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Texas Gulf Sulphur. A Case Study on Responding to Market Rumors

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TEXAS GULF SULPHUR: A CASE STUDY ON RESPONDING TO MARKET RUMORS

Wendy G. Couture*

ABSTRACT

This essay uses Texas Gulf Sulphur as a case study on an issue that companies continue to face today: whether, and how, to respond to market rumors. This essay analyzes the countervailing incentives that influence whether companies respond to market rumors, applies those pressures to the facts of Texas Gulf Sulphur, and concludes that counsel today would likely advise similarly situated companies to remain silent rather than respond to market rumors. Drawing therefrom, this essay argues that silence is not the socially optimal response and that the dueling pressures on companies should be adjusted to incentivize companies to respond to market rumors.

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I. INTRODUCTION

ALTHOUGH the Second Circuit's opinion in *SEC v. Texas Gulf Sulphur Co.* (hereinafter "*Texas Gulf Sulphur*") was issued fifty years ago,¹ the quandary that Texas Gulf Sulphur (hereinafter "TGS") faced still resonates today: whether, and how, to respond to market rumors. Companies today still face dueling pressures, with some incentivizing response and others incentivizing silence. In this essay, I seek to analyze those countervailing incentives, using *Texas Gulf Sulphur* as a case study, and, drawing therefrom, to propose a modest reform.

This essay proceeds in four parts. In Part II, I present the case study, explaining the quandary that TGS faced and the fallout from its choice. In Part III, I analyze the competing pressures currently facing public companies and apply those pressures to TGS, concluding that counsel today would likely advise companies like TGS to remain silent rather than respond to market rumors. Drawing therefrom, in Part IV, I argue that the countervailing pressures on companies should be adjusted to incentivize companies like TGS to respond to market rumors and propose such an adjustment. Finally, Part V briefly concludes.

II. PRESENTATION OF *TEXAS GULF SULPHUR* CASE STUDY

As summarized below, in the face of optimistic market rumors, TGS elected to quell those rumors with a rather pessimistic press release. This choice exposed TGS to liability for securities fraud, exemplifying companies' quandary when faced with market rumors.

A. TEXAS GULF SULPHUR'S RESPONSE TO MARKET RUMORS

TGS was engaged in exploratory mining activities in Canada.² Beginning on November 8, 1963, the company drilled a series of holes near Timmons, Ontario, which eventually led to the discovery of "a strike of

1. See generally *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

2. *Id.* at 843.

least 25 million tons of ore.”³ The company publicly announced the discovery at 10:00 a.m. on April 16, 1964.⁴ In the interim, however, the following rumors were reported in the press about the potential discovery, some of which were arguably misleadingly optimistic in light of the facts then known to TGS:

[O]n April 9 Toronto newspapers reported that TGS had discovered ‘one of the largest copper deposits in North America,’ ‘a major copper strike. . . .’⁵

. . .
 . . . [On April 11] [t]he Herald Tribune article announced that TGS had ‘the biggest ore strike since gold was discovered more than 60 years ago in Canada * * * a bed of copper sulphide 600 feet wide with a possible over-all copper return of 2.87% [t]hrough most of its width.’; that TGS had four drill rigs in operation with four more to go into operation the following week; and that the richness of the copper was so great that it had been flown out of Canada to be assayed. . . .’⁶

A quantity of false statistics appeared in the press, the company was accused of illegal conduct, and it was erroneously reported that a “penny stock” mining company was a partner with Texas Gulf in the exploration.⁷

In the face of these swirling rumors, TGS faced the difficult decision about whether to address the rumors before it believed that it had sufficient information to publicly announce the discovery. At 3:00 p.m. on April 12, 1964, the company issued a press release responding to the market rumors.⁸ The press release included the following statements:

‘During the past few days, the exploration activities of Texas Gulf Sulphur in the area of Timmins, Ontario, have been widely reported in the press, coupled with rumors of a substantial copper discovery there. These reports exaggerate the scale of operations, and mention plans and statistics of size and grade of ore that are without factual basis and have evidently originated by speculation of people not connected with TGS. . . .’⁹

. . .
 . . . ‘Numerous prospects have been investigated by geophysical means and a large number of selected ones have been core-drilled. These cores are sent to the United States for assay and detailed examination as a matter of routine and on advice of expert Canadian legal counsel. No inferences as to grade can be drawn from this

3. *Id.* at 843, 846.

4. *Id.* at 846.

5. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 293 (S.D.N.Y. 1966), *aff’d in part, rev’d in part*, 401 F.2d 833 (2d Cir. 1968).

6. *Id.* at 293–94 (alteration in original).

7. Petition for Writ of Certiorari at 10, Texas Gulf Sulphur Co. v. SEC, 404 U.S. 1005 (1971) (No. 71-327).

8. See *Texas Gulf Sulphur Co.*, 401 F.2d at 845.

9. *Id.*

procedure. . . .¹⁰

. . . ‘Recent drilling on one property near Timmins has led to preliminary indications that more drilling would be required for proper evaluation of this prospect. The drilling done to date has not been conclusive, but the statements made by many outside quarters are unreliable and include information and figures that are not available to TGS. . . .’¹¹

. . . ‘The work done to date has not been sufficient to reach definite conclusions and any statement as to size and grade of ore would be premature and possibly misleading. When we have progressed to the point where reasonable and logical conclusions can be made, TGS will issue a definite statement to its stockholders and to the public in order to clarify the Timmins project.’¹²

Between the April 12 press release and the April 16 public announcement, the company completed additional drilling and encountered additional mineralization, thus arguably explaining its dramatic shift in tone over a short period of time.¹³

B. TEXAS GULF SULPHUR’S LIABILITY FOR RESPONDING TO MARKET RUMORS

The SEC, as well as investors who had sold TGS stock between the April 12 press release and the April 16 public announcement, brought suit against TGS for securities fraud under § 10(b)¹⁴ and Rule 10b-5,¹⁵ alleging that the April 12 press release was materially misleading in its pessimism. The SEC contended that the press release was fraudulent because, when the press release was issued, “TGS knew that it had discovered a copper mine on the Kidd 55 segment and that the press release was materially misleading in characterizing this discovery as a ‘prospect’ and in stating that ‘any statement as to size and grade of ore would be premature.’”¹⁶

After a bench trial, the district court initially found that TGS had not violated § 10(b) and Rule 10b-5 because (1) absent evidence that the purpose of the press release was “to affect the market price of TGS stock to the advantage of TGS or its insiders,” the April 10 press release was not issued “in connection with the purchase or sale of any security;”¹⁷ and (2) regardless, the SEC had failed “to demonstrate that it was false, misleading or deceptive.”¹⁸

10. *Id.*

11. *Id.*

12. *Id.*

13. *See id.* at 846.

14. *See* 15 U.S.C. § 78j(b) (2012).

15. *See* 17 C.F.R. § 240.10b-5 (2017).

