Corporate Information: Texas Gulf Sulphur and Its Implications

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1. The Importance of the Case

In a year of landmark corporate and securities decisions, Texas Gulf Sulphur (TGS) is undoubtedly the most important. This is not to minimize cases like BarChris (imposing strict standards of due diligence to avoid liability for a false registration statement) and Law Research (allowing punitive damages for a false offering circular and invalidating an underwriter’s indemnification agreement from an issuer). But TGS is the work of the U.S. Court of Appeals for the Second Circuit, which has appellate jurisdiction over the nation’s financial center and over the federal law which is coming increasingly to be the law for corporations as well as for securities markets. All nine of the judges participated (instead of the usual panel of three); seven of them concurred in most phases of the decision, and all of them agreed on some. The case makes or confirms new law on a number of points which have daily importance to corporations and their insiders, as well as to the financial community. And the several opinions are full of hints and remarks which are seeds of more new law.

Although the majority opinion may end in oblivion if the Supreme Court grants review, it now stands as a current and crucial statement, of a kind the Supreme Court itself would probably write.

The facts of the case are too familiar to need more than a very summary recapitulation. One of many drill holes, which were part of an extensive Canadian exploration program, showed extremely heavy mineral-

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ization. Operations were suspended for several months while land was acquired. Company officials and employees bought stock of the company in the open market, or calls on its stock, during this period and when drilling resumed after land acquisition. Some of them told their friends to buy. When rumors of a major discovery began to circulate in the mining and financial world, the company issued a press release saying that they were exaggerated and that further drilling would be necessary to evaluate the situation, and promising a more definite statement when information could be evaluated. Four days later it announced a major discovery. The stock went up dramatically.

This Article first sketches the major issues in the case, then comments on some of them at greater length, and extrapolates to other situations.

2. The Major Issues

The TGS suit was brought by the SEC in 1965, alleging violations of SEC Rule 10b-5 which prohibits misleading statements and acts that would operate as a fraud or deceit upon any person in connection with the purchase or sale of a security. The Rule has, by a curious course of decisions, accelerating in the 1960's, become more comprehensive than the half dozen or so antifraud provisions enacted by Congress itself.

After an extended non-jury trial, Judge Bonsal of the Federal District Court in New York wrote a lengthy opinion in 1966 holding that a few acts of the parties were in violation of 10b-5 but most were not. Two years later the Second Circuit, in an opinion by Judge Waterman, upheld all the violations found by the lower court and found violations on almost all the other counts. Judge Moore dissented sharply on practically all points and was joined by Chief Judge Lumbard. Here is a synopsis of the major issues resolved by the two courts.

2.1 Trading with Material Information. Does a person violate 10b-5 by buying or selling securities with material inside (undisclosed) information about the issuer of the security?

District Court: yes.
Second Circuit: yes.

2.2 Materiality. When did information on TGS' drilling results in the Kidd Creek area near Timmins, Ontario become "material"?

District Court: 7 p.m., April 9, 1964, when a third drilling core established the third dimension of the ore body. The court used as a test of materiality what would have had a substantial impact on the market price of the stock. Accordingly, purchases before this time did not violate 10b-5 by using material inside information.

Second Circuit: November 12, 1963, when the first drill core was ter-

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*See Bromberg §§ 2.4-2.5.
*Note 1 supra.
minated and showed, by visual estimate, very high mineral content. The court used as a test of materiality whether the information would have been important to a reasonable, if speculative, investor in deciding whether he should buy, sell or hold. Accordingly, purchases after this time (and before public disclosure) did violate 10b-5 by using material information. (See further discussion in 6 below.)

2.3 **Stock Options.** Do executives violate 10b-5 by receiving stock options if they have material inside information about the company not known to the committee granting the options?

District Court: possibly, but the information was not material at the time of the grant.

Second Circuit: yes, if they are top management (here president, executive vice-president, and vice-president and general counsel). Lower officers and employees who have reported information to their superiors may assume that it has been passed on to the option committee.  

2.4 **Tipping.** Does an insider violate 10b-5 by “tipping” material information to others?

District Court: did not decide, since the tipping was of information it considered non-material.

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*In a footnote, CCH at p. 97,184 n.24, the court suggests (but expressly declines to decide, since the argument was not made to it) that the recipient of an option who has material inside information is cleansed of violation if there is later disclosure followed by ratification of the option before it is exercised. The court seems here to regard exercise (rather than grant) as the crucial event. But this naively overlooks a vital fact: the option price is typically fixed on the date of grant at the then market value of the security. Postponing exercise may deprive the optionee of any short term trading benefits. But it certainly does not deprive him of long term benefits which accrue from the information if it is material enough (as it was for TGS) to move stock prices onto a higher plateau.

There may also be a tax question whether such an option—which is, in a sense, inchoate until ratification—is effectively granted when issued or only when ratified; if the latter is true, and market values have risen, the option fails to meet the tax requirement that the option price be 100% of fair market value. INT. REV. CODE of 1954, § 422(b) (4). Even if the option is effective from the date of grant, the Internal Revenue Service may argue that the market value is not the fair market value because of the undisclosed material information. Cf. Treas. Reg. § 20.2031-1(b) (1965): “fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts” (emphasis added). There is also some corporate question whether ratification would be proper if the market were at a substantially higher level than when the option was granted.

Some of the same questions have to be raised in the situation contemplated by the court: where the employee fully discloses his material information to the option committee at the time of grant. There is no longer withheld information. But there are surely corporate questions whether an option at prevailing prices is waste or dilution. And, if the recipient belongs to top management, there may well be 10b-5 questions as fiduciary duties are more fully embraced by the Rule. See Baom. Code §§ 4.7(1), 4.7(2).

In short, caution suggests that disclosure to the option committee is not enough to eliminate the possibility of trouble with options if the information is likely to have a long range effect. In this case even ratification after disclosure may not do the job.

Judge Friendly suggests that top management may be liable for options issued to lower employees when material information is undisclosed to the option committee. CCH at p. 97,191.

There are situations in which the exercise, rather than the grant, of a stock option may be a 10b-5 violation. One is an option, granted when there is no undisclosed material information, which is about to expire. If the option price is below the market price, the optionee would normally let it expire. But if he has material inside information which would tend to lift the market price above the option price, he would exercise.

See also note 33 infra, and accompanying text.
Second Circuit: yes.\(^{10}\) (See further discussion in 10.1, 10.2 below.)

2.5 Moment of Disclosure. When did the Timmins information become public?

District Court: when released to a press conference. Hence a purchaser immediately after that was not in violation.

Second Circuit (unanimously\(^{11}\)): not before the news could reasonably have been expected to appear over the media of widest circulation (Dow-Jones broad tape). Hence a director who placed a buy order before this but after the press conference was in violation. (See also 9 below.)

