GAMES, LIES, AND SECURITIES FRAUD

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The federal securities laws prohibit companies from lying to their securityholders. However, they also prevent companies from making public statements designed to mislead other parties—in particular, parties with whom the company is negotiating or competing—even if the company has no obligation to be truthful to them. In this Article, Professor Kahan uses game theory to analyze the implications of this loss of the ability to lie from both positive and normative perspectives. On the positive side, the author demonstrates that the loss of the ability to lie empowers companies to make commitments and that such commitments can be used to companies' strategic advantage. On the normative side, the author concludes that while securities fraud liability is still appropriate for lies designed to mislead competitors, it should not be imposed for certain lies made in the context of negotiations.

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INTRODUCTION

The federal securities laws\(^1\) aim to protect investors in public companies through a comprehensive system of disclosures.\(^2\) The general anti-fraud provisions\(^3\) form an important part of this disclosure system. These provisions essentially prohibit companies from making false public statements about any important aspect of the company's affairs.\(^4\)

The anti-fraud provisions are intended to prevent companies from misleading their investors.\(^5\) However, in the course of protecting investors, the anti-fraud provisions also prevent companies from making public statements that mislead others—even if these other parties have no legal entitlement to receive truthful information from the company.

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Consequently, the securities laws have effects on the strategic interaction between companies and such third parties, which may be unintended and have frequently gone unnoticed.

This Article provides a detailed analysis of the strategic dynamic created by the operation of the federal securities laws. Earlier commentators have generally concluded that companies are handicapped when they lose the freedom to lie.6 By employing the techniques of game theory,7 this Article shows that the magnitude of the handicap which arises as a result of not being permitted to lie has been substantially overstated. More importantly, this Article demonstrates that liability for securities fraud can be exploited by subject companies to their strategic advantage—a point that has been generally overlooked. Thus, subject companies can benefit from the fact that they might be held liable for false statements.

The first aim of this Article is, therefore, positive: to show how companies can gain from the strategic use of the securities laws. The second aim is normative: to analyze whether the strategic effects of the securities laws are socially desirable; and if not, to consider whether cer-

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7 In game theory, decisions and their results are described by highly structured games in which one or more players can adopt one or more strategies, and obtain, depending on each player's strategy, a certain payoff. In games with incomplete information, the payoffs may also depend on factors other than the players' strategies. These games are commonly represented by matrixes in which one player's strategies are listed vertically, the other player's strategies are listed horizontally, and each player's payoffs (depending on both players' strategies) are tabulated in the appropriate intersection. This is called a normal-form representation of a game. See Eric Rasmusen, Games and Information: An Introduction to Game Theory 43-48 (1989).
tain "lies" should be excluded from the scope of the securities laws.

Part I begins with a taxonomy of commercial lies and their status under both the common law and the federal securities laws. Part II then focuses on the strategic dynamic under both legal regimes, emphasizing in particular the effect of the federal securities laws on lies relating to a company's negotiating or competitive strategy. Part III examines whether the strategic effects described in Part II are socially desirable, and concludes that particular categories of commercial lies should be exempted from the reach of the federal securities laws.

I

LIES

Suppose XYZ Corp. is negotiating with ABC, Inc. to buy ABC's toy division. XYZ plans a major reorientation of the toy division—it wants to replace the war games presently produced by ABC with ecological toys such as baby dolls with recyclable diapers and tropical rain forest building sets. XYZ anticipates earning huge profits, but only if it can keep its business plans secret from its competitor Toys For Us (TOFU)—the leading producer of toy cooking sets for cholesterol-free meals—until the ecological toys are ready for mass production. XYZ is willing to pay up to $32 million for ABC's toy division, but of course prefers to pay less.

At the same time, XYZ plans to raise additional funds through a public offering of its stock, and is involved in negotiations with its union over a new collective bargaining agreement. Internal financial reports show that XYZ's earnings last quarter dropped significantly, and XYZ is worried that a premature release of these reports may impede its share offering. At a board meeting, XYZ's management decides that it would settle for a 5% to 8% wage increase rather than endure a strike.

During the course of these events, XYZ issues the following press releases:

"We just made an offer of $25 million for ABC's toy division. This is our final and highest offer."
"We are looking forward to acquiring ABC's toy division and plan to continue its focus on producing war games."
"The company has rejected the union's demand for an 8% wage increase. An 8% wage increase is absolutely out of the question, and would seriously endanger the company's economic survival. The company recommends that its employees accept the company's offer of a 5% wage increase. Otherwise, a strike is inevitable."
"In our last quarter, we experienced a slight increase in earnings."

Each statement is false. XYZ is willing to pay up to $32 million for the toy division if necessary; it plans to phase out the production of war
games; it would be willing to accept the union’s wage demand before countenancing a strike; and its earnings last quarter declined.

Each statement is also designed to benefit XYZ through a deception. XYZ’s statement that it is unwilling to pay more than $25 million is meant to induce ABC to accept XYZ’s offer. The statement regarding XYZ’s plan to produce war games is meant to sidetrack XYZ’s competitor TOFU. XYZ’s announcement on its earnings is aimed at increasing the price investors are willing to pay for XYZ’s newly issued shares. And XYZ’s rejection of the union offer is aimed at convincing its employees to settle for a lower increase in order to avert a strike.