16. *SEC v. Tex. Gulf Sulphur Co.*, 258 F. Supp. 262, 292–93 (S.D.N.Y. 1966), *aff’d in part, rev’d in part*, 401 F.2d 833 (2d Cir. 1968).

17. *Id.* at 294.

18. *Id.*

On appeal, the Second Circuit, considering the case *en banc*, reversed the judgment dismissing the complaint against TGS and remanded the Rule 10b-5 claim against TGS.¹⁹ The Second Circuit held that the press release was “in connection with the purchase or sale of any security” because it was “reasonably calculated to influence the investing public.”²⁰ The Second Circuit further held that the district court had failed to apply “the appropriate primary inquiry into the meaning of the statement to the reasonable investor and its relationship to truth.”²¹ Therefore, the Second Circuit remanded the case to the district court “for a determination of the character of the release in light of the facts existing at the time of the release, by applying the standard of whether the reasonable investor, in the exercise of due care, would have been misled by it.”²²

On remand, the district court heard testimony from shareholders that the press release’s usage of words “such as ‘without factual basis,’ ‘misleading,’ ‘premature,’ and ‘exaggerated’ . . . indicated to them that the rumors as to the Timmins discovery were unfounded and that there was either no discovery or, if there was, it was not as rich as it was rumored to be.”²³ The court also found that TGS “did not exercise due diligence in its issuance.”²⁴ Therefore, the court found that TGS had violated Rule 10b-5, but the court denied the SEC’s application for a permanent injunction because there was not a proper showing of a reasonable likelihood of future violations by TGS.²⁵ On a second appeal, the Second Circuit affirmed the district court’s rulings with respect to TGS.²⁶

Similarly, investors who had sold TGS stock in the period between the April 12 press release and the April 16 public announcement asserted private claims for securities fraud, contending that the press release was “false and misleading” and that “they would not have sold had they known the true facts which were announced by TGS in a press release issued four days later.”²⁷ In addition to individual actions asserted by various investors,²⁸ a federal district court in the Southern District of New York conditionally certified a class of “Reliance Claimants who sold their

19. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 864 (2d Cir. 1968).

20. *Id.* at 862.

21. *Id.*

22. *Id.* at 863.

23. SEC v. Tex. Gulf Sulphur Co., 312 F. Supp. 77, 82 (S.D.N.Y. 1970), *aff’d in part, rev’d in part*, 446 F.2d 1301 (2d Cir. 1971).

24. *Id.* at 86.

25. *Id.* at 88.

26. SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1306 (2d Cir. 1971) (“The finding that TGS violated 10b-5 is well-founded and, in our view, unassailable, and though TGS argues that the complaint should be dismissed as to it inasmuch as the injunction the SEC sought was not granted, we affirm the denial of an injunction without dismissing the complaint as a proper discretionary decision by the trial judge under the circumstances.”).

27. Cannon v. Texas Gulf Sulphur Co., 55 F.R.D. 308, 310 (S.D.N.Y. 1972).

28. See, e.g., Mitchell v. Texas Gulf Sulphur Co., 446 F.2d 90, 107 (10th Cir. 1971) (affirming judgments against TGS and one of its officers for securities fraud on the basis of the April 12 press release and remanding for entry of judgments in favor of two investors who sold TGS stock in reliance on the press release, with damages calculated at \$7,600.00 for one and at \$12,687.50 for the other).

stock between April 12 and 10:55 A.M. on April 16, 1964 at a price of \$33 per share or less.”²⁹ The court ultimately approved a settlement pursuant to which TGS paid the Reliance Claimants \$2,200,000.³⁰

C. RECOGNITION OF THE QUANDARY THAT TEXAS GULF SULPHUR FACED

Throughout the SEC litigation, courts acknowledged the difficulty of TGS’s disclosure decision when faced with market rumors. In its first opinion after the bench trial, the district court recognized that TGS’s executives “were under considerable pressure”:

If they said too much, they would have been open to criticism and possible liability if it turned out that TGS had not discovered a commercial mine. If they said too little and later announced a mine, they subjected themselves to the charge that their press release was misleading or deceptive—and, indeed, this is what has happened.³¹

The Second Circuit also acknowledged the quandary that TGS faced, despite rejecting TGS’s argument that it served to excuse a misleading response:

The avoidance of liability for misrepresentation in the event that the Timmons project failed, a highly unlikely event as of April 12 or April 13, did not forbid the accurate and truthful divulgence of detailed results which need not, of course, have been accompanied by conclusory assertions of success. Nor is it any justification that such an explicit disclosure of the truth might have “encouraged the rumor mill which they were seeking to allay.”³²

Similarly, Judge Friendly’s concurrence recognized the difficulty of TGS’s decision, especially in light of the potential for private civil liability:

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 amass or weigh the facts—all judged in the bright gleam of hindsight—will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers, most corporations would opt for the former.³³

Judge Moore’s dissent framed the issue most starkly, including a plea for additional guidance for issuers:

When and how are promising results to be disclosed. If they are not disclosed, the corporation is concealing information; if disclosed and hoped-for results do not materialize, there will always be those with the advantage of hindsight to brand them as false or misleading. . . .

29. Cannon v. Texas Gulf Sulphur Co., No. 65-Civ-1223, 1973 WL 417, at *1 (Aug. 7, 1973).

30. Cannon v. Texas Gulf Sulphur Co., 55 F.R.D. 308, 311 (1972).

31. SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 296 (S.D.N.Y. 1966).

32. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 864 (2d Cir. 1968).

33. *Id.* at 867 (Friendly, J., concurring).

May the Future, the Congress or possibly the SEC itself be able to bring some semblance of order by means of workable rules and regulations in this field so that the corporations and their stockholders may not be subjected to countless lawsuits at the whim of every purchaser, seller or potential purchaser who may claim he would have acted or refrained from acting had a news release been more comprehensive, less comprehensive or had it been adequately published in the news media of the 50 States.³⁴

Since *Texas Gulf Sulphur*, scholars³⁵ and the SEC³⁶ have struggled to provide guidance to public companies facing this quandary. Indeed, in light of the rise of the internet, this issue is perhaps even more pressing today,³⁷ particularly with recent research demonstrating that false rumors are more likely to spread virally on social media than truthful ones.³⁸

III. ANALYSIS OF TEXAS GULF SULPHUR CASE STUDY

Absent a duty to disclose, companies may remain silent.³⁹ If a company is the source of an inaccurate market rumor, it likely has a duty to correct the inaccuracy; if a company is not the source of a market rumor, however, it potentially has the option to remain silent rather than correcting or verifying the rumor.⁴⁰

When public companies are considering whether to respond to externally-sourced market rumors, they face multiple countervailing pressures. Although companies today continue to confront the same difficult decision as TGS about whether to respond or remain silent, the competing pressures affecting their disclosure decisions have evolved since *Texas Gulf Sulphur*. In order to exemplify those modern pressures, this case study applies them to TGS's disclosure decision as if the company faced it today. Although the *Texas Gulf Sulphur* record is silent about whether

34. *Id.* at 888–89 (Moore, J., dissenting).