2.6 Misleading Press Release. Was the first press release misleading? (The release was issued April 12 on the basis of information at April 10, when the fifth drill core was showing substantial mineral. Its basic message was that further work would be necessary to evaluate the prospect and that rumors about it were exaggerated. Four days later TGS announced a major mineral discovery.)

District Court: no, on the basis of information then known. The release was prepared with reasonable business judgment although hindsight showed it to be gloomy.

Second Circuit: maybe. The circuit court remanded to the district court for further consideration whether the reasonable investor might have been misled. (Judges Hays and Friendly were persuaded that the release was misleading, and Judges Kaufman and Anderson may have been too, although the terms of their concurrences in the Friendly opinion do not make this clear.)

2.7 "Connection" of Press Release with Security Transaction. Was the press release issued "in connection with" a purchase or sale of securities, so as to be within the scope of 10b-5?

District Court: no, since there was no showing of purpose to affect the market for the benefit of TGS or its insiders, and there was no unusual market reaction.

Second Circuit: yes, since reasonable investors would rely in buying or selling. Investors are hurt by false statements irrespective of purpose.

2.8 Good Faith, Intent, and Negligence. Is good faith a defense to a violation charge?

District Court: yes as to the press release. The court did not pass directly on the issue in connection with insider-buyers who contended that the mining information had become public.

Second Circuit: no as to the press release if, in fact, it was misleading. No also as to purchasing insiders who believed that the mining information had become public, since their belief was not reasonable under the

\(^{10}\) CCH at p. 97,181.
\(^{11}\) Id. at pp. 97,182 (majority), 97,209 (Judges Moore and Lumbard).
circumstances. Intent is not essential for a violation; negligence may suffice. (See 7 below.)

3. THE STATEMENT OF POLICY

Perhaps more significant than any particular holding in the TGS case is the policy which underpins them all. It is an egalitarian idea expressed several times in similar phrases. In general, it is that all investors shall "have relatively equal access to material information." Relative to non-disclosure (by insiders trading with material information), it is that "all investors should have equal access to the rewards of participation in securities transactions . . . and be subject to identical market risks." (The court recognizes that these "risks include, of course, the risk that one's evaluative capacity or one's capital available to put at risk may exceed another's capacity or capital." ) In deciding whether the press release was "in connection with" a securities transaction the court stated that the purpose of federal securities law is "to protect the investing public from suffering inequities in trading, including, specifically, inequities that follow from trading that has been stimulated by the publication of false or misleading corporate information releases." 

There is surprisingly little effort to justify the general statement of policy in terms of either economics or history. The court did not come to grips with the arguments of critics like Henry Manne and David Ruder. Very likely the court felt that equality is its own excuse for being. By contrast, it served up a considerable portion of legislative history to support the application of the policy to press releases. Dissenter Moore was quick to retort that the cited history pertained to the registration and reporting provisions of the 1934 Act, not to the antifraud provisions. What the majority was doing was continuing an already advanced process of telescoping the policies and coverage of a number of different securities law provisions into a general antifraud provision, 10b-5.

Other elements might have gone into the policy formulation. To take only one, the threat of violation by negligent press release is almost certain to deter or defer some releases. But it will presumably improve the quality and scope of those which are made. What will be the net effect, and will it promote or retard the overriding purpose of investor protection?

The policy of equal access to information is not a new one in the 10b-5

18 Id. at p. 97,177.
19 Id. at p. 97,180.
20 Id.
21 Id. at p. 97,181-86.
24 CCH at pp. 97,183-87.
25 Id. at p. 97,207.
26 See Bromberg § 2.1.
cases. But it has never been stated more emphatically or applied more broadly than in TGS.

4. THE FATE OF THE DEFENDANTS

4.1 Injunction. TGS began as an injunction suit by the SEC. In its usual form, this is a relatively mild technique, often used for testing new legal propositions, free from the pressures of monetary liability (civil or criminal) and jail sentences. An injunction may be little more than a warning to behave in the future. But history suggests that law developed in injunction cases is later applied in liability and criminal cases as well. The injunction suit is often the camel's nose in the tent.

No injunction has yet been issued against any of the TGS defendants. The Second Circuit left this to the lower court, subject to a possible further appeal.

It is worth noting that an injunction may be more than a slap on the wrist, even for the honest and competent who obey it. It may be grounds for denying a broker-dealer or salesman's registration under federal or state law, or for denying the Regulation A exemption for securities offerings up to $300,000, or for denying the registration of securities under some state laws. Probably none of these sanctions is applicable to the TGS defendants. But there is always the possibility of another violation, even though unintentional, bringing fine or imprisonment for contempt of the injunction.

Even if a violation is established, an injunction does not have to be issued, although Judge Hays, in his separate opinion, was ready to order one against the company and the top management who received stock options. The lower courts have discretion to decide whether such a writ is necessary to deter future violations. Judge Friendly (and those concurring

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10 Id. §§ 12.2, 3.2.
13 E.g., United States v. Custer Channel Wing Corp., 376 F.2d 675 (4th Cir. 1967) (interpretation of private offering exemption; criminal contempt proceeding).
15 Uniform Securities Act § 204(a)(2)(D).
17 Uniform Securities Act § 306(a)(2)(C).
18 E.g., United States v. Custer Channel Wing Corp., 376 F.2d 675 (4th Cir. 1967).
19 Judge Moore (Chief Judge Lumbard concurring) dissented vehemently: "The issuance of any injunction . . . would place a large company and its many executive employees under the possibility, without even a Miranda warning, that anything they say may be held against them and place them under danger of criminal sanctions [and would constitute] not 'double' jeopardy but 'perpetual' jeopardy," CCH at p. 97,209-10. The last phrase was used to keynote a bitter criticism of the decision from the financial press, "Perpetual Jeopardy"—An Angry Note on the Texas Gulf Sulphur Case, Barron's, Aug. 19, 1968, at 1.
20 CCH at pp. 97,194-95.
with him) underlined the discretion of the trial court not to issue an injunction if it saw fit. This discretion (to grant or deny an injunction) is rarely overruled by the appeal courts.

4.2 Monetary Damages and Other Relief. TGS was not an ordinary injunction suit. From the outset, the SEC sought private relief against the individual defendants. In one instance (which appears to disregard the parties' stipulation mentioned below), this has already been given; the Second Circuit ordered rescission (cancellation) of the stock options granted to Kline, the vice-president and general counsel. No doubt the same would have happened to the other top executives who received options, except that they had previously surrendered theirs for cancellation. The thrust of the Second Circuit's ruling on Kline is reinforced by the fact that his options had ben ratified by the directors after disclosure of the mining information, both to them and to the public. The court does not make it clear why the ratification fails to cure the violation. Judge Friendly indicates that it is because the directors lacked the necessary appreciation of the illegality of his conduct. My thought is that the court was looking on the offense as one against the investing public (i.e., issuance of cheap stock) rather than against the company; corporate ratification might cure the latter, but not the former.