Yet one’s intuitive assessment of these “lies” may be widely different. The misrepresentation made in the course of negotiations over the toy division does not feel like a “real lie,” but merely a standard bargaining move—an implied threat to leave the table if one’s offer is not accepted—which the seller of the toy division would be foolish to take at face value. Similarly, the misrepresentation relating to XYZ’s future plans might be regarded as a lie, but one that is nevertheless permissible or justifiable between competitors in the morals of a competitive marketplace. However, the misrepresentation regarding XYZ’s earnings may be viewed as crossing the line, because XYZ would be intentionally misrepresenting its financial status in order to sell its stock for a higher price.

Building upon these intuitive distinctions between different types of misrepresentations, Section A of this Part develops a taxonomy of commercial lies. Sections B and C then discuss the extent to which different categories of commercial lies give rise to liability under the common law and under the federal securities laws.

A. A Taxonomy of Commercial Lies

Commercial lies can be differentiated along two dimensions: audience and subject matter. As used in this Article, the phrase “audience of a lie” refers exclusively to the persons that are meant to be misled by the lie, even if the lie incidentally misleads other parties as well. That is, the fraudulent intent of the speaker, rather than the misleading effect, determines the audience of a lie. Assume, for example, that XYZ overstates its earnings for the sole purpose of obtaining better terms on a bank loan, but also incidentally induces some investors to purchase XYZ stock. For purposes of the taxonomy in this Article, only XYZ’s bank would constitute an audience of XYZ’s lie.

A wide range of different audiences could be the target of commercial lies. For instance, in addition to deceiving creditors and investors, statements inflating or minimizing earnings could be aimed at suppliers to convince them to lower their prices, at employees to convince them to
accept wage reductions, at governmental agencies to divert them from beginning regulatory action, or at potential competitors to divert attention from profitable product lines. It is, therefore, helpful for analytical purposes to divide these audiences into two categories. The first includes parties with whom the company or management has (or plans to have) a contractual or similar commercial relationship. These parties are referred to as the company’s “transactees,” and include the company’s suppliers, employees, and securityholders. Lies addressed to such parties will commonly relate to the terms of the commercial relationship between them and the company.\(^8\)

The second category includes parties with whom the company has no such relationship. This category is roughly equivalent to the class of persons with whom the company competes on some level, and may include competitors in the company’s product market or entities which buy the same supply goods. For that reason, parties who fall into this category will be referred to generically as the company’s competitors, even though the category includes non-traditional competitors and excludes competitors to the extent that they have a contractual relationship with the company and the lie relates to this relationship (making such competitors “transactees” in this taxonomy). In general, lies addressed to these competitors attempt to insulate the company’s relationship with third parties from the competitors’ interference.

Each of XYZ’s false statements fits easily within this scheme. XYZ’s “final” offer of $25 million for the toy division, XYZ’s inflated quarterly earnings, and XYZ’s “final” offer of a 5% wage increase are all addressed to parties (a potential seller, investors, and employees) with whom XYZ has or plans to have a commercial relationship. Each statement is designed to get XYZ better terms in its relationship with the respective transactees. In contrast, XYZ’s statements about its strategic plans are addressed to XYZ’s competitor, TOFU. By misleading TOFU, XYZ seeks to protect the profits it expects from selling a novel line of toys to ecologically conscious parents.

In addition to audience, commercial lies can be distinguished on the basis of the subject matter being misrepresented. For instance, a company may misrepresent its revenues, its product quality, or its future business plans. It is again helpful to divide these subject matters into two categories: misrepresentations relating to the terms on which the company is willing to enter into a relationship with the audience of the lie, and all other types of misrepresentations.\(^9\)

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\(^8\) For example, the company may seek to influence the price of raw materials in a contract to purchase such materials from a supplier, the price at which managers buy or sell stocks in or bonds of their company, or the price for which the firm’s assets are sold.

\(^9\) For a more general treatment of the use of lies and deception in negotiations, see Geof-
XYZ's $25 million offer for ABC's toy division is a misrepresentation about XYZ's willingness to enter into a contract to purchase the division. By pretending that it is not willing to make a better offer, XYZ seeks to induce ABC to accept $25 million for the toy division. In contrast, XYZ's misrepresentation about its earnings relates to a subject matter other than XYZ's willingness to sell stock, and thus falls in the second category.

Combining the dimensions of audience and subject matter yields a matrix of commercial lies. First, a lie could misrepresent to transactees one's willingness to enter into a business relationship with them. I will refer to such lies as negotiatory lies since they tend to be a component of one's negotiation strategy.