35. *E.g.*, John M. Sheffey, *Securities Law Responsibilities of Issuers to Respond to Rumors and Other Publicity: Reexamination of a Continuing Problem*, 57 NOTRE DAME LAW REV. 755, 755 (1982) (“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.”).

36. *See, e.g.*, SEC. & EXCH. COMM'N, SEC ROUNDTABLE: MARKET RUMORS AND TRADING HALTS 3 (Feb. 19, 1986) (“The SEC Roundtable on Market Rumors and Trading Halts was convened to discuss disclosure of merger negotiations, trading halts, and the origins and effects of rumors in the marketplace.”).

37. *See* HOWARD M. FRIEDMAN, *Responding to Online Rumors and Cybergossip*, in SECURITIES REGULATIONS IN CYBERSPACE § 11.05 (2017) (“When the power of modern social media is coupled with the impact of computerized high-frequency trading, malicious rumors can have a particularly powerful impact.”).

38. *See* Soroush Vosoughi et al., *The Spread of Trust and False News Online*, 359 SCIENCE 1146, 1147 (2018) (finding that “[f]alsehood diffused significantly farther, faster, deeper, and more broadly than the truth in all categories of information,” including false business information).

39. *See* Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988).

40. *See* Eisenstadt v. Centel Corp., 113 F.3d 738, 744 (7th Cir. 1997) (“Obviously a corporation has no duty to correct rumors planted by third parties.”); State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981) (“A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company.”).

any of the market rumors could be traced back to TGS, this case study assumes that the rumors were externally-sourced.

A. KEY PRESSURES ON PUBLIC COMPANIES TO RESPOND TO MARKET RUMORS

Three key pressures potentially incentivize public companies to respond to externally-sourced market rumors: (1) SEC rules requiring disclosure; (2) stock exchange listing standards requiring response; and (3) market forces incentivizing response.

1. SEC Rules Requiring Disclosure

Generally, SEC rules require only periodic disclosure of specified information by public companies, including annual reports on Form 10-K,⁴¹ quarterly reports on Form 10-Q,⁴² and current reports on Form 8-K.⁴³ Current reports must be filed within four business days after specific triggering events (like entry into a material definitive agreement or a material impairment),⁴⁴ or sooner in order to prevent selective disclosure prohibited by Regulation FD.⁴⁵ Exceptions to these circumscribed disclosure duties apply if the company is repurchasing its own securities⁴⁶ or if a specific transaction triggers additional disclosure requirements.⁴⁷

Under current rules, it is largely happenstance whether a company must disclose information about the substance underlying market rumors, as it is dependent on (1) the timing of the rumors and (2) the subject matter of the rumors. First, if market rumors are swirling when a company's Form 10-Q or Form 10-K is due, and if the rumors also touch on a topic that must be disclosed in the periodic filing, then the company's filing would, in effect, address the rumors by discussing the substance underlying them. Second, if market rumors relate to a topic about which the company is already required to file a current report, then the company's Form 8-K would, effectively, address the rumors by providing information about the underlying subject matter. Third, if the rumors are circulating when the company is also repurchasing its own securities, and if the

41. 17 C.F.R. §§ 240.13a-1, 240.15d-1, 249.310 (2017).

42. 17 C.F.R. §§ 240.13a-13, 240.15d-13, 249.308a.

43. 17 C.F.R. §§ 240.13a-11, 240.15d-11, 249.308.

44. 17 C.F.R. § 249.308.

45. 17 C.F.R. §§ 243.100–103.

46. See ALAN R. BROMBERG ET AL., 3 BROMBERG & LOWENFELS ON SECURITIES FRAUD § 6:186 (2d ed. 2017) (“When a company is trading in its own securities, courts have said it has a duty to disclose all material information, including acquisition negotiations.”); SEC Release Notice, Timely Disclosure of Material Corporate Developments, Release No. 5092 (Oct. 15, 1970), 1970 WL 10576, at *2 (“It should be noted 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, and its insiders may not be able to trade its securities without running a serious risk of violating § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.”).

47. E.g., 15 U.S.C. § 78m(d) (2012) (5% acquisitions); 15 U.S.C. § 78n(d) (third-party tender offers) (exemplifying the statutes covering transactions that would invoke additional disclosure duties).

rumors relate to material information, then the company, by disclosing all material information, would thereby address the substance of the rumors. Finally, if the rumors relate to a specific transaction that triggers an independent disclosure obligation, then the mandated disclosures about that transaction would likewise have the impact of addressing the rumors.

Applying these rules to TGS, it is unlikely that, even today, the company would be required to discuss the substance of the market rumors in an SEC filing. First, the deadlines for filing Forms 10-Q and Forms 10-K depend on a company's fiscal year and issuer classification,⁴⁸ but it is unlikely that these deadlines would happen to coincide with the circulation of rumors.⁴⁹ Second, although Form 8-K requires the disclosure of specified current information, none of the line items would mandate an update on the status of TGS's exploration activities,⁵⁰ absent the need to prevent selective disclosure under Regulation FD.⁵¹ Finally, TGS was neither repurchasing its own securities at the time of the rumors nor engaging in a specific transaction that would compel additional disclosure.

2. *Stock Exchange Listing Standards Requiring Response*

Stock exchange listing standards generally require companies to respond promptly to market rumors. For example, the New York Stock Exchange ("NYSE") Listed Company Manual states: "If rumors or unusual market activity indicate that information on impending developments has leaked out, a frank and explicit announcement is clearly required."⁵² This requirement applies regardless of whether the rumors are true⁵³ or false,⁵⁴ even if prompt disclosure would inconvenience the company.⁵⁵ The NYSE American⁵⁶ (formerly the American Stock Exchange) and

48. See 17 C.F.R. §§ 249.310, 249.308a (2017).

49. However, if these deadlines did happen to coincide, TGS's management would likely be required to discuss its exploration activities in its Management, Discussion & Analysis. See 17 C.F.R. § 229.303 (requiring management to discuss any known trends or any known demands, commitments, events, or uncertainties that are reasonably expected to have a material impact on results of operations, liquidity, or capital resources).

50. See 17 C.F.R. § 249.308.

51. See 17 C.F.R. §§ 243.100–.103.

52. NYSE LISTED CO. MANUAL § 202.03 (Sept. 2, 2015), 1992 WL 12137711, at *1.

53. *Id.* ("If rumors are correct or there are developments, an immediate candid statement to the public as to the state of negotiations or of development of corporate plans in the rumored area must be made directly and openly.")

54. *Id.* ("If rumors are in fact false or inaccurate, they should be promptly denied or clarified.")

55. *Id.* ("Such statements are essential despite the business inconvenience which may be caused and even though the matter may not as yet have been presented to the company's Board of Directors for consideration.")

