasts or goals; (c) research efforts and new products or services; (d) marketing plans; (e) exploration activities and discoveries; (f) acquisitions, including mergers and tender offers; (g) joint ventures; (h) exclusive licenses and other patent or franchise agreements; (i) dividend changes; (j) stock splits and stock dividends; (k) public or private sales of debt or equity securities; (l) calls, redemptions, or repurchases of securities; (m) adoption of stock option plans, grants of options, or other compensation plans; (n) purchases or sales of assets; (o) capital investment plans such as those for new plants; (p) contract awards or cancellations; (q) top management or control changes; (r) bankruptcy or Chapter 10 or 11 proceedings; (s) defaults on debts or contracts; (t) write-offs; (u) changes of accounting method; (v) labor negotiations or contracts, disputes, strikes, or lockouts; (w) disputes with suppliers or customers; and (x) litigation or governmental proceedings.

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42. See section I(C) of text *infra*.

43. For a similar list, see AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 103-04 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-99 (1970). *See also* SEC Form 8-K, 2 CCH FED. SEC. L. REP. ¶ 31,001 (1969), listing somewhat similar items, with emphasis on the company's securities, which must be reported to the SEC if they occur. An expansion of the list appears in suggested SEC Form 10-Q in DISCLOSURE TO INVESTORS Appendix X-2 (Wheat Report 1969, CCH ed.) and has been proposed for adoption by SEC Securities Exchange Act Release No. 8683 (Sept. 15, 1969), [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. Special Report No. 272, Extra Edition at 81 (1969).

44. See section II(A)(3) of text *infra*.

While the determination of what information is material is always a matter of judgment, dependent on too many variables to be subject to any established formula, at least 95 percent of all material information will probably be in one of the categories indicated. Not all of the listed information—even if it is material—has to be released,[45] but it must be controlled. Finally, the Information Officer should remember that unfavorable, as well as favorable, information may be material.

2. *Monitoring Information and Controlling Use*

Monitoring. Potentially material information should be monitored as it develops. Very rarely does material information spring full blown. More commonly it results from a continuing effort in a research, planning, market testing, mineral exploration, labor negotiation, or acquisition program. Even the preparation of financial results takes days or week to complete and is commonly preceded by indicators. Thus, sales or cost levels and their general impact on earnings are usually known before the earnings themselves are computed.

When the Information Officer is alerted to the possibility that information will be material, he should follow it closely and make inquiries concerning details and development of the information.

Controlling Access. Of the utmost significance are measures to insure that access to potentially material information is limited to those persons who need to know about it.[46] This limitation is the key to avoiding or minimizing insider trading, tipping, and tippee trading. It is also vital to the avoidance of competitive use of the information and the preservation of trade secrets.[47]

Establishing Policy. Every publicly held company should have some established policy concerning access to, and use of, inside information. Such a policy sets a moral tone, may prevent violations, and may protect against corporate injury even if it is not completely successful.[48] A standing policy is obviously preferable to one

45. See section II(A)(4) of text *infra.*

46. For further discussion, see N.Y. STOCK EXCHANGE, THE CORPORATE DIRECTOR AND THE INVESTING PUBLIC 6 (1965); Fleischer, *Corporate Disclosure/Insider Trading,* 45 HARV. BUS. REV. 129 (Jan.-Feb. 1967); Fleischer, *Controls on Insider Trading,* 34 U. MO. K.C.L. REV. 210, 221 (1965); Fleischer, *Securities Trading and Corporation Information Practices: The Implications of the Texas Gulf Sulphur Proceeding,* 51 VA. L. REV. 1271, 1305 (1965).

47. *See, e.g.,* Niemann, *The Departing Employee; Trade Secrets and Other Problems,* PROCEEDINGS OF THE EIGHTH ANNUAL CORPORATE COUNSEL INSTITUTE 138, 143-47 (1970).

48. See section I(B) of text *supra.*

inaugurated when material information is at hand. The latter policy is likely to defeat its purpose by creating speculation that material information is developing.

Three examples of policies appear at the end of this article. Appendix A, adopted by Merrill Lynch, was submitted to the SEC as part of the settlement of the Commission's disciplinary action against the firm. The SEC staff may have assisted in drafting the statement. Although it did not exactly approve the statement, the Commission did discuss it at some length, give it positive consideration in meting out punishment, and publish it verbatim as an appendix to its opinion.[49] If this does not amount to de facto endorsement, it comes very close.

Designed for a securities firm charged with tipping violations, the Merrill Lynch statement emphasizes information about other companies. But it is a useful general model in listing clearly the persons or departments entitled to certain types of information, prohibiting disclosure to others, attempting to define material information,[50] requiring identification of nonpublic information as such, and specifying means of dissemination and reinforcement. On the other hand, it says nothing about trading with inside information, very likely because the firm already had a statement on this subject.

Appendix B, prepared by a financial public relations concern for its clients, is applicable to all kinds of companies. It is noteworthy in covering trading as well as tipping, attempting to itemize the various types of material information,[51] and counseling protection of confidentiality in all cases.

Appendix C, the policy promulgated by Texas Gulf Sulphur Co. after the historic Second Circuit decision in the SEC's suit against the company,[52] deals broadly with conflict of interest. The seventh paragraph takes aim at trading with inside information and undoubtedly reflects the experience of the company, its management, and its advisers as the targets of the first great inside information litigation.

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49. Merrill Lynch, Pierce, Fenner & Smith, Inc., Securities Exchange Act Release No. 8459 (Nov. 25, 1968), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,629 (1968).

50. *Compare* section II(A)(3) of text *infra.*

51. *Compare* the check list of potentially material information in section II(A)(1) of text *supra.*

52. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968). For the inferences drawn from the timing of the policy statement, see note 29 *supra.*

Company statements of policy are neither memorable nor self-executing. They should be repeated periodically, and they can provide a pattern for implementation by appropriate means.

Marking and Securing Documents. Some kind of physical identification of material nonpublic information—for example a "confidential" stamp—will often be useful. While such precautions are probably worthwhile, they create some risk that they will backfire by calling attention to matters which might otherwise go unnoticed. Physical security arrangements such as limited and numbered copies, sign-out sheets, lock-up procedures, and restricted-access areas may also be appropriate but suffer from the same defect as the "confidential" stamp.

Suspending Actions. If potentially material information is developing, the company should attempt to minimize its risks by blocking actions wbicb may be violations if carried out. Company purchases of its own shares should very likely be halted if the information is potentially favorable.[53] The granting of stock options, at least to top management, should also stop, since the grants will constitute violations if the optionees have material nonpublic information.[54] The same caution should be applied to other employee

53. *See* Rogen v. Ilikon Corp., 361 F.2d 260 (1st Cir. 1966) (rule 10b-5 cause of action stated against issuer for purchasing its own shares in a face-to-face transaction without disclosing material information); Ward La France Truck Corp., 13 S.E.C. 373 (1943) (investigative report concluding that company violated rule 10b-5 by purchasing its own shares over the counter without disclosure of vastly increased earnings).

If the company has established a consistent pattern of buying over time, perhaps it may continue at the same rate. The theoretical justification for continued buying is that inside information, even though it is possessed, is not being used in such purchases. *Cf.* 401 F.2d at 851. A policy justification is that cessation of company purchases would tend to drop the market price, thus aggravating the rise expected upon release of the information. *Symposium, Insider Trading in Stocks*, 21 BUS. LAW. 1009, 1026-27 (1966) (Halleran). Another approach analyzes the propriety of purchases in terms of the buyer's motive. Kennedy, *The Corporation's Obligations When It Is Trading in Its Stock*, 50 CHI. B. RECORD 384, 386-88 (1969). For other aspects of company purchases, see BROMBERG § 7.3(3); TEXAS GULF SULPHUR—INSIDER DISCLOSURE PROBLEMS 528-48 (A. Fleischer & J. Flom eds. 1968).