Second, a lie could be addressed to transactees but misrepresent some other subject matter relevant to the relationship, such as the quality of a product to be sold to a buyer. I will refer to such lies as substantive lies.\(^{10}\)

Third, a lie could be addressed to a competitor. By definition, such a lie must concern a subject matter other than the company's willingness to enter into a relationship with the competitor. I will refer to such lies as competitory lies.\(^{11}\)

Some statements may, of course, fall into more than one category; and, in some instances, categorizing a particular statement may be difficult. Take, for example, XYZ's assertion that "an 8% wage increase is absolutely out of the question and would seriously endanger the company's economic survival." The claim that XYZ would not be willing to settle with its employees for 8% would be a negotiatory lie addressed to XYZ's employees. But, at the same time, XYZ may conceivably aim at misleading its shareholders about the likelihood of a strike, in which case the statement would also constitute a substantive lie addressed to share-
holders (since the lie does not mislead shareholders about XYZ's willingness to enter into a transaction with them). The second element of the statement, that an 8% wage increase would put XYZ's economic survival at risk, would seem to be a misstatement of XYZ's financial position to its employees, and thus (another) substantive lie addressed to the employees.

Nevertheless, it is useful for the moment to ignore difficulties in categorizing borderline statements, and to focus instead on the strategic effects of liability at common law and under the federal securities laws. The implications of the practical difficulties in differentiating between these categories will be revisited in Part III.

B. Liability for Commercial Lies

The treatment of commercial lies under the common law is fundamentally different from their treatment under the federal securities laws. As this Section will show, the common law sanctions neither negotiatory nor competitive lies, although both can constitute fraud under the federal securities laws.

I. Under the Common Law

Two major doctrines of law create liability for commercial lies: fraud and breach of warranty. A prima facie claim for fraud requires that the plaintiff show that the alleged deceiver knowingly made a material misrepresentation for the purpose of inducing the plaintiff to act (or refrain from acting) and that the plaintiff suffered a loss by so acting in justifiable reliance on the misrepresentation. A claim for breach of warranty requires the plaintiff to show that the defendant violated the terms of an express or implied contractual warranty.

Under the common law, substantive lies can generally support actions for fraud or breach of warranty. Take, for instance, XYZ's misrepresentation about its earnings. If investors buy XYZ stock in actual reliance on XYZ's misstatement, their later fraud claim would likely succeed: XYZ knowingly misrepresented its earnings (which are presumably material to the value of XYZ stock) for the purpose of inducing investors to purchase such stock, the investors justifiably relied on the earnings statement, and they suffered damages from overpaying for the stock. Alternatively, investors could ask XYZ to warrant that its finan-

12 Restatement (Second) of Torts §§ 525, 526, 538 (1977).
14 See, e.g., Equitable Life Ins. Co. of Iowa v. Halsey, Stuart & Co., 312 U.S. 410 (1941) (finding that misrepresentation in sale of securities constituted common law fraud); Moresh v. McMonagle, 385 F. Supp. 888 (S.D.N.Y. 1974) (holding that false statement by partnership to investor that partnership had 12 other members who had each contributed $50,000 constituted
cial statements fairly represent XYZ's financial condition, or that XYZ has no knowledge of any material adverse developments. If these representations are false, the investors will be able to recover damages based on their contract with the company. In either case, the investors could get sanctionable assurances from XYZ that it did not lie about its earnings.

However, competitors will find it difficult or impossible to establish a successful fraud or breach of warranty claim. This is because such parties can prove neither justifiable reliance on, nor privity of contract with, the company. As such, liability for competitive lies at common

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15 Such warranties are commonly included in bank credit agreements. See, e.g., Credit Agreement among RJR Holdings Corp., various subsidiaries, and Banker's Trust Company et al., dated Jan. 31, 1989, § 6.11 (warranty that financial statements had been prepared in accordance with Generally Accepted Accounting Principles, that there had been no material changes, and that the company, except as reflected in financial statements, was not aware of any basis for assertion of liability which would be material) (on file with the New York University Law Review).

16 See, e.g., Valente, Inc. v. Mascitti, 295 N.Y.S. 330, 334-36 (Rochester City Ct. 1937) (holding that seller's claim that radio could receive transmissions from Rome constituted warranty, and buyer entitled to recover purchase price).

17 It is important to note, however, that substantive lies will not automatically create liability for fraud or breach of warranty. Assume, for example, that XYZ's union relied on XYZ's financial statements in approving a collective bargaining agreement, but failed to get appropriate assurances from XYZ that the financial statements are accurate. In that case, the union may not be able to bring a claim against XYZ.