56. NYSE AMERICAN LLC CO. GUIDE § 401(c) (Mar. 11, 2016) ("*Clarification or Confirmation of Rumors or Reports*—Whenever a listed company becomes aware of a rumor or report, true or false, that contains information that is likely to have, or has had, an effect on the trading in its securities, or would be likely to have a bearing on investment decisions, the company is required to publicly clarify the rumor or report as promptly as possible."); *id.* at § 402 ("*Explanation of Exchange Disclosure Policies*") ("If rumors concerning such [temporarily withheld] information should develop, immediate public disclosure becomes necessary.")

NASDAQ impose similar prompt disclosure requirements, although NASDAQ provides some leeway for “unusual circumstances.”⁵⁷

Although these listing standards require companies to respond promptly to market rumors, companies generally do not have a strong incentive to comply therewith, especially before receiving a specific inquiry from an exchange. A company’s violation of disclosure listing standards does not give rise to a private right of action.⁵⁸ An exchange could theoretically sanction a company for violating its listing standards, including public reprimand, suspension of trading, or delisting,⁵⁹ but the common wisdom among practitioners is that these sanctions are seldom, if ever, imposed for failing to respond to market rumors.⁶⁰ Moreover, com-

57. THE NASDAQ STOCK MARKET RULES, RULE 5250(b)(1) (2009) (“Except in unusual circumstances, a Nasdaq-listed Company shall make prompt disclosure to the public through any Regulation FD compliant method (or combination of methods) of disclosure of any material information that would reasonably be expected to affect the value of its securities or influence investors’ decisions.”); *id.* at IM-5250-1 (“If rumors or unusual market activity indicate that information on impending developments has become known to the investing public, or if information from a source other than the Company becomes known to the investing public, a clear public announcement *may* be required as to the state of negotiations or development of Company plans. Such an announcement *may* be required, even though the Company may not have previously been advised of such information or the matter has not yet been presented to the Company’s Board of Directors for consideration. In certain circumstances, it *may* also be appropriate to publicly deny false or inaccurate rumors, which are likely to have, or have had, an effect on the trading in its securities or would likely have an influence on investment decisions.”) (emphasis added).

58. *See* State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 852–53 (2d Cir. 1981) (“In the case at bar, we are faced with a corporation’s obligations under section A2 of the Exchange Company’s Manual to disclose general corporate news. . . . [S]ection A2 of the Exchange’s Company Manual touches upon areas of corporate activity already extensively regulated by Congress and the Securities and Exchange Commission. Thus, a legislative intent to permit a federal claim for violation of the Exchange’s Company Manual regarding disclosure of corporate news cannot be inferred.”).

59. *E.g.*, NYSE LISTED CO. MANUAL, PUBLIC REPRIMAND LETTER, COMMENTARY § 303A.13 (Nov. 25, 2009), 2003 WL 23737131, at *1 (“Suspending trading in or delisting a listed company can be harmful to the very shareholders that the NYSE listing standards seek to protect; the NYSE must therefore use these measures sparingly and judiciously. For this reason it is appropriate for the NYSE to have the ability to apply a lesser sanction to deter companies from violating its corporate governance (or other) listing standards. . . . For companies that repeatedly or flagrantly violate NYSE listing standards, suspension and delisting remain the ultimate penalties.”); *id.* at § 802.01D (“Other factors which may lead to a company’s delisting include . . . [t]he failure of a company to make timely, adequate, and accurate disclosures of information to its shareholders and the investing public.”).

60. *See, e.g.*, AARON RACHELSON, CORPORATE ACQUISITIONS, MERGERS, & DIVESTITURES § 4:87 (2017) (“The exchanges’ only practical remedy if a corporation refuses to respond is to suspend trading of the corporation’s stock. Exchanges hesitate to pursue such a remedy.”); BRIAN M. O’NEILL, MODERN CORPORATION CHECKLISTS § 19:21 (2017) (“Responding to questions concerning rumored M&A negotiations”) (“If a company refuses to comment, the stock exchange’s only practical remedy is to suspend trading of the company’s stock. Stock exchanges are usually hesitant to pursue such a remedy.”); Memorandum from Cleary Gottlieb Steen & Hamilton LLP, *Alert Memo: Communication with Financial Analysts and Related Disclosure Issues*, at 14 n.59 (Feb. 25, 2013), [<https://perma.cc/XLF7-KA8H>] (“It is important to note that while the NYSE and Nasdaq place more onerous duties upon companies in this regard, violations of their disclosure rules have been held not to give rise to private causes of action, no issuer’s shares have been delisted for violation of the policy and many companies adhere to a no-comment policy if there are rumors of (sic) unusual market activity.”); Daniel L. Goelzer et al., *Securities Law Compliance: Dealing With Analysts and the Press*, C800 ALI-ABA 97, 135 (1992) (“In

panies generally do not feel compelled by the listing standards to proactively address market rumors until such time as an exchange's stock-watch committee contacts the company. Finally, even if an exchange makes an inquiry, the company may be able to convince the exchange to permit a delayed response by citing business reasons for confidentiality, even if that delay is not explicitly permitted by the listing standards.⁶¹

Applying these listing standards to TGS, it is unlikely that the company today would feel compelled by the standards to respond proactively to the market rumors. TGS's stock was listed on the NYSE.⁶² Even in 1964, the NYSE Manual included a disclosure requirement similar to the one included today.⁶³ Although this listing standard was cited in the *Texas Gulf Sulphur* record, the record does not suggest that anyone from the exchange had contacted TGS prior to its press release. Therefore, absent an inquiry from the exchange, the listing standards would probably not serve as a strong incentive for TGS to respond to the market rumors.

3. Market Forces Incentivizing Response

Various market forces may incentivize companies to respond to rumors. In general, consistent with the SEC's policy of full disclosure (albeit not mandated by SEC rules),⁶⁴ "it is in the company's interest to keep the analyst and investor communities well-informed and to employ a 'no surprises' philosophy."⁶⁵ If a company withholds important information, in-

theory, a company which fails to comply with applicable listing requirements could be delisted or subjected to a trading suspension by the exchange or association. As a practical matter, this is exceedingly unlikely to occur as a consequence of an isolated failure to disclose information, especially where the information was not required to be disclosed by SEC periodic reporting or antifraud requirements.").

61. Broc Romanek & Mark S. Britton, *Online Shareholder Activism: How to Guard Against Its Fallout*, 20 No. 5 ACCA DOCKET 32, 38 (2002) ("On the other hand, in practice, companies may not be forced to address a rumor by its exchange if it has a valid business reason to remain silent."); Jeffrey B. Rudman et al., *D&O Liability in Cyberspace: Taking Advantage of Technology Without Tripping over the Federal Securities Laws Part III of III*, 15 No. 18 ANDREWS OFF. & DIR. LIAB. LITIG. REP. 16, 19 (2000) ("In practice, the operation of the self-regulatory organizations' rules is less than certain. In many cases, no disclosure will be required if the company has a valid business reason for not making the disclosure. A company should, therefore, seek the assistance of qualified legal counsel before making any statements commenting on rumors in the marketplace.").