Without specifying the exact relief, the SEC has asked the courts to deprive the individual defendants of the benefits of their use of inside information. Neither court has decided this issue yet, since the parties agreed to hold it in abeyance until determination of the violation issues. Some sort of liability would seem to follow from the finding of violation, if damage can be shown, or perhaps (on some fiduciary theory) even if it cannot. There is a question whether the SEC has standing to enforce the liability. The measure of the liability will probably be the difference between the prices paid by the insiders using material information, and the price prevailing some reasonable time after dissemination of the information. Theoretically, the time should be the same as that when disclosure is sufficient for insiders to trade. (See 8.3 and 9 below.)

Those who tipped face possible liability for their tippees' profits, measured in the same way. The tippees themselves were not parties to the suit. (See 10 below.)

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20 Id. at p. 97,194.
21 See authorities collected in 7 J. Moore, FEDERAL PRACTICE § 61.21 (2d ed. 1968).
22 In addition, Judge Bonsai took note that at least 49 private actions based on the same facts were pending in his court, claiming more than $2.8 million compensatory damages and $27 million punitive damages. 258 F. Supp. at 267 n.1. The Second Circuit must have been aware of the private suits and the influence on them of the decision it was giving in the SEC suit. Judge Friendly's concurrence mentions them explicitly, CCH at p. 97,192.
23 See additional discussion of ratification in note 9 supra.
24 CCH at p. 97,191 n.2.
26 For the arguments on whether trading (rather than non-disclosure) is the causative element, and whether trading by insiders is actually beneficial rather than harmful, see BROMBERG § 8.7 (2), especially at 217 and references there.
27 See id. § 8.7 (2), especially at 218.
28 See id. § 7.4 (6) (e).
It is an open question whether any damages assessed will be awarded to 
(1) the persons who actually sold to the insiders, (2) all persons selling 
about the time the insiders bought, or (3) the company. The first might 
be impossible to identify. The second and third would be something of a 
windfall.

The only relief asked against the company was injunction against future 
 misleading releases. The majority stated that an injunction might issue if 
the lower court, on remand, found that the first release was misleading 
and was the result of lack of due diligence by TGS.

Judge Friendly (with Kaufman and Anderson concurring) emphasized 
that negligence in the preparation of a press release—at least this one—is 
not the kind of case for monetary damages. The majority does not say 
specifically that it is, but leaves the matter up in the air, declining to say 
whether bad faith would have to be shown. The three concurring judges 
argue that any liability of the company would fall ultimately on its share-
holders, who should be beneficiaries of securities law, not victims. This ig-
nores the company’s rights over against the officers who prepared the re-
lease, rights some shareholder will surely assert in a derivative suit if the 
company does not enforce. Depending on the company’s exculpation and 
indemnification provisions (and their validity, which is clouded by the 
Law Research decision⁴⁰), the rights over may or may not be effective to 
shift liability from the company to the individual wrongdoers.

5. Who is an Insider?

5.1 The Nature of the Question. People have been agonizing for years 
over “Who is an insider?” The answer determines who is legally barred 
from using information about a company for his personal benefit. But 
many seekers for the answer have looked for boxes in organizational charts, 
or other well-defined relationships. This misconceives the nature of the 
answer, which has been available for a long time.

5.2 The Nature of the Answer. In Cady, Roberts & Co.,⁴¹ the SEC de-
cided that a broker-dealer violated 10b-5 by selling Curtiss-Wright shares 
with nonpublic knowledge of a large dividend cut. The SEC laid down 
an “access test” which treats as an insider anyone with a relationship to an 
issuer giving access, directly or indirectly, to information intended to be 
available only for a corporate purpose of the issuer. The test was adopted 
by both lower and upper courts in TGS, and was described by the latter as “the essence” of Rule 10b-5.⁴²

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⁴⁰ See id. § 8.7(2), at 218-19.
⁴¹ CCH at pp. 97,192-94.
⁴³ An intriguing question is whether one can “use” inside information and violate 10b-5 without 
trading. Consider, for example, a person who is about to sell a security but refrains from doing so 
on learning favorable information about the issuer. Conversely, someone about to buy might decide 
not to, when informed of adverse developments. Variants include expiration of an option (see note 
y supra), non-exercise of a put or call, and not covering a short sale.
In short, the answer to the question is not a matter of categories but of information-yielding relationships, whatever they happen to be. Anyone who gets information from a company is potentially an insider for 10b-5. This is quite distinct from Securities Exchange Act section 16 which applies reporting requirements and short-swing (six-month) profit recapture to a class of insiders defined to include only officers, directors and holders of 10% or more of a class of equity securities.

The difficulties in the "access test" come when information is second-hand or more remote. The problem, which is part of tipping, is considered further in 10-12 below.

5.3 A Checklist. A checklist of potential insiders—necessarily incomplete for the reasons given in 5.2—might include:

(A) Directors, officers, major security holders
(B) Lower employees
(C) Outside professional advisers: lawyers, accountants, engineers, management counselors, public relations consultants, financial advisers, testing laboratories, etc.
(D) Business connections: lenders, underwriters, proposed merger partners, customers, suppliers
(E) Financial analysts and institutional investors
(F) Personnel of press, wire services and other communication media
(G) Personnel of stock exchanges and other self-regulatory agencies
(H) Firms, associates and families of anyone on the list
(I) Brokers of anyone on the list
(J) Tippees of anyone on the list

6. What Is Material?

TGS is a fountain of new law on the central issue of what information is material. Unfortunately, not all of it is consistent, and there will be difficulty in applying it to other sets of facts. Nor is it quite clear whether the same standards determine materiality of nondisclosures (by the insiders buying shares) and of misrepresentations (which the first press release may have been).

6.1 The Reasonable Investor Test. The Second Circuit begins with Arthur Fleischer's concept that a disclosure duty exists only in "those situations which are essentially extraordinary ... and which are reasonably certain

44 Not only did the Second Circuit reject the test of materiality used by the district court. It went on to use its test to hold material certain facts which the lower court had ruled non-material. Dissenting Judges Moore and Lumbard accused the majority of usurping the fact-finding function of the trial court, CCH at p. 97,195, and ignoring Fed. R. Civ. P. 52(a) (findings of fact shall not(5,5),(997,993)
to have a substantial effect on the market price of the security. This looks like the applicable standard of materiality. But the court rapidly drops the "extraordinary" component and settles on "not only information disclosing the earnings and distributions of a company, but also those facts which affect the ... desire of investors to buy, sell or hold." This is given a further stretch by including speculators among the reasonable investors used for the measure of materiality. The result—in view of the way market professionals sometimes react to relatively slight bits of information—seems to be to set a very low threshold of materiality.