18 The notion of justifiable reliance contains an element of circularity. If one knows the existing legal rules on justifiable reliance, one would be justified in relying on the accuracy of exactly those (and only those) statements which would, if false, give rise to a fraud claim, i.e. on statements which justify reliance under the existing rules. To avoid such circularity, justifiable reliance must have a reference point outside of the legal rules of reliance themselves. This reference point may be derived from an economic analysis of the efficient level of reliance. See Jim Leitzel, Reliance and Contract Breach, 52 Law & Contemp. Probs. 87, 89 (Winter 1989). Or it may be derived from some commercial practice of reliance that is at least to some degree independent of the legal rules on justifiable reliance. See Richard Craswell, Contract Law, Default Rules, and the Philosophy of Promising, 88 Mich. L. Rev. 489, 500 n.30 (1989) (arguing that reliance is often commercially reasonable even if not protected by legal rule); see also David Charny, Nonlegal Sanctions in Commercial Relationships, 104 Harv. L. Rev. 373, 398-403 (1990) (non-legal sanctions affect parties' behavior); Stewart Macaulay, An Empirical View of Contract, 1985 Wis. L. Rev. 465, 467 (asserting that business culture determines actions of parties to contract to greater extent than do legal rules); Stewart Macaulay, Non-Contractual Relations in Business: A Preliminary Study, 28 Am. Soc. Rev. 55, 60 (1963) (discussing commercial practice in paper industry to include pricing clause in contract even though it is known that clause is unenforceable). Thus, legal rules on justifiable reliance would both follow and determine commercial practice of reliance.

19 Competitors could enter into a contractual relationship for the sole purpose of warranting competitive statements. For instance, XYZ could contract with TOFU that it will pay TOFU $50 million in damages if it starts producing ecological toys. In many instances, however, such contracts would violate the antitrust laws. See United States v. Topco Assoc., 405
law is essentially nonexistent.

Transactees encounter similar difficulty when attempting to seek redress for negotiatory lies under the common law. Statements such as XYZ's announcement that its $25 million offer for the toy division is final are frequently described as mere sales talk, or "puffing," which in the words of Prosser should "be discounted . . . and on which no reasonable man would rely." Moreover, even if ABC were entitled to rely on XYZ's statement and accepted XYZ's offer in such reliance, or if ABC obtained a warranty that XYZ's $25 million offer was indeed its highest, ABC would find it difficult to prove that the statement by XYZ was false or the warranty was breached. To do so, ABC would have to present evidence that XYZ would have made a higher offer had ABC rejected the $25 million bid. Absent unusual circumstances, efforts to obtain such evidence of XYZ's subjective intent would likely be futile.  

U.S. 596, 608 (1972) (holding that agreements among competitors to allocate market are illegal per se).

20 William L. Prosser & Page Keeton, The Law of Torts, § 109, at 757 (1984); see also The Sample, Inc. v. Pendleton Woolen Mills, Inc., 704 F. Supp. 498 (S.D.N.Y. 1989) (finding that manufacturer advertisement of "relationships that last a lifetime" constituted puffing and could not reasonably be relied upon as obligation not to terminate a retailer's account without good cause); W. Prosser & P. Keeton, supra, at 758 (stating that there is no justifiable reliance on value statements); Ian Ayres & F. Clayton Miller, "I'll Sell It To You At Cost": Legal Methods to Promote Retail Markup Disclosure, 84 Nw. U. L. Rev. 1047, 1049-55 (1990) (discussing common law rule that misrepresentations of retailer's costs or markups are immaterial or, alternatively, that reliance on such statements is unreasonable).

It is sometimes stated that fraud requires a duty by the alleged deceiver to the defrauded. See, e.g., Verschell v. Pike, 445 N.Y.S.2d 489 (App. Div. 1981) (finding no fraud where, in negotiation of separation agreement, wife's attorney falsely stated that lease complied with zoning ordinance); Srob v. Raymount Realty, Inc., 313 N.Y.S.2d 83 (App. Div. 1970) (holding there can be no fraud without breach of some legal or equitable duty); Steinberg v. Guild, 258 N.Y.S.2d 670 (App. Div. 1965) (finding no breach of duty to future limited partners where seller falsely represented income and operating expenses of property sold to partnership); Cummings v. Kaminski, 290 N.Y.S.2d 408 (Sup. Ct. 1968) (finding no breach of duty to decedent's wife where decedent's lover falsely induced life insurance company to pay policy proceeds to her). This duty analysis seems to be the functional equivalent of a "reasonable reliance" analysis; that is, to say that there is no duty is equivalent to saying that reliance is not reasonable.

21 If ABC did not accept XYZ's offer, it would not be able to prove that it relied on the statement and suffered damages. See Restatement (Second) of Torts § 537 (1977) (stating that recovery for fraudulent misrepresentation requires actual reliance). ABC would also not be helped if it obtained such a warranty before accepting XYZ's offer. At that point, ABC would like to get a higher price for its toy division, and the last thing it is interested in is obtaining a binding promise from XYZ that it will not make or accept a higher offer.

22 The best proof that ABC could adduce would be an admission by XYZ officials that they intended to make a higher offer if their $25 million offer were rejected. To be sure, occasionally a company's records may contain such evidence. But with careful planning and good legal counsel, a company can easily assure that its records support a warranty. Note, however, that since XYZ's statement on wage increases contains substantive elements, a union could get an effective warranty, such as a warranty of profit forecasts showing that XYZ would suffer substantial losses if wages were increased by 8%. Without these substantive elements, a mere
In sum, at common law, neither transactees nor competitors can obtain enforceable assurances that negotiatory or competitory statements are indeed true.