62. SEC v. Texas Gulf Sulphur Co., F. Supp. 262, 268 (S.D.N.Y. 1966).

63. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 878 n.2 (2d Cir. 1968) (Moore, J., dissenting) (quoting the NYSE Company Manual) ("Dealing with Rumors Affecting the Market: Occasions may also arise when rumors have been circulated which have no basis in fact or which require clarification or interpretation and which also result in unusual activity or price changes in a particular security. Under such circumstances, the most effective procedure is the quick and speedy denial of such rumors through a release to the public Press.").

64. SEC Release Notice, Timely Disclosure of Material Corporate Developments, Release No. 5092 (Oct. 15, 1970), 1970 WL 10576, at *2 ("Corporate managements are urged to review their policies with respect to corporate disclosure and endeavor to set up procedures which will insure that prompt disclosure be made of material corporate developments, both favorable and unfavorable, so that investor confidence can be maintained in an orderly and effective securities market.").

65. Daniel L. Goelzer et al., *Securities Law Compliance: Dealing with Analysts and the Press*, C800 ALI-ABA 97, 150 (1992).

vestors may avoid the company's securities altogether or discount them because of the lack of information.⁶⁶ In addition to these general market forces incentivizing disclosure, specific market forces incentivize companies to respond to market rumors, although those forces vary depending on whether the rumors are true or false, and on whether the rumors reflect positively or negatively on the company.

If the rumors are true, regardless of whether they reflect positively or negatively on a company, the company has an incentive to respond in order to prevent the perception that those "in the know" have an advantage, which could dissuade others from investing in the company's securities.⁶⁷ In addition, if the rumors are true and reflect positively on the company, the company may have an incentive to disclose the information sooner rather than later to prevent the oft-occurring phenomenon whereby, upon the company's eventual disclosure of the positive information, the stock price actually drops because so many investors "[bought] on the rumor."⁶⁸ If the rumors are false and reflect positively on the company, the company has an incentive to address the rumors in order to avoid alienating (upon eventual disclosure of the truth) those who invest on the basis of the false rumors.⁶⁹ If the rumors are false and reflect poorly on the company, the company has an incentive to address the rumors in order to allay the worries of various stakeholders (including employees and investors) and to protect its reputation.⁷⁰ Indeed, the literature on corporate crisis management classifies false, negative rumors about a company as a type of crisis and recommends that companies pro-

66. See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 684 (1984) ("A firm that wants the highest possible price when it issues stock must take all cost-justified steps to make the stock valuable in the aftermarket, so it must make a believable pledge to continue disclosing.").

67. SEC. & EXCH. COMM'N, SEC ROUNDTABLE: MARKET RUMORS AND TRADING HALTS 6 (Feb. 19, 1986) (comments of William A. Schreyer, Chairman of Merrill Lynch & Company Inc.) ("Mr. Levitt agreed with Mr. Phelan that rumors are difficult to define, but commented that the public's perception that some persons have an advantage in the markets will hurt the markets.").

68. See Richard Peterson, "Buy on the Rumor:" *Anticipatory Effect and Investor Behavior*, 3 J. PSYCHOL. & FIN. MARKETS 218, 218 (2002) ("The traders' aphorism 'buy on the rumor and sell on the news' (BRSN) describes a strategy for exploiting a frequently observed financial market price pattern. This pattern (BRSN) is characterized by security prices rising prior to and falling subsequent to positively anticipated events.").

69. See Robert A. Prentice, *The Future of Corporate Disclosure: The Internet, Securities Fraud, and Rule 10b-5*, 47 EMORY L.J. 1, 75 (1998) ("A company may not feel quite as strong an impetus to squelch inaccurate rumors when those rumors are causing its stock price to soar. Should the company do so? It probably should, because the truth will ultimately come out. Then the company's stock price will drop, alienating investors and perhaps precipitating litigation.").

70. See *id.* at 74 ("In many cases [involving injurious rumors], however, the company may determine that a response is necessary in order to clear up misapprehensions or otherwise give its side of the story."); SEC. & EXCH. COMM'N, SEC ROUNDTABLE: MARKET RUMORS AND TRADING HALTS 5 (Feb. 19, 1986) (comments of Arthur Levitt, Jr., Chairman of the American Stock Exchange, Inc.) ("A policy of 'no comment,' however, does not help calm the volatility of the stock or allay the concerns of employees and shareholders. Mr. Schreyer said that he would like to have greater flexibility, in dealing with unfounded rumors, to state that there is no truth to the rumors, without incurring a possible duty to update.").

tect their reputations by communicating a prompt denial.⁷¹

Turning to TGS's situation, if faced today, some of these market forces would incentivize TGS to respond. The rumors, which generally reflected positively on TGS, were partially true (in that there was a potentially significant discovery) and partially false (in some of their bombast and certainty). Under these circumstances, TGS would be motivated to respond to the rumors in order to (1) build investors' trust via a policy of full disclosure to prevent the perception that people "in the know" have an advantage when trading in the company's securities; (2) prevent the stock price from being so inflated by the rumors that it actually drops upon eventual disclosure of the discovery; and (3) avoid alienating investors who believe the overly-hyped aspects of the rumors.

B. KEY PRESSURES ON ISSUERS TO REMAIN SILENT IN RESPONSE TO EXTERNALLY-SOURCED MARKET RUMORS

Three key countervailing pressures operate to incentivize issuers to remain silent in response to externally-sourced market rumors: (1) liability for misleading disclosure; (2) business reasons for silence; and (3) avoidance of confusion.

1. Liability for Misleading Disclosure

As exemplified by the *Texas Gulf Sulphur* litigation, if an issuer chooses to respond to market rumors, the issuer risks liability for securities fraud under § 10(b) and Rule 10b-5 to the extent the disclosure is materially misleading.⁷² Injured investors could potentially assert a private right of action for damages, and the SEC could potentially assert an enforcement action for penalties and other relief.

But, not all materially misleading disclosures are actionable as securities fraud. Three key post-*Texas Gulf Sulphur* developments lessen the chilling impact of potential securities fraud liability, especially in private civil litigation: (1) the heightened proof and pleading standards for the element of scienter; (2) the safe harbor for forward-looking statements; and (3) the narrowed pathways of recovery for misleading opinions.

71. See Allan J. Kimmel, *Rumors and the Financial Marketplace*, 5 J. BEHAV. ECON. 134, 140 (2004) ("Assuming a potentially harmful rumor begins to circulate, the firm should be prepared to launch a crisis management plan, . . . [which] requires an immediate response to the situation."); W. Timothy Coombs & Sherry J. Holladay, *Helping Crisis Managers Protect Reputational Assets*, 16 MGMT. COMM. Q. 165, 169-72 (2002) (reviewing literature on crisis communication theory) (identifying "attack on the accuser" and "denial" as the most effective crisis response strategies to protect a company's reputation when the company is faced with rumors that circulate false negative information).

72. See, e.g., SEC Release Notice, *In re Carnation Co.*, Release No. 22214 (July 8, 1985), 1985 WL 547371, at *5 ("Whenever an issuer makes a public statement or responds to an inquiry from a stock exchange official concerning rumors, unusual market activity, possible corporate developments or any other matter, the statement must be materially accurate and complete. . . . Thus, in the Commission's view, an issuer statement that there is no corporate development that would account for unusual market activity in its stock, made while the issuer is engaging in acquisition discussions, may be materially false and misleading.").

