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Tenth Circuit clarifies duty to disclose preliminary merger discussions to shareholders

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On May 11, 2018, the Tenth Circuit held that an energy company and its executives had no duty to disclose preliminary merger discussions with a competing energy firm because defendants had not made any statements that were "inconsistent" with the possibility that the company was engaging in such discussions. *Emps. Ret. Sys. of Rhode Island v. Williams Cos.*, 889 F.3d 1153 (10th Cir. 2018) (Hartz, J.).

The Tenth Circuit further found that the merger discussions were not material under the probability/magnitude test set forth in *Basic v. Levinson*, 485 U.S. 224 (1988).

The merger discussions at issue took place shortly after defendants announced that the company intended to merge with its affiliate, which was majority-owned by the company. Following the announcement, plaintiffs purchased shares in the affiliate company.

Several weeks later, the competing energy firm announced that it intended to merge with the company, and that this merger would preclude the company's planned merger with its affiliate. The stock price of shares in the affiliate company subsequently dropped.

Plaintiffs brought suit alleging that they overpaid for the affiliate's shares because of defendants' failure to disclose the merger discussions with the competing energy firm. Plaintiffs also contended that defendants falsely represented that the company's merger with its affiliate "was a done deal."

The district court dismissed plaintiffs' claims, and plaintiffs appealed.

Rule 10b-5 does not impose a stand-alone duty to disclose merger discussions

The Tenth Circuit held that the company had "no duty under the securities laws to disclose the merger talks" with the competing energy firm.

The court emphasized that "Rule 10b-5 does 'not create an affirmative duty to disclose any and all material information.'" *Id.* (quoting *Matrixx Initiatives v. Siracusano*, 563 U.S. 27 (2011)).

Rather, Rule 10b-5 requires disclosure "only when necessary to make statements made, in the light of the circumstances in which they were made, not misleading." *Id.* (quoting *Matrixx*, 563 U.S. 27).

The Tenth Circuit found defendants had no duty to disclose the merger discussions at issue because defendants did not speak to the possibility that the company might merge with any entities other than, or in addition to, its affiliate company.

The court reasoned that defendants did not make any statements that were "inconsistent" with the fact that the company was engaging in merger discussions with a competing firm.

In reaching this conclusion, the Tenth Circuit found persuasive the Ninth Circuit's decision in *Brody v. Transitional Hospitals Corp.*, 280 F.3d 997 (9th Cir. 2002) and the Second Circuit's decision in *Glazer v. Formica Corp.*, 964 F.2d 149 (2d Cir. 1992).

> The court's decision makes it clear that the existence of a duty to disclose merger discussions depends on the substance and scope of the company's other disclosures.

In *Brody*, the Ninth Circuit found a company had no duty to disclose acquisition proposals when it announced its plan to buy back thousands of the company's shares. The Ninth Circuit held that the securities laws do not require "complete" disclosures because "[n]o matter how detailed and accurate disclosure statements are, there are likely to be additional details that could have been disclosed but were not."

Similarly, in *Glazer*, the Second Circuit held that "the mere fact that exploration of merger or LBO possibilities may have reached a stage where that information may be considered material does not, of itself, mean that the companies have a duty to disclose."

Merger discussions are typically not material unless the parties have evidenced 'a serious commitment to consummate the transaction'

The Tenth Circuit further held that even if defendants had a duty to disclose the merger discussions with the competing energy firm, plaintiffs "failed to adequately allege that the discussions were material."

The court explained that *Basic*'s "probability/magnitude" test governs the question of "when preliminary merger discussions

are material." This "fact-specific" inquiry requires courts to "analyze the probability that a merger will succeed and the magnitude of the transaction."

The Tenth Circuit explained that "merger discussions are generally not material in the absence of a serious commitment to consummate the transaction."

The Tenth Circuit noted that in *Jackvony v. RIHT Financial Corp.*, 873 F.2d 411 (1st Cir. 1989), a decision authored by now-Justice Stephen Breyer, the First Circuit held that merger talks were not material because there were "no concrete offers, specific discussions, or anything more than vague expressions of interest." The First Circuit reasoned that announcements of such "'tentative feelers' ... would more likely confuse, than inform, the marketplace."

Similarly, in *Taylor v. First Union Corp. of S.C.*, 857 F.2d 240 (4th Cir. 1988), the Fourth Circuit found that the merger discussions at issue were not material because they were "preliminary, contingent, and speculative." The Fourth Circuit explained that requiring disclosure of such discussions would "threaten to bury the shareholders in an avalanche of trivial information."

"Guided by these decisions," the Tenth Circuit found that plaintiffs failed to plausibly allege that, at the time of the claimed omission, the company was likely to merge with the competing energy firm. The court noted that there were no allegations of "concrete offers, specific discussions, or anything more than vague expressions of interest."

The court determined that the allegations were "fully consistent with there being no commitment whatsoever." The court also found that there were no factual allegations that investors "would reasonably view such a combination as fatal to" the company's planned merger with its affiliate.

TAKEAWAYS

The Tenth Circuit's decision in *Williams* provides some protection for companies that would prefer not to disclose preliminary-stage merger discussions before there is a realistic possibility that a transaction may occur.

However, *Williams* makes it clear that the existence of a duty to disclose merger discussions depends on the substance and scope of the company's other disclosures.

If a company has made statements that may be considered "inconsistent" with the company's engagement in such discussions, then that company may have a duty to disclose merger talks under *Williams*, even if those talks are still preliminary.

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