2. Under the Federal Securities Laws

The federal securities laws impose a number of disclosure obligations on publicly traded companies and certain other persons subject to these laws. Disclosure statements that must be filed pursuant to these provisions, of course, may not contain any materially false statements. Moreover, Rule 10b-5 prohibits the making of "any untrue statement of a material fact . . . in connection with the purchase or sale of any security." Rule 10b-5 applies to all corporate communications, and not just to materials filed with the SEC; thus, a press release or an oral statement by a corporate executive can give rise to a violation of the anti-fraud provisions of the federal securities laws.

The elements of a securities fraud claim superficially resemble the elements of common law fraud: in brief, and without regard to a number of details significant in other contexts, a plaintiff must show that the defendant has misrepresented a material fact with some degree of intentionality ("scienter"), that the plaintiff purchased or sold a security in justifiable reliance on the misrepresentation, and that the plaintiff suffered damages as a result. As in the case of common law fraud, the test for whether a fact is material is basically economic, and turns on whether a reasonable investor would consider the misrepresented information significant.

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26 See Basic Inc. v. Levinson, 485 U.S. 224, 227 n.4 (1988) (finding press release relating to merger negotiations provided basis for liability under Rule 10b-5); Sprayregen v. Livingston Oil Co., 295 F. Supp. 1376 (S.D.N.Y. 1968) (describing prediction of increased earnings at meeting with securities analysts as basis for liability under Rule 10b-5). See generally 1 Alan R. Bromberg & Lewis D. Lowenfels, Securities Fraud & Commodities Fraud § 1.1 (1991) (discussing different kinds of corporate communications to which Rule 10b-5 has been applied).


28 See Basic, 485 U.S. at 240-41 (outlining standard of materiality); Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2757-59 (1991) (holding that materiality standard applies with equal force to statements of motivation, opinion or belief); cf. Restatement (Second) of
But in spite of this surface similarity, the doctrinal elements of securities fraud have developed in a manner which allows companies to be subject to liability for competitory and negotiatory lies. One major development has been the erosion of the requirement of reliance. To show "reliance" under the securities laws, plaintiffs do not even have to prove they heard or learned of the misstatement and, a fortiori, need not show that they relied on the misstatement in any conventional sense. Rather, such plaintiffs can assert they relied on "the integrity of the stock market," which means that they must only show the misstatement influenced the stock price.

A second difference between the common law and the federal securities regime is that a misstatement can create liability for an issuer when the issuer did not intend to defraud its securityholders, did not trade in its shares, and did not otherwise profit from the misstatement. Indeed, the Supreme Court has held that even though a misstatement is in the best interest of shareholders as a group, the issuer can still be liable to individual shareholders who suffered losses in trading their securities.

Thirdly, in the context of securities fraud, little weight is given to arguments that misstatements are mere "puffing" and that shareholders should have known better than to give credence to them. Courts have repeatedly stated that the purpose of the securities laws is to protect unsophisticated investors. As the SEC explained:

The concept of "puffing" is derived from the doctrine of caveat emptor and arises primarily in the sale of tangibles where it appears that exam-

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Torts § 538 (1977) (stating that facts are material if reasonable person would attach importance to their existence in determining her course of action).


Basic, 485 U.S. at 241-49. To be sure, Basic creates merely a presumption of reliance that can be rebutted, for example, by showing that the plaintiff was aware that the subject statement was false or that the plaintiff would have sold the securities even if she had known that they are mispriced due to the misstatement. Id. at 248-49. But given the standards for rebuttal announced in Basic, defendants will rarely succeed in doing so.

In Basic, the Court acknowledged in the abstract that premature disclosure of merger discussions might injure the company and most of its shareholders, but dismissed this issue as irrelevant to whether the company had violated Rule 10b-5. See Basic, 485 U.S. at 235.

ination by the purchaser may offset exaggerated statements and expressions of opinion by the salesman. It can have little application to the merchandising of securities.\(^{33}\)

Not surprisingly, a leading treatise on the securities laws concludes that “the ‘puffing’ concept in the securities context has all but gone the way of the dodo.”\(^{34}\)

Finally (as in modern common law), the concept of “material fact” has been greatly expanded. Material fact does not only encompass “hard” historic information, but also includes opinions and beliefs, forecasts, estimates and predictions, and intentions.\(^{35}\) Thus, the mere fact that a misrepresentation concerned soft, forward-looking information will not take it out of the realm of misstatements of material fact.

Thus, there is little doubt that companies face securities fraud liability for competitive lies as long as the materiality threshold has been met. As discussed above, competitive lies differ from other types of misstatements, in that the company intends to deceive competitors, not shareholders, and in that such deception may be in the best interest of shareholders as a group.\(^{36}\) Exactly these arguments against the sanctioning of competitive lies have, however, been rejected as irrelevant by the Supreme Court.\(^{37}\)

Though courts have not directly addressed the issue, it is likely that material negotiatory lies would equally subject companies to securities fraud liability. It is particularly likely that liability would be imposed in the context of negotiatory lies addressed to securityholders. Such lies could, for example, relate to an acquirer’s willingness to increase the amount it will pay to shareholders of the target firm in a tender offer,\(^{38}\) or to a company’s willingness to increase the amount paid to its bondhold-


\(^{34}\) See L. Loss, supra note 27, at 717.