Perhaps, as suggested by an SEC staff member speaking as an individual, this rather broad description of materiality ought to be limited by the context: a gigantic discovery by TGS, which Judge Friendly called a "once-in-a-lifetime affair." I would welcome this limitation, but doubt that the court intended it. In employing the language, the court was speaking not of the final results of the discovery, but of preliminary phases in the exploration. Regardless of intent, the language will be urged at face value in future litigation.

It would be helpful for the courts to develop some rule of thumb on materiality in terms of probable effect on stock prices. A predicted shift of a few percentage points seems non-material for most stocks; 20% would be material for any stock. Perhaps the range can be narrowed.

A refinement of the rule of thumb might take into account the wider fluctuations which are typical for some stocks, often the more actively traded issues. This approach would attempt to measure materiality in terms of probable price movement (attributable to the information in question) related to historical price patterns. For example, if a stock normally moves $5 in a week, information likely to cause it to move $10 in a day looks material.

I need hardly add that such probability testing has its uncertainties. But evidence is available in the opinion testimony of market professionals as well as in actual market behavior, although uncritical acceptance of the latter gives undue weight to hindsight. In any event, the principal value of a rule of thumb would be to give companies and insiders a better basis for judging when they have material information, when they should release it, and when it is safe for them to trade.

6.2 The Probability Factor. The Second Circuit introduced into materiality an element of probability: "whether facts are material ... when the

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48 CCH at p. 97,178.
49 Id.
51 CCH at p. 97,194. Judge Friendly apparently thinks of materiality in terms of “information likely to produce a rapid and substantial increase in the price of the stock,” Id. at p. 97,171, although he does not offer this as a formal test. It approximates closely the “immediate and substantial effect” concept which SEC staff members, like Mr. Ferber, note 50 supra, seem to prefer.
facts relate to a particular event . . . will depend at any given time upon a
balancing of both the indicated probability that the event will occur and
the anticipated magnitude of the event in light of the totality of the
company activity. While realistic in terms of investor judgment, the
probability element will be difficult to apply fairly, and lends itself easily
to distortion by hindsight.

6.3 The Cut-Your-Own-Throat Element. A major support of the Second
Circuit's holding of materiality was the extensive buying of stock (over
$100,000) by insiders and their tippees during the period when the mining
information was developing. Even more significant was the purchase of
calls—essentially short term speculations—on more than 10,000 shares,
mostly by persons who had never owned calls before. (There was some
indiscriminate lumping together of defendants here, which the court fails
to mention.)

The implication is clear: any trading by insiders creates evidence of the
materiality of whatever information hindsight shows that they had when
they traded. The Second Circuit leaves the door open to them to show that
they were motivated by some factor other than the information in ques-
tion. In fact, it seems to put on them a burden of proof in this regard.
Perhaps the only kind of trading which will be altogether safe is the peri-
odic purchase plan suggested by the New York Stock Exchange.

7. LIABILITY FOR NEGLIGENCE?

It has been clear at least since the Capital Gains Research decision of
the Supreme Court in 1963 that no particular evil intent or willfulness
has to be shown to obtain an injunction under the antifraud provisions.
The TGS majority opinion repeats this holding and observes, with apparent
approval, that the same rule has been accepted by other circuit courts in
private suits for damages. This appears to bring the Second Circuit to the
brink of holding that money damages may be imposed for 10b-5 violations
by negligence as well as by intentional conduct. On this point three judges
(Friendly, Kaufman and Anderson) express strong reservations about im-
posing liability on a corporation for a negligent press release. They show
less concern about liability for negligent individuals. The two dissenters
(Moore and Lumbard) use different arguments (primarily that the release
was neither negligent nor "in connection with" a securities trade), but
their tone suggests that they hold no brief for monetary liability for neg-
ligence under 10b-5. Thus five of the nine judges may pull back from the
brink, depending on whether liability is sought against the corporation, or

88 CCH at p. 97,178.
89 Id. at p. 97,180.
90 Id.
91 See notes 71-72 infra, and accompanying text.
92 Note 21 supra.
93 CCH at p. 97,183.
against its management. And even the majority opinion intimates that bad faith may be necessary for liability. 8

8. Corporate Publicity

8.1 Timing. There is nothing in the Second Circuit’s decision that dictates when information must be released. In particular, there is no requirement that it be disseminated merely because it becomes material. 80 Nonetheless, the decision increases the risks of tardy disclosure: violations by insider trading and tipping. And the New York Stock Exchange has recently re-emphasized its policy of prompt disclosure by companies listed with it. 82 Unless there are business reasons (for example, the desire to acquire additional land without running the price up, as in TGS 87), any delaying of disclosure beyond the time of materiality is suspect.

8.2 Content. If anything, TGS—with its speculator element in the standard for measuring materiality—creates temptations for premature disclosure, when evolving information is not yet ripe enough to be very meaningful. Releases of tentative information carry the danger that they will seem either negligently or intentionally inaccurate with hindsight, 88 thereby producing a 10b-5 violation in the other direction, e.g., an attempt to manipulate security prices. The danger can be reduced to acceptable levels by sticking close to the facts and letting them speak largely for themselves. Not doing so was a principal failing the Second Circuit found in TGS’ first release. The court suggested several guides: (1) give the date (and perhaps the hour) of the information used if not contemporaneous with the release; (2) indicate that the situation is in flux if this is the case; (3) describe the known facts in detail or in summary; (4) draw conclusions or not, as the circumstances warrant.

88 "It seems clear, however, that if corporate management demonstrates that it was diligent in ascertaining that the information it published was the whole truth and that such diligently obtained information was disseminated in good faith, Rule 10b-5 would not have been violated." CCH at p. 97,188.

80 "[T]he 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." CCH at p. 97,179 n.12. But see N.Y. STOCK EXCHANGE, COMPANY MANUAL A-19 (1968), advising publication as soon as information is known outside top management and its individual confidential advisors. See also id. at A-21 calling for publication if rumor or unusual market activity indicates that the information has leaked.

See also note 106 infra.

82 N.Y. STOCK EXCHANGE, EXPANDED POLICY ON TIMELY DISCLOSURE (July 18, 1968), and N.Y. STOCK EXCHANGE, COMPANY MANUAL A-18, A-22 (1968).

81 Curiously, no opprobrium seems to attach to using the information to acquire land for the company. (The landowners who sold or leased to TGS are, however, litigating some aspects of the acquisition.) The securities laws have apparently elevated ethics in securities transactions above those of other kinds of business deals. Interesting questions arise if the information is used for personal purposes in a nonsecurities transaction. Darke was reported to have bought a number of mining claims in the vicinity of the TGS discovery. Wall Street Journal, Mar. 9, 1965, at 4, col. 3 (Southwest ed.).