First, the scienter element of securities fraud is now arguably more difficult for plaintiffs to both prove and plead. In *Texas Gulf Sulphur*, the Second Circuit held that, at least in an action for injunctive relief, the SEC needed only to establish “a lack of due diligence on the part of TGS.”⁷³ In the companion private litigation, courts applied varying standards. For example, the Tenth Circuit required TGS to either prove that “it did not know of the misrepresentation” or demonstrate “that with due diligence TGS could not have known of the faultiness of the statement.”⁷⁴ The court presiding over the class action in the Southern District of New York held that “plaintiffs must show more than that the April 12 press release was negligently prepared,” without resolving the degree of scienter required.⁷⁵

With respect to proving scienter, in 1976, the Supreme Court held that a plaintiff must prove more than mere negligence in order to establish liability under § 10(b) and Rule 10b-5.⁷⁶ The courts of appeals agree that, in order to prove scienter, a plaintiff must show that the defendant acted intentionally or recklessly.⁷⁷ However, there is an important caveat. Although there is not a private right of action under § 17(a)(2) of the Securities Act, the SEC could avoid the need to prove scienter by bringing an enforcement action under § 17(a)(2),⁷⁸ which only requires proof of negligence.⁷⁹ In addition, lower courts have broadly interpreted the remaining elements of § 17(a)(2), such that a company’s statements about publicly traded stock are potentially actionable.⁸⁰

With respect to pleading scienter, in 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA), which requires plaintiffs in private civil actions to plead a strong inference of scienter, without the benefit of discovery, in order to withstand a motion to dismiss.⁸¹ As inter-

73. *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 863 (2d Cir. 1968).

74. *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90, 102 (10th Cir. 1971).

75. *Astor v. Texas Gulf Sulphur Co.*, 306 F. Supp. 1333, 1344 (S.D.N.Y. 1969); *see also Cannon v. Texas Gulf Sulphur Co.*, 55 F.R.D. 308, 316 (S.D.N.Y. 1972) (approving settlement of the Reliance Claims) (“The plaintiffs will have to prove at a jury trial . . . that some degree of scienter can be attributed to the persons who prepared the press release.”).

76. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1976) (“When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances—the commonly understood terminology of intentional wrongdoing—and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct.”).

77. *See, e.g., Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 318 n.3 (2007) (“Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly, though the Circuits differ on the degree of recklessness required.”).

78. *See* 15 U.S.C. § 77q(a)(2) (2012).

79. *See Aaron v. SEC*, 446 U.S. 680, 697 (1980).

80. *See, e.g., SEC v. RPM Int’l, Inc.*, 282 F. Supp. 3d 1, 28–29 (D.D.C. 2017) (analyzing the “in the offer or sale of securities” element) (“Many courts have concluded that an allegation that the company’s stock was publicly traded is sufficient to plead this element under Section 17(a)(2).”); *id.* at 29 (analyzing the “to obtain money or property” element) (“An allegation that ties a company officer’s received bonus to the company’s performance has been found to be sufficient to state a claim under Section 17(a)(2).”).

81. *See* 15 U.S.C. § 78u–4(b)(2) & (3) (2012).

preted by the Supreme Court, plaintiffs must plead an “inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.”⁸²

Second, the PSLRA introduced another protection from private civil liability for defendants: the safe harbor for forward-looking statements. Under the safe harbor, a defendant’s forward-looking statements, if accompanied by meaningful cautionary language, are not actionable.⁸³ Congress specifically intended to encourage companies to “disseminate relevant information to the market without fear of open-ended liability.”⁸⁴

Third, as recently clarified by the Supreme Court in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, although statements of opinion can be actionable, there are only two narrow pathways to liability: (1) an opinion is actionable as an untrue statement of material fact only if the opinion was disbelieved by the speaker; and (2) an opinion can give rise to omissions liability to the extent the issuer fails to disclose a fact showing that the company lacked the basis for expressing the opinion that a reasonable investor would expect.⁸⁵ If a plaintiff seeks to impose liability under the second pathway, the plaintiff must plead “particular (and material) facts going to the basis for the issuer’s opinion—facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have—whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context.”⁸⁶

Applying this liability risk to TGS today, by electing to respond to the market rumors, TGS would still risk SEC enforcement, but the company could significantly reduce the risk of private civil liability. With respect to SEC enforcement, the SEC could potentially assert a claim under § 17(a)(2), thus invoking a negligence standard. And, even if the SEC asserted a claim under § 10(b) and Rule 10b-5, the PSLRA’s protections (heightened scienter pleading standard, discovery stay, and safe harbor for forward-looking statements) would not apply. The company could, however, potentially limit its risk by expressing only opinions and ensuring that the bases thereof were stated, thus undercutting the second liability pathway under *Omnicare*.⁸⁷ With respect to private civil liability, TGS could further reduce the risk of liability by accompanying its forward-looking statements with meaningful cautionary language, and the com-

82. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 324 (2007).

83. 15 U.S.C. § 78u-5(c) (2012).

84. H.R. REP. NO. 104-369, at 32 (1995) (Conf. Rep.), as reprinted in 1995 U.S.C.C.A.N. 730, 731.

85. See *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1327, 1332 (2015).

86. *Id.*

87. *Id.* (“[T]o avoid exposure for omissions . . . an issuer need only divulge an opinion’s basis.”)

pany could seek dismissal of any asserted claims on the basis of the heightened scienter pleading standard.

In sum, although the risk of potential liability would incentivize TGS to remain silent in the face of market rumors, TGS could craft a response that limits its exposure, especially to private civil liability.

2. *Business Reasons for Silence*

Business reasons for maintaining confidentiality might also incentivize an issuer to remain silent in the face of market rumors, particularly if the rumors have a kernel of truth. Examples of such business reasons include the potential that disclosure would benefit competitors,⁸⁸ interfere with a plan to acquire certain real estate,⁸⁹ disrupt corollary negotiations,⁹⁰ prematurely commit the company to a course of action,⁹¹ interfere with preliminary merger negotiations,⁹² or exacerbate a challenge facing the company by rattling creditors or customers.⁹³ Turning to TGS's situation, if faced today, none of the business reasons incentivizing silence would apply. TGS had already completed the land acquisitions associated with its exploration by the time the rumors began to circulate, and no other business reason for confidentiality is indicated in the record.

3. *Avoidance of Confusion*

In certain circumstances, disclosure might actually increase confusion. First, in a rapidly-changing situation, a series of successive disclosures based on evolving information risks confusing investors.⁹⁴ Second, if a

88. See Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COLUM. BUS. L. REV. 1, 12 (1999) (“[P]ublic disclosure, ostensibly meant for investors, can harm the issuer’s business when used by competitors.”).