\(^{35}\) See Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2749, 2757-59 (1991) (holding statement by directors that they believed merger consideration constituted high value for shares to be material); Wilson v. Great American Industries, Inc., 855 F.2d 987, 992 (2d Cir. 1988) (finding failure to disclose intention to raise $1.8 million by selling bonds material); Flynn v. Bass Bros. Enter., 744 F.2d 978 (3d. Cir. 1984) (holding that appraisals of share value may be material); SEC v. MacDonald, 699 F.2d 47, 50 (1st Cir. 1983) (finding material a failure to disclose possibility that agreement on important lease may be reached); Sonesta Int’l Hotels Corp. v. Wellington Assoc., 483 F.2d 247, 253-54 (2d. Cir. 1973) (holding failure to disclose possibility that stock may be delisted material).

\(^{36}\) See text accompanying notes 8-11 supra.

\(^{37}\) See Basic Inc. v. Levinson, 485 U.S. 224, 234-35 (1988) (holding that supposed benefits of secrecy are irrelevant to case involving misrepresentation); see also Kaufman, supra note 29, at 75-78 (concluding after review of case law that, to establish liability, it is sufficient to show injury from a purchase or sale of a security by defendant’s material misstatement).

ers in a tender offer or consent solicitation. Lies in this setting are likely to be material since they directly relate to payments to be received by securityholders. The amount of such payments is almost by definition significant to a reasonable investor. Moreover, the fact that such lies are addressed to securityholders—the very group for whose protection the securities laws were enacted—may lead courts to dismiss any doubts over the applicability of the federal securities laws in this setting.

If the securities laws are violated, the resulting liability can be substantial. Depending on whether the misstatement inflated or depressed the share price, the company would be liable in private suits by securityholders who purchased or sold the company's securities in the time frame following the misstatement and prior to any correction. Such securityholders would be entitled to damages measured by the difference between the value of their securities if the company had told the truth and the price they actually paid or received. In the case of sellers, damages may also include any increases in the market value of the security after the sale. Furthermore, the company might be liable for civil penalties in an action brought by the SEC, or criminal fines in an action by the Department of Justice. The company would, of course, have to bear

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39 In bondholder consent solicitations, companies try to obtain bondholder consent to changes in the agreement governing the bonds. In such solicitations, companies frequently offer consenting holders a consent payment. See Marcel Kahan & Bruce Tuckman, Do Bondholders Lose From Junk-Bond Covenant Changes? (1992) (working paper, on file with the New York University Law Review).
40 Cf. Coopers & Lybrand v. Livesay, 437 U.S. 463, 476 (1978) (noting that securities fraud class actions may involve substantial damage liability and litigation costs and that plaintiffs can obtain generous settlements); see also Jonathan M. Moses & Milo Geyelin, RJR to Pay $72.5 Million to Settle Suit, Wall St. J., Feb. 26, 1992, at B8 (reporting that company had paid total of about $125 million to settle shareholder suits alleging violation of disclosure provisions).
41 See Michael J. Kaufman, No Foul, No Harm: The Real Measure of Damages Under Rule 10b-5, 39 Cath. U. L. Rev. 29, 130 (1991). Assume, for example, that Alpha Inc., in its tender offer for shares of Beta Inc., announces that it will not raise the price offered for Beta beyond $20 per share. If Alpha later on raises the price to $25 per share, and Beta shareholders in the meantime sold 1 million shares for $20, Alpha would have to pay $5 million in damages. See also Bradford Cornell & R. Gregory Morgan, Using Finance Theory to Measure Damages in Fraud on the Market Cases, 37 UCLA L. Rev. 883 (1990).

It is significant to note that the damages suffered by these securityholders do not reflect social losses resulting from the securities fraud. Rather, any damages suffered by investors who bought the securities at too high a price are offset by gains to investors who sold the securities at too high a price. See Kahan, supra note 2, at 1018; see also Paul G. Mahoney, Precaution Costs and the Law of Fraud in Impersonal Markets, 78 Va. L. Rev. 623, 636 (1992) (arguing that fraud on the market theory is inefficient since it awards damages in excess of social losses).
42 See Gerstle v. Gamble-Skogmo, Inc. 478 F.2d 1281, 1306 n.27 (2d Cir. 1973) (measuring damages based on accreted value up to reasonable time after discovery of fraud); Janigan v. Taylor, 344 F.2d 781, 786-87 (1st Cir.), cert. denied, 382 U.S. 879 (1965) (measuring damages on the basis of accreted value).
its own litigation expenses as well as the expenses of the private plaintiffs in some cases.\textsuperscript{43} Finally, the company may suffer reputational losses associated with having been found to have committed securities fraud, and the stock exchange on which the company's securities are listed may independently impose sanctions.\textsuperscript{44}

Liability would be even higher if the company, or one of its officers, bought or sold stock after making the misstatement.\textsuperscript{45} In that case, the SEC may recover treble damages,\textsuperscript{46} and the likelihood of criminal sanctions would be significantly higher. Furthermore, a "pattern" of repeated violations of Rule 10b-5 may give rise to liability under the Racketeer Influenced and Corrupt Organizations Act (RICO).\textsuperscript{47} If RICO is violated, defendants face the possibility of criminal fines, imprisonments, and forfeitures; in addition private plaintiffs would be able to recover treble damages and attorneys' fees.\textsuperscript{48}

Thus, competitory and negotiatory lies may result in substantial liability under the federal securities laws while being totally unsanctioned by the common law. The consequences of the differing treatment of these lies under the common law and the securities laws are explored in the following Part.