82 For example, five major mergers—which had been announced in early stages of negotiation—were called off on a single day recently. N.Y. Times, Oct. 23, 1968, at 59, col. 2. See also Wall Street Journal, Nov. 15, 1968, at 1, col. 6 (Southwest ed.), discussing the large number of merger cancellation announcements, and attributing them not to a higher failure rate in negotiations but to earlier announcement of the negotiations. Market prices of Xerox and C.I.T. shares are traced through the announcement of their merger negotiations, and later cancellation, id. at 25 col. 3.
There are difficulties with the all-fact approach. For one thing, as Judge Moore stresses in his dissent, the volume of such releases may be too great for the media to handle, and they are likely to be too technical for investors to draw much benefit from. However, this kind of evaluation is one of the things the experts (brokers, advisers, analysts) are for. Another difficulty is in persuading the media, especially those of broad, general circulation, that dry facts are worth printing.

8.3 Method of Release. The Second Circuit discusses this issue only in connection with when an insider may trade. The test is that the "information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public." A press release is only the first step in the necessary dissemination. The court intimates that appearance on the Dow-Jones broad tape will be satisfactory, but it stops short of an affirmative statement. (All it says is that an insider should wait at least for broad-tape dissemination before trading.) The SEC had argued that less speculative investors who merely read the daily papers should be protected by requiring insiders to wait until information has appeared there. Prudence indicates releases not only to Dow-Jones and Reuters, but to the wire services, major New York papers, and local papers where operations or stockholders concentrate. A growing number of companies also mail copies of releases to their stockholders. Apart from the public relations value, this fortifies the company's legal position by adding to the number of relevant recipients of the information, although the effect is partly vitiated by the slowness of mail.

9. When May Insiders Trade?

The basic answer is clear: before materiality and after disclosure. We have already observed (in 6 above) the difficulties of determining materiality. Deciding when disclosure has occurred should be easier, but no precise answer is yet possible. As noted in 8.3 above, the Second Circuit remarked merely that insiders should wait at least until the broad tape carries the news.

Other attempts to pinpoint the time of disclosure have produced strikingly divergent results. The New York Stock Exchange thinks in terms of a trading halt for about 15 minutes after important news appears on the tape, to provide "a period for the public evaluation of the announcement." But it recommends that insiders not trade until information "has appeared in the press," presumably the newspapers. The Second Circuit suggested that the SEC might appropriately issue a rule on this point, and the Commission is reported to be considering a rule requiring a wait for 24 hours or until appearance of the next morning's newspapers.

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68 CCH at p. 97,182.
69 Id.
71 Id. A-25.
72 Id. A-26.
73 CCH at p. 97,182 n.18.
74 Wall Street Journal, Aug. 30, 1968, at 3, col. 2 (Southwest ed.).
The Second Circuit stated that the time the insider places his order is determinative, not the time it is exercised.\(^7\) Thus he may not place it until proper publication occurs.

Purchases (and presumably sales) under periodic plans appear to be safe if the plans have been in operation for some time before there is any material information. The New York Stock Exchange recommends them for insiders,\(^8\) and the Second Circuit hints that they may be carried on even when material information is in the air.\(^9\)

What if the media do not carry the news? This is a distinct possibility as more companies release more news to minimize risks to their insiders. Smaller companies and smaller transactions will inevitably be less likely to get publicity. Thus, Dow-Jones seems to have a rule of thumb that acquisitions involving less than $3 million will not be reported either on the broad tape or in the Wall Street Journal. If the legal test turns out to be appearance on the tape, and the tape is bare of the news in question, the insider would be wise not to trade until publication of the other media (e.g., newspapers) to which the news has been given.\(^10\) If none of them carries the news, he should hardly be asked to wait longer.

Prior to the appearance of the news on the tape or in the papers, it would be risky for the insider to assume from an increase in trading volume in the security, or from price movements, that the necessary disclosure has occurred.\(^11\)

### 10. Tipping and Its Consequences

10.1 **Tippers—Violation.** The Second Circuit in TGS squarely held that one of the defendants (Darke) violated 10b-5 by tipping.\(^12\) With respect to another defendant, the court went a step farther and recognized a sort of vicarious responsibility of the tipper for the trades of the tippees: "Coates's violations encompass not only his own purchases but also the

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\(^7\) CCH at p. 97,181 n.17.


\(^9\) CCH at p. 97,180.

\(^10\) Failure of the tape to carry the news is some evidence that it is not material. But the news could be very significant for the company, especially a small one, though not significant enough to the world at large to be worth printing. Materiality is measured in reference to the company. See Bromberg § 8.3, at 201. Cf. CCH at p. 97,178: "the anticipated magnitude of the event in light of the totality of company activity."

\(^11\) A remoter insider (one who is a tippee) may be justified in relying on such an inference. See 10.1(C) of the text.

\(^12\) CCH at p. 97,181. Cf. Petition for Rehearing on Behalf of Defendants-Appellees, Texas Gulf Sulphur Co., et al., supra note 1, at 33-34:

As the District Judge found that the preliminary drilling results were not material, he did not reach the question, and made no factual finding as to whether Darke had "tipped" anyone with respect to the drilling results. The witnesses deposed by the SEC . . . all denied such tipping. Because of this posture of the case on appeal, significant legal questions with respect to the application of Rule 10b-5 to Darke's conduct were not argued or briefed by the defendant. The question of the scope of Rule 10b-5 in this regard is of great importance, as for example, it involves the duties of corporate personnel with respect to security analysts, mutual funds, etc. Such important legal issues should not be determined . . . without briefs on the law or factual findings by the District Court. At the very least, this issue should be remanded to the District Court for the necessary factual findings and for initial consideration by that court of the important legal questions presented . . .

See note 46 supra. Another tipping case is discussed at note 105 infra.
purchases by his son-in-law [a broker] and the customers of his son-in-law, to whom the material information was passed."

The information transmitted by the two defendants was not the same. Darke told persons that TGS stock "was a good buy" and apparently gave them more specific information about the initial drilling results and the later drilling resumption." Coates, immediately after the second press release, "told . . . of TGS's discovery." It is still an open question whether an insider violates by telling someone merely that the stock "is a good buy."

Since a basic policy is to prevent material undisclosed information from being used for personal (non-corporate) purposes, the transmission of information should not violate if it is for a corporate purpose, e.g., to an accountant for reference in the company's financial statements, to a lawyer for advice on how to handle, or to a public relations consultant for preparation of a release. Indeed, this should not be called "tipping" at all. Even in situations like this, the transmitter might violate if he knows (or, perhaps, if he has reason to believe) that the receiver will use the information for personal purposes like market trading. (See also 11.2 below.)

