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# Corporate M&A Advisor

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Finance and Transactions Group

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## DISCLOSING ACQUISITION AND MERGER DISCUSSIONS TO THE PUBLIC

Early acquisition and merger discussions are almost always conducted under a shroud of secrecy. Although such negotiations are eventually made public, a public company must decide when to release that information — too soon and the deal could fall apart, or too late and the company could be accused of failing to disclose material information or of making material misrepresentations.

Since a public company generally has no duty to disclose acquisition or merger talks as long as it refrains from trading in its own stock<sup>1</sup>, most companies typically make no public announcement until a definitive agreement has been reached. Many companies have also adopted a policy of responding "no comment" to merger rumors. Adding confusion to this well-established practice in a period of heavy M&A activity, recent media reports of a late 1997 Third Circuit decision (*Weiner v. The Quaker Oats Company*) have suggested that earlier disclosure of acquisition or merger discussions may now be required and that the "no comment" corporate policies are no longer viable.

In fact, the decision in the *Quaker* case *does not* require companies to disclose acquisition and merger negotiations and the potential consequences of a successful bid much earlier in the combination process. As discussed below, while the *Quaker* decision does shed light on appropriate disclosure policies for public companies, it does not change the existing legal guidelines concerning *when* a company must disclose acquisition and merger discussions.

Under the federal securities laws, public companies have no affirmative duty to disclose material information except

in the required reports that must be filed pursuant to the Securities Exchange Act of 1934, as amended. In effect, SEC reporting requires full public disclosure of all material information on at least a quarterly basis. (Of course, stock exchange listing agreements expect prompt public disclosure of any material developments.) Once a public company speaks, whether in required periodic reporting or in an optional public statement, the company has a duty to confirm that its disclosure is accurate in all material respects and does not omit any material information. In addition, if a public company is purchasing or selling its own securities, this triggers an immediate duty to disclose all material nonpublic information.

If a duty to disclose exists, corporate information must be disclosed if it is material. In its 1976 *TSC Industries v. Northway, Inc.* decision, the United States Supreme Court found that company information is material if there is a substantial likelihood that a reasonable shareholder would consider it important in making investment decisions. The Court explained further that nonpublic corporate information is material if it would significantly alter the "total mix" of information available to shareholders. In *Basic v. Levinson*, decided in 1988, the Supreme Court specifically applied the *TSC Industries* standard to preliminary merger discussions. In measuring whether information regarding a given set of merger negotiations is material, a company must evaluate the facts surrounding the negotiations to balance the probability that the merger will occur and the magnitude of the impact that the merger would have on the company as a whole.

The *Quaker* case, decided by the Third Circuit of the United States Court of Appeals on November 6, 1997, involved a situation in which Quaker had repeatedly made public statements of corporate policies and future financial goals in its periodic filings with the SEC. From its October 1993 Annual Report and November 1993 Form 10-Q through its September 1994 Annual Report and Form 10-K, Quaker continued to cite the company's financial policy goal to increase its total debt-to-total capitalization ratio from approximately 59 percent to the "upper-60 percent" range. Without making any public disclosure, Quaker began negotiations to purchase Snapple in the spring of 1994 and commenced due diligence in connection with a merger in early August 1994. At no time prior to the November 1994 announcement of its acquisition of Snapple did Quaker modify this stated guideline or report

any information that such projected ratio was no longer relevant.

Nevertheless, to finance the Snapple acquisition, Quaker increased its debt from approximately \$1 billion to approximately \$2.7 billion, enlarging its total debt-to-total capitalization ratio to approximately 80%, which was higher than the projected range. The plaintiff shareholders maintained that during the course of merger discussions, Quaker knew that the impending purchase of Snapple would increase Quaker's total debt-to-total capitalization ratio, but did not adjust its public projections. The plaintiffs argued that the pre-Snapple financial projections kept the price of Quaker's stock inflated from August 4 (the beginning of Snapple acquisition talks) through November 1, 1994 (the day before the Snapple acquisition announcement).