II
THE STRATEGIC IMPLICATIONS OF LIABILITY FOR NEGOTIATORY AND COMPETITORY LIES

The fact that liability for certain commercial lies will attach under the federal securities laws but not under the common law allows us to examine the impact of such liability on the behavior of companies. This Part supplies a detailed analysis of the effects of negotiatory and competitory statements on the company, its transactees, and its competitors.

A. The Effect of No Liability

Under common law, companies do not face liability for negotiatory

\textsuperscript{43} See generally Securities Exchange Act of 1934, §§ 9(e), 18(a), 15 U.S.C. §§ 78i(e), 78r(a) (1988) (stating that attorney's fees may be awarded if false statements are contained in report filed with the SEC or in cases of intentional manipulation); 5 A. Bromberg & L. Lowenfels, supra note 26, § 9.3, at 231.2-.3 (discretion of court to award attorney's fees in securities fraud class actions).

\textsuperscript{44} See, e.g., American Stock Exchange, Inc., Listing Standards, Policies & Requirements, § 1003(d) (1992) (providing that exchange may suspend trading or delist companies that violate exchange's disclosure provisions).


\textsuperscript{47} 18 U.S.C. §§ 1963-64.

\textsuperscript{48} 18 U.S.C. §§ 1961-68.
and competitory lies. From the perspective of the audience of a commercial lie, this means there is less reason to trust the accuracy of negotiatory or competitory statements. From the perspective of the speaker, it means that it is more difficult to make negotiatory and competitory statements that will be believed.\footnote{See, e.g., Steven C. Salop, Strategic Entry Deterrence, 91st Am. Econ. Ass'n Papers & Proceedings 335 (1979) (asserting that to affect strategic behavior, commitment must be credible); Schelling, supra note 9, at 299-301 (noting the importance of ability to be sued).}

The strategic implications of this state of affairs are illustrated in Diagrams 1 and 2. Assume for simplicity the following bargaining structure. Both ABC and XYZ know that if ABC does not sell the division to XYZ, ABC values its best alternative (which may be either keeping the division or selling it to another company) at $20 million. Only XYZ knows whether it assigns a “high” value of $32 million or a “low” value of $26 million to the toy division. ABC can adopt one of two strategies: accept XYZ’s $25 million offer, or reject it and make a $30 million counteroffer. XYZ also has a choice between two strategies: accept ABC’s counteroffer if ABC makes one, or reject the counteroffer. If ABC makes a counteroffer but XYZ rejects it, the bargaining “game” ends, and ABC does not sell the toy division to XYZ.\footnote{Obviously, the structure of this game is highly simplified. In reality, ABC could make a counteroffer at different levels, XYZ’s potential valuations of the toy division will cover a wider spectrum, and XYZ could respond to a counteroffer with a new offer. Still, the simplified structure of the game captures the essential elements of bargaining: the choice between accepting an offer or holding out for a better one, and the danger that if one holds out too long, one may jeopardize the entire deal.}

As Diagrams 1 and 2 indicate, ABC’s and XYZ’s potential profits depend on XYZ’s valuation of the toy division and each side’s strategy. If ABC’s strategy is to agree to sell the toy division for $25 million, it would earn a $5 million profit and XYZ would earn $7 million or $1 million, depending on whether its valuation of the division is high or low (left boxes).\footnote{ABC’s profits are $25 million less the $20 million value of the toy division to ABC. XYZ’s profits are $32 million or $26 million, respectively, less the $25 million price paid.} ABC and XYZ would earn these payoffs irrespective of XYZ’s strategy. If ABC’s strategy is to make a counteroffer of $30 million, the payoffs depend on XYZ’s valuation of the division and on XYZ’s strategy. If XYZ’s strategy is to accept the counteroffer, ABC would earn $10 million and XYZ would, depending on its valuation of the toy division, earn $2 million or lose $4 million (bottom right boxes).\footnote{If XYZ values the toy division at only $26 million, buying it for $30 million would, relative to not buying it, generate a loss of $4 million.} If XYZ’s strategy is to reject the counteroffer, ABC will not sell the toy division to XYZ, and ABC and XYZ will both earn a payoff of 0 (top right boxes). Accordingly, it would pay for XYZ to accept ABC’s counteroffer if it assigned a high value to the toy division, but it would
ABC's and XYZ's situation presents a dynamic game of incomplete information. Dynamic games are those in which the players move sequentially (i.e., ABC first accepts or rejects the offer, then, if appropriate, XYZ decides whether to accept or reject the counteroffer). See Jean Tirole, The Theory of Industrial Organization 424 (1988). Games with incomplete information are games in which a player does not know the other player's characteristics. In our example, ABC does not know whether XYZ attributes a high or a low value to the division.