54. 401 F.2d at 856-57. The court intimates that grant of the option will create no violation if exercise of the option is postponed until ratification of the option plan after disclosure of the information. I think this is dangerous nonsense. *See* Bromberg, *Corporate Information:* Texas Gulf Sulphur *and Its Implications*, 22 SW. L.J. 731, 734 n.9 (1968). The court also implies that the gist of the violation is nondisclosure of the favorable material information to the committee awarding the stock optious. 401 F.2d at 857. Even if the optionees inform the committee, there is a serious question whether a grant of options would be proper under state law. The grant might well entail waste of corporate assets or unreasonable dilution if the option price were based, as is customary, on the market price; for the latter does not reflect the information. In short, the option price would be too low, resulting in injury to the company and its shareholders.

plans based on the market value of the company's securities.[55] But the exercise of options granted earlier at prices fixed prior to the development of material inside information appears entirely proper.[56]

The company should also consider cutting off interviews with securities analysts, brokers, and financial reporters. Otherwise, the information may be elicited by them, resulting in a "tipping" problem and perhaps an effort to solve it by premature release of the information. On the other hand, an obvious embargo on interviews may raise suspicions that "something is up." Polite postponement may be the best tactic.

3. *Determining Materiality*

Market Impact or Reasonable Investor Standard. The most difficult task in disclosure compliance is deciding whether information is material. If the information evolves gradually over time, the question may be one of deciding when it becomes material. The decision is often complex and elusive, involving technical, financial, and other viewpoints; but it is primarily a legal decision. Materiality is no longer limited to "facts" which are fully established; tentative or incomplete information can be material.[57]

The legacy of *Texas Gulf* is a dual standard of materiality: first, information which is reasonably certain to have a substantial impact on the market;[58] and second, information which affects the desire of investors, including speculators, to buy, sell, or hold.[59] The first test looks to the probable collective market reaction if the information is released. This would be hypothetically measured by unusual price movement in the company's stock, either in dollar or percentage terms. Knowledgeable company officials, securities brokers, or analysts should be able to make a reasonable estimate of materiality by this criterion, particularly if the necessary degree of market reaction can be refined in future court decisions or otherwise.

The second test looks to the reasonable investor or speculator and his probable reaction. Since individual responses vary so greatly and this test has no substantiality element, the test renders virtually all information material.[60] Universal materiality may simplify judicial

55. *See* Jacobs, *Trading and Disclosure Under Rule 10b-5*, 1 P-H CORPORATION GUIDE 26,005, 26,030 (1970) (not distinguishing, however, between plans based on market price and plans based on other formulae).

56. *See* West, *supra* note 30, at 245.

57. *See* 401 F.2d at 849-50.

58. *Id.* at 848.

59. *Id.* at 849.

60. For a fuller discussion and comparison of the tests, see BROMBERG § 7.4(3).

decision making, but it enormously complicates company information controls.

The Second Circuit's decision in *Texas Gulf* regarded both tests as valid but emphasized the wrong one—the individual investor. Thus the decision set a much lower standard of materiality than is appropriate. Fortunately, the SEC's later pronouncements, both official and unofficial, seem to prefer the market impact test.[61] Some lower courts use the market impact test.[62] But the Second Circuit has more recently employed the reasonable investor version[63] as has the Ninth Circuit.[64]

Other Factors. Another factor warranting consideration in deciding whether information is material is the relation of the information to the total company activity.[65] A new oil field may be a drop in the bucket for Standard Oil of New Jersey, while the same discovery for a much smaller company would be highly material.

The use of information by insiders in their trading is an index of materiality.[66] From an evidentiary point of view, a plaintiff will rarely be able to prove that an insider consciously used the information in his trades unless the insider was incautious in his spoken or written comments. The plaintiff can probably establish use by showing knowledge and trading in proximity.[67] But little inference of

61. It is used in each of the SEC decisions cited in note 15 *supra*. *See also* the formulations by various individuals: P. LOOMIS, CORPORATE DISCLOSURE AND INSIDER INFORMATION 14 (1968) (SEC General Counsel); Cohen, *Inside Information and Corporate Publicity*, [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,652, at 83,415, par. 4 (1969) (then SEC Chairman); Ferber, Texas Gulf Sulphur—*Insider Disclosure Problems*, in PLI CORP. LAW AND PRAC. TRANSCRIPT, SERIES NO. 1, at 228-29, 314 (A. Fleischer, Jr. & J. Flom eds. 1968) (SEC Solicitor, Office of General Counsel). The same view appears by implication in SEC, DISCLOSURE TO INVESTORS 133 (Wheat Report 1969, CCH ed.).

62. *See* Britt v. Cyril Bath Co., 290 F. Supp. 934, 939 (N.D. Ohio 1968), *rev'd on other grounds*, 417 F.2d 433 (6th Cir. 1969).

63. *See* Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 796-97 (2d Cir. 1969).

64. *See* Northwest Paper Corp. v. Thompson, 421 F.2d 137, 138 (9th Cir. 1969).

65. 401 F.2d at 849.

66. *Id.* at 851.

67. *But see* II SEC STAFF REPORT OF INVESTIGATION IN RE LOCKHEED AIRCRAFT CORP., HO-423 at v-viii (1970) (summarized in BNA SEC. REG. & L. REP. A-3 (No. 54, 1970)). The staff reviewed sales by Lockheed insiders with knowledge of the growing cost overruns and attendant losses for the company on a major contract. See note 82 *infra*. Without specifically stating whether it found violations, the staff apparently concluded that none existed. Factors cited include purchases followed by sales (so that total holdings of the insiders remained relatively stable over the period) and personal reasons given for the sales including purchases of new residences and tax factors. Query how influential these factors would be if the information had been a single dramatic event rather than a gradual accretion over a period of years. Query also whether later purchases are significant evidence of non-use of information in prior sales, when the purchases are pursuant to options at prices below the market level when exercised. I

materiality can be drawn from such limited evidence alone. Independent tests of materiality, like those discussed above, should also be employed. From a planning point of view, the company must strive to prevent trading in cases of possible materiality, since the trading itself tends to establish the materiality.

If the information is still incomplete or tentative, another materiality test is the probability of the expected outcome. The higher the probability, the greater the materiality.[68]

A useful acid test is this: if there is resistance to disclosing the information, particularly on the part of the chief executives or other persons in charge of the area concerned, it is probably material. From a legal point of view, it pays to be suspicious of such resistance. These individuals may, of course, have perfectly good reasons for not wanting to disclose.[69] But the odds are that their resistance constitutes strong evidence of materiality, particularly in the case of adverse information which companies traditionally tend to bury.

4. *Deciding Whether to Release*

Pressures to Release. Deciding whether to release the information, also a critical step in controlling disclosure, is distinct

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doubt that one can reasonably infer that a seller at $70 with knowledge of non-public adverse information does not use the information merely because he later exercises an option to buy at $40. Indeed, quite apart from the option, little inference can be drawn from a repurchase at a lower market price. However, the *method* of sale may indicate that inside information was not used. *Id., Institutional Trading* at 4 (318,000 shares sold by investment company in round lots through many brokers over several months; this "does not appear to point to panic selling based upon non-public corporate information"). After receiving the staff report on Lockheed, the Commission determined that it disclosed no evidence of unlawful insider trading. SEC Securities Exchange Act Release No. 8897 (June 2, 1970), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,825 (1970).

For other clues to SEC thinking on use of information by tippees, see Investors Management Co., Inc., (June 26, 1970), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,832, at 83,959-61 (1970) (Initial Decision of Hearing Examiner at 96-102). The Dreyfus Corporation was cleared of violation on a sale of Douglas Aircraft ordered by the Dreyfus president on the advice of a junior analyst. While the analyst had information of a sharp decline in Douglas earnings, he did not transmit it to the president. The Hearing Examiner concluded that the president's decision was based on chart data and previously existing doubts about Douglas. *See also id.* ¶ 77,832, at 83,952-54 (Hearing Examiner Decision at 77-78) (violation in sales by one portfolio manager who had inside information but not in sale by another competing manager who did not know). Applying the same governing principle which controls the use of information by true insiders, the Hearing Examiner also concluded that the tippees, the other respondents in the proceeding, had used the information and thereby violated rule 10b-5.

68. 401 F.2d at 849.

69. See the discussion of valid reasons for withholding information appearing in section II(A)(4) of text *infra*.

from the determination of materiality: nonmaterial information may be released and material information withheld.[70] But a conclusion of materiality greatly increases the pressures for release. These pressures stem from possible violations of rule 10b-5 by insider trading with—or tipping of—the information or by tippee trading.[71] The longer the information remains nonpublic, the higher the risk of these occurrences. Stock exchange and over-the-counter prompt disclosure requirements provide additional pressures to release the information.[72] The Second Circuit's low threshold test of materiality,[73] which renders evolving information material at an earlier stage, increases the interval during which the several pressures operate.

Justifications for Withholding. Nevertheless, present law clearly allows the withholding of material information for good business reasons. In *Texas Gulf*, the need to acquire land surrounding the great mineral discovery furnished this reason.[74]

Postponement is justified if the facts are in flux and a firmer statement is possible following a slight delay.[75] Nor is disclosure

70. For further discussion of a company's possible disclosure duty when no insiders or tippees are trading, see De Lancy, *Rule 10b-5—A Recent Profile*, 25 BUS. LAW. 1355, 1362-64 (1970).

71. See sections I(A)(1)-(3) of text *supra*.

72. See section I(C) of text *supra*.

73. See section II(A)(3) of text *supra*.

74. *See* note 35 *supra*; AMERICAN STOCK EXCHANGE COMPANY GUIDE § 403(1), at 104 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-9, -10 (1970) (*semble*). Nothing more clearly demonstrates the strictures on securities transactions in comparison to other commercial actions. For example, concealing the material information from the seller of the land is apparently not improper. *See* BROMBERG § 7.4(6)(c) at n.186; Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 550-51 (1970). *But cf.* N.Y. Times, July 10, 1970, at 45, col. 1 (Texas Gulf pays $27 million to settle litigation with royalty owner in the area; basis of claim not indicated); The Wall St. Journal, July 10, 1970, at 8, col. 1.

Another possible corporate reason for delaying disclosure is to gain lead time over competitors in developing a product. DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES 218 (J. Flom, B. Garfinkel, & J. Freund eds. 1967). A final reason is to avoid prejudicing acquisition negotiations. See note 75 *infra* and text accompanying note 89 *infra*.

75. *See* 401 F.2d at 863. *Accord*, AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 104 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124, at 17,097-10 (1970) (referring to various stages in merger negotiations and recommending release on reaching agreement in principle on specific terms). For an alternative, see West, *supra* note 30, at 243. The author, a New York Stock Exchange vice president, describes with approval a company's decision not to disclose a desalinization process it had developed when there was great investor interest in such activity. The company had withheld disclosure pending determination of the commercial feasibility of the project. In fact, the project proved to be infeasible months later.

Information may remain in flux over quite long periods, sometimes years. For an example involving a prime contract for transport aircraft, see note 82 *infra*. The report cited in that instance led the SEC to order an investigation of disclosure of costs incurred in major defense contracts. SEC Securities Exchange Act Release No. 8897 (June 2, 1970), *reprinted at* [1969-

necessary—or, indeed, permitted—if it would violate some other securities law.[76]

Consequences of Withholding. Though a good business reason may save the company from a violation for withholding the information, it gives no immunity from violation to insiders who trade or who tip the information or to tippees who trade.[77] In other words, even with a good business reason for non-disclosure, risks of violation remain. Nor are the risks confined to insiders and tippees. One of the more startling current developments in securities fraud is the expanding degree to which parties may incur liability by aiding and abetting, by conspiracy, or by common plan and concert of action.[78] Thus the company which withholds material information for good business reasons may be implicated in a violation if insiders are trading. More remote, but still possible, is a company violation in the absence of insider trading if tipping and tippee trading occur.

In summary, while business reasons may justify a delay in the release of material information, they will rarely justify a permanent withholding of the information.

Financial Projections. One category of information which is present in all well managed companies, yet is rarely disclosed, is financial projections. The forecasts exist most importantly for earnings or profits but also for sales, costs, capital expenditures, and other items. Probably no information is more important to the ordinary investor or to investment advisers and analysts than the projected earnings of a company.

Obviously not every projection is material information. Materiality depends greatly on the probability that the information is accurate,[79] and this probability varies inversely with the length of the period covered. Materiality also depends on the variance of the projection from the company's present performance and from the performance expected by the securities market as reflected in the projections by analysts and others. But it can be safely said that many projections are material. If they are, the company is under the same

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1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,825 (1970). Guidelines for disclosure may emerge from the investigation.

76. See notes 30 and 37 *supra*. Disclosure might also be contrary to notes (a) or (d) of SEC Securities Exchange Act Rule 14a-9, 17 C.F.R. 240.14a-9 (1970), prohibiting (in proxy solicitation) predictions as to values or earnings and claims as to proxies obtained.

77. See note 36 *supra*.

78. *See* BROMBERG § 8.5.

79. 401 F.2d at 849.

pressures to disclose them as to disclose other kinds of material information.[80] Despite all this, a company is probably wiser not to release projections[81] unless it has great confidence in the accuracy of forecasts, either because they cover only a very short period—say, the next quarter—or because the company's operations are extremely predictable as in the case of some public utilities. In such cases, especially if the information is highly material and discloses, for example, a large variation from prior corresponding periods, the risks of withholding are probably greater than those of releasing. Normally the reverse is true, particularly for long range forecasts. The inherent uncertainty in projections[82] is likely to be misleading to investors who place undue reliance on them. Moreover, the company faces the very real danger that lawsuits claiming misrepresentation will follow if the predictions do not come true.[83]

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80. *See, e.g.*, SEC v. Parvin/Dohrmann Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,500 (S.D.N.Y. 1969) (consent injunction in general terms against violation of rule 10b-5 and other provisions; the plaintiffs complaint had alleged tipping of projections, plans, and other information to institutional investors); SEC v. Glen Alden Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,280 (S.D.N.Y. 1968) (consent injunction against tipping by company of projected sales, earnings, and cash flow); Merrill, Lynch, Pierce, Fenner & Smith, Inc., SEC Securities Exchange Act Release No. 8459 (Nov. 25, 1968), *reprinted at* [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,629 (1968) (underwriter violation by tipping information which included projection of greatly reduced earnings); Investors Management Co., Inc., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,832 (June 26, 1970) (Initial Decision of SEC Hearing Examiner) (tippee violation by trading with information which included a projection of greatly reduced earnings).

81. AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 103 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-8 (1970).

82. Perhaps the most dramatic example of erroneous forecasting is Lockheed's internal estimates on the C-5A transport it was building for the Air Force. Early in 1966 the company estimated total costs on the project at $1.1 billion; by early 1970 the estimate was over $2.6 billion. Since the contract was for a fixed price with some elements of cost sharing, the first estimate contemplated a pre-tax company profit of $137 million while the last indicated a loss of some $500 million. 1 SEC STAFF REPORT OF INVESTIGATION IN RE LOCKHEED AIRCRAFT CORP., HO-423, at 47, 71, 73, 79, 85 (1970). For related private litigation, see Stull v. Baker, 311 F. Supp. 1205 (S.D.N.Y. 1970).

83. *See, e.g.*, Heit v. Weitzen, 402 F.2d 909 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969) (open market purchaser states cause of action for false earnings reports and forecasts); Sprayregen v. Livingston Oil Co., 295 F. Supp. 1376 (S.D.N.Y. 1968) (cause of action for false earnings predictions stated by open market purchaser); Fischer v. Kletz, 266 F. Supp. 180, 194-97 (S.D.N.Y. 1967) (*semble*); Miller v. Steinbach, 268 F. Supp. 255, 276-77 (S.D.N.Y. 1967) (cause of action stated for insufficiency of proxy statement reference to expectation of "some" decline in earnings); Freed v. Szabo Food Service, Inc., [1961-64 Transfer Binder] CCH FED. SEC. L. REP. ¶ 91,317 (N.D. Ill. 1964) (*semble*).

For a pending case, apparently based on the failure to disclose the projected losses on the

If projections are material and are not publicly released, they cannot be safely tipped to brokers or analysts,[84] and they probably make insider trading illegal. If projections are publicly released, they should be carefully qualified by a statement of their assumptions and the use of ranges rather than single figures. Many lawyers feel that it is safer to label them "goals" rather than projections or predictions. The company should revise them, with equal publicity, if they begin to appear inaccurate.[85]

Thus a company faces potential trouble either by disclosing or by not disclosing predictions. The no-win game becomes worse when someone else—usually an analyst or broker—is circulating an earnings prediction that the company regards as clearly erroneous. The advice of the American Stock Exchange concerning this quandary provides as good a solution as any:

> In the case of a . . . [prediction of] future sales, earnings or other data, no response from the company is ordinarily required. However, if . . . [the prediction] is manifestly based on erroneous information, or is wrongly attributed to a company source, the company should respond promptly to the supposed factual elements . . . [by releasing the correct facts and calling them to the attention of the persons circulating the projection]. Moreover, if . . . [a prediction] is clearly erroneous, the company should issue an announcement to the effect that the company itself has made no such prediction and currently knows of no facts that would justify making such prediction.[86]

The same problem may arise at an earlier stage if the analyst or broker asks the company to confirm his prediction before he circulates it. At this point, the company has a chance to prevent an erroneous prediction from being disseminated but only at the price of tipping possibly material information to the broker or analyst or publishing its own prediction with the attendant risks. Again, there is

Lockheed C-5A contract, see Stull v. Baker, 311 F. Supp. 1205 (S.D.N.Y. 1970) (motions to transfer denied).

For injunctions against release of false financial projections, see SEC v. Intercontinental Indus., Inc., Civil No. 69-3003 (S.D.N.Y. July 15, 1969) (consent judgment) (earnings and sales); SEC v. Dumont Corp., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,424 (S.D.N.Y. 1969) (sales). For the stock exchange delisting which followed, see note 31 *supra*.

84. *See* SEC v. Parvin/Dohrmann Co., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,500 (S.D.N.Y. 1969); SEC v. Glen Alden Corp., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,280 (S.D.N.Y. 1968).

85. AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 103 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-8 (1970). *See generally* section I(A)(5) of text *supra*.

86. AMERICAN STOCK EXCHANGE, *supra* note 85, § 403(3), at 109, *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-13 (1970). Measures for dealing with false rumors or reports about the company generally are discussed at the text accompanying note 140 *infra*.

no ideal solution.[87] If the company habitually makes public projections, it should issue its own projection to prevent or counteract an erroneous one by someone else.

5. *Preparing for Release*

Gathering the Data. Preparing the information for release requires verification and validation by the best available means. The Information Officer will usually need to ask questions and examine reports, distill the facts presented to him, and understand these facts thoroughly. He may need to consult with specialists.

Choosing the Time. If the information is complete—involving, for example, the destruction of a plant, the award of a contract, or the increase of a dividend—the publication should be immediate. If the information is developing over an interval, the timing is much more troublesome. One objective is to provide the market with the most current information, releasing it as soon as it is material or perhaps even before. A competing objective is to provide the market with the most meaningful information, releasing it only when it is mature and fully developed.

Each objective is worthy, justified, and has it perils. Although early release is the best preventive of insider trading and tipping, it may confuse the market,[88] excite speculative trading, and appear manipulative, particularly if corrections in the information have to be made later. Early release may prejudice corporate activities such as merger negotiations or property acquisitions,[89] while later release expands the opportunity for misuse of the information by insider trading or tipping. An ideal time might be the moment materiality is attained, but this is difficult to pinpoint even with a clear legal

87. *Cf.* AMERICAN SOCIETY OF CORPORATE SECRETARIES, INC., SUGGESTED GUIDELINES FOR DEALING WITH FINANCIAL ANALYSTS AND THE INVESTMENT COMMUNITY ¶ A.5.a (1969):

> If however, an independently arrived at estimate is deemed [by the company] to be unreasonahly high or low for the period in question in the light of responsible projections made by management, it may be appropriate to indicate that sueh estimate is "too high" or "too low" in order to prevent widespread dissemination of a substantially incorrect earnings projection within the investment community.

88. *See* SEC Securities Act Release No. 5016 (Oct. 20, 1969), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,753 (1969), noting that investors may be confused by early reports on the great oil discoveries of the Alaskan North Slope. A flood of information, partly motivated by the Texas Gulf Sulphur litigation, was issued by companies exploring there. The SEC expressed mixed feelings about the information, favoring prompt disclosure but worrying about premature statements of oil reserves and expected profits.

89. See section II(A)(4) of text *supra*. The collapse of a number of merger negotiations has been attributed to premature disclosure of their pendency. The Wall St. Journal, Nov. 15, 1968, at 1, eol. 6 (E. ed.).

standard and is greatly complicated by the ambiguity which prevails.[90]

For one common kind of evolving material information, a fairly standard usage has crystallized. Merger and acquisition negotiations are occasionally announced when they start. More frequently, nothing is said until they reach agreement in principle on the main terms of the transaction such as the exchange ratio of securities.[91]

Annual earnings figures which have been computed by the company but not yet audited present another common problem. If adjustments on audit are unlikely, the company can release the figures with little risk and probably should release them if they circulate anywhere outside the accounting department and the executive offices. Any such release should emphasize their tentative character. If adjustments are probable, the company will normally prefer to wait for completion of the audit.

If the information is material in the sense of indicating a probable sharp rise or fall in the market price of the company's securities, there is much to be said for releasing the information in the afternoon after the market closes or on a weekend. In this way, the information can be better disseminated, evaluated, and absorbed before trading begins again.

Advancing the Time. Choosing the ideal time for publication is not enough. The company must be prepared to make an earlier release if circumstances dictate.[92] The two most common circumstances, of course, are insider trading and tipping or leakage of the information. The company rarely has direct knowledge of these acts but must infer them. The typical clues are unusual price fluctuations or volume of trading in the company's securities,[93] the circulation of rumors, and inquiries from reporters, brokers, analysts,

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90. See section II(A)(3) of text *supra*.

91. *See* AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 104 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-10 (1970); BROMBERG § 7.4(4)(b).

92. *See* N.Y. STOCK EXCHANGE—COMPANY MANUAL A-23, *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,123, at 17,097-5 (1970); AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), (3)-(4), at 105, 108-10 (1970), *reprinted at*, 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-10, -13, -14 (1970); CCH MIDWEST STOCK EXCHANGE GUIDE ¶ 2448.10, at 2083-10, -11 (1970). The exchanges may halt trading if a heavy imbalance of orders indicates that information needs to be released. See note 98 *infra*. This intensifies the pressures to disclose.

93. Many companies keep close watch on the trading in their securities as clues to possible takeovers, as an effort to avoid dumping by large holders, and for other purposes. *See Corporate Sleuths on Wall Street*, 95 DUN'S REV., April, 1970, at 29.

or stock exchanges. The Information Officer should be particularly alert in this area, keeping an eye on the market.

The New York Stock Exchange recommends public disclosure of material information whenever it is discussed outside top management and the company's confidential individual advisers.[94] The underlying theory is sound: when information leaves top management circles, so many people know about it—and their discretion is likely to be so much less—that the danger of leakage and trading is too great to control. But a judgment must be made in each case about the reliability of the persons receiving the information.[95]

The possible need to advance the projected time of disclosure makes it advisable for the company to have a contingent plan which can be activated on very short notice. This would commonly include drafting a statement of the release when information is first recognized as potentially material and updating it frequently, perhaps daily or hourly, depending on the information.

Giving Prior Notice. If the company's securities are traded on a stock exchange, the Exchange should be notified before release of information expected to have a substantial impact on the market.[96] One purpose is to let the exchange halt trading briefly, perhaps for 15 minutes after the announcement,[97] so the information can be evaluated. Another purpose is to let the exchange halt trading pending the announcement, particularly if it appears that the information is leaking before it can be properly released.[98] No comparable mechanism permits a trading halt in the over-the-counter market. A partial halt might be reached by agreement with the market makers

94. N.Y. STOCK EXCHANGE COMPANY MANUAL A-19, *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,121, at 17,097-2 (1970). *See also* CCH MIDWEST STOCK EXCHANGE GUIDE ¶ 2448.10, at 2083-7, -8 (1970) (*semble*).

95. *See* AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 105 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-11 (1970) (counselling caution but not requiring publication). *See generally* section II(B)(5) of text *infra*.

96. AMERICAN STOCK EXCHANGE, *supra* note 95, § 403(2), at 106, *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-11 (1970). *See* N.Y. STOCK EXCHANGE COMPANY MANUAL A-23 *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,123, at 17,096-5 (1970) (notify by telephone no later than simultaneously with release); CCH MIDWEST STOCK EXCHANGE GUIDE ¶ 2448.10, at 2083-11 (1970) (*semble*).

97. For an example of a somewhat longer trading halt, see The Wall St. Journal, Aug. 4, 1970, at 21, col. 2 (E. ed.) (American Stock Exchange halts trading in Realty Equities Corp. for overdue semiannual report; company announces it expects to report large loss).

98. See West, *supra* note 30, at 241, describing a halt initiated by the New York Stock Exchange after a specialist reported a large influx of buy orders where the company expected a large contract award which had not been officially made.

for the company's securities, but this is impractical if the makers are numerous and creates risks of misuse of the information in any case. A request to the SEC to suspend trading[99] is a rarely used possibility, partly because it takes longer for dissemination of an SEC suspension order through the scattered over-the-counter market than for an exchange to stop trading on its own floor. Companies are also reluctant to get involved with the Commission and feel that an SEC suspension is much worse for the company's reputation than is a stock exchange halt.

6. *Contents and Method of Release.*

General Aim. The purpose of any release of material information is to convey the information as completely, accurately, and meaningfully as possible. This requires plain and forceful language and good organization as well as a number of aspects considered below.

Time of Information. The release should give the latest information available. If it is more than a few hours old and the information is in process of change, perhaps because acquisition negotiations or laboratory tests are continuing, the release should give the time of the information and refer to the ongoing process. Otherwise, the release may paint a misleadingly outdated or static picture.

Facts v. Conclusions. The known facts should be described in considerable detail.[100] Even though these detailed facts include technicalities unintelligible to the average investor, presumably they will be intelligible to some analysts and professionals. More importantly, the whole SEC tradition of disclosure centers on facts in detail, and the courts seem unlikely to choose another path.[101] If the facts are complex, the company should do some editing and

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99. The power is given by Securities Exchange Act Section 15(c)(5), 15 U.S.C. § 78o(5) (1964) (over-the-counter) and Section 19(a)(4), 15 U.S.C. § 78s(4) (1964) (securities exchanges).

100. *Compare* the rather sketchy original release of Texas Gulf Sulphur Co., quoted at 401 F.2d at 845, *with* this part of the same company's release on an African oil discovery, as reported in the press. The effect of years of SEC litigation is clear in the latter. The company

> emphasized that the significance of the "good oil shows" can't be evaluated without further drilling. One of the wells recovered 13 barrels of 33.6-degree-gravity (relatively light) crude oil daily on a one-hour drillstem test through a one-quarter inch opening. That's a preliminary indication of 312 barrels a day. The potential discovery is a long way from the nearest present commercial production. Nigeria's oil fields are about 1,300 miles to the southeast and Morocco's fields are about 1,600 miles northeast.

The Wall St. Journal, June 15, 1970, at 14, col. 2 (Sw. ed.).

101. *See* 401 F.2d at 863-64, disparaging the TGS release for "vague generalities" and for lack of detail. Judge Moore's dissent is particularly acid on this point. *Id.* at 878-79.

summarizing to emphasize the more significant elements. Otherwise, the media will do the editing.[102] A balanced presentation is essential.[103] If important assumptions underlie the information, or contingencies are inherent in it, they should be disclosed and explained.

Conclusions by the company concerning the significance of the information are desirable to inform the investing public and can usually be given freely.[104] While the company is typically in a better position to make an evaluation than anyone else, it apparently has no obligation to go beyond the bare facts. It may well be reluctant to do so, because of the possibility of making a misleading statement. If conclusions are stated, they should be reasonable, balanced, adequately based, and appropriately qualified.[105] The usual enthusiasm of public relations work will need some legal neutralizer.

Length. A company may write as long a release as it likes. But there are practical limitations on the amount that will be used by the media and a likelihood that shorter releases will be received more appreciatively and used more quickly. Shorter releases are also likely to be grasped more readily by readers. While no specific length can be recommended, brevity has to be weighed against the completeness necessary to inform the market. A fuller release may be appropriate for mailing to shareholders, or even for the newspapers, than for the wire services.

Testing. The proposed release needs to be tested mentally by those preparing it. All aspects of the release—for example, amount and kind of information, meaningfulness, and balance—should be judged primarily in terms of probable effect on investors.[106] The company should also consider the expected effect on creditors,

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102. See text accompanying note 109 *infra.*

103. I mean a balance between the favorable and unfavorable elements of the information. An effort to offset unfavorable information by favorable data on another subject is, from the legal side, a more dubious exercise in public relations.

104. *But see* note 37 *supra.*

105. *See* SEC Securities Act Release No. 5016 (Oct. 20, 1969), *reprinted at* [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,753 (1969) (Alaskan North Slope oil drilling information may be given but should be qualified by uncertainties about exploration, operations, transportation and marketing; the effect is to discourage statements of reserves and expected profits). *See also* the cautious conclusions in the quotation in note 100 *supra. See generally* AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 404, at 112-13 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124C (1970), including examples of misleading language which should be avoided.

106. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d at 849-50 (materiality), 860-62 (connection).

suppliers, employees, and others, although these groups are less important for securities law purposes.

Media. Many media are at least theoretically available to achieve the desired speedy and thorough dissemination of information to the market—potential buyers and sellers of the company's securities. They include:[107] financial wire services (Dow Jones, Reuters, and major brokers); general wire services (Associated Press, United Press International); newspapers in major cities and areas where the company has major operations or high security holder concentrations; statistical services (Standard and Poor's, Moody's); brokers and analysts interested in the company; bulletins to management and employees; letters or other communications to security holders; and paid advertisements in newspapers.

As a general rule, the more media used, the better. Broad media coverage increases dissemination of the information and is necessary since the media differ greatly in the audiences they reach. The financial wire services are closely watched by most brokers and institutional investors and are therefore regarded as the most effective channel to trading market activists.[108] But they do not touch the millions of small investors except through the relay of a broker or newspaper.

While some of the media are within a company's control, many others are not. Thus a company has no assurance that the financial or general wire services will carry a particular item, or even that the newspapers will. The media will be influenced by their appraisal of the importance of the information and of the company to their subscribers. Moreover, the company has no insurance against editing and cutting and will probably be held accountable for the revision, at least where it issues the information "For Immediate Release."[109] If the company is in doubt whether the independent media will transmit the message at all, or in the desired form, the company should use—in addition or perhaps even instead—the media within its control such as

107. For various lists with addresses and phone numbers, see N.Y. STOCK EXCHANGE COMPANY MANUAL A-24, *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,123, at 17,097-6 (1970); AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(1), at 107 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-12 (1970); Midwest Stock Exchange, Supp. to Rule 8, art. XXII, CCH MIDWEST STOCK EXCHANGE GUIDE ¶ 2448.10, at 2083-11, 2084 (1970).

It is a good idea to keep a current list of media handy so that a quiek release can be made to them.

108. *See* 401 F.2d at 854 (Dow-Jones regarded as media of widest circulation).

109. SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 86-87 (S.D.N.Y. 1970).

letters to shareholders even though the company-controlled media are less rapid.

Transmission to the independent media can be by telephone, although they may require written confirmation. Hand delivery of a written release may be a little slower, but the chances of error are reduced. When the distance between the company and the media is great, telegraphic transmission will sometimes be the best way to combine speed and preservation of the company's exact wording. The information, if it is material, should always be marked "For Immediate Release." A designation for delayed release may make the information seem unimportant to the media, and thus inhibit dissemination. Alternatively, if the information is recognized as material, the delay may not be respected, or those in possession may use it for their own purposes. Relevant stock exchanges and perhaps market makers should be notified directly in addition to the general release.

Another means of communication which ought to be considered along with the listed media is the filing of an immediate 8-K report[110] with the SEC if the company is subject to filing requirements.[111] Although there are some subscribers to SEC filings of this sort, this produces little dissemination by itself. But the SEC, in extreme instances, might issue a public announcement or suspend trading; news of such actions travels fast and wide within the securities industry and often beyond. In any event, filing with a regulatory agency is good evidence that the company is not trying to hide the information. Even if the company is not subject to filing requirements, it may notify the SEC if it has some information of extraordinary importance which affects its securities.

Considerable dissemination of information may occur by way of third party announcements, news reports, or market rumors. Although these may amount to publication in the legal sense, a company would be unwise to rely on them or to advise its insiders to do so.[112] The company's only safe procedure is to make its own release or join in a release by other interested parties.

110. SEC Form 8-K, 2 CCH FED. SEC. L. REP. ¶¶ 31,001-02 (1954). Normally it is due within 10 days after the end of the month. *Id.* ¶ 31,002. *See generally* 17 C.F.R. § 249.308 (1954).

111. *See generally* Securities Act § 13(a), 15 U.S.C. § 78m(a) (1964), applicable to companies registered, for example, under the Securities Act § 12(a), 16 U.S.C. § 78*l*(a) (1964).

112. *See* 401 F.2d at 853 (such dissemination does not constitute effective disclosure). For

7. *Actions after Release*

Insider Trading. Insiders are not free to trade the moment a release is issued. They must wait at least until some sort of media publication[113] and probably an additional time for absorption and evaluation of the information.[114] The American Stock Exchange recommends a 24 hour delay when the information is complex and a 48 hour delay if the dissemination is not widespread.[115] The New York Stock Exchange has not been so specific,[116] and the SEC has not committed itself at all. Consequently, an insider has no clear indication of how soon he may trade following the release. Caution calls for waiting a substantial period comparable to the American Stock Exchange's 24-hour recommendation.[117] Whatever the proper waiting period—and it may vary with the type of information and the effectiveness of the transmitting media—insiders should be warned that merely turning the release over to Dow Jones, or reporting it to the stock exchange, does not free them to trade instantly.

Followup on Release. The Information Officer's job is not done yet. If confusion arises over the release, for example, he should clarify it.[118] He should also correct the release if it was distorted in reproduction, correct errors that are discovered, and supplement the release with information concerning relevant new developments. Finally, he should watch the market reaction for clues to any of these problems. Maintenance of a permanent file of all action and correspondence in connection with a particular release will be helpful in case questions come up later.

B. People Controls

1. *General Aims.* The primary purposes of "people controls" are to encourage the prompt reporting of potentially or actually material information to the Information Officer and other persons in

further details on the extent of the third party dissemination, see the district court's opinion in *Texas Gulf.* 258 F. Supp. 262, 285-86 (S.D.N.Y. 1966).

113. 401 F.2d at 854.

114. *Id.* at n.18.

115. AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(4), at 111 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-15, -16 (1970).

116. N.Y. STOCK EXCHANGE COMPANY MANUAL A-25-A-28 (1968), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 26,100 (1970).

117. For further discussion, see BROMBERG § 7.4(7)(b).

118. For curative possibilities see Schy v. The Susquehanna Corp., 419 F.2d 1112 (7th Cir. 1970).

the company who should know about it, to discourage insider trading, and to discourage tipping. All of these, particularly the reporting purpose,[119] partly overlap the purposes of the "information controls" discussed above. Hence the discussion here concentrates on the second and third purposes—discouraging insider trading and tipping. Rather different problems may arise with different groups of people, especially officers and directors on the one hand and other employees and advisors on the other.

2. *Officers and Directors.* The officers and directors are usually few in number, fairly conscious of their legal responsibitities and vulnerabilities, and closely identified with the company in their own minds. They should be briefed carefully, both orally and in writing, on the law concerning trading and tipping of inside information[120] and on the company's policy.[121] Rebriefing is necessary from time to time. They should also realize that trading by their immediate relatives is probably as dangerous as trading by themselves.[122] Trading through a street name, a Swiss bank, or a partnership, trust, or holding company presents the same problem under rule 10b-5 that it does under 1934 Act section 16(b).[123] Indeed, the section 16(b) guidelines on these points may even be too narrow for rule 10b-5. One may assume that officer-directors' self-protection instincts will operate and that the officer-directors will be fairly careful when they learn the applicable law.

I think it advisable that the company receive copies of all Forms 3 and 4[124] on officer-director holdings and trading[125] filed with the SEC pursuant to Exchange Act section 16(a).[126] Curiously, section 16(a)

119. See section II(A)(1) of text *supra.*

120. Quite apart from the problems of inside information, they should be advised of the insider reporting requirements, short-swing trading recapture provisions, and prohibitions on insider short sales, if applicable. Securities Exchange Act §§ 16(a), (b), (c), 15 U.S.C. §§ 78p(a), (b), (c) (1964).

121. See section II(A)(2) of text *supra.*

122. *See* 401 F.2d at 841 n.4 (no distinction between insiders' purchases and their wives' purchases), *on remand,* 312 F. Supp. 77, 96 n.25 (S.D.N.Y. 1970); SEC v. Golconda Mining Co., [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,504 (S.D.N.Y. 1969) (consent injunction covering trades by insider, wife, and children).

123. 15 U.S.C. § 78p(b) (1964). *See generally* 2 L. LOSS, SECURITIES REGULATION 1100-08 (2d ed. 1961).

124. SEC Forms 3 & 4, 2 CCH FED. SEC. L. REP. ¶¶ 33,701, 33,711, 33,721, 33,731 (1961). *See generally* 17 C.F.R. § 249.103-.104 (1961).

125. *Accord,* DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS 234 (J. Flom, B. Garfinkel, & J. Freund eds. 1967).

126. 15 U.S.C. § 78p(a) (1964).

does not require that these forms be furnished to the company even though the company is the beneficiary of any recovery under section 16(b). Often, of course, the forms are prepared by company counsel and come to company attention that way.

Filing Forms 3 and 4 with the company, as well as the SEC, has at least two values. First, the filing is evidence of the company's effort to stay abreast of insider trading and to prevent violations. This supports good faith and due diligence in the event of a lawsuit. The second value is a mild deterrent to violation. An inside may be a bit more reluctant to use inside information if he knows his transactions may be reported to people who are otherwise unlikely to be aware of the information.

3. *Major Shareholders.* Most major shareholders—holders of ten percent or more of the company's stock—will be officers and directors covered by the discussion in the previous section. If they are not, their circumstances may greatly influence the concern of the company's disclosure program for them. In general, the company has no responsibility for the acts of shareholders who are not officers or directors. Indeed, the company may be hostile to a shareholder in some instances, as in a takeover fight where the acquirer has bought a toehold block of stock. The company is not going to any great effort to help him avoid securities violations. Large institutional investors who are cordial to the company can look out for themselves and generally may be ignored by the company's compliance program, although the potential tipping and trading risk here may need attention.[127] In contrast, friendly individual holders of large blocks, particularly ex-officer-directors and their families, may need to be advised and restrained by the company in much the same way as officer-directors, even though they are less likely to receive material information.

4. *Other Employees.* Employees below the executive level are far more numerous, probably less aware of—or sensitive to—their responsibilities in handling information, and generally more difficult to control in this respect. The best that can normally be done to inhibit their use of inside information is to have a general statement on the importance of maintaining the confidentiality of all company information by not talking about it outside the company or even to other employees who do not have a particular corporate need to know

127. See note 79 *supra*.

about it. The Appendix contains several sample statements which have already been discussed.[128] The gist of the policy may be written into contracts with key employees at the middle management levels. Less forcefully, some or all employees may simply be asked to acknowledge in writing their familiarity with the policy.

An important element of such a policy is a prohibition on trading with inside information. While this prohibition should be handled in a manner which preserves the important advantages of employee stock ownership in general, it should also make clear that buying or selling on material inside information is a different proposition and a violation of federal law.

Some companies require that all employees report to the company their transactions in the company's securities. Such a policy is almost impossible to enforce and may be resented as an invasion of privacy. But it does have some therapeutic value, both as a deterrent of violations, and as a protection to the company. While not recommending it for general use, I think it is worth considering in some cases.[129]

These measures present the danger of waving too many red flags. They may suggest to employees or others the possibility of sizable profits in the stock market with inside information that would not otherwise have occurred to them.

A company can take a positive approach to this whole arca by having a good employee stock program for accumulation of employee investment in the company's securities. It can operate either by payroll deduction purchase or through qualified profit-sharing or stock bonus plans. The point, in the present context, is to divert attention away from short term market movements and toward the benefits of long term ownership.

5. *Outside Advisors and Contacts.* Material information, in the course of business, may come to be known by a variety of persons outside the company. Typically these persons fall in one of two groups: those engaged by the company, such as its legal and public relations counsel, accountants, testing laboratories, and financial advisors; and those negotiating with the company—mainly other

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128. See section II(A)(2) of text *supra.*

129. For various conflict of interest problems in advising employees when to trade, see W. PAINTER, FEDERAL REGULATION OF INSIDER TRADING 340-44 (1968). *But see* DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS 236 (J. Flom, B. Garfinkel, & J. Freund eds. 1967).

companies seeking investment, merger, licenses, or joint ventures. In addition, commercial bankers are often privy to inside information about their customers.

Such persons should be made aware of the company's policy on inside information. Negotiations may begin with an understanding, formal or informal, that information being disclosed is not to be used for any purpose other than the transaction being negotiated; an express prohibition on trading the company's securities might be considered. Engagement of outside advisors may be based on similar understandings. Indeed, they may be more discreet than employees or insiders or subject to special legal restrictions.[130] But there is no guaranteed way to control the use of information in such hands. For this reason, it should be divulged only when necessary, and then probably given to the public as soon as feasible.[131]

C. *Consultation in the Program*

It has been convenient in this article to personify the company's necessary activities in the role of the "Information Officer." This is, of course, a great oversimplification. A successful disclosure compliance program requires the participation—at least to the extent of consultation—of many persons with divergent ranks, duties, and disciplines. Inside the company will be officers, directors, house counsel, public relations staff, accountants, technicians, and other relevant employees. Outside the company may be lawyers, financial advisors, public relations firms, and others. Their form and degree of consultation or participation will naturally vary from one company to another, from one type of information to another, and from one business and factual setting to another.

Despite the need for consultation, it is important that the program not bog down or become diffuse. Lines of authority to gather information and make decisions should remain clear and effective.[132]

III. OVERALL ROLE AND IMPORTANCE OF A DISCLOSURE PROGRAM

A. *Other Functions of a Disclosure Program*

Disclosure programs have been described here primarily in terms of handling material information and preventing its mishandling.

130. *See* SEC Accounting Series Release No. 81 (Dec. 11, 1958), *reprinted at* 4 CCH FED. SEC. L. REP. ¶ 72,103 (1964) (restrictions on financial and other interests of independent accountants who certify financial statements subject to SEC jurisdiction).

131. See note 94 *supra*.

132. See section II(A)(1) of text *supra*.

Other aspects may be as diverse as the company's business and communications. A few are suggested in this section.

The Information Officer should review in advance all company communications to the investment world including reports to shareholders[133] and speeches to security analysts.[134] Even when no material information is involved, he should see that all statements are consistent, accurate, and balanced. When material information is scheduled for release to a meeting of analysts, the Information Officer should see that the press is invited or that a simultaneous release is made.

The Information Officer should be aware of, if not control or sit in on, interviews of company officials by analysts, reporters, and brokers. The purposes, of course, are to see that information is properly presented without distortion and that material information is not privately divulged, whether deliberately or inadvertently. If it is divulged, he should try to effect a cure by public disclosure or by restricting use and transmission by the person who received it. For consistency and coordination, the company should limit the number of persons who give financial interviews. Records of interviews should be kept in order to provide evidence of what was said if allegations of tipping or misrepresentation are later made.[135]

Broadly speaking, the Information Officer should see that the company does not overdo its disclosures. Constant releases, strident publicity, and company-sought financial interviews may violate stock exchange policies[136] and be viewed as efforts to manipulate the market.[137]

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133. *See* Butler Aviation Int'l, Inc. v. Comprehensive Designers, Inc., 425 F.2d 842 (2d Cir. 1970) (exchange offer enjoined partly because letter in offeror's annual report pointed to earnings increase without explaining that it was due to a change of accounting method); DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS 232-33 (J. Flom, B. Garfinkel, & J. Freund eds. 1967) (cautioning against exaggeration in the narrative parts of the annual report which tend to become commercials for various departments of the company).

A cause of action has been stated for false statements in a president's cover letter for a proxy statement. *See* Miller v. Steinbach, 268 F. Supp. 255, 278 (S.D.N.Y. 1967).

For numerous allegations of misleading letters and reports to shareholders, see Complaint for Injunction ¶¶ 22, 23, 26, 30-33, SEC v. Liberty Equities Corp., Civ. No. 2351-70 (D.D.C., filed Aug. 6, 1970) (concerning assets, construction plans, acquisitions, and profits and losses).

134. *See* Sprayregen v. Livingston Oil Co., 295 F. Supp. 1376 (S.D.N.Y. 1968) (cause of action stated for misrepresentation of future income and cash flow in speech to security analysts).

135. AMERICAN SOCIETY OF CORPORATE SECURITIES, INC., SUGGESTED GUIDELINES FOR DEALING WITH FINANCIAL ANALYSTS AND THE INVESTMENT COMMUNITY (1969).

136. AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(5), at 110 (1970), *reprinted at* 2

Another significant function is the filing of Form 8-K current reports[138] and other periodic reports with the SEC and the stock exchanges. These forms should be carefully prepared with a view to legal exposure[139] as well as to consistency with other communications by the company.

The program should be prepared to deal with false rumors or reports about the company by denying them and issuing correct information.[140]

B. *The Need For a Program*

In theory, every company needs a disclosure program. But the strength of the need will differ widely among companies, as will the extent of the optimum program. Relevant factors are the kinds of information the company is likely to generate, the public interest in its securities, and the volatility of its securities in the market. Ordinarily the need increases in rough proportion to the number of shareholders. But a new company which has just gone public with a relatively small offering in a glamour industry may need a program far more than an established company with many times the number of security holders. The new company's thin market is more susceptible to fluctuation in response to news, and investors are more sensitive to developments since they are typically buying on indications of the future rather than history of the past.

The managers of a business will, quite reasonably, look at the cost

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CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-14, -15 (1970) ("unwarranted promotional disclosure").

137. For allegations of manipulative publicity concerning Westec Corporation, see Original Complaint ¶¶ 18, 19, 124, 125, Carpenter v. Hall, Civ. No. 68-H-738 (S.D. Tex., filed Aug. 26, 1968), *motions to dismiss denied*, [1969-1970 Transfer Binder] CCH FED. SEC. L. REP. ¶ 92,729 (S.D. Tex. March 16, 1970).

138. SEC Form 8-K, 2 CCH FED. SEC. L. REP. ¶¶ 31,001-02 (1969). *See generally* 17 C.F.R. § 249.308 (1954).

139. Exchange Act § 18(a), 15 U.S.C. § 78r(a) (1964), creates an express cause of action for false reports to the SEC but poses serious obstacles for plaintiffs. The easier implied cause of action under rule 10b-5 also covers false reports to the SEC. Heit v. Weitzen, 402 F.2d 909 (2d Cir. 1968), *cert. denied*, 395 U.S. 903 (1969); Miller v. Bargain City, U.S.A., Inc., 229 F. Supp. 33 (E.D. Pa. 1964).

140. *See* N.Y. STOCK EXCHANGE COMPANY MANUAL A-23 (1968), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,123, at 17,097-5 (1970); AMERICAN STOCK EXCHANGE, COMPANY GUIDE § 403(3), at 108 (1970), *reprinted at* 2 CCH FED. SEC. L. REP. ¶ 23,124B, at 17,097-13 (1970); Midwest Stock Exchange, Supp. to Rule 8, art. XXII, CCH MIDWEST STOCK EXCHANGE GUIDE ¶ 2448.10, at 2083-10, -11 (1970). On the special problems of earnings projections, see section II(A)(4) of text *supra*.

of a disclosure program, relative to its benefits, in deciding how much to spend on this kind of program and what form to give it. They must weigh the cost against other expenditures of company funds. The costs are fairly easy to measure on the basis of the personnel assigned. Naturally, these will vary according to the program undertaken: a few hours of legal and public relations time will produce a statement of policy for employees; an information monitoring program will cost a good deal more.

The benefits of a compliance program are very diffieult to estimate in dollars. There are too many contingencies in the way of measuring either the value of avoiding litigation and other sanctions or in the probability that a program will avoid them.

How extensive are such programs? While I have seen no current survey, a study as recent as 1967 indicated that eighty percent of the largest companies had not even taken the simple first step of issuing a policy against the use of inside information.[141] Plainly, much can be done at quite modest expense.

No one should be deceived about the efficacy of compliance programs. The best program will not prevent deliberate violations by individuals. Nor is there any guarantee against misjudging the materiality of information, and therefore mishandling it, releasing too soon or too late, or failing to control access—or against handling it in a misleading fashion.

A good program, on the other hand, helps to prevent violations, to minimize company implication in individuals' violations, and to avoid liability or other sanctions if violations do occur. It also helps to improve the company's standing in the market and with investors. These are important enough reasons to make any company think seriously about installing a compliance program.

141. BURSON-MARSTELLER ASSOCIATES REPORT, KEEPING COMPANY SECRETS 2-3 (1967).

IV. APPENDICES

A. *Statement of Policy on Nondisclosure of Material Information by Merrill Lynch as Part of Settlement of SEC Proceeding,* Securities Exchange Act Release No. 8459 (Nov. 25, 1968), CCH FED. SEC. L. REP. ¶ 77,629 (1968) (discussed in section II(A)(2) of text *supra*).

The Statement of Policy is adopted to provide more effective protection against disclosure of confidential information.

Material information obtained from a corporation by the Underwriting Division in connection with the consideration or negotiation of a public or private offering of its securities and which has not been disclosed by the corporation to the investing public, and conclusions based thereon, shall not be disclosed by any member of the Underwriting Division to anyone outside that Division except to

(a) senior executives of the firm and its Legal Department;

(b) lawyers, accountants and other persons directly involved with the underwriters in connection with the proposed offering;

(c) appropriate personnel of the Research Division whose views in connection with the proposed offering are to be sought by the Underwriting Division; and

(d) members of the buying departments of other firms who are prospective members of the underwriting group for the purpose of enabling such other firms to decide whether, the extent to which or the price at which, they will participate in the proposed offering.

Any employee of the firm who receives such information pursuant to the foregoing shall not disclose such information or any conclusions based thereon except as provided above for members of the Underwriting Division.

Material information, as used herein, refers to matters relating to a corporation which would be important to a reasonable investor in deciding whether he should buy, sell, or hold securities of the corporation or which would be likely to have substantial market impact. Any such information which has not been disclosed by the corporation to the investing public, communicated in accordanee herewith, shall be clearly identified as non-public information which is to be used by the recipient solely for the purpose of carrying out his responsibilities in connection with the proposed offering and which is not to be disclosed orally or in writing for any other purpose.

Any question as to the applicability or interpretation of this statement of policy or any portion thereof should be promptly referred to the Legal Department or Department of Supervision and Guidance, as appropriate.

The above statement of policy shall be promulgated by a bulletin which shall be distributed to all senior management personnel, all Division Directors, all Department Managers, all Office Managers, all members of the Underwriting Division, all Research Analysts and all Account Executives and shall be included in the firm's Operations Manual.

It shall be the duty of each Department and Offiee Manager to review periodically with the personnel subject to his supervision the provisions of this statement of policy.

B. *Comments and Suggested Memorandum to Employees on Nondisclosure and Trading,* BURSON-MARSTELLER ASSOCIATES, KEEPING COMPANY SECRETS (1967) (discussed in section II(A)(2) of text *supra*).

How can a company alert employees to their individual obligations and responsibilities toward confidential information?

A company memorandum—perhaps from the chief executive officer—circulated to those in sensitive positions may be a starting point, but it should be followed by periodic reminders, at least once annually.

These reminders may relate to a specific development, such as an upcoming new product line. This not only would refresh memories about security in general, but also indicate a subject that employees may not have considered confidential.

Here are some statements the memorandum may contain:

1. As an essential part of our work, most of us use or have access to a large amount of corporate information, some highly confidential and of considerable value to our company. Those of us who possess or monitor confidential information hold a special position of trust and confidence toward this data.

2. We have an important responsibility to keep confidential information within the company until it is declassified or made public. This means the information should not be discussed with your family, relatives, business or social acquaintances. Nor should it be discussed with other employees here unless they have a clear right and need to know.

3. Those of us who possess confidential corporate information also have a legal obligation. Under the law, a person who, during the course of his work, obtains confidential information which could affect the price of the company's stock can be considered an "insider." This means he is liable to legal action should he buy or sell company stock on the basis of this inside information without disclosing it to the other party in the transaction. He also is liable if he causes others to buy or sell the company's shares on the basis of his inside information.

4. While it is virtually impossible to label clearly the confidential information likely to affect the value of the company's stock, we can specify some of the general subjects: earnings, dividend actions, significant mergers and acquisitions, major discoveries, major new products, significant advances in research, major personnel changes, labor negotiations, price changes on major products, major shutdowns, unusual gains or losses in major operations, major marketing changes.

5. Actually, there is no need to determine whether a particular piece of confidential information will affeet the price of the company's shares. Simply treat all corporate information with discretion and discuss confidential data *only* with those who have a right and need to know. In the meantime, it is wise to refrain from trading in the company's shares until that item of inside information you possess is made public.

C. *Statement of Policy Governing Conflict of Interest, Issued by Chairman of the Board, Texas Gulf Sulphur Co.* (Sept. 17, 1969) (discussed in section II(A)(2) of text *supra*).

While I am confident that each member of the Texas Gulf team is well aware of his duties and obligations to the company, I thought it would be helpful to make this statement regarding the legal obligation we all have to avoid situations in which our personal interest may conflict with that of the company.

Texas Gulf is entitled to the undivided loyalty of each and every one of its employees and none of us should allow our own personal interest to conflict with that of the company in connection with transactions affecting the company.

Thus no employee should allow himself to be placed in a situation (either directly or indirectly) in which he might in fact be influenced or be thought by others to be influenced to favor himself, his family or others at the expense of the company. For example, he should not have a financial interest in any firm which is a supplier, contractor or customer of Texas Gulf Sulphur such as to cast doubt upon the propriety of his actions. Employees should promptly report all investments or other relationships which may give rise to such a possible conflict to his superior and be guided by his advice.

No employee may be employed by or render service to another company as an employee, director, consultant or in any other capacity except with the approval of his superior who must be satisfied that: 1. such affiliation does not work to the detriment of Texas Gulf Sulphur; 2. non-public information about Texas Gulf Sulphur will be safeguarded; 3. no adverse outside influence will be brought to bear upon the decisions or actions of the employee in the performance of his work for Texas Gulf Sulphur; and 4. Texas Gulf Sulphur will not be deprived of the full measure of his working time, attention to assigned duties and loyalty.

Employees should avoid giving or receiving gifts or entertainment if there is likelihood that they may be intended to, might, or might be thought to influence improperly the recipient's judgment in dealing with or for Texas Gulf Sulphur.

Confidential knowledge or information about Texas Gulf Sulphur is the property of Texas Gulf Sulphur and must not be disclosed to unauthorized persons. Employees should not seek to derive benefit from such information for himself, his family or friends.

While it has always been thought that investments by employees in the stock of his company were desirable, the uncertainty of the law in this field today requires that such investments be made with extreme caution. For example, any time an employee is in possession of, or on notice of information which has not been publicly disclosed and which if generally known might reasonably be expected to have an effect upon the market price or value of Texas Gulf Sulphur shares, he must not for himself, his family, his friends or others, purchase or sell Texas Gulf Sulphur shares or recommend that others do so. While this test is extremely difficult to apply in any company it is even more so in a company such as ours which is constantly exploring and developing new projects. An employee who has a question concerning purchases or sales of Texas Gulf Sulphur stock should consult the company's General Counsel.

Each of us has a duty to protect the interests of the company and its stockholders and to refrain from doing anything that would work injury to it or deprive it of a profit or advantage to which it might be entitled. For example, it is unlawful for an employee who learns of a corporate opportunity to divert it to himself and to take personal advantage of it.

The number of possible situations in which there may be a conflict of interest such as to make an action improper or unlawful are too numerous to detail. If any question should arise you should consult with the company's General Counsel.