10.2 **Tippers—Liability.** No case has yet imposed liability for tipping.\(^{66}\) The issue will be faced on the TGS remand. Although tipping is itself a violation, there can hardly be any liability unless it results in some damage, e.g., through trading by the tippees.\(^{67}\) Given the nature of the financial world, an insider who tips a friend should probably be charged with foreseeing that the friend will tell one or two others and that the information will continue to spread.\(^{68}\) Quite conceivably he will be liable for all the trades which can be traced to information emanating from him. In the abstract, there is reason to hold the original tipper even for trades by tippees which—because of the muted form in which the information reaches the tippees—are not violations by them. (See 10.3 below.) If the overriding policy is to prevent informational inequities in the market,\(^{69}\) it would be served by such a rule, which would also operate as a powerful deterrent to tipping. To the extent a tippee is liable for his own trades (see 10.4 below), vicarious liability of the tipper for the same trades would make little sense, unless the tipper were given a right over against the tippee. After all, it is the latter who has enjoyed the direct economic gain from the tip. There is an indemnification analogy in other kinds of vicarious liability, e.g., when a principal suffers liability for misconduct of his agent.\(^{70}\)

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\(^{66}\) CCH at p. 97,184 n.23.
\(^{67}\) Id. at p. 97,181.
\(^{68}\) 258 F. Supp. at 288.
\(^{69}\) Notes 43-44 supra, and accompanying text.
\(^{71}\) See note 36 supra.
\(^{72}\) Information exchanges and their economic functions are discussed in H. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966), especially chs. IV and V.
\(^{73}\) See notes 12-14 supra, and accompanying text.

\(^{74}\) See RESTATEMENT (SECOND) OF AGENCY §§ 399, 401 (1958); cf. id. § 395. On a partner's right of indemnification, see J. CRANE & A. BROMBERG, ON PARTNERSHIP 371-73 (1968).
The previous paragraph rests mainly on tort and fiduciary ideas. A different theory—which regards the tipper as an aider and abettor of the tippee—reaches similar results at least where the tippee’s trade is a violation. Aider-abettor concepts have been applied in 10b-5 liability cases.\footnote{Brennan v. Midwestern United Life Ins. Co., 286 F. Supp. 702 (N.D. Ind. 1968); Ross v. Licht, 263 F. Supp. 395, 410 (S.D.N.Y. 1967). See Note, Securities Regulation—Civil Liability for Failure To Disclose the Fraud of a Third Person, 35 U. Mo.-K.C.L. Rev. 320 (1967). For other 10b-5 cases using the aider-abettor concept in determining the validity of a cause of action, see Bromberg § 8.5 n.34.2. For related ideas of “common plan” and conspiracy see id. nn.34, 34.1. Aiding-abetting is charged in the Merrill Lynch proceeding, SEC Order for Public Proceedings (Aug. 26, 1968), Admin. File No. 5-1680, CCH Fed. Sec. L. Rep. ¶ 77,596.}

Whatever the theory of liability, it seems likely that the measure of damages will be profit confiscation: the difference between the price of the tippee’s actual trade and the price prevailing after appropriate disclosure of the information in question.\footnote{Text accompanying note 38 supra.}

10.3 Tippees—Violation. No tippees were made defendants in the TGS case, which therefore lays down no binding rules for their conduct. However, the Second Circuit said trading by tippees “with actual or constructive knowledge that the material information was undisclosed . . . certainly could be equally reprehensible”\footnote{CCH at p. 97,181.} compared to trading by tippers. This carries at least a hint that tippees are encompassed by the “access test,” and are to be treated more or less like inner insiders if they possess material undisclosed information. Indeed, the access test was laid down in the course of the SEC’s holding that a tippee violated by using such information, in this case news of a substantial dividend reduction, communicated by a director of the company to the broker for whom he worked.\footnote{Text accompanying note 43 supra.} Additional confirmation of the possibility of violation by tippee trading can be found in a lower court case involving a closely held company.\footnote{Ross v. Licht, 263 F. Supp. 395 (S.D.N.Y. 1967), noted in 20 Stan. L. Rev. 347 (1968).} Further evolution of the law can be expected in the \textit{Merrill Lynch} proceeding discussed in 11.2 below.

Clearly, not all tippees are in the same position. Some criteria will have to be developed to distinguish their responsibility. I suggest that they be along the following lines.

\textbf{(A) Specificity of Information.} Some degree of specificity of information is inherent in the concept of materiality. The abundance of tips and recommendations in the market vary widely in this respect. At one extreme is “TGS is a good buy.” At or near the other is “TGS found 25 million tons of high grade, pit-mineable zinc, copper and silver in Timmins.” The more specific the information, the more likely is its use to be a violation.

It is difficult, perhaps impossible, to separate the specificity component from the source component discussed in the next subsection. Thus, one who trades on hearing a total stranger say “TGS is a good buy” should not be a violator. But one who trades on being told the same thing by a director of
a company, in a tone of mysterious and emphatic confidentiality, may well be guilty of breaking the Rule.

Since information tends to be generalized and distorted as it passes from hand to hand, remoter tippees probably will have less responsibility than original tippees. But a particular tippee may be unable to tell how far down the chain he is from the original source. This brings us to the next factor.

(B) Knowledge of Company Source. Unless the policy is to stamp out all trading on tips, regardless of their source, the law must consider whether the tippee knows or has reason to know that his information comes from the company generating it. There is little problem if he hears it from a company officer, or from the officer’s wife or secretary. But he may hear it from his broker, who has no particular connection with the company, as one of several recommendations. Or the tippee may be the broker himself, who gets it from another broker as one of dozens of bits of information they exchange. Or either of them may hear it from a total stranger in an elevator or at a bar.

One might argue for a presumption that all information about a company emanates from the company. Such a rule would be almost absolute, and would put the active trader to an often impossible burden of proof of tracing the information he receives. Moreover, it ignores the fact that information about a company can be externally generated or released, for example, by governments, analysts, brokers, competitors, suppliers, customers, bankers and merger partners. Attribution of source is likely to be imprecise in the market; people claim that information is from the inside when it is not, and vice versa.

Unless informational exchange processes in the market are to be radically transformed, a tippee’s violation should depend on whether he knows or has reason to know that his information comes, directly or indirectly, from inside the company whose securities are involved.

(C) Degree of Diffusion of Information. The burden of releasing information about a company is primarily on the company. It is reasonable to charge persons within that company, at least those near the top, with knowing the formal channels of release and when the channels have operated. For this reason, a true insider must wait until publication. (See 9 above.) The same reasoning does not apply to all persons outside the company who receive the information secondhand. The fact that they receive it may lead them to think that it is in circulation and not inside information. They may not be in a position to learn whether the company has made a press release, to whom and when, and with what result. In such cases, unless they know or have reason to know the information is not public, they should be free to trade if they do not know that the information has come from the company, and perhaps even if they do, particularly if it is not very specific information.

This view is supported by the cases. The original formulation of the tip-
pee's violation spoke of his trading with inside information "knowing it is unavailable to those with whom he is dealing."

The Second Circuit's dictum on reprehensibility of tippee trading describes the trading in terms of "actual or constructive knowledge that the material information was undisclosed."

(D) Probability of Accuracy of Information. Closely related to specificity of the information (A) above is the likelihood of its truth, whether dealing with an estimate (e.g., of mineral content) or a future event (e.g., the occurrence of a merger). An inner insider will normally be in a better position to make judgments of this sort. The Second Circuit, in TGS, introduced a probability factor in its test of materiality for such insiders. (See 6.2 above.) Remoter tippees are unlikely to be as well equipped to weigh such probabilities. For them a higher probability of accuracy ought to be a necessary element of violation.

(E) A Proposed Synthesis. Pulling these four criteria together, I suggest this test. A tippee violates if he (1) trades with specific material information which he knows (or should reasonably know) comes from an inside source and (2) knows (or should reasonably know) that the information is undisclosed to the public. The standard for determining reasonableness of knowledge is that of a person in his or similar circumstances. The same standard applies in determining the probability element in the materiality of the information.

Further tipping by the tippee should probably be regarded as a violation to the same extent as trading by him.

10.4 Tippees—Liability. Liability of tippees will presumably have the same relation to violations by tippees (10.3 above) as liability of tippers will have to violations by tippers (10.1-10.2 above). This should take into account the more relaxed standards for tippees suggested in 10.3.

One lower court has imposed liability on tippees for buying shares in a closely held company from other holders, using material inside information of a planned public offering by the company at a much higher price.

10.5 Other Aspects. Among the unsolved questions is to whom any recovery is to be paid. (See 4.2 above.) Another is whether a tipper held liable for the trading of his tippee has rights over against him. (See 10.2 above.)

11. Broker-Dealers

11.1 In General. The recent focus of insider trading cases has been on company executives, but brokers have been under similar strictures at least since the Cady, Roberts decision in 1961. The strictures have been con-
firmed by the TGS decision although no brokers were involved in that case.

If brokers receive material information simply by inquiring of the company, they are in much the same position as analysts and institutional investors who make similar inquiries. (See 12 below.) They are tippees, and therefore insiders of a sort. (See 5.2, 10.3 and 10.4 above.) Their problems are likely to be more serious if they have more formal relations with the company. Some of these are discussed below.

11.2 Underwriting. One person who has thorough-going access to a company's information is the underwriter of its securities, particularly if the underwriter is making the kind of probe required by BarChris.90 To drive home the point under lob-5, the SEC, its appetite for big game whetted by TGS, and its weapons sharpened by the Second Circuit, has opened administrative proceedings against Merrill Lynch, a number of its executives and employees, and more than a dozen mutual funds, fund managers and hedge funds. The SEC charged that Merrill Lynch, as underwriter for a Douglas Aircraft offering then in registration, (1) learned that Douglas' current and projected earnings were sharply down, (2) passed this information to the funds and advisers who then sold or sold short 190,000 shares of Douglas before public disclosure, and (3) bought Douglas for other customers without disclosing the information.91 By moving against large and reputable firms, the SEC shows its determination to expand and enforce vigorously the limitations on use of inside information by brokers and their clients.

All the parties to the proceeding are one or more removes from the generating company (Douglas). The stage is thus set for defining the responsibilities of transmitters, receivers and relayers of information. Backed by the dictum in TGS on the reprehensibility of transactions by tippees,92 and the court's general policy against informational inequities in the market,93 it is not hard to predict how the SEC will see the law. There remain significant fact questions, e.g., whether or how the information was used, and whether it was so widely known in the financial world that it could be regarded as disclosed. Other elements of the kind discussed in 10.3 above deserve consideration. If the information was as charged by the SEC, there can be no serious question of its materiality.

Newspaper reports indicate that some of the mutual funds will defend on the ground that, as fiduciaries, they were obliged to sell on receipt of the information in order to protect their beneficiaries (stockholders). A somewhat similar conflict faces broker-dealers who owe some fiduciary

91 SEC Order for Public Proceedings (Aug. 26, 1968), Admin. File No. 3-1680, CCH FED. SEC. L. REP. § 77,196. Although part of a larger struggle between the SEC and the industry over customer-directed give-ups, the case has independent importance for the antifraud provisions. The SEC staff charged that Merrill Lynch benefited from commissions on the sales and from give-ups. It remains to be seen whether a purely gratuitous tip would be a violation. There is authority in related areas that benefit is not prerequisite to a violation. See Bromberg § 8.5, at n.17.4.
92 CCH at p. 97,181.
93 Text accompanying notes 12-14 supra.
duty to their customers, but presumably a lesser duty than to refrain from using nonpublic information.100 Merrill Lynch would face this conflict squarely if only charges (1) and (3) were made. While the SEC seems confident that the duty (under 10b-5) not to use material inside information takes priority over duties to individual customers, it remains to be seen whether a court, particularly a state court, would accept this proposition in a private action by a beneficiary against the fiduciary.

Pending clarification of the rules, a prospective underwriter of a company may well want to cut off outgoing information and comment on the company (except, of course, through the registration statement and prospectus, or to other prospective underwriters) until all material information has been adequately disclosed. As a practical matter, cutting off means keeping the information bottled up in the underwriting department and not letting it seep out to the sales force. Still safer would be to withdraw from the market in the company's securities, even on unsolicited orders, early in the underwriting negotiations. It need hardly be said that these courses of action, particularly the second, carry a substantial cost in lost business and customer disaffection. Nor do such drastic steps seem necessary if material information which comes to the underwriters is adequately safeguarded against personal use before public release.

11.3 Representative on Board of Directors. Cady, Roberts obtained its inside information on a dividend cut from one of its registered representatives who was a director of Curtiss-Wright. A recently filed stockholder suit alleges violation in a rather similar situation. A partner of Butcher & Sherrerd is charged with learning as a director of Penn Central that the railroad's 1968 earnings projections were reduced, and using this information for the firm and its clients to sell stock before a general decline in the price of the stock.101 Issues here will be materiality as well as misuse.

Cases of this kind point up the vulnerability of a broker serving on a corporate board. He is bound to obtain inside information, and the chances are good that he will be accused of misusing it if there are significant price movements or transactions in the stock. Over-the-counter dealers managed to get a market-maker exemption from the short-swing insider trading provisions of Exchange Act section 16. It is unlikely that any such exemption could be obtained from Congress or the courts from the general antifraud provisions like 10b-5.

Here, as in the underwriter situation, the alternatives are to run substantial legal risks or forego valuable business connections. The risks are more likely to recur because of the continuing director relationship, and it is probably less feasible to wall off the information he receives. Perhaps in recognition of these factors, the defendant in the Butcher & Sherrerd case resigned as a Penn Central director a few weeks after the suit was filed.102

100 Bromberg § 5.6.
101 N.Y. Times, Sept. 7, 1968, at 47, col. 3; Wall Street Journal, Sept. 9, 1968, at 6, col. 3 (Southwest ed.).
102 Wall Street Journal, Sept. 26, 1968, at 4, col. 2 (Southwest ed.).
and, only days later, members of the firm gave up all 36 directorships they held in publicly owned companies.\textsuperscript{103}

12. ANALYSTS AND INSTITUTIONAL INVESTORS

Several aspects of the TGS Second Circuit decision will affect analysts and institutional investors who traditionally rely at least in part on information obtained from issuers but not generally disseminated.

12.1 Ability To Obtain Information. TGS holds the tipping of inside material information to be a violation. Although the tipping was to individual investors, the result certainly applies to tipping to any persons for any purpose other than the business of the company generating the information.\textsuperscript{104}

The TGS decision will probably stop most private meetings between companies and analysts or institutions (unless any material information discussed is simultaneously released to the public), or limit them to routine (non-material) matters. It has been suggested that companies may give analysts and institutions nonpublic information which they would give to any serious inquirer. This seems to me unsafe in light of the TGS emphasis on dissemination of information to public investors. Of course, if the information is not material, there is no disclosure requirement. If it is material, the only prudent disclosure is a wide disclosure.

For an object lesson, the week before the Second Circuit decided TGS, the SEC sought an injunction against Glen Alden Corp. The SEC alleged that Glen Alden had held private sessions with two prospective buyers of its securities (Investors Diversified Services and Putnam Growth Fund) and an institutionally oriented broker (Carter, Berlind & Weill), giving them company and divisional sales, earnings and cash flow projections for 1968-72, acquisition plans and other material, nonpublic information. Glen Alden, denying that any securities had been bought or sold on the basis of the information, nonetheless consented to the injunction, somewhat coerced, we may surmise, by the long pendency of a registration statement which was cleared the next day.\textsuperscript{105} No relief was asked against the broker or institutions, but one can readily foresee the possibility. Indeed, a number of institutional investors are respondents in the Merrill Lynch proceeding discussed in 11.2 above.

If the TGS decision results in monetary liability of the tipper for the trades of the tippee (see 10.2 above), there will be a further deterrent to the private flow of information.

Companies may properly continue to supply information to gatherings of analysts, although the companies will probably protect themselves

\textsuperscript{103} Id. Oct. 1, 1968, at 6, col. 1.

\textsuperscript{104} One institutional investor was a tippee in the TGS case. After the press release was issued but before it was disseminated, TGS director Lamont told a bank (of which he was an officer and director) that good news would shortly be coming out on the tape. The bank made purchases for several accounts. 258 F. Supp. at 289-90. Because of Lamont's death, this part of the case was not appealed. CCH at p. 97,173 n.6.

against charges of selective disclosure by simultaneously releasing the information (often condensed for manageability) to Dow-Jones, the wire services and the press. They may mail to shareholders too. Material information may also be given to individuals or institutions, but only with the same concurrent public dissemination. Until the dissemination is complete—whenever that may be—trading by the early recipients may be a violation.

The "inside scoop" is largely a thing of the past. TGS has helped to end it by insistence on equal access—through information—to the rewards of participation in the markets.

The total flow of information, after a period of hesitation, will probably be greater than before, because of the increased emphasis on facts and on early materiality. (See 6.1, 6.2, 8.1, 8.2 above.) It will be more widely disseminated because of the dangers of selective disclosure. Analysts, then, are likely to be relegated to the area of their professed expertise: evaluation of information. They are not barred from asking questions about data already disclosed. Institutions will be in much the same position, although their market power and economies of scale will continue to operate. The SEC, in Cady, Roberts, recognized that there were no limitations on the use of "perceptive analysis of generally known facts." Later cases (including TGS) have only highlighted this proper function. There is nothing in the legal development to keep the analyst from being very selective in revealing his "perceptive analysis," i.e., only to his clients or employer.106

Leaks will, naturally, continue to occur, and information to be pumped. But the risks are large at both ends.

Perhaps the most serious open question concerning analysts (and, to some extent, institutions) is whether information, which is important to them because of their knowledge of trends, companies and industries, and because of their related evaluative ability—but which would not be important to less sophisticated investors—is material.

12.2 Liability for Use of Information. To the extent an analyst or institution obtains and uses material inside information, he or it is a tippee of the kind discussed in 10.3 and 10.4 above.

13. Private Litigation

The propositions established by TGS, and the standards used, are not technically binding on private suits. They may become so to the extent that claims by the SEC for private relief are ultimately decided in future phases of the case. Regardless of that, they will naturally be argued strongly in private litigation, and will have a highly stimulating effect on it.

Perhaps the most popular aspects of the decision for plaintiffs' lawyers will be the broad statement of information-equalization policy and the stress on accuracy in press releases. Close behind will be the holding that

106 Changes in information practices as a result of the TGS decision are comprehensively reported in Wall Street Journal, Oct. 9, 1968, at 1, col. 6 (Southwest ed.); id. Aug. 16, 1968, at 1, col. 6.
tipping is a violation, the holding that a press release has sufficient "connection" with securities to be within 10b-5 (which has already begun to influence other cases on the frontier of 10b-5 which turn on "connection"), the intimations of liability which may result for tipper and tippee, the apparently low threshold of materiality, and the discounting of good faith as a defense. Lawyers of the defense bar will find little consolation in the court's opinion.

Suits by open market buyers and sellers—charging misleading publicity—will probably be the most numerous class encouraged by the TGS decision. But shareholder derivative suits against insiders for misusing material information—by trading or tipping—will abound too, and will get aid and comfort from the opinion. Derivative suits against tippees will test the theory that they are liable to the company for misusing corporate property (information). Open market traders may sue the tippees for the same acts, claiming injury to themselves.

14. Conclusion

TGS takes antifraud securities law significantly farther along the paths traced in recent years: toward negligence and away from intentional conduct, toward misleading information and away from material fact, toward equalization of access to market rewards, and toward greater burdens for the corporate and financial community.

Far from a break with the recent past, TGS is very much of a piece with it. But the recent past is so unlike the beginning as to be almost unrecognizable. So grows the common law.