Based on its duty to speak accurately, once Quaker knew that a total debt-to-total capitalization ratio in the high 60-percent range was no longer a realistic possibility, it had a duty to correct the financial projections in its disclosure documents. The *Quaker* court declared that although none of the company's financial statements were incorrect at the time of their publication, the statements were not made in isolation but with knowledge of a possible acquisition. The court determined that the statements could have induced a reasonable investor to expect either a total debt-to-total capitalization ratio in the upper 60 percent range or an announcement from Quaker regarding an anticipated change in such ratio that it had earlier predicted. Quaker argued that requiring the company to announce that it is seeking financing is equivalent to requiring the company to disclose its planned acquisition or merger. The district court agreed with Quaker, concerned that finding for the plaintiffs and requiring disclosure about plans to increase its debt load would be tantamount to requiring the disclosure of the Snapple negotiations. However, the circuit court disagreed with Quaker and reversed the district court's decision, noting it appeared that Quaker could have announced a proposed increase in the level of the company's debt without keying the public into its acquisition of Snapple. (Previously, Quaker had announced changes in a financial ratio without explicitly or implicitly leaking secret negotiations.) The circuit court remanded the case for further proceedings to determine whether Quaker's total debt-to-total capitalization ratio guideline was material to reasonable investors.

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Vedder, Price, Kaufman & Kammholz is a national, full-service law firm with approximately 180 attorneys in Chicago, New York City and Livingston, New Jersey.

The *Quaker* court did not mandate early disclosure of acquisition or merger negotiations. It indicated Quaker may not hide behind the protection of the general rule that there is no affirmative duty to disclose merger negotiations when Quaker's repeated statements of financial policy and total debt-to-total capitalization guidelines became misstatements in light of the ongoing Snapple merger negotiations. Since Quaker was required to speak in its Annual Reports and periodic securities filings, it had a duty to speak truthfully. Quaker violated such duty by not considering the consequences of the proposed Snapple acquisition on its financial policies and guidelines. If such financial policies and guidelines constituted material information, Quaker had an obligation not to misstate them despite any ongoing, secret acquisition negotiations. Disclosing information that may be untrue or misleading in the context of secret acquisition or merger discussions (and violating the duty to speak truthfully) cannot be excused by the general absence of any affirmative duty to disclose such discussions.

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Set forth below are some practical tips for public companies in the aftermath of the *Quaker* case:

- ⊘ Public companies should regularly review their forward-looking statements, including financial projections and management predictions, to ensure that such statements contain cautionary language that allows for continuing business development and growth. With every quarterly report, a company should review its statements of corporate policy, financial trends and outlook for any inconsistencies with recent developments.
- ⊘ A company with a specific acquisition strategy should consider including a general statement regarding the possible impact of an acquisition or merger on its financial condition in required disclosures.
- ⊘ Any company considering disclosing hard financial projections should carefully consider the implications of updating such projections in light of merger or acquisition activity.
- ⊘ Throughout the course of acquisition or merger discussions, a company must consistently balance the probability and magnitude of a proposed

transaction in connection with any affirmative disclosure the company is making. The company must also carefully assess the accuracy and truthfulness of all affirmative disclosures in the context of any ongoing acquisition or merger discussions.

Complex issues of fact and law must be weighed in deciding when to disclose ongoing combination discussions. Careful consideration of disclosure content and timing is crucial in the marketplace and under the securities laws. Companies should consult with their securities counsel prior to making the decision of whether or not an affirmative disclosure duty exists under the securities laws.

<sup>1</sup>We strongly advise companies involved in serious merger or acquisition discussions that have not been publicly disclosed to refrain from trading in their own stock.

[Return to Text of Article](#)

- ⌘ [Return to: Corporate M&A Advisor Index](#)
- ⌘ [Return to the Vedder Price: Publications Page.](#)
- ⌘ [Return to: Top of Page.](#)

---

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[Top of Page](#)

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