89. NYSE AMERICAN LLC CO. GUIDE, EXPLANATION OF EXCHANGE DISCLOSURE POLICIES § 402 (Dec. 21, 2016) (“Public disclosure of a plan to acquire certain real estate, for example, could result in an increase in the company’s cost of the desired acquisition or could prevent the company from carrying out the plan at all.”); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 850 n.12 (2d Cir. 1968) (“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 by the SEC. Here, a valuable corporate purpose was served by delaying the publication of the K-55-1 discovery.”).

90. See *State Teachers Ret. Bd. v. Fluor Corp.*, 654 F.2d 843, 852–53 (2d Cir. 1981) (“The ostensible purpose of this pledge of confidentiality was SASOL’s need to complete delicate negotiations with the French government for financing prior to the contract’s announcement.”).

91. See *United States v. Koenig*, 388 F. Supp. 670, 705 (S.D.N.Y. 1974) (identifying as “a genuine corporate interest” management’s interest “in keeping their options open with regard to solving the European financial situation”).

92. See Brian M. O’Neil, MODERN CORPORATION CHECKLISTS § 19:21 (2017) (discussing the business reasons why parties to a potential merger might choose to remain silent).

93. See ALAN K. BROMBERG ET AL., 3 BROMBERG & LOWENFELS ON SECURITIES FRAUD § 6:172 (2d ed. 2017) (“A classic example is the company in financial difficulty. Disclosure of the difficulty may aggravate the company: credit may be withdrawn or available only on crippling terms, orders may be cancelled, customers may go elsewhere, depositors may make a run on the bank.”).

94. See NYSE AMERICAN LLC CO. GUIDE, EXPLANATION OF EXCHANGE DISCLOSURE POLICIES § 402 (Dec. 21, 2016) (“Occasionally, corporate developments give rise to

company has a general “no comment” policy, divergence from that policy in a particular situation, such as to deny a specific false rumor, risks communicating to the market that “no comment” really means “we confirm.”⁹⁵ As a result, the decision to respond to one rumor might change the meaning of “no comment” in subsequent responses, potentially rendering those subsequent “no comment” responses confusing or even misleading.⁹⁶

Turning to TGS’s situation, if faced today, the desire to prevent confusion might counsel silence rather than premature disclosure. TGS knew that it would have more concrete information about its potential discovery in a matter of days. Under those circumstances, the desire to avoid successive disclosures based on rapidly-changing facts would likely incentivize TGS to remain silent until a disclosure containing definitive information was possible.

C. COUNSEL’S LIKELY ADVICE TO TEXAS GULF SULPHUR TODAY

Weighing these competing pressures, counsel advising TGS today would likely recommend that the company remain silent in response to market rumors until definitive information is available. On the one hand, the following pressures would likely incentivize immediate response: (1) proactive compliance with NYSE listing standards, despite the absence of an inquiry from the exchange; and (2) market forces, including preventing investors from feeling alienated (either because they were unaware of the rumors or because they were overly buoyed by them) and limiting inflation of the stock price by investors “buying on the rumor.” On the other hand, the following pressures incentivizing silence would likely outweigh the aforementioned pressures: (1) the risk of liability for misleading disclosure, even with the protections afforded by the scienter element, the safe harbor for forward-looking statements, and the *Omnicare* liability standard for statements of opinion; and (2) the desire to avoid confusing investors with successive disclosures in response to a rapidly-changing situation.

Indeed, consistent with this likely advice to TGS, most commentators recommend that companies implement formal, written “no comment”

information which, although material, is subject to rapid change. If the situation is about to stabilize or resolve itself in the near future, it may be proper to withhold public disclosure until a firm announcement can be made, since successive public statements concerning the same subject (but based on changing facts) may confuse or mislead the public rather than enlighten it.”).

95. See *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) (citing *Flamm v. Eberstadt*, 814 F.2d 1169, 1178 (7th Cir. 1987)) (“It has been suggested that given current market practices, a “no comment” statement is tantamount to an admission that merger discussions are underway. That may well hold true to the extent that issuers adopt a policy of truthfully denying merger rumors when no discussions are underway, and of issuing ‘no comment’ statements when they are in the midst of negotiations.”).

96. See *Flamm*, 814 F.2d at 1178 (“When a firm suddenly says ‘no comment,’ the inquisitor will realize that his suspicions have a foundation—yet the response may sow confusion all the same.”).

policies, which expressly state that companies will not respond to market rumors, and that companies do not diverge therefrom unless an exchange or the SEC compels disclosure.⁹⁷ For example, the National Institute of Investors Relations' Sample Disclosure Policy includes the following provisions:

Section 2(c). No Comment Policy

The Company shall follow the "no comment" policy detailed in Sections 9 and 10, which prohibits the Company from disclosing or responding to inquiries or commenting on rumors concerning analyst or Company projections, potential transactions or unusual market activity.⁹⁸

Section 10. Public Comment on Transaction Discussions or Unusual Market Activity

The Company generally will not comment on unusual market activity or market rumors and generally will not disclose ongoing discussions regarding potential transactions. . . . It is very important that the Company adhere to this policy consistently. If the Company denies rumors that are not correct, for example, the Company will not be able to effectively give a "no comment" response to an inquiry regarding a rumor that is true or partially true. If contacted by someone outside the Company and asked to comment, the response given by the Company should simply be "It is our policy not to comment on rumors (or other applicable item)" or "No comment."⁹⁹

Therefore, after weighing the competing incentives for disclosure and silence, companies in TGS's situation today would likely remain silent.

IV. IMPLICATIONS OF *TEXAS GULF SULPHUR* CASE STUDY

If silence by issuers like TGS in the face of externally-sourced market rumors would be the optimal disclosure decision, then no adjustments need to be made to the competing pressures on issuers facing rumors. If, however, the marginal social benefits of disclosure would exceed the mar-

97. See, e.g., Jeffrey B. Rudman et al., *D&O Liability in Cyberspace: Taking Advantage of Technology Without Tripping over the Federal Securities Laws—Part III of III*, 15 ANDREWS CORP. OFF. & DIR. LIAB. LITIG. REP. 16, 18 (2000) ("Generally, it is not advisable to respond to rumors about the company, whether these rumors appear on television, in the newspapers or on the Internet. While a management's instinct may be to respond, especially when the rumor is patently offensive in nature (as many message board posts are), turning the other cheek is usually the best course of action."); Daniel L. Goelzer et al., *Securities Law Compliance: Dealing with Analysts and the Press*, C800 ALI-ABA 97, 156–57 (1992) ("[I]t is desirable to draft and implement a formal, written press policy which outlines recurring situations in which the company will not comment. Such situations might include inquiries regarding nonpublic merger negotiations; adverse personnel actions involving specific individuals; relations with suppliers; and unattributed rumors.").

98. National Institute of Investor Relations, *Standards of Practice for Investor Relations—Disclosure*, app. B at ch. 2(c) (2014) ("Sample Disclosure Policy").

99. *Id.* at ch. 10(a).

ginal social costs thereof,¹⁰⁰ then the pressures facing issuers should be adjusted to incentivize issuers like TGS to respond.