The normal (i.e., matrix) form presentation of a dynamic game is somewhat misleading, since this form hides the game’s sequential structure. Nevertheless, in order not to confuse any reader with little exposure to game theory, the games here are presented in the more accessible normal form, rather than in the more complex extensive form.
contrary if it attributed a high value to the toy division, and ABC would receive a profit of $10 million. But if XYZ attributes only a low value to the division, it would reject ABC’s $30 million counteroffer, and ABC would earn nothing. If ABC knew XYZ’s valuation of the toy division, its choice of strategy would be easy. Alas, ABC has no reason to trust statements by XYZ that it will not pay more than $25 million, since ABC knows XYZ could make such a statement even if it actually attributed a high $32 million value to the division.54

From XYZ’s perspective, the situation is no better. Since ABC may not believe XYZ’s statement, ABC may reject the $25 million offer. But if XYZ really was unwilling to pay more than $25 million for the toy division, the sale of the toy division may fall through—an undesirable result which could have been avoided if XYZ could have convinced ABC that it would not make a higher offer.

XYZ’s competitive statement that it will expand its war game production yields a similar dynamic between it and TOFU. Assume that, if XYZ indeed continues to produce war games, it is assured profits of $5 million independent of whatever strategy TOFU adopts. On the other hand, if XYZ introduces ecological toys notwithstanding its statement to the contrary, its profits depend on TOFU’s strategy. If TOFU continues producing traditional toys (conventional strategy), XYZ will earn $7 million; if TOFU explores new product lines (innovative strategy), XYZ will earn only $1 million. If XYZ sticks with war games, TOFU would either earn $10 million with a conventional strategy or $7 million with an innovative one; if XYZ moves to ecological toys, TOFU earns $3 or $5 million.55 Both XYZ and TOFU must decide on their strategies without knowing the strategy picked by their competitor.

Both XYZ and TOFU will therefore try to outguess each other. If XYZ did not lie and continues producing war games, TOFU is better off pursuing a conventional strategy; but if TOFU pursues a conventional strategy, XYZ is better off producing ecological toys. If XYZ produces ecological toys, TOFU is better off pursuing an innovative strategy, and if TOFU pursues an innovative strategy, XYZ would be better off pro-

54 ABC’s optimal strategy depends on the probability that XYZ attributes a high value to the division. If ABC is risk neutral, ABC should reject XYZ’s offer if it estimates that probability to be more than 50% and accept it if it estimates that probability to be less than 50%. Such a strategy would be a Bayesian equilibrium strategy for ABC. See E. Rasmusen, supra note 7, at 56-60.

55 In game theoretic usage, Diagram 3 presents a static game with complete information. Static games are games in which the players move simultaneously (i.e., both XYZ and TOFU simultaneously decide what to produce and what strategy to pursue). See J. Tirole, supra note 53, at 424. In a game with complete information all players know for certain everyone’s payoff in each outcome. See id. at 432.
Diagram 3

Competitive Statement—No Fraud Remedy

<table>
<thead>
<tr>
<th>XYZ's strategy</th>
<th>TOFU's strategy</th>
<th>Conventional Strategy</th>
<th>Innovative Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Produce War Games</td>
<td>5</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Produce Ecological Toys</td>
<td>7</td>
<td>3</td>
<td>1</td>
</tr>
</tbody>
</table>

XYZ's payoff

TOFU's payoff

Again, such a guessing game would not arise if XYZ would be bound by its stated plans to produce war games.

B. The Effect of Liability

Under the federal securities laws, companies can be liable for competitive or negotiatory lies even if the company's securityholders were not an audience of the lies. This section explores the effects of such liability on the interaction between a company, its transactees, and its competitors.

1. Liability for Negotiatory Lies

a. Negotiatory Statements as Commitments. The main impact of subjecting negotiatory lies to liability is to provide companies with the

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56 In game theoretic terminology, the game in Diagram 3 has no pure strategy Nash Equilibrium. In a Nash Equilibrium, no player would want to change its strategy given the other player's actions. A pure strategy is a strategy in which each player's choice is certain (rather than randomized). See E. Rasmusen, supra note 7, at 69-73. Here, there is no pure strategy Nash Equilibrium since in each of the four boxes, either XYZ or TOFU would want to change its choice. (For example, in the War Games/Conventional Strategy box, XYZ would want to move to the Ecological Toys/Conventional Strategy box.) There is, however a mixed strategy Nash Equilibrium in which TOFU pursues a conventional strategy with a \(\frac{2}{3}\) probability and XYZ produces war games with a \(\frac{1}{3}\) probability. If TOFU pursues a conventional strategy with a \(\frac{2}{3}\) probability, XYZ's expected payoff of producