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Securities Law Responsibilities of Issuers to Respond to Rumors and Other Publicity: Reexamination of a Continuing Problem

John M. Sheffy*

I. Introduction

A common and recurring problem facing corporate management and counsel is whether some action should be taken to correct or respond to inaccurate publicly disseminated information concerning the corporation. Because their greater size and number of security holders result in more widespread public interest, this concern is encountered more frequently by publicly held corporations; but even smaller enterprises are not immune.

The problem can arise in several ways.1 A security analyst or brokerage firm may report results of its research in a "market letter"...
which misstates facts concerning the issuer or in which the conclusions drawn by the analyst are unsupported by the facts.\(^2\) Similarly, a news report based on interviews with management or other investigation by the reporter may inaccurately state facts or draw inaccurate conclusions.\(^3\) More frustrating to management is the misquoting or misreporting by the news media of a carefully drafted press release.\(^4\) Perhaps the most difficult situation, from the standpoint of management, is when incorrect rumors circulate.\(^5\)

Each of these examples presents a common problem: Do the federal securities laws' disclosure requirements require a correcting response from the issuer? This article considers that question and provides a framework for use by management in deciding whether to speak up.

The article will address three major issues. First, an investigation of an issuer's obligation to respond to rumors or publicity must start with consideration of whether the issuer is obligated to disclose all material information, even in the absence of publicity or trading. If so, a duty to respond to rumors would clearly be included. Although some have argued for such an expanded duty, reason compels its rejection. Second, the only duty which has yet been imposed on an issuer facing inaccurate rumors or publicity concerning its affairs is the responsibility to respond if such information is "attributable" to the issuer. The few decisions in this area have failed to develop the attribution concept so that it might be applied consistently to the myriad settings in which rumors and publicity originate and are disseminated. To fill that gap, the third part of this article proposes a fault analysis for determining attribution. Under that analysis, whether the information is attributable to the issuer will depend upon the issuer's responsibility or fault for the initiation or publication of the misleading information. The article concludes that the mere presence of rumors or publicly circulating inaccuracies concerning the issuer does not, by itself, require a response from the issuer.

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\(^5\) See State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969) and 404 U.S. 1005 (1971). In each of those cases the rumors turned out to be well founded.
But, such a response may become necessary when the issuer is the source of the inaccuracy or is responsible for its dissemination.

II. Background

A. Materiality

Materiality is an element of virtually all the disclosure requirements of the federal securities laws. Thus, no discussion of disclosure obligations and liability for non-disclosure or faulty disclosure is complete without reference to the materiality of the fact omitted or misstated. Without a materiality requirement, disclosure would become largely useless. The issuer would be forced to include all facts, immaterial as well as material, and it would become impossible for investors to separate the latter from the former. This discussion will be based on the assumption that materiality is not at issue. Clearly, if the fact which is the subject of the inaccurate rumor or news article is not material, the failure of the issuer to respond will not constitute a violation. Any duty to respond to publicly circulating information is limited to material facts.

B. Exchange and NASD Requirements

The question of whether to respond to rumors and other publicly circulated inaccuracies is readily answered for any issuer whose securities are listed on either the New York or American Stock Ex-

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7 The Supreme Court of the United States has most recently defined materiality as follows:
An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available.

TSC Indus. v. Northway Inc., 426 U.S. 438, 449 (1976). Although the issue there was the materiality of a fact omitted from a proxy statement allegedly in violation of SEC rule 14a-9, it is generally assumed that this definition would apply under the anti-fraud provisions as well. See, e.g., Sharp v. Coopers & Lybrand, 649 F.2d 175, 187 (3rd Cir. 1981); Panter v. Marshall Field & Co., 646 F.2d 271 (7th Cir. 1981).

8 The effect of a rumor or news report on the materiality of the fact at issue presents a special problem. An otherwise immaterial fact may become material because of the publicity. An example is when the issuer plans no stock split but a false report circulates that a 2 for 1 split is imminent. Although the absence of a plan to split the stock is clearly not material prior to the report, it may well be afterward. See Hewitt, Developing Concepts of Materiality and Disclosure, 32 Bus. Law. 887, 898 (1977), where the author indicates that changes of the context in which the question of materiality is raised may affect the determination of whether a particular fact is material.
change, or on the National Association of Securities Dealers Automated Quotation System (NASDAQ). The two exchanges have adopted full affirmative disclosure requirements, commonly referred to as "timely disclosure policies." These policies are premised on the assumption that an orderly and efficient securities market can be achieved only if all participants share equal access to material information.

The rules of the New York Stock Exchange (NYSE) require the issuer to release promptly and fully any information "which might reasonably be expected to materially affect the market" for its securities. The rules recognize that, at times, public release of material information may be premature or that the issuer may have legitimate business reasons for temporarily withholding material information from the public. In such event, the rules will permit secreting the information only so long as it truly remains confidential. As soon as the information is disclosed to other than senior management, or if there is any indication that the information has leaked, the rules mandate immediate public release. Consistent with this requirement, the rules specifically require a prompt "frank and explicit" response to rumors. If the rumors are correct, an explanatory confirmation is necessary; if the rumors are false or inaccurate, a denial or clarification is in order; and, if the issuer knows of no corporate development to account for the unusual market activity, a statement to that effect must be issued. Issuer response is required regardless of the source of the rumors or the possible business incon-

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10 NEW YORK STOCK EXCHANGE COMPANY MANUAL, A-18, 2 FED. SEC. L. REP. (CCH) ¶ 23,121 (Feb. 11, 1981) [hereinafter cited as NYSE MANUAL].

11 Id, supra note 10, at A-19.

12 Id. at A-23.

13 Id. In defending its initial press release concerning the now famous Timmons, Ontario ore find, Texas Gulf Sulphur contended that the need for a quick response to a rumor would excuse its failure to set forth all the facts in detail. The apparent basis for this position was that assimilation of the facts and drafting of such a release would unduly delay the response, thereby permitting the rumor a longer opportunity to do its damage. The argument did not prevail. Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 100 (10th Cir. 1971), cert. denied, 404 U.S. 1004 (1971).

14 2 BROMBERG & LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD 138.469 (1979) [hereinafter cited as BROMBERG & LOWENFELS].
The timely disclosure policy of the American Stock Exchange (AMEX) is very similar to that of the NYSE. Its basic requirement is that the issuer must make an immediate public announcement of all material information except in certain "exceptional" circumstances, such as when immediate disclosure would prejudice corporate objectives, or when the situation is a fluid one and a more appropriate time for disclosure is imminent. Withholding material information under those circumstances is permissible only so long as confidentiality is maintained. If rumors or reports are circulating publicly, a response is necessary even if the source cannot be traced back to the issuer.

A shorter and less flexible disclosure rule has been adopted by The National Association of Securities Dealers (NASD) affecting securities quoted on NASDAQ. It provides that the issuer must promptly disclose to the public "any material information which may affect the value of its securities or influence investors' decisions." Unlike the policies of the exchanges, the issuer has no discretion to withhold disclosure temporarily for legitimate business reasons or while the facts may be in a state of flux. In addition, the provision includes a requirement to respond promptly to publicly disseminated but inaccurate rumors, news reports or market letters.

It is clear that each of these self-regulating agencies has adopted

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15 NYSE MANUAL, supra note 10, at A-23.  
16 For this purpose the American Stock Exchange has adopted its own definition of materiality:  
   (a) where the information is likely to have a significant effect on the price of any of the company's securities; or (b) where such information (after any necessary interpretation by securities analysts or other experts) is likely to be considered important, by a reasonable investor, in determining his choice of action.  
   AMERICAN STOCK EXCHANGE COMPANY GUIDE, 2 FED. SEC. L. REP. (CCH) ¶ 23,124 [hereinafter cited as ASE GUIDE].  
17 Id. at ¶¶ 402, 403(1).  
18 Id. at ¶ 403(1). The Guide specifies that if the rumor or report is correct it should be publicly confirmed by the issuer. If it is incorrect it should be denied, and if it is misleading the issuer's response should set forth sufficient facts to clarify it. Id. at ¶ 403(3). With respect to erroneous earnings projections, however, ordinarily no response from the issuer is necessary unless the projection is clearly erroneous, manifestly based on erroneous information or is wrongly attributed to the issuer. Id.  
19 Id. at ¶ 403(1); Intercontinental Indus. v. American Stock Exch., 452 F.2d 935, 940 (5th Cir. 1971), cert. denied, 409 U.S. 842 (1972); 2 BROMBERG & LOWENFELS, supra note 14, at 138.469.  
20 NATIONAL ASSOCIATION OF SECURITIES DEALERS MANUAL, Schedule D, Part II, § (B)(3)(b) [hereinafter cited as NASD MANUAL].  
21 3 A. H. BLOOMENTHAL, SECURITIES AND FEDERAL CORPORATE LAW § 8.09[3], at 9-35 [Rev. 1980] [hereinafter cited as BLOOMENTHAL].
a full disclosure policy which not only includes the duty to respond to rumors and other publicly circulating information, but also imposes a duty, subject to few exceptions, to disclose all material information, even in the absence of rumors or leaks. Thus, for any issuer whose securities are listed on either of the major exchanges or are authorized for quotation on NASDAQ, the duty of disclosure is clear. Rumors and other publicity must be answered if investors would otherwise be misled or left at an informational disadvantage. But the number of such issuers comprises only a small fraction of publicly held companies. For the many others, the timely disclosure policies of the two exchanges and the NASD do not provide an answer to the question of whether to respond to rumors.

III. An Affirmative Duty to Disclose?

For those issuers whose securities are not listed on an exchange or authorized for quotation on NASDAQ, the same duty would exist.
if the federal securities laws imposed a duty to disclose similar to that embodied in the timely disclosure policies of the exchanges and NASD. If an issuer had an affirmative duty to disclose all material information, it would have a duty to respond to rumors concerning material facts. The latter duty would be encompassed within the former and would provide an easy answer to the present inquiry. However, despite the continuing debate about whether an affirmative disclosure obligation exists, a careful reading of the relevant statutory provisions reveals no such duty and it is highly unlikely that such a duty would now be implied by the courts.

Both the Securities Exchange Act of 1933 (1933 Act) and the Securities and Exchange Act of 1934 (1934 Act) require disclosure of specifically itemized information. They do not include a requirement that the issuer disclose everything that is material.26 Thus, the mandated disclosures of the federal securities laws do not duplicate the full disclosure policies of the exchanges and NASD.27 The Securities and Exchange Commission (SEC) apparently possesses the authority to go beyond statutorily mandated disclosure by promulgating rules requiring additional disclosures, perhaps even disclosures of all material information,28 but it has chosen not to do so.29 After giving it some consideration, the SEC decided not to rec-

26 Schneider, Nits, Grits and Soft Information in SEC Filings, 121 U. Pa. L. Rev. 254, 270-71 (1972). See, for example, Schedule A to the Securities Act of 1933 setting forth what must be included in a 1933 Act Registration Statement (15 U.S.C. § 77aa); Form 10 and instructions thereto dealing with the required contents of a 1934 Act Registration Statement; and Form 10-K and instructions thereto for the annual report of a 1934 Act Registered Issuer.

27 Wheat Report, supra note 9, at 39, 331. In the same vein, the Commission has noted that "informal corporate publicity is an important supplement to the disclosures required by the securities acts" (emphasis added). SPECIAL STUDY OF SECURITIES MARKETS, supra note 23, at 65.


29 Posner, supra note 28, at 1709-10. SEC Commissioner Friedman recently proposed, however, a modification of the structure of mandated disclosure for larger issuers about which
ommend a comprehensive federal statute or rule pertaining to corporate publicity, despite the presence of myriad abuses:

The volume of corporate publicity [presently circulating], the paramount aim of full and prompt disclosure, the difficulty of making judgments among specific items of publicity, and the proximity of this field to, the constitutionally protected right of freedom of expression—all combine to make legal control a relatively clumsy instrument.\(^3\)

Therefore, the SEC has left the regulation and oversight of corporate publicity primarily to the exchanges, the NASD, the business and financial community, and the press.\(^3\)

That the disclosure requirements of the 1933 and 1934 Acts do not impose a general disclosure obligation is not disputed.\(^3\) However, there is no similar consensus as to whether the anti-fraud provisions, and particularly rule 10b-5, impose an affirmative duty to disclose.\(^3\)

While some commentators conclude that there is no such duty,\(^3\) some believe that the issue is unsettled,\(^3\) others have concluded that there is such a duty,\(^3\) and still others, although conceding that no much is already known. The proposal would largely eliminate the periodic reporting requirements of the 1934 Act and the registration requirement of the 1933 Act and replace them with general requirements of current disclosure of material facts. Address by Stephen J. Friedman to the New York Chapter of the Financial Executives Institute, March 24, 1981, reported in 58 Daily Report for Executives A-9 (BNA) (March 6, 1981). The effect of this proposal would be to create an affirmative disclosure obligation with respect to covered issuers.

\(^{30}\) Special Study of Securities Market, supra note 23, at 102.

\(^{31}\) Id.

\(^{32}\) However, any such affirmative disclosure obligation is more consonant with the primary purpose of the disclosure requirements—creating a free flow of information to enable the market to operate more efficiently—than the primary objective of the anti-fraud provisions which is to prevent overreaching of investors. Brudney, Insiders, Outsiders and Informational Advantages Under the Federal Securities Laws, 93 Harv. L. Rev. 322, 334-38 (1979) [hereinafter cited as Brudney].

\(^{33}\) The issuer, of course, can remain silent concerning material developments only so long as whatever other statements or disclosures it makes contemporaneously are not rendered misleading by that silence. See, e.g., 17 C.F.R. §§ 240.10b-5, 230.408.


\(^{36}\) Dickman, SEC Requirements of Disclosure of Inside Information, 26 Inst. on Oil & Gas L.
court has clearly articulated such a duty, argue that such a duty ought to be implied from the anti-fraud provisions.37

Those commentators who conclude that there is an affirmative duty to disclose material facts, or who argue that such a duty ought to be established, find support in several judicial decisions. Some rely on cases holding that there is no disclosure obligation when the issuer has a legitimate business reason for secreting the information.38 The implication drawn is that, in the absence of a legitimate business reason, the issuer should make full disclosure.39 A similar implication could be drawn from decisions holding that in order to avoid misleadingly premature announcements, the timing of a release of information should be left to the sound business discretion of the issuer.40 Some commentators conclude, therefore, that these decisions are

[37] Bauman, supra note 24; Talesnick, supra note 9.
[38] See, e.g., Matarese v. Aero Chatillion Corp., [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) §§ 93,322 (S.D.N.Y. 1971). In the protracted Texas Gulf Sulphur litigation, the SEC did not allege any violation by the issuer prior to its initial press release, despite the fact that the issuer had consciously decided to withhold any information prior to that for the stated reason of allowing acquisition of the adjoining land. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 843 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). Thus the court was not called upon to determine whether the issuer’s earlier silence was a breach:

We do not suggest that material facts must be disclosed immediately; the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and the SEC. Here, a valuable corporate purpose was served by delaying the publication of the K-55-1 discovery. 401 F.2d at 850 n.12. The issue was more squarely addressed in the civil litigation arising out of the same events, where it was held that until the land acquisition program was completed on March 27, 1964, there was a legitimate corporate purpose for non-disclosure. Summary judgment for the issuer was therefore granted on the issue of breach of disclosure obligations before that date. Astor v. Texas Gulf Sulphur Co., 306 F. Supp. 1333, 1339 (S.D.N.Y. 1969). The issue was left open, however, concerning the period from that date until disclosure was made: “Whether TGS had a proper corporate purpose in not disclosing after March 27, 1964, and whether the lack of such corporate purpose would give rise to a duty to disclose, involve issues which cannot be determined on these motions for summary judgment.” Id. at 1338. Even if the court had resolved the latter issues, the timely disclosure policy of the New York Stock Exchange, see notes 10-15 and accompanying text supra, upon which stock of Texas Gulf Sulphur was listed, would have governed rather than the more general provisions of rule 10b-5.

based upon an “unarticulated premise that the corporate defendant owes a disclosure duty to the plaintiff” to which these cases create temporary exceptions.42

Although this conclusion may be appealing at first glance, it is simply not supported by the decisions from which it is drawn. Some of these decisions must be limited to their particular facts.43 The other decisions concerning the timing of disclosure and business purposes for withholding information did not reach the question of a general disclosure duty. It cannot be assumed that if the courts had reached that issue they would have found such a duty.44 Indeed, the most persuasive aspect of these decisions is that, given many opportunities to do so, even during the climate of the ever-expanding jurisprudence of 10b-5, not one court held that there was an affirmative general obligation to disclose.45

41 Allen, supra note 1, at 489.
42 Bauman, supra note 24, at 954, 976; Bauman, Corporate Disclosure and Dissemination, CORPORATE NEWS DISSEMINATION (P.L.I.) 63, 89 [hereinafter cited as Bauman, Corporate Disclosure]; Blackstone, supra note 28, at 84; Dickman, supra note 36, at 251; Flom & Atkins, supra note 36, at 112; Ruder, Current Problems in Corporate Disclosure, 30 BUS. LAW. 1081, 1981 (1975). It has been suggested that SEC v. Shattuck Denn Mining Corp., 297 F. Supp. 470 (S.D.N.Y. 1968), and Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967) also support an affirmative disclosure duty by implication. Talesnick, supra note 9, at 400-02. However, because of the facts of each (Shattuck Denn involved non-correction of an earlier statement by the issuer rendered incorrect by subsequent events, and Fisher concerned the special case of a certified public accountant who learns that the financial statements he earlier certified were in error) it seems inappropriate to draw such a broad implication from either one.
43 See note 42 supra.
44 The court in Financial Indus. Fund, Inc. v. McDonnell Douglas Corp., 474 F.2d 514 (10th Cir.), cert. denied, 414 U.S. 874 (1973), even pointed out that the plaintiff’s burden in a silence case included not only that the information was “ripe” for publication, but also that “there existed a duty owed by the defendant to the plaintiff to so disclose as to do otherwise would be a violation of Rule 10b-5. . . .” Id. at 521.
45 Staffin v. Greenberg, 672 F.2d 1196, 1204 (3d Cir. 1982); R. JENNINGS & H. MARSH, SECURITIES REGULATION CASES AND MATERIALS 950 (4th ed. 1977); Ruder, Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, in Pari Delicto Indemnification and Contribution, 120 U. PA. L. REV. 597, 622-23 (1972). But see Issen v. GSC Enterprises, Inc., 538 F. Supp. 745 (N.D. Ill. 1982), where the plaintiffs complained of the omission of the terms of loans to insiders from the defendant corporation’s annual report. The court stated that despite the absence of an explicit statutory or regulatory duty to do so, a corporation must disclose all material facts in its annual report since it has the “special relationship” with its shareholders, specified by Chiarella v. United States, 445 U.S. 222 (1980), which triggers a duty to disclose material facts. To the extent that this court intended to articulate a generally applicable affirmative disclosure obligation, it stands alone. A more reasonable construction, however, is that when making other disclosures, such as the annual report to shareholders, the omission of material facts which renders the disclosure misleading constitutes a violation of 10b-5. Viewed in this manner, the decision is consistent with earlier decisions and the provisions of 10b-5 and does not create a revolutionary affirmative disclosure obligation of all material facts even in the absence of trading or other disclosures by the issuer.
Some commentators are persuaded that the SEC has taken the position that the anti-fraud provisions impose an affirmative disclosure duty, but this conclusion also will not withstand careful scrutiny. Certainly, the SEC has repeatedly encouraged and applauded full and prompt disclosure by issuers, but it has never stated that there is a duty, imposed by the securities laws, to disclose in the absence of trading or other disclosures. On the contrary, the SEC has consistently recognized that much corporate disclosure goes beyond statutory requirements.

Understandably, some confusion concerning the SEC's position has resulted from its release No. 5092. This release, which has been termed the SEC's "basic" and "most definitive" statement concerning a general affirmative disclosure obligation, almost completely conceals the SEC's position because of its poor draftsmanship. It starts out by declaring, without qualification, that issuers have "an obligation to make full and prompt announcements of material facts regarding the company's financial condition."

Then, at the close of the release, appears the admonishment "that unless adequate and accurate information is available, a company may not be able to purchase its own securities or make acquisitions using its securities,"

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46 Alberg, supra note 35, at 1225; Schoenbaum, supra note 35, at 573-74; Talesnick, supra note 9, at 402-03; Comment, Liability Under Rule 10b-5 for Negligently Misleading Corporate Releases: A Proposal for the Apportionment of Losses, 122 U. Pa. L. Rev. 162, 170 n.40 (1973) [hereinafter cited as Comment on Liability Under Rule 10b-5].

47 The following statement is an example:

There has been an increasing tendency, particularly in the period since World War II, to give publicity through many media concerning corporate affairs which goes beyond the statutory requirements. This practice reflects a commendable and growing recognition on the part of industry and the investment community of the importance of informing security holders and the public generally with respect to important business and financial developments.

Securities Act Rel. No. 3844 (Oct. 8, 1957). See also Special Study of Securities Markets, supra note 23, at 65; Address of former SEC Commissioner Sommer, "Financial Reporting in a Troubled Industry," June 5, 1975, discussed in Bauman, Corporate Disclosure, supra note 42, at 98. In fact, the SEC may at times have indirectly enforced such an obligation by invoking its power to suspend trading when disclosure may be necessary to stem unusual market activity. Cohen, supra note 34, at 1364. See also Faust, Disclosure—Fact and Fancy, 2 SEC REG. L.J. 160, 162-63 (1974).

48 Bauman, Corporate Disclosure, supra note 42, at 96.

49 See authorities cited in note 47 supra.


52 Comment on Disclosure, supra note 28, at 812.

and its insiders may not be able to trade its securities without running a serious risk of violating section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.\textsuperscript{54} In other words, the "obligation" to disclose originally mentioned is nothing more than a restatement of the well-worn principle of "disclose or abstain." Thus, there is an obligation to disclose only if the issuer or an insider trades.\textsuperscript{55}

Those who contend that there is an affirmative disclosure obligation in the absence of trading or other disclosures have advanced novel theories, supplemented by policy reasons, to buttress their position. They have argued that by issuing its securities for public trading, the issuer impliedly represents that it will deal fairly with the public and fair dealing encompasses complete disclosure.\textsuperscript{56} They have also contended that an issuer's past history of multiple informational disclosures induces public reliance on the continuing validity of such disclosures and creates an implied representation that the issuer will continue to disclose fully.\textsuperscript{57} Policy considerations advanced are that current 1934 Act disclosures are insufficient and should be supplemented by complete disclosure of all material facts;\textsuperscript{58} investor confidence cannot be fostered without complete disclosure;\textsuperscript{59} full disclosure by issuers is the only effective way to deal with insider trading;\textsuperscript{60} and, without required full disclosure, issuers will minimize the

\textsuperscript{54} Id.

\textsuperscript{55} Accord, Allen, supra note 1, at 488; Bauman, Corporate Disclosure, supra note 42, at 92; Posner, supra note 28, at 1709-10; Sommer, supra note 34, at 54; Comment on Disclosure, supra note 28, at 812. Contra Alberg, supra note 35, at 1225; Schoenbaum, supra note 35, at 573-74; Talesnick, supra note 9, at 402-03; Comment on Liability Under Rule 10b-5, supra note 46, at 170 n.40.

The confusion bred by the poorly drafted Release No. 5092 was compounded by subsequent releases which incorporated by reference or repeated nearly verbatim the main point of the earlier release. Securities Act Release No. 5447 (Dec. 20, 1974); Securities Act Release No. 5263 (June 22, 1972). See also Securities Act Release No. 5592 (Nov. 7, 1978). Securities Act Release No. 5447 is arguably closer than any of the others to stating an affirmative disclosure obligation because it describes the issuer's and insider's inability to trade without disclosure as being "in addition" to the responsibility for full disclosure.

\textsuperscript{56} Bauman, supra note 24, at 944. Contra Comment on Disclosure, supra note 28, at 800. This reasoning may have recent support in the SEC's pronouncement that "investors have legitimate expectations that public companies are making, and will continue to make, prompt disclosure of significant corporate developments." In re Sharon Steel Corp., Securities Exchange Act Rel. No. 18,271 (Nov. 19, 1981).

\textsuperscript{57} Bauman, supra note 24, at 944. See also Brudney, supra note 32, at 327; Talesnick, supra note 9, at 385. Contra Comment on Disclosure, supra note 28, at 801-04.

\textsuperscript{58} Talesnick, supra note 9, at 371-76, 398, 406.

\textsuperscript{59} Bauman, supra note 24, at 954.

\textsuperscript{60} Fiflis, supra note 35, at 140 n.171. For a current report on the apparent proliferation of insider trading and how present tools to attack it are inadequate, see Louis, The Unwinnable War on Insider Trading, FORTUNE, July 13, 1981, at 72.
disclosures they do make, because of fear of liability resulting from those disclosures being found misleading due to omissions.61

Assuming arguendo that these implied representations and policy considerations are legitimate objectives for rule 10b-5,62 the starting point of any consideration of the securities laws must now be the language of the statute and rule.63 It is difficult, if not impossible, to fit the suggested result, full issuer disclosure even in the absence of trading or other disclosures, into the language of section 10(b) and rule 10b-5. Both the statute and rule require that the alleged fraud be "in connection with the purchase or sale of any security."64 It is difficult to conceive of a connection between total silence and a security transaction. Nevertheless, the requisite connection can probably be supplied by the same reasoning which supplied it for affirmative misrepresentations by the issuer in the absence of issuer transactions. There, reliance by investors on the misrepresentations supplied the necessary connection.65 In the case of omissions of material facts, reliance by investors can still be presumed from materiality66 and, therefore, the connection between the silence and the purchase or sale of a security can be drawn.67 Although this approach toward the "in connection with" requirement would be of doubtful validity if raised now for the first time, that it is a long established rationale suggests that challenge is unlikely.68

61 Allen, supra note 1, at 491.
62 A general refutation of these arguments may be found in Comment on Disclosure, supra note 28.
67 Bauman, supra note 24, at 943; Bromberg, 10b-5 Liabilities for Non-disclosure, 1 INTRODUCTION TO SECURITIES LAW DISCLOSURE 225, 251 (P.L.I. 1976) [hereinafter cited as Bromberg]; Dickman, supra note 36, at 250; Comment on Disclosure, supra note 28, at 797. But see Staffin v. Greenberg, 672 F.2d 1196, 1203 (3d Cir. 1982), in which the court held that issuer silence in the absence of issuer trading was not "in connection with" a purchase or sale of securities. The court distinguished this from the situation where the issuer makes misleading statements without contemporaneous trading, concluding that in the latter event "the strictures of the 'in connection with' clause are loosened somewhat." Id. at 1204 n.8.
68 It would seem that a plausible argument could be made that section 10b and rule 10b-5 were originally intended to deter fraud by purchasers and sellers of securities, and that the "in connection with" clause was the means chosen to verbalize that limitation. Had this been a question of first impression today, the current antipathy of the Supreme Court to expansion of the coverage of the securities laws might well result in a different outcome. See notes 77-78
A more serious obstacle is raised by the jurisdictional requirement that the alleged fraud be accomplished "by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . ."69 Silence, of course, does not employ any of these means and, therefore, should not be covered by the statute or rule.70 However, it has been suggested that the jurisdictional requirement, which has been very broadly construed,71 should be analyzed by focusing on the affected purchase or sale in the same fashion as the "in connection with" requirement. Thus, so long as the purchases or sales induced by the silence are effected by the jurisdictional means, this requirement would be satisfied.72 This approach has definite appeal when the fraud alleged is in the context of a fraudulently induced sale by the defendant to the plaintiff. In that situation, it makes little difference whether the use of the jurisdictional means is initiated by the defendant or plaintiff, so long as the jurisdictional means are utilized toward completion of the fraud.73 However, in the case of issuer silence, the alleged fraud (nondisclosure) is accomplished in the complete absence of any of the jurisdictional means. Use of the jurisdictional means by the plaintiff, such as purchasing the issuer’s securities on a national securities exchange, takes place after the purported wrongful conduct of the defendant is complete. That subsequent use

and accompanying text infra. However, because the construction of the “in connection with” language described in the text is of such long-standing, it will probably survive. Its survival, parallels the survival of the private cause of action to enforce rule 10b-5 which was originally created by an approach to statutory construction which would be wholly unacceptable today. Compare Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947), with Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) and Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11 (1979). Nevertheless, the private cause of action under rule 10b-5 is expected to survive because it is so long established. See Touche Ross & Co. v. Redington, 442 U.S. 560, 577 n.19 (1979); Cannon v. University of Chicago, 441 U.S. 677, 692 n.13 (1979); Frankel, Implied Rights of Action, 67 VA. L. REV. 553, 562 (1981).

70 Loss, supra note 34, at 3597.
71 For example, it is not necessary for the misrepresentation or misstatement itself to be transmitted by some means of interstate commerce, but only that such means or instrumentality be used in connection with the transaction. Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Stevens v. Vowell, 343 F.2d 374 (10th Cir. 1975). The classic example of how the jurisdictional requirement is applied loosely is that an intra-state telephone call may satisfy the requirement. See, e.g., Myzel v. Fields, 386 F.2d 718, 727-28 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968).
72 Talesnick, supra note 9, at 379-80.
73 See, e.g., 3 Bromberg & Lowenfels, supra note 14, at § 11.2; Loss, supra note 34, at 1524-25. One of the often cited decisions in this area states: "[I]t is not material who instituted the communication [by telephone or mail]. Instead, the real question is whether the mails or instrumentality of interstate commerce were used to mislead the plaintiffs." Travis v. Anthe Imp. Ltd., 473 F.2d 515, 526 (8th Cir. 1973) (emphasis added).
does not relate to whether securities "fraud" was committed by the silent issuer, but only to whether the "fraud" was effective in inducing transactions. As Professor Loss, who initially raised the problem of the absence of jurisdictional means in the area of issuer nondisclosure, has stated: "It must not be overlooked that some use of the mails or interstate facilities, however indirect, must be brought home to defendant."74

An additional obstacle to implying an affirmative duty to disclose from the language of rule 10b-5 is that the rule speaks specifically of omission only in clause (2), which makes it unlawful to "[o]mit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading . . . ."75 Because the affirmative disclosure obligation under consideration in this article goes far beyond this limited proscription, it would have to be based on one of the other two clauses, if required by the rule.76 Yet it would be curious if the other two clauses, which do not specifically mention omissions, were construed to deal with omissions in a much more comprehensive fashion than clause (2). Indeed, the qualified proscription of omissions in clause (2) would be meaningless if the other two clauses applied to omissions without such qualification. The better construction would seem to be that interpretation of either the first or third clause to cover omissions in the absence of trading is precluded by the more specific reference to omission in the second clause.77

Most significant is the current attitude of the Supreme Court of the United States. Since 1975 the Court has consistently taken a re-

74 Loss, supra note 34, at 3597 (emphasis added).
75 17 C.F.R. § 240.10b-5(b) (1981).
76 Bromberg, supra note 67, at 242-43.
77 This is nothing more than a restatement of the statutory construction principle "expressio unius est exclusio alterius." 2A C. Sands, Statutes and Statutory Construction § 47.23 (4th ed. 1973).

There is some authority for the proposition that clauses (1) and (3) of rule 10b-5 encompass complete omission. SEC v. Capital Gains Bureau, Inc., 375 U.S. 180, 197-99 (1963); 1 Bromberg & Lowenfels, supra note 14, at 51; 3 Loss, supra note 34, at 1439. Such an interpretation is acceptable in the trading context. Limiting the insider trader's liability to misleading half-truths under 10b-5(2), and excluding liability for complete silence would effectively immunize insider trading from liability because, typically, the insider is totally silent. It does not necessarily follow, however, that clauses (1) and (3) of rule 10b-5 should be extended to situations where the non-trading issuer is totally silent. The prohibition of half-truths in clause (2) is consistent with an issuer's mandatory disclosure obligations. But, to interpret clauses (1) and (3) as also prohibiting all issuer silence would carry the issuer's disclosure obligation far beyond the carefully constructed obligations of the mandated disclosures.
strictive view of the federal securities laws. The liberal construction which placed greater emphasis on the security laws' general purpose of investor protection than on their specific provisions is no longer acceptable. It has been replaced by an analysis which starts with the statutory language itself. If the statutory language is unambiguous, the analysis also ends there. It is in this context that the question of an affirmative obligation to disclose must be considered. In view of the absence of any judicial decision or SEC statement declaring such a duty, it would be an expansion of the securities laws to create it now. The carefully structured disclosure provisions of the 1933 and 1934 Acts, which clearly do not impose such a duty, hardly lend themselves to an expansive interpretation, particularly by the present Court. Thus, even though it might legitimately be viewed as a closer step toward effecting the overall purpose of the securities laws, the Supreme Court is unlikely to infer an affirmative disclosure obligation, in the absence of trading or other disclosures by the issuer, from the unambiguous language chosen by Congress.

The balance of this article will proceed on the assumption that no such duty exists. This precludes an easy answer to the present inquiry, that issuers are compelled to respond to rumors, publicity, or unusual market activity because of a general affirmative disclosure obligation.

IV. The Limited Duty to Respond to Rumors

There is little disagreement about the issuer's minimum duty to respond to rumors and other publicly-disseminated information. Although some feel the duty should be expanded, all agree that the


80 See note 45 and accompanying text supra.

81 See notes 46-54 and accompanying text supra.

82 It has been argued, for example, that although the issuer should not be charged with knowledge of everything published about it, it should nevertheless speak up when it learns of
issuer has a duty to respond when the rumor or report is attributable to it. When such attribution will be deemed sufficient, however, is far from settled.

The foundation for the issuer's duty to respond was laid in the *Texas Gulf Sulphur* litigation.\(^83\) Rumors concerning the company's spectacular ore find began spreading by early 1964,\(^84\) became rampant in Canada during early April, 1964, and were prominently reported in the New York press on April 11, 1964.\(^85\) Texas Gulf

published errors, particularly when the errors appear in those sources upon which investors are most likely to rely, such as the Wall Street Journal and the Dow Jones tape. Bauman, *Corporate Disclosure and Dissemination*, in *CORPORATE NEWS DISSEMINATION* (P.L.I., R. Haft & C. Wile eds. 1976). Another author has similarly contended that "the best approach would be to require a correction by the corporation if it learns of the statement and has no valid corporate reason for withholding the facts." Jacobs, *What is a Misleading Statement or Omission Under Rule 10b-5?*, 42 FORDHAM L. REV. 243, 259 (1973) [hereinafter cited as Jacobs on Misleading Statements]. Others seem to have assumed that the timely disclosure policies of the major exchanges, which clearly demand an issuer's response to known rumors or publicity, see notes 9-25 and accompanying text supra, should be extended in principle to all issuers. See CCH Executive Disclosure Guide § 1140 (1976); Fleischer, *Corporate Disclosure/Insider Trading*, 45 HARV. BUS. REV. 129, 133 (1967); Flom & Atkins, supra note 36, at 116; Haft, *Corporate "News" Dissemination — An Introduction*, *CORPORATE NEWS DISSEMINATION* 13 (P.L.I., R. Haft & C. Wile eds. 1976); Shade, supra note 9, at 504.

The only decision which lends serious support to that position is that rendered in *Green v. Jonhop, Inc.*, 358 F. Supp. 413 (D. Ore. 1973), where the court stated:

A corporation cannot be held responsible for all omissions or misrepresentations made about its financial condition and future prospects by every broker-dealer or securities salesman. It is only obligated to take some action when it learns of such misstatements or omissions and is aware that their publication or nonpublication will be misleading to members of the investing public.

*Id.* at 420. If taken literally, this passage clearly imposes a duty to respond without regard to the source of the inaccuracy. Such a broad conclusion was not necessitated by the facts and thus ought to be limited to its facts. Bauman, supra note 24, at 971-72. See also Peacock, *Correcting Rumors*, 12 REV. SEC. REG. 901, 903 (1973) [hereinafter cited as Peacock]. A discussion of the facts of *Green* appears at notes 150-55 infra and accompanying text.

Even if a broader meaning was intended by the court, two later Second Circuit decisions implicitly reject it. In both Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980), and State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981), the issuer learned of publicity and was undoubtedly aware that the publicity would have an effect on the investing public, yet the issuer was held not have breached any duty to speak out.

83 The initial groundwork was actually laid in *Mills v. Sarjem Corp.*, 133 F. Supp. 753 (D.N.J. 1955), where the sellers of stock alleged that the buyers breached the securities laws because a letter to the buyers concerning the terms was incorrectly reported by the news media. In rejecting this claim the court stressed the absence of allegations that the buyers were responsible for the news report or that they even knew of those reports. However, the real basis for the decision seems to have been the impossibility of plaintiffs' reliance on the erroneous newspaper reports of the content of a letter that the plaintiffs had previously received. *Id.* at 767.


responded with the now famous "clarifying" press release on the following day which was subsequently found to be misleading. Although the litigation surrounding those events was concerned primarily with insider trading and the press release which was issued, the various decisions charted a course for answering the question of whether an issuer has a duty to make a statement concerning rumors. First, by holding Texas Gulf liable for the misleading press release it issued, the litigation resolved the question of whether an issuer will be held responsible for its own statements. The decisions also suggested that the issuer would not be held accountable for statements and rumors from others. For example, in the context of discussing whether Texas Gulf exercised due diligence in preparation of the release, the court stated:

At the very least, if TGS felt compelled to respond to the spreading rumors of a discovery it would have been more accurate to have stated that the situation was in flux and that the release was prepared as of April 10 information rather than purporting to report the progress "to date." In his concurring opinion, Judge Friendly referred generally to corporate responses to such rumors as being "not legally required." The Texas Gulf Sulphur litigation thus suggested that issuer liability would not be extended to statements made by others and that any response from the issuer to such statements was optional.

That suggestion was expressly adopted in Electronic Specialty Co. v. International Controls Corp. In that case, it was reported in the press that a rumored tender offeror had already acquired approximately

87 Neither the private damage actions nor the SEC enforcement action sought to impose liability on Texas Gulf for failure to respond to the rumors prior to April 12. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 978 (1969); Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90 (10th Cir.), cert. denied, 404 U.S. 1004 (1971); Astor v. Texas Gulf Sulphur Co., 306 F. Supp. 1333 (S.D.N.Y. 1969). Perhaps that was because the company did respond just one day after the first broad publication of the rumors in this country. In view of the scientific complexity of the subject matter involved, even the most stringent duty to respond would probably not have demanded a more prompt response.
88 401 F.2d at 863-64 (emphasis added).
89 Id. at 867 (Friendly, J., concurring).
90 On remand from the Second Circuit, the trial court noted: "When a company chooses to issue a press release to respond to spreading rumors regarding its activities, it must describe the true picture at the time of the press release . . . ." SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 85 (S.D.N.Y. 1970), modified, 466 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971) (emphasis added). If an issuer can "choose" whether to respond to rumors, a response is not mandatory.
91 409 F.2d 937 (2d Cir. 1969).
5% of the target company's outstanding stock and intended to offer between forty-five and fifty dollars per share. In fact, the offeror had acquired less than 2 1/2% of the target company's shares and the reported offering price was without foundation. There was no evidence that the offeror was the source of this report. The court rejected the target company's claim that the offeror was under a duty to correct these errors, holding that "[w]hile a company may choose to correct a misstatement in the press not attributable to it . . . we find nothing in the securities legislation requiring it to do so."92 In other words, the court refused to extend the issuer's responsibility to include a duty to correct erroneous public information when such information was not attributable to it. The converse proposition, that the issuer does have a duty to correct errors attributable to it, is clearly implied.93

Several commentators have questioned whether *Electronic Specialty* should be read so broadly and have suggested that it should be limited to its particular facts. The important facts were that the offeror had a valid business reason for non-disclosure at the time, that the entire tender offer process had a statutorily prescribed timetable for disclosure in the Williams Act,94 under which offeror disclosure was not yet due, and that there was a possibility that the false report had actually been planted by the target company to thwart the offer. It has been suggested that without these mitigating facts the court might have expanded further the issuer's duty to respond.95 However, subsequent decisions have applied the *Electronic Specialty* holding without limiting it to its facts.96 Moreover, the *Electronic Specialty* result has been consistently applied in the takeover area, where it would be most ludicrous to require one party in a takeover battle to

92 Id. at 949.
93 Although *Electronic Specialty* decided this question under § 14(e) of the 1934 Act, the anti-fraud provision of the Williams Act pertaining to tender offers, 409 F.2d at 949, the reasoning and the result are equally applicable to § 10(b) and rule 10b-5. Elkind v. Liggett & Myers, Inc., 472 F. Supp. 123, 126 (S.D.N.Y. 1978), aff'd in part and rev'd in part on other grounds, 635 F.2d 156 (2d Cir. 1980).
correct the misstatements of the other.  

The United States Court of Appeals for the Second Circuit has been twice called upon within the last two years to rule again on the question of issuer duty to respond to publicity. In both instances, the holding in *Electronic Specialty* was unequivocally reaffirmed. In *Elkind v. Liggett & Myers, Inc.*, security analysts had published optimistic projections of issuer performance which turned out to be erroneous and inconsistent with the issuer's own estimates. In rejecting the contention that the issuer was obligated to correct the projections, the court stated that it "readily agree[d] that *Electronic Specialty* is the law of this circuit." Shortly thereafter, in *State Teachers Retirement Board v. Fluor Corporation*, the Second Circuit was presented with a similar question as to whether the issuer had a duty to correct marketplace rumors concerning itself. This case was perhaps more significant because the lower court had boldly expanded the issuer's duty far beyond the attribution principle. On appeal, the issuer's duty to correct rumors was again restricted to the *Electronic Specialty* standard: "A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company."  

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98 635 F.2d 156 (2d Cir. 1980).  

99 *Id* at 163. This portion of the decision principally addressed whether the issuer had so entangled itself with the published projections that they could be attributable to the issuer. *See* notes 141-49 and accompanying text infra.  

100 654 F.2d 843 (2d Cir. 1981).  

101 The district court adopted the view of several commentators that when possible the issuer should correct rumors, even if from unrelated sources, to better serve the overall purpose of investor protection:  

"[E]ven in the absence of insider trading or prior inaccurate disclosures, this court believes a violation of 10b-5(e) may arise from a failure to disclose where, as here, the rumors are rampant, the price of the stock is shooting upward and the defendants are in possession of all the material facts but refrain from disclosing them. In such cases, liability could be imposed only upon a showing that the failure to disclose was motivated by defendant's intent to deceive investors for their own gain since a wrongful purpose is required to establish liability in a private action under Rule 10b-5."  

500 F. Supp. 278, 292 (S.D.N.Y. 1980), *rev'd*, 654 F.2d 843 (2d Cir. 1981). In reaching this conclusion, the only reference to *Electronic Specialty* and *Elkind* was in a "but see" citation. *Id* at 292. However, one commentator interprets the district court opinion in *Fluor* as a restrictive rather than an expansive view of the duty to disclose because of its reliance on the business judgement rule. Vaughn, *Timing of Disclosure*, 13 REV. SEC. REG. 912 (1980).  

102 *State Teachers Retirement Bd. v. Fluor Corp.*, 654 F.2d 843, 850 (2d Cir. 1981). As an alternative to the asserted duty to respond to rumors, the plaintiff in *Fluor* argued that an issuer which chooses to remain silent in the face of rumors or other publicity should at least attempt to have trading in its securities halted pending release of the information. Any fail-
V. Is the *Electronic Specialty* Rule Sound?

More important than how often or how consistently *Electronic Specialty* has been followed is whether the rule announced by the court is supported by reason. The policy justification most often given is that the issuer cannot be held responsible for the accuracy of all that is said and published about it, and it would be an impossible burden to require that the issuer discover and correct all errors concerning its affairs. In essence, it is argued that the issuer should not be held responsible for not correcting misstatements by others of which it was unaware. Although that proposition can hardly be disputed, it alone does not justify limiting issuer responsibility to misstatements attributable to it. There will often be errors not so attributable which, nonetheless, are known to the issuer.

The policy justification for the *Electronic Specialty* rule has also been buttressed by the valid concern that when rumors are circulating it is often difficult, if not impossible, to ascertain the precise content of the rumor. In addition, the rumor may be unwittingly modified through multiple transmissions, with the result that several different but related rumors may be extant. In such a climate, it is perhaps unfair to impose a duty to respond on the issuer because the issuer will not know exactly to what it must respond. Again, while seemingly correct in principle, this justification for the rule is not complete because it does not address whether the issuer should respond to other publicly circulating information, such as news reports or market letters, where the content is readily ascertainable.

ure to notify the exchange and seek a halt to trading would, according to this argument, violate 10b-5. *Id.* at 850. The court rejected the argument on several grounds. It held: (1) that under the facts of the case (particularly that the rumors were having little, if any, impact on the market) there was no indication that an earlier suspension of trading was necessary; (2) that in view of its candid responses to the exchange's inquiries and acquiescence in the ultimate suspension of trading there was an absence of scienter on the part of the issuer; and (3) that whether the exchange would have been receptive to an earlier request for cessation of trading was purely speculative. *Id.* at 851. Each of these conclusions, however, was dependent on the facts of the case and did not reject the theory of the argument. In addition, the court refused to find an alternative duty because a request to halt trading is simply not required by the New York Stock Exchange Manual. *Id.* at 851 n.7. This last conclusion rejects not only the applicability but also the rationale of the argument.


104 [T]he very nature of rumors lends support to the position that there should be no general obligation to dispel them. The corporation cannot be certain it has obtained a complete version of the rumor, and answering an incomplete version may merely disseminate more incorrect (or at least partial) information. Allen, *supra* note 1, at 495-96. See also Peacock, *supra* note 82, at 905.
Another reason advanced in support of limiting the issuer's duty to respond only to information attributable to it is that it avoids forcing the issuer into a posture of undesired and, perhaps, unnecessary disclosure. For example, if an erroneous earnings projection is disseminated, the issuer, if forced to respond, might feel compelled to prepare and distribute its own projections even though it otherwise chooses not to engage in earnings projections. However, it would seem that even if the issuer had a duty to respond, the duty would be fulfilled by a simple disclaimer of responsibility for the published projection.

Finally, it is a justifiable concern that a broader duty to respond might be used as a tool to force corporate disclosure by an unscrupulous analyst or takeover opponent. For instance, an analyst too anxious to await regular periodic disclosure might, without foundation, plant a news item suggesting a material change in the issuer's earnings in the hope of forcing the issuer into a premature earnings release.

As always, there are competing concerns. A narrow duty to respond allows the one party most likely to know the truth, the issuer, to stand mute while the market labors under false or unconfirmed information. Obviously, market efficiency and investor confidence will be sacrificed to some degree. Furthermore, rendering an issuer response optional rather than mandatory will perhaps encourage issuer silence, because the risk of material misstatement or omission in the response and the resulting potential liability for violation of the securities laws are so great.

On balance, however, the limitation of the obligation to respond

105 Jacobs on Misleading Statements, supra note 82, at 258-59. See also Schneider, Financial Protections, 7 REV. SEC. REG. 907 (1974).
106 Fiflis, supra note 35, at 144 n.199.
107 Address by SEC Chairman G. Bradford Cook, [1973 Transfer Binder] Fed. SEC. L. REP. (CCH) ¶ 79,341 (Apr. 19, 1973) [hereinafter cited as Address by Cook]; Allen, supra note 1, at 496; Peacock, supra note 82, at 902. Because of the nature and timing of the news report concerning the takeover battle at issue in Electronic Specialty, there was a strong suspicion that the target company planted the story in order to force disclosure of the aggressor's intentions. Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 949 (2d Cir. 1969).
108 Jacobs, supra note 95, at 4-29 n.27. See also Address by Cook, supra note 107; Fiflis, supra note 35, at 140 n.171.
109 If the only choices open to a corporation are either to remain silent and let false rumors do their work, or to make a communication, not legally required, at the risk that a slip of the pen or failure properly to access or weigh the facts — all judged in the light of hindsight — will lead to large judgements, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers, most corporations would opt for the former.

SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring).
only to rumors and other publicity which are attributable to the issuer is a workable and sensible rule. Although achieving the statutory goal of full and accurate information in the securities markets is important, it does not justify thrusting the entire burden of that goal upon the issuer. Securities law responsibilities and liabilities should be assigned not solely with reference to statutory goals, but also with regard to responsibility for breach. The serious consequences of being held to have violated the securities laws should not be imposed on any party irrespective of fault. Holding the issuer liable for not correcting errors of others clearly extends the issuer’s responsibilities beyond traditional concepts of fault. But restricting the issuer’s duty to correct publicity attributable to itself limits issuer responsibility in a manner consonant with fault concepts because it confines the issuer’s responsibility to its own misconduct and does not hold it liable for the misconduct of others.\footnote{This same sentiment seems to have been behind the more straightforward conclusion in Zucker v. Sable, 426 F. Supp. 658, 663 (S.D.N.Y. 1976), that “it would be unreasonable to require the defendants to correct errors not of their making.” See also Schneider & Shargel, \textit{Now That You Are Publicly Owned...}, 36 Bus. Law. 1631, 1644 (1981), where the attribution principle has been paraphrased as requiring a reaction from the company “where there is a rumor or a market report circulating for which the company had some responsibility.”}

It is perhaps dangerous to base legal analysis upon a loose and easily manipulated concept such as “fault.” What constitutes actionable fault may change over time as society’s views of when injury or loss should be compensated alter.\footnote{Professor Prosser, while noting that “fault” in the law of torts is not a concept of moral blame, stated: “There is a broader sense in which ‘fault’ means nothing more than a departure from a standard of conduct required of a man by society for the protection of his neighbors . . . .” \textit{W. PROSSER, HANDBOOK OF THE LAW OF TORTS} 493 (4th ed. 1971) [hereinafter cited as PROSSER ON TORTS]. As society’s standards of conduct inevitably}
settled that a product manufacturer's responsibility for injuries caused by its product was limited to negligent manufacture or design. Now that concept has been expanded to impose liability for harm caused by an unreasonably dangerous defective condition in the product even when the manufacturer was not negligent. Further examples of the transient nature of fault concepts may be found in the metamorphosis of liability in connection with securities transactions. Although the duty to abstain or disclose was essentially unknown to the common law, it is now well established under the anti-fraud provisions of the securities laws. Thus, an analysis premised on fault might be superficially dismissed by the assertion that expanding an issuer's duty to respond is nothing more than recognition of the continuing evolution of the fault concept.

In this instance, however, the difference is in kind and not simply in degree. Expansion of the issuer's duty to respond to rumors and publicity of others is nothing less than rendering the issuer responsible for the actions of others. That is even a more drastic departure from fault concepts than the examples cited previously, all of which expand the actor's responsibility for its own actions but not for the actions of others. Although one party may become responsible

change, actionable fault will also. Prosser noted: "In a very vague general way, the law of torts reflects current ideas of morality, and when such ideas have changed, the law has kept pace with them." Id. at 17.

112 Restatement (Second) Torts § 402A. See generally Prosser on Torts, supra note 111, chap. 17.

113 See Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659 (1933). Nevertheless, some courts did attempt to find that kind of a rule, at least in face-to-face as opposed to anonymous market transactions, based on "special facts," Strong v. Repide, 213 U.S. 419 (1909), or "utmost fairness," Hotchkiss v. Fischer, 136 Kan. 530, 16 P.2d 531 (1932). See also Restatement (Second) Torts § 551.

114 SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969). The Supreme Court has recently restricted the disclose or abstain rule to those instances where the defendant had a duty to disclose "arising from a relationship of trust and confidence between parties to a transaction." Chiarella v. United States, 445 U.S. 222, 230 (1980). While this result may make liability for non-disclosure look very similar to simple common law liability, there are still significant differences. For example, under common law it was usually held that only corporate insiders had a duty to disclose and that the duty was owed only to the corporation itself, not its shareholders. Note, Securities Regulation—Insider Trading—Duty of Non-Insiders to Disclose Material Nonpublic Information, 48 Tenn. L. Rev. 161, 164 n.12, 165 n.14 (1980). Under common law, a corporate insider might owe no duty to speak to buyers who do not become shareholders until after the transaction is completed and a "tippee" might have no such relationship giving rise to a duty. Cann, A Duty to Disclose? An Analysis of Chiarella v. United States, 85 Dick. L. Rev. 249, 262-63 (1981). The Chiarella decision is not limited in any of these respects.

115 Although the so-called "strict liability" which a product manufacturer now faces may be properly characterized as liability without fault, it is not liability without responsibility. The manufacturer is only being held liable for defects in its own products from which it
for the actions of others in a "control" relationship, or under an agency or respondeat superior theory, these concepts have been confined to those situations where the person in control is answerable for the other's misconduct. By contrast, requiring the issuer to correct rumors and publicity imposes on it potential liability for conduct in which it did not participate and which was engaged in by others wholly unrelated to the issuer and over whom the issuer has no power or control. Such a departure from traditional notions of fairness, fault, and responsibility is highly questionable and certainly should not be implied solely for the convenience of effecting a generalized statutory purpose.

VI. The Meaning of "Attributable"

The _Electronic Specialty_ rule that an issuer is not obligated to correct rumors and other publicity not attributable to it, is too ambiguous to be of much help in resolving specific cases. The ambiguity results from uncertainty in the meaning of "attributable." For example, does the rule apply only to situations where the issuer

116 An issuer of securities may also be secondarily liable under these concepts by reason of its failure to respond to rumors. For example, in the controlling person provisions of the securities laws, § 15 of the 1933 Act and § 20(a) of the 1934 Act, if the issuer has a controlling influence over the source of the rumor or publicity, or over someone who neglected an obligation to correct the publicity, and if the controlled person thereby committed a violation of the securities laws, the issuer may also be responsible secondarily. Once the primary violation and control relationship are established, the issuer may assert its own good faith as a defense. An issuer who was unaware of the publicity, or being aware of the rumor or report, was unaware of the attendant securities law violations, and had no constructive knowledge of the foregoing, should not suffer liability under either of the controlling person provisions.

Under the common law theories of agency and respondeat superior, secondary liability may be imposed on the issuer with respect to a primary violation committed by an agent within his authority or scope of employment. These theories resemble the controlling person provisions because an agency relationship is also dependent upon the power of control. See _Restatement (Second) of Agency_ §§ 1, 2(2). There is also, however, a significant difference. The vicarious liability which flows from agency or respondeat superior is strict liability in the sense that it cannot be avoided by the issuer's good faith. Accordingly, should an agent or servant commit a primary violation by starting or spreading a false rumor, or by taking advantage of such a false report by trading, and if those actions are within the agent's authority or the servant's scope of employment, the issuer may be vicariously and thus secondarily responsible even though it was unaware of the primary violation or even of the rumor itself.

117 In the discussion of whether the publicity is attributable to the issuer, the issuer will be deemed to include not only the issuer as defined in section 2(4) of the 1933 Act, 15 U.S.C. § 77(b)(4), and section 3(a)(10) of the 1934 Act, 15 U.S.C. § 78c(a)(10), but also officers, directors and other management personnel whose duties include public disclosure. A. JA-
fact, the source of the rumor or publicity, or could it be interpreted more liberally to include any situation where the issuer is erroneously cited as the source? In either of these two extreme cases, and in many cases in between, it might be definitionally correct to say that the rumor is "attributable" to the issuer. It is imperative, therefore, to ascertain exactly how the term should be construed before the general duty can be consistently applied.

The clearest example of when a rumor or publicity is attributable to the issuer is when the issuer is, in fact, the source. If that is all that Electronic Specialty and its progeny intended, however, they added nothing to the already decided law. Texas Gulf Sulphur had already established that an issuer has a duty of accuracy in its public statements even in the absence of trading.\footnote{118} Also, a failure to correct the issuer's own misstatements is nothing more than a continuing violation of the duty breached upon the original misstatement.\footnote{119} In addition, because rumors seldom have an identifiable source, the

\footnote{Cobs, supra note 95, at 4-16 n.5. For example, if while carrying out his corporate responsibilities the president makes an erroneous public statement, that statement should be deemed to have been made by the corporate issuer for purposes of deciding whether the issuer has a duty of correction. The issuer's duty to correct is thus a primary duty not dependent upon application of principles of secondary or vicarious liability. Compare Sharp v. Coopers & Lybrand, 649 F.2d 175, 182 n.8 (3d Cir. 1981):

We note that high ranking officers in a corporation, or partners in a partnership, present a different situation from lower level employees. Officers are able to make policy and generally carry authority to bind the corporation. Their action in behalf of the corporation is therefore primary, and holding a corporation liable for their actions does not require respondeat superior. The First Circuit apparently recognized this precept, stating in Holmes [v. Bateson] that the corporation "cannot escape its primary liability to the party defrauded." 583 F.2d at 561. But see Bauman, supra note 24, at 968-69. See also Affiliated Ute Citizens v. United States, 406 U.S. 128, 154 (1972) and Reeder v. Mastercraft Elec. Corp., 363 F. Supp. 574 (S.D.N.Y. 1973), in which the liability of the corporation was held, without any discussion of agency principles, to be "co-extensive" with its principal officers and directors who actually perpetrated the fraud.
}

\footnote{118 SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 857-64 (2d. Cir. 1968), cert. denied, 394 U.S. 976 (1969). The court in Texas Gulf Sulphur, however, did limit the issuer's liability to the misstatements made "in a manner reasonably calculated to affect the market price of TGS stock and to influence the investing public," because only those could be said to be "in connection with the purchase and sale" of a security. Id. at 864. This referred to those statements intended for publication and dissemination as opposed to those issued in confidence. Electronic Specialty, even if confined to creating a duty to respond when the issuer is the original source, would possibly have expanded the law to a limited degree by rendering the issuer responsible for correcting its own misstatements which were not made in a manner reasonably calculated to affect the market, but which nevertheless did have that effect because of a leak, greater publicity of the statement than anticipated, or otherwise.
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\footnote{119 Compare ALI Federal Securities Code § 1602(b), in which comment 3 states that a "failure to correct a belatedly discovered defect [in one's own earlier statement] is neither more nor less than a continuing violation of § 1602(a) [the general antifraud provision]."}
duty to correct, if construed so narrowly, would rarely be applicable. Thus, although the duty to correct must encompass those instances where the issuer is the source, it should not be limited to that situation.120

How broadly the rule ought to be applied should be resolved with reference to the rationale underlying it, i.e., the fault of the issuer in the dissemination of the inaccuracy.121 In other words, whether the issuer has a duty to respond to public information or rumors should turn on whether the issuer was at fault with regard to the original publication. Correction of its own inaccuracies fits neatly into this approach, because the issuer is clearly to blame for the original misleading of the market. Although the courts which have been called upon to apply the Electronic Specialty rule in different contexts have not articulated their rationales, the results have been consistent with a fault analysis.

The possible fact variations may be viewed as a continuum, with the cases where the issuer is the source of the rumor or inaccuracy at one extreme of the continuum, the cases where the issuer is demonstrably not the source at the other extreme, and the cases where the source of the information is doubtful falling in between these two extremes. The variations will be analyzed in the order suggested by the continuum, beginning with the situation where the issuer is the source.

A. When the Issuer Is the Source of the Rumor

As indicated earlier, “attributable” must, at the very least, include any case where the issuer itself is the source of the inaccuracy. A somewhat analogous situation is when the issuer is the source of the information, but the inaccuracy is traceable only to the transmission. The clearest example is a correct press release by the issuer

120 It bears noting that the various formulations of the rule, such as “supplied by or attributed to” the issuer, Jacobs on Misleading Statements, supra note 82, at 258, and “can be attributed” to the issuer, State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981), easily lend themselves to a broader interpretation. But see Zucker v. Sable, 426 F. Supp. 658 (S.D.N.Y. 1976). According to one commentator, Zucker interpreted the Electronic Specialty holding as being limited to those instances where the issuer is the source. Bauman, supra note 24, at 968. This conclusion is undoubtedly based upon the statement in Zucker that “it would be unreasonable to require the defendants to correct errors not of their making.” 426 F. Supp. at 663. As indicated previously, however, see note 110 supra, the better construction of the conclusion in Zucker is that issuer liability for failure to correct should be restricted to those instances when the issuer bears some responsibility for the publicity, not just where the issuer was the source.

121 See notes 110-15 and accompanying text supra for a discussion of “fault” as that concept is used herein.
which is misquoted, misunderstood, or otherwise garbled by the press. As a general proposition, the error is then attributable solely to the press with the consequent absence of any fault or responsibility for the error on the part of the issuer. The issuer, therefore, should not have a duty to respond or to correct the error. Thus, when the release is misreported because of negligence or clerical error of the media, the issuer need say nothing further. The responsibility for the erroneous report of an accurate release, however, often will not be so easily isolated. If the release drafted by the issuer is ambiguous, poorly drafted, technically complex, or if the press is asked to publish the information in haste, it may be that the responsibility for the erroneous report is not the media's alone. When preparing and releasing information, the issuer clearly has a duty of due diligence and that duty may be breached in any of the given examples which suggest that errors in reporting by the press are foreseeable because of the issuer's own deficiencies in the preparation of the release. Bearing at least a portion of the responsibility for the dissemination of the inaccuracy, the issuer, under fault analysis, can reasonably be required to correct the error.

122 Cf. Zucker v. Sable, 426 F. Supp. 658 (S.D.N.Y. 1976). In that case the issuer issued a press release announcing an "investigational" new drug application with the Food and Drug Administration. An "investigational" application allegedly signified that it would be at least several years before the drug would be approved for commercial production. Various financial journals omitted the word "investigational" from their reports. The court held that the issuer had no duty to correct these erroneous reports of its accurate press release. But see Bauman, Corporate Disclosure, supra note 42, at 105; A. Jacobs, supra note 95, § 88.04[b], at 4016 n.4 (both argue for a duty to correct garbled press releases).

123 Jacobs on Misleading Statements, supra note 82, at 258-59. The example given by Jacobs is where the media, as a result of a negligent transposition, reports earnings of $190,000.00 rather than the correct figure of $910,000.00 listed in the company's press release. For this type of clerical error, which may have an obvious impact on the market if left uncorrected, Jacobs concludes there is no duty to speak out. Id. at 159 n.89.

124 In the Texas Gulf Sulphur litigation, one of the defenses raised by Texas Gulf was that even if held liable for the press release itself, it should not be liable for the inaccurately or incompletely reported versions. Texas Gulf asserted that the media materially distorted the release by omitting the company's promise to issue a definite statement when more information was available and by reporting a portion of the release out of context. The trial court was unpersuaded by the argument, stating that by issuing the press release "for immediate release," the company was depending on the press to report to its shareholders and could not expect the entire release to be reported verbatim. SEC v. Texas Gulf Sulphur Co., 312 F. Supp. 77, 86-87 (S.D.N.Y. 1970), modified on other grounds, 446 F.2d 1301 (2d Cir.), cert. denied, 404 U.S. 1005 (1971). The holding implicitly suggests that by designating the information "for immediate release," with the knowledge that the release would be edited before reporting, errors by the media could be anticipated by the issuer.


126 When the issuer thereby shares in the responsibility for the error and consequently has
Precisely when the issuer can anticipate an error in reporting for which a duty to correct arises will be a fact question in each case. In all circumstances, however, care must be exercised in order not to lose sight of whether the issuer shares blame for the inaccuracy. For instance, press releases are virtually always edited and errors may result. This, in itself, would be insufficient to create a duty to correct because nothing suggests any issuer responsibility for the error. Similarly, reporter incompetence, even if suspected by the issuer, should not, by itself, result in a duty to correct. The resulting errors in the report, although foreseeable, were not caused by the issuer. As a practical matter, however, the issuer's contention that it was not responsible for and had no duty to correct erroneous reports of company releases will often be an unappealing one. The issuer initially attempted to inform the public by the release and, in all probability, was aware of the inaccurate reporting. It would not be surprising, therefore, if factfinders were predisposed to find some issuer responsibility for the error. Thus, the issuer might be well advised to notify the press that a correction is necessary. Since the issuer has already determined to inform the public by the first release, there will seldom be any corporate interest served by silence.

...a duty to correct it, it might even be reasonable to require the issuer to verify the accuracy of the reporting of the release, at least in the most prominent media. Compare Bauman, supra note 24, at 951-52, which argues that a duty to correct a garbled press release should include an affirmative duty to review the reporting of the release in "those publications on which the corporation reasonably believes investors are most likely to rely." For an issuer of national importance this might include the Dow Jones Broad Tape and The Wall Street Journal, and for other issuers it might be limited to reports in local newspapers. The significance of this conclusion is that although the scienter requirement may often shield the issuer from liability for reporting errors of which it is unaware, it need not insulate an issuer which intentionally chooses to remain ignorant of press reports of its own informational releases and which has reason to suspect or anticipate erroneous reporting.

127 For example, in Texas Gulf Sulphur discussed in note 124 supra, the court stressed that the information was issued "for immediate release," and that the issuer could not have expected the media to publish the entire release. 312 F. Supp. at 86. The implication is that the issuer's knowledge that the release would be edited was not alone sufficient to impose liability for error in the report. Rather, the issuer must have contributed in some way to the likelihood of error, such as by encouraging immediate publication. By prompting haste, the issuer might reasonably expect, and therefore foresee, resulting errors in the news report. Contra, Jacobs on Misleading Statements, supra note 82, at 159 n.88, where the author concludes that the fact that the release was issued "for immediate release" should not make a difference in result. The author asserts that a better rationale for the decision is that "the risk of error [in reporting a release] is on the issuer whenever the release can be easily misconstrued." Id. Even this rationale is consistent with that advanced in this article. An issuer that distributes a news release subject to easy misconstruction can readily anticipate that misconstruction and thus is at least partially responsible when such misconstruction occurs.

128 If the initial company release was pursuant to a duty to speak, the issuer may be constrained to correct the erroneous report even in the absence of any responsibility for the
Related to the garbled press release is the problem of the misquoted interview with the press or with financial analysts. On a theoretical level, the resolution should be approached in the same manner as the erroneously reported press release. Unless the issuer shares some responsibility for the erroneous report of the interview, such as responding to questions in an ambiguous or overly technical manner, the issuer should have no duty to correct. On a practical level, however, there are significant differences. Compared to a carefully drafted press release, statements made during an interview, even when given some advance thought, are oral, extemporaneous, and often difficult to verify. Thus, there is a greater likelihood that statements by company management are at least a contributing cause to the inaccurate report. In any event, uncertainty over what was said, absent a verbatim transcript or recording of the interview, renders a defense based on an issuer’s lack of responsibility risky. Both the reporter or analyst and the executive may sincerely recollect different versions of the same interview, leaving the fact finder with no solid basis for resolving the dispute.

Another related situation arises where the issuer gives an “off the record” interview or comment which contains inaccuracies but was not intended for publication. In that event, the issuer may assert that it is free from fault in the dissemination of the inaccuracy, even though the error is, in some sense, attributable to it. Of course, this conclusion will depend upon the facts. While “off the record” press error. For example, the disclose or abstain rule requires that material information be “effectively disclosed” to the public before insiders may trade. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854 (2d Cir. 1968). Effective disclosure certainly requires accurate public dissemination. Consequently, in the event of misreporting of a correct release, neither the issuer nor its insiders should be permitted to trade until a correction is publicized. See also ALI Proposed Federal Securities Code, § 1602(b)(comment 8(b)), in which a duty to correct garbled reports of a press release issued pursuant to a duty to speak is left to ad hoc determination on the facts.

The similarity of the manner in which the issues may arise is illustrated by SEC v. Shattuck Denn Mining Corp., 297 F. Supp. 470 (S.D.N.Y. 1968), where a news report concerned an earlier interview with a company official regarding the financing arrangement for an acquisition by the company. The company official claimed that he could not be liable for inaccuracies in the news report because it did not mention that such financing was “subject to long term financing,” which the official alleged he stressed in the interview. The court, however, was unconcerned with that alleged omission because it found the official’s statements to the reporter false in other respects.

Even when the company executive speaks from a carefully prepared text to a formal gathering of security analysts, responses to questions thereafter will invariably involve the same dangers of communication problems as in an informal interview. See Marx v. Computer Sciences Corp., 507 F.2d 485 (9th Cir. 1974).

This type of selective disclosure would undoubtedly be viewed as nothing more than a tip and thus is not advisable in any event. Dayan, supra note 95, at 944.
Interviews may not be uncommon, perhaps there can be no true “off the record” discussion between management and security analysts. In view of the business of analysts, who evaluate securities on the basis of all available information and share their evaluation with customers and clients in the form of buy and sell recommendations, it is, perhaps, unreasonable to assume that they will treat as truly confidential any material information revealed to them. In any event, when an error is clearly traceable to the issuer and the attribution link is drawn thereby, the issuer is in part at fault for the public dissemination of the inaccuracy and, therefore, has a duty to correct, regardless of its subjective desire to avoid publicity.

B. When the Source of the Rumor Is Unknown

Another instance in which the attribution question arises is when the source of a rumor is unknown, so that it is impossible to determine whether the rumor is attributable to the issuer. The burden of proof on the attribution issue is then elevated to primary significance. However, there seems to be no reason to shift the burden from the party on whom it normally rests, the one seeking to prove that a duty under the securities laws has been breached. The issue of whether there is a duty to correct marketplace rumors was squarely presented in State Teachers Retirement Board v. Fluor Corp. In that case, the defendant-issuer refrained from comment on rampant rumors which caused the price and volume of the stock to rise rapidly. The company had been awarded a significant contract and was

132 However, a common scenario is that while the precise source of the rumor may be undeterminable, the substance of the rumor may suggest that it could only have originated with the issuer. For example, the rumors of a large contract in State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981), almost had to have been leaked out by the issuer, which was the only party that knew of the agreement. While this likelihood may create a legitimate question of fact concerning the source of the rumor, it should not relieve the plaintiff of his burden of proof on that issue. In other words, no presumptions concerning the source of the rumors should be entertained simply because of their content. The reason, quite clearly, is that no matter how apparently obvious the likely source, there are always other possible explanations. For example, the rumor in Fluor might well have come from the South African enterprise with whom Fluor contracted, even though such a disclosure might have prejudiced their ongoing financing negotiations. The rumor could also have been planted by an analyst fishing for a reason for the unusual activity in the company's stock and hoping to prompt an issuer response.

Another example is the rumors of a rich strike in Texas Gulf Sulphur, which would seem to have originated only from those in the know, i.e., the issuer or its employees. In fact, at least some of the reports were simply speculation inferred from the fact that samples were flown to the United States for chemical assay. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 844 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969).
contractually bound to remain silent temporarily. As to whether the company was obliged to speak in the face of the rumors, the court first reiterated the rule that there is no duty to correct rumors unless the rumors can be attributed to the issuer. It then concluded that there could be no duty to correct because "[t]here is no evidence that the rumors affecting the volume and price of Fluor stock can be attributed to Fluor." The court found no need to shift the burden of proof to the issuer on the question of attribution. Thus, when the source of a rumor is truly unknown, the rumor should not be attributed to the issuer, and the issuer has no duty to correct it.

C. When the Issuer Is Not the Source of the Rumor

Having discussed the situations in which the issuer is the source of the information or the source is unknown, the next step in the continuum is where the issuer is demonstrably not the source of the rumor or publicity. The fault analysis proposed in this article suggests that rumors or publicity generated by others need not be corrected by the issuer because the issuer bore no responsibility for dissemination and, thus, the rumors or publicity are not "attributable" to the issuer. While that is the correct conclusion, its generality may be deceiving. The issuer may share responsibility for the dissemination of inaccuracies, and thereby have a duty to speak, even though it was not the initial source. For example, if an analyst's research report concerning the issuer, prepared independently of the issuer, is distributed by the issuer to its shareholders, does not the issuer share responsibility even though it is not the original source? By distributing the report, the issuer has vouched for the accuracy of the analysis and adopted it as its own. Such a report is, in a very real sense, attributable to the issuer, and the issuer should be compelled to correct any errors in the report. Likewise, a specific confirmation by the issuer of the facts and conclusions in a news report or research analysis verifies its accuracy and is no different than if the issuer had been the initial source. Again, this should create a duty on the part of the issuer to correct any errors in the report or analysis.

134 Id. at 850.
135 Those commentators who argue for a broader obligation on the issuer in this context have looked solely to the purpose of the securities laws. See, e.g., Jacobs, supra note 95, at § 89, pp. 4-20 to 4-21, and authorities cited therein.
136 See Fleischer, Regulation, 1972 SEC. L. REV. 105, 109 [hereinafter cited as Fleischer, Regulation]; Fleischer, supra note 82, at 134.
The same reasoning should apply when the issuer's ratification of the report is not so straightforward but can be implied from conduct. In such situations, difficult fact questions will arise as to whether the issuer's conduct constitutes an implied adoption or confirmation of the report. For example, if unreasonably optimistic reports or projections are presented in the presence of company officials who offer no dissent and who speak in optimistic terms which encourage reliance on the report, the issuer may be held to have a duty to correct the errors in the report. The more common occurrence is when the issuer consents to review an analyst's market letter for errors in advance of publication. It may well be that by such involvement the issuer will be deemed to have verified the accuracy of the matter stated in the market letter. If so, the issuer clearly has a duty to correct its own verification, just as it would have a duty to correct any of its own erroneous statements.

Whether the issuer created such a duty by conduct was at issue in Elkind v. Liggett & Myers, Inc. In that case, the issuer, Liggett & Myers, decided that its stock was undervalued by the market and to help cure this problem instituted an "analyst program" which included promoting closer contact between security analysts and company management. As part of the program, the issuer regularly

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138 Confirmation by the issuer of a report prepared by another, resulting in a duty to correct, can be express or implied. Bromberg and Lowenfels, supra note 14, at 138.461.

139 Green v. Jonhop, Inc., 358 F. Supp. 413 (D. Ore. 1973). Based on these facts, and apparently the additional fact that the erroneous analysis originated with the issuer's underwriter, the issuer was held to have aided and abetted the analyst's violation of the act and, in addition, to have breached a duty to correct the publicized misstatements. It was not entirely clear from the opinion whether the special relationship between the analyst and the issuer was essential to the conclusion that the issuer's actions created a duty to correct. This decision is discussed in greater detail in notes 150-55 and accompanying text infra.

140 Although undoubtedly less common, the issuer might also be given the opportunity to review news reports in advance. See, for example, SEC v. Shattuck Denn Mining Corp., 279 F. Supp. 470 (S.D.N.Y. 1968), in which a reporter for the Wall Street Journal permitted a company official to review a draft of his article based on an earlier interview with the same official. According to Jensen, Business and the Press, in Corporations and Their Critics, (D. Vogel & T. Bradshaw ed. 1981) [hereinafter cited as Jensen], news reports in the financial press "often have been cleared, word for word, by the publicatons in advance." Id. at 52. Advance reviews of news reports and market letters involve the same considerations.

141 472 F. Supp. 123 (S.D.N.Y. 1978), aff'd in part, rev'd in part, 635 F.2d 156 (2d Cir. 1980). The facts of this case recited herein are taken from both opinions.

142 The issuer's argument that it did not have a duty to correct faulty earnings projections by analysts was not helped by the manner in which it went out of its way to cultivate analyst interest. This fact did not appear to have any significant effect on the ultimate outcome,
reviewed analysts’ market letters prior to publication to correct errors and other misunderstandings. The issue of a duty to correct was raised because several analysts had published favorable reports concerning the issuer containing projections of an earnings increase of approximately ten percent over the previous year. Management was considerably less optimistic and the issuer’s internal budget projections predicted only a two percent profit increase. The issuer maintained that its policy was only to correct factual errors and not to comment upon incorrect opinions or projections based on correct factual information. Pursuant to the company’s policy, it reviewed the reports in advance, correcting factual errors where necessary, but did not comment (or make evasive or noncommittal remarks) on the earnings projections. The United States Court of Appeals for the Second Circuit stated the issue as follows: “[T]he controversy before us is whether Liggett sufficiently entangled itself with the analysts’ forecasts to render those predictions ‘attributable to it,’ thus removing it from the conduct held protected in *Electronic Specialty.*”

The court resolved the issue by affirming the trial court’s decision that the issuer had breached no legally imposed duty to correct the erroneous projections. However, the court expressly recognized that such a duty could arise from too close an association of the issuer with the preparation of market letters:

> We have no doubt that a company may so involve itself in the preparation of reports and projections by outsiders as to assume a duty to correct material errors in those projections. This may occur when officials of the company have, by their activity, made an implied representation that the information they have reviewed is true or at least in accordance with the company’s view.

Nevertheless, stressing that the company’s policy was not to comment on earnings forecasts, that the analysts knew they were not being made privy to the company’s internal projections and that the company did not fail to correct any purely factual errors, the Second

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143 635 F.2d at 163.
144 Id.
145 Variations in any of these facts may distinguish future cases. For example, if the issuer has no policy that pre-release review of market letters is to be limited to factual matters, or if that policy is not well documented, even a limited review of the facts may create a duty to correct earnings projections. Such a review might create an inference that the review covered everything. Indeed, there is a suggestion in *Elkind* that it is common for issuers to review analysts’ earnings projections as well as factual recitations. 472 F. Supp. at 126. Likewise, if the corporate policy of limited factual review is not known to analysts the same inference of
Circuit affirmed the trial court's finding of fact that no representation of verification was made by the company's advance review of the market letters.\textsuperscript{146}

The true significance of this decision could be lost if the precise holding is not understood. Certainly, it reaffirms \textit{Electronic Specialty} and the attribution principle. And, while interpreting "attributable" to include issuer involvement with information from an independent source, it confines the issuer's duty to those instances where its own actions render the issuer partly responsible for the inaccurate dissemination.\textsuperscript{147} However, the decision does not necessarily stand for the proposition that by reviewing only the facts, the issuer need not be concerned with an obligation to correct erroneous earnings forecasts or other interpretive matter published in market letters or elsewhere. Although that specific result prevailed as to the issuer in \textit{Elkind}, the court's holding was a limited one, i.e., that the lower court's resolution of this fact question was not clearly erroneous. Consequently, essentially the same facts, if presented again, could result in a different outcome without inconsistency with the Second Circuit's decision in \textit{Elkind}. Indeed, the court's opinion suggests some displeasure with complete review could be drawn from any advance review, regardless of how limited. Of course, a limited review will create a duty to correct any subsequently discovered inaccuracy in the factual material reported in the market letter.\textsuperscript{146} 635 F.2d at 163. Whether the lower court made any such finding of fact is not entirely clear. Applying the \textit{Electronic Specialty} standard, the lower court held simply that, "[t]he plaintiff has not stated a cause of action against Liggett for failure to correct speculation about its earnings." 472 F. Supp. at 126. Perhaps the failure to state a claim resulted, as the appellate court suggests, from inability to infer verification of the projections from the issuer's review of the facts contained in market letters. Equally plausible, however, is that the lower court determined that even if such an inference could be drawn, the erroneous projection would still not be "attributable" to the issuer. In other words, the lower court might not have made any finding of fact but simply interpreted the \textit{Electronic Specialty} standard of attribution very narrowly.\textsuperscript{147} This conclusion is drawn from the result reached in the case. If the issuer could be liable for failure to correct where it simply remained silent and did nothing, the entire inquiry concerning whether the issuer, by its actions, "entangled itself" with the forecast would have been unnecessary.

Also implicit in this result is the rejection of the theory that the issuer is obligated to correct publicity simply because the proximity of the independent source to the issuer lends greater credence to the publicity. See notes 150-55 and accompanying text \textit{infra}. The public is unlikely, or at least less likely than analysts, to appreciate the distinction between review of facts and review of opinions. Thus, if the public knows that the issuer has reviewed the report in advance it may think that the entire market letter, including earnings projections, has been confirmed by the issuer even when the review was limited to facts. Such a conclusion by the public is particularly reasonable if, as attested to by expert witnesses at the \textit{Elkind} trial, it was the custom and the practice in the industry to correct analysts' earnings projections which err by a significant margin. 472 F. Supp. at 126. But see Bauman, \textit{supra} note 24, at 971-72, which reasons that investors should not conclude that a market letter represents the views of the issuer simply because it is based on information supplied by the issuer.
the outcome of the case. The opinion contains a warning that advance review of market letters is dangerous:

[I]t bears noting that corporate pre-release review of the reports of analysts is a risky activity, fraught with danger. Management must navigate carefully between the ‘Scylla’ of misleading stockholders and the public by implied approval of reviewed analyses and the ‘Charybdis’ of tipping material inside information by correcting statements which it knows to be erroneous. A company which undertakes to correct errors in reports presented to it for review may find itself forced to choose between raising no objection to a statement which, because it is contradicted by internal information, may be misleading and making that information public at a time when corporate interests would best be served by confidentiality. Management thus risks sacrificing a measure of its autonomy by engaging in this type of program.148

Several definitive conclusions can be reached on the basis of the Elkind decision. First, publicity can be attributable to the issuer within the meaning of Electronic Specialty even if the issuer is not the source, as long as the issuer, by its actions, implies that it confirms the accuracy of the publicity. Second, although advance review of facts will not necessarily imply issuer confirmation as to forecasts and opinions contained in market letters, the issue remains a question of fact. Consequently, the risks of creating a duty to correct all errors is inherent in even limited advance review of market letters or news reports. Normally, management reaction to such a risk would simply be avoidance of all pre-release review of market letters, even review limited to facts. That reaction, in turn, would lead to distribution of more inaccurate information to the investing public, rather than less. Other forces, however, will probably combine to avert such normal expectations. For instance, the issuer’s desire to promote public interest in its securities by promoting the interest of analysts, and trading by the issuer and/or its insiders in the issuer’s securities (which could not legally take place if the issuer remains silent concerning material publicized inaccuracies) should prompt continuation of advance review of factual matters discussed in market letters, despite the risks involved.149

Another situation concerning the issuer’s duty to correct occurs

148 635 F.2d at 163-64. The commentators have also cautioned against any advance review of market letters beyond their purely factual statements, and even then have warned of danger. Fleischer, supra note 82, at 134; Flom & Atkins, supra note 36, at 117.
149 That issuer review of analysts’ market letters involves some risk is obviously not a new discovery. See, for example, the authorities cited in note 148, supra in which the risks were discussed in 1967 and 1974 publications. The fact that such review has not been curtailed in the past is itself persuasive that reviews will continue.
when the publicity emanates not from the issuer but from some independent source which has a special relationship with the issuer. This situation was first addressed in *Green v. Jonhop, Inc.*,\(^{150}\) in which an investment firm, acting as the underwriter and a market maker in the issuer's securities, distributed a market letter containing unfounded earnings estimates, an unrealistically optimistic discussion of the issuer's operations and future plans, and a recommendation to buy the issuer's securities. Although the issuer was fully aware that the market letter's conclusions were unsubstantiated, it chose to remain silent. The investment firm had also issued a "special situation report" which was similarly misleading. With respect to this report, the president of the issuer made a private protest to the investment firm, but the executive vice president attended sales meetings at which the report was discussed and, not only did not refute the report, but also spoke in optimistic terms, thereby lending credence to the projections in the report. At one point, the vice president of the issuer even confirmed the earnings projections in a conversation with a broker. Based upon these facts, the court held that the issuer had a duty to take some action to stop the deception of the public caused by the market letters.\(^{151}\) The court stressed that public reliance on

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\(^{151}\) *Id.* at 420. Whether the court held there was a primary duty to speak out or only that the issuer was secondarily liable is not entirely clear from the opinion. Initially the court held that the issuer's silence and related conduct were actionable because public reliance on the market letter was encouraged thereby and, therefore, that the issuer was liable under an aiding and abetting theory. *Id.* at 419, 420. In a subsequent section of the opinion, the court spoke of the duty to correct in terms which suggested primary rather than secondary responsibility:

> A corporation cannot be held responsible for all omissions or misrepresentations made about its financial condition and future prospects by every broker-dealer or securities salesman. It is only obligated to take some action when it learns of such misstatements or omissions and is aware that their publication or nonpublication will be misleading to members of the investing public.

*Id.* at 420. However, immediately thereafter the court suggested that it was holding the issuer on an aiding and abetting or conspiracy theory: "Under the circumstances of this case, failure by [the issuer] or [its executive vice-president] to take appropriate action amounted to a tacit agreement with [the investment firm] to encourage investors to buy and hold Jonhop stock." *Id.*

A careful reading of the opinion, however, reveals that the court did not hold that a special relationship alone creates a primary duty to correct. In considering the dealer's erroneous market letter, in connection with which the issuer took no affirmative steps which might be viewed as confirming or adopting its conclusions, the court held:

> Jones' and Jonhop's silence and inaction encouraged reliance by the public on the misrepresentations and omissions in the comment, since it was well known that American Western was the underwriter and principal dealer in Jonhop stock. Such acquiescence through silence is a form of *aiding and abetting* cognizable under § 10(b) and Rule 10b-5.
the market letter was encouraged because it was well known that the investment firm was the underwriter and principal dealer in the issuer's stock.

The result in Jonhop has led some commentators to conclude that errors published by someone in a "special relationship" with the issuer may create a duty for the issuer to correct the errors. The rationale is that because of the special relationship, the public will be led to believe that the publisher of the report has access to the issuer's information and, therefore, that the report has more credibility than one published by a stranger to the issuer. Under this analysis, the special relationships which might give rise to a duty to correct could include almost any connection with the issuer which might suggest that the publicity is based upon inside information. Thus, beyond the underwriter and principal market maker involved in Jonhop, such a special relationship might be had by an independent accountant, outside counsel, management consultant and, depending upon the nature of the information which is the subject of the report, a customer, supplier, distributor or almost anyone who has dealings with the issuer. In fact, because the focus of the analysis is exclusively on the perceived reliability of the publicity, the logical conclusion is that a special relationship is not even necessary if, for some reason, the report is particularly believable. Perhaps a report published by an analyst who is an acknowledged expert in the issuer's industry

358 F. Supp. at 419 (emphasis added). The court's later discussion concerning primary rather than secondary liability followed its consideration of, and appears to be dependent on, the additional facts of actions by the issuer by which the issuer expressly and impliedly confirmed the erroneous reports.

152 Bauman, supra note 24, at 940, 971-72; Bromberg and Lowenfels, supra note 14, at 138.469; Fiflis, supra note 35, at 144; Peacock, supra note 82, at 904.

153 Bauman, supra note 24, at 940, 971-72; Fiflis, supra note 35, at 144; Peacock, supra note 82, at 904.

154 For example, if the report is that the issuer's production has been interrupted, that report will take on greater credibility if a regular customer of the issuer is quoted as the source. In SEC v. Electrogen Indus., Inc., [1967-1969 Transfer Binder] FED. SEC. L. REP. (CCH) § 92, 156 (E.D.N.Y. 1968), the SEC sought to enjoin alleged 10b-5 violations based upon misleading statements concerning the utility of the defendant-issuer's product, an anti-fatigue device. Apparently many of the statements at issue were made by the issuer's unaffiliated distributor. However, because there were also such statements made by the issuer and its officers, the court did not find it necessary to differentiate between statements from the two sources when enjoining the issuer.

If reliability alone is the issue, it would be necessary to require the issuer to respond even when the analyst-author "becomes associated with the issuer in the minds of the public . . . ." Fiflis, supra note 35, at 144. This suggests that a special relationship in fact is not the key, but rather that the issue will turn on whether the public thinks there is such a relationship.
may be considered so reliable that the issuer should have the duty to correct the analyst’s errors.\footnote{155} Carried to its logical extreme, the issuer should respond to all publicity which has a high degree of reliability and, therefore, a strong capacity to deceive. As a practical matter, however, this would translate into a very broad duty to correct and one which clearly exceeds the attribution principle.

The basic flaw in the reasoning that the issuer should respond to statements made by those with the special relationship to the issuer is its focus on the likelihood of deception rather than on whether the issuer caused or contributed to the deception. That reasoning will produce liability on the silent issuer even when it is totally innocent and free from any responsibility for the dissemination of the inaccuracy and the resulting investor reliance. As indicated above, the decisions concerning an issuer’s duty to correct have never looked solely to the capacity of the rumor or publicity to deceive.\footnote{156} In all those cases, the information not only had a capacity to deceive, but, in fact, allegedly did deceive the plaintiffs who bought or sold in reliance on it. Nevertheless, the courts limited the issuer’s duty to respond to those situations where the issuer was in some way responsible for the publication of the inaccuracy.

The fault analysis proposed in this article\footnote{157} submits that issuer responsibility rather than investor deception triggers the duty to respond. This approach is consistent with the decision in Jonhop. In that case, a primary duty to correct was imposed on the issuer only after the company management spoke optimistically at the same meeting in which the erroneous projections were discussed and even

\footnote{155} The question of the issuer’s duty to correct errors by an analyst who is an expert in the issuer’s industry is discussed in Bauman, supra note 24, at 972. Although Professor Bauman seems to acknowledge that this line of reasoning would logically result in a duty to correct such an expert’s errors, he concludes that such a result would nevertheless be inappropriate.

\footnote{156} See, e.g., State Teachers Retirement Board v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981); Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937 (2d Cir. 1969). Even Professor Bauman, who argues vigorously for a broader duty than that advocated in this article, would excuse the issuer who is completely free of fault. While concluding that issuers should respond to statements by outsiders with a special relationship and by corporate officials whose positions lend greater credence to their statements, Professor Bauman would nevertheless remove that duty from the issuer “if it has established procedures to prevent such misstatements, and these procedures are breached through no fault of the corporation.” Bauman, supra note 24, at 940. But his suggestion looks at issuer fault in a different way. The fault concept is not dependent on affirmative action by the issuer, but looks solely to whether the issuer has in any way caused or contributed to the dissemination of inaccuracies and resulting public deception. The issuer should be absolved of fault even if it has not taken any affirmative steps to avoid misstatements by outsiders.

\footnote{157} See notes 109-15 and accompanying text supra.
confirmed the projections to a broker. Those facts indicate a degree of issuer culpability upon which even the fault analysis would find a duty to correct. With respect to issuer silence in the face of inaccuracies published by one with a special relationship to the issuer, the court concluded only that the issuer was liable as an aider or abettor.158

Although a duty to correct should not result simply from a special relationship, such a relationship is not irrelevant in determining whether such a duty exists. It may be significant in ascertaining whether the issuer has any responsibility for the public dissemination. On the facts of *Jonhop*, for example, if an officer of the issuer speaks optimistically from a podium shared with an analyst who has reported erroneously high earnings projections, it might be inferred that the issuer has confirmed the analyst’s projections where a special relationship exists between the issuer and the analyst. In the absence of such a relationship, the case for issuer confirmation is less persuasive. But even in such a situation, the inference results from the issuer’s own actions, not from the relationship alone.

The last stop in the continuum is when the issuer is demonstrably not the source of the information, but either it or one of its officers is cited as the source in the report. The erroneous reference to the issuer may result from inadvertence or it may be intentional.159 Regardless of the reporter’s motive, the result is publicity which, on its face, is attributable to the issuer. It has been suggested that, in this event, the issuer has a duty to respond,160 probably because the association of the article with the issuer will render the report more believable. As indicated earlier, the fact that the report will be more

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158 358 F. Supp. at 319. See note 151 supra.

159 It is probably more common for there to have simply been a breakdown in communication, where the issuer misspoke or the reporter or analyst misunderstood. In that situation, whether the issuer is the source is simply a matter of proof. See notes 129 and 130 and accompanying text supra.

160 For example, JACOBS, *supra* note 95, at § 88.04[b], states:

> If a statement made by an outsider is wrongfully attributed to the corporation, the company’s obligation to correct should be less stringent than when its own statement became inaccurate, but more severe than situations in which the prior assertion was made by and attributed to a third party.

Similarly, the attribution of someone else’s statement to the issuer has been listed as one of the variables to be considered in deciding whether the issuer is obligated to speak up. BROMBERG & LOWENFELS, *supra* note 14, at 138.469. See also Milberg v. Western Pac. RR. Co., 51 F.R.D. 280, 282 (S.D.N.Y. 1970), where the court rejected the plaintiff’s argument that the issuer should be liable simply because its earnings did not match the optimistic prediction found in a financial publication. The court did point out, however, that the report “did not purport to quote” the issuer, thereby suggesting that the result may have changed had that fact been different.
credible should not be sufficient to impose a duty to correct unless there is evidence of issuer responsibility or fault. Although such a report is literally attributable to the issuer, the *Electronic Specialty* standard should not be applied because it would allow others to force disclosure by the issuer by planting a false rumor or news story and simply adding, "according to the issuer."

VII. Conclusion

There will be many times when an issuer has no option about whether to publicly correct or clarify a rumor or other publicity. When the company is trading in its own securities, when it is making other contemporaneous disclosures which would be rendered misleading by the omission of a response, or when it is subject to the timely disclosure policies of the self-regulatory organizations, the issuer must make an appropriate response to material publicity. Otherwise, there is no affirmative disclosure obligation. Whether the issuer is legally obligated to disclose will turn on whether the rumor or report is "attributable" to it. As proposed in this article "attributable" should be interpreted to refer only to situations when the issuer is at least partially responsible for the dissemination of the publicity.

The result is that many issuers will have broad and, at least, temporary discretion in deciding whether to answer or clarify publicity. In the exercise of that discretion they may decide that the law in this area, especially as applied to the particular circumstances they face, is simply too uncertain to risk silence. Or they may feel a moral, if not legal, obligation to issue a correcting response, so that their shareholders, other investors and employees are not harmed by the inaccurate or unconfirmed publicity. Their motives may even be so lofty as to protect the market from inefficiencies resulting from informational imbalances, or so base as to simply protect their own

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161 See notes 151-58 and accompanying text supra.
162 For notes, whether a court will accept the fault approach to the attribution issue and how it might resolve the fact questions inherent in deciding whether the issuer was in any way responsible for the publicity may be sufficiently uncertain to lead the cautious issuer to conclude that the risk of liability from silence is simply too great. The other side of this coin, of course, is the risk of material errors or omissions or misleading phraseology in the response, which might also result in liability. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring), cert. denied, 394 U.S. 976 (1969).
164 See generally Clausen, supra note 163.
interests when threatened by unfavorable publicity. 165 Whatever their motives, in order that they might pursue their primary objective of profit for their shareholders most effectively, it is important that issuers' discretion not be unreasonably restricted. The fault analysis suggested in this article allows management the broadest latitude in dealing with rumors and publicity, while simultaneously protecting the public from attempts by the issuer to manipulate the market through the dissemination of publicity.

165 An issuer response to a rumor is made more likely if the rumor is adverse, because it will depress the price of its stock (and thus the value of the management's holdings) and perhaps impede the issuer's immediate business objectives. A favorable rumor, on the other hand, because of its tendency to enhance rather than injure the issuer, is less likely to be answered. Jensen, supra note 140, at 51; R. Stevenson, Corporations and Information 87-88 (1980); Comment on Liability Under Rule 10b-5, supra note 46, at 169-70.