A. ARGUMENT THAT SILENCE IS NOT SOCIALLY OPTIMAL

I contend that the socially optimal decision would be for an issuer in TGS's situation to respond to market rumors with a forward-looking opinion disclosure about the potential for an ore strike. In a forthcoming article, I have proposed a framework to identify the optimal issuer disclosure choice among the following three options: (1) remaining silent; (2) expressing the disclosure as an opinion (i.e., without certainty); or (3) expressing the disclosure as a statement of fact (i.e., with certainty).¹⁰¹

Applying this proposed framework to TGS's situation,¹⁰² I contend that the marginal benefits of an opinion disclosure by an issuer like TGS would exceed the marginal costs thereof. Where the market is plagued with inflated rumors about the certainty of a major discovery (thus affecting price accuracy, disrupting the efficient allocation of capital, and misleading investors), the issuer has already incurred the costs to compile information that is directly responsive to those rumors, and the issuer would not be competitively harmed by disclosing information about the potential discovery, I argue that the marginal benefits of providing more accurate information to the marketplace would exceed the marginal costs thereof. I further contend that disclosure in the form of an opinion rather than as a statement of fact would be optimal under these circumstances, because the informational value of the disclosure would actually be enhanced by the expression of the company's uncertainty. In addition, if the company forecasted that it would make additional, more concrete disclosures when additional information becomes available, it would allay the concern about confusing investors with successive disclosures.

And yet, as discussed above in Part III.C, in light of the competing pressures on companies facing market rumors, counsel would be unlikely to so advise TGS today. Therefore, I contend that the pressures on companies facing market rumors should be adjusted to incentivize optimal disclosure decisions.

100. See Merritt B. Fox, *Retaining Mandatory Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1338–39 (1999) (“For each U.S. issuer, there is a socially optimal level of disclosure. More information about the issuer and the resulting increase in its share price accuracy produces social benefits in the form of improved selection of new investment projects, improved managerial performance, and reduced investor risk. More information, however, entails additional social costs as well, such as the time and talent of lawyers and accountants as well as the diversions of management and staff time involved in gathering and providing the information.”).

101. See generally Wendy Gerwick Couture, *Optimal Issuer Disclosure of Opinions*, U. CIN. L. REV. (forthcoming 2018), <https://ssrn.com/abstract=3102667>.

102. *Id.*

B. PROPOSAL TO INCENTIVIZE ISSUERS TO RESPOND TO RUMORS

In short, I propose two adjustments to the pressures on issuers facing externally-sourced market rumors: (1) the exchange listing standards should be amended to expressly permit a company to remain silent in the face of market rumors, with the exchange's permission, if confidentiality is required for compelling business reasons; and (2) the incentives for listed companies to comply with these revised disclosure listing standards should be strengthened.

First, the exchange listing standards should be revised to take into account those circumstances where a company has compelling business reasons to delay its response to market rumors. As discussed above in Part III.A.2, the common wisdom is that exchanges already grant this exception, even though it is not included in the standards. This ad hoc approach to the listing standards undercuts the overall authority of the standards, inhibits companies from proactively contacting the exchanges, and causes investor and company uncertainty about whether the listing standards are being enforced.

Second, the incentive for companies to comply with the disclosure listing standards, as amended, should be strengthened. In light of the existing pressures incentivizing disclosure and the liability protections already in place, this adjustment need not be so draconian as affording investors a private right of action for violating disclosure listing standards or further insulating responses to market rumors from potential securities fraud liability. Rather, a slight increase in the incentive to comply with disclosure listing standards would be sufficient to offset the countervailing pressures.

In particular, a listed company should be required to (1) annually certify to its exchange that it is not aware of any material noncompliance with the disclosure listing standards; (2) promptly notify the exchange of any material noncompliance with the disclosure listing standards; and (3) disclose annually to investors, on its Form 10-K, any such notifications of material noncompliance, as well as provide an explanation thereof.

Comparable, albeit more stringent, requirements already apply with respect to a company's compliance with the NYSE's corporate governance listing standards. The NYSE listing standards require the CEO of a NYSE-listed company to annually certify to the NYSE that "he or she is not aware of any violation by the company of NYSE corporate governance listing standards, qualifying the certification to the extent necessary."¹⁰³ In addition, the CEO must "promptly notify the NYSE in writing after any executive officer of the listed company becomes aware of any non-compliance with any applicable provisions" of the corporate governance listing standards.¹⁰⁴ Finally, if the CEO notifies the NYSE of

103. NYSE LISTED CO. MANUAL § 303A.12(a) (Nov. 25, 2009), 2008 WL 23737130, at *1.

104. *Id.* § 303A.12(b); see also THE NASDAQ STOCK MARKET RULES, RULE 5625 (2009) ("Notification of Noncompliance") ("A Company must provide Nasdaq with

noncompliance with the corporate governance listing standards, and if that noncompliance is “material,” the company must file a current report on Form 8-K, disclosing the date of the notification, the implicated standard, and “any action or response that, at the time of filing, the registrant has determined to take regarding its noncompliance.”¹⁰⁵

My proposal to incentivize compliance with disclosure listing standards is less stringent than the requirements already in place to incentivize compliance with corporate governance listing standards. First, the annual certification requirement would be on behalf of the company rather than the CEO. Second, the certification would be limited to “material noncompliance,” rather than “any violation.” Third, the prompt exchange notification requirement would be triggered only by “material noncompliance,” rather than “any non-compliance.” Finally, the SEC filing disclosing any notifications of material noncompliance would be required annually, rather than immediately.

This adjustment to the competing pressures on companies would likely be sufficient to incentivize compliance with disclosure listing standards, including the requirement that companies respond to market rumors. Companies could, of course, continue to express those responses as opinions or forward-looking statements, largely insulating them from private liability. Neither the failure to disclose noncompliance to an exchange nor the noncompliance itself would give rise to a private right of action (rather, as they do now, exchanges could determine whether, and how, to sanction noncompliance); however, the failure to disclose a notification of material noncompliance on a company’s Form 10-K would potentially be actionable as an omission.

V. CONCLUSION

Public companies today face the same quandary that TGS faced: whether, and how, to respond to market rumors. On the one hand, SEC mandatory disclosure rules, exchange listing standards, and market forces may incentivize companies to respond to rumors. On the other hand, the risk of liability for misleading disclosure, business reasons for confidentiality, and the desire to avoid confusion may incentivize companies to remain silent. After balancing these competing pressures, most companies today would likely choose silence. And yet, I contend that silence is not the socially optimal response. Therefore, I argue that these countervailing pressures should be adjusted slightly to incentivize companies to respond to market rumors, and I propose a modest reform to accomplish that adjustment.

prompt notification after an Executive Officer of the Company becomes aware of any non-compliance by the Company with the requirements of this Rule 5600 Series [Corporate Governance Requirements].”)

105. 17.C.F.R. § 249.308 (2017) (Item 3.01(b) of Form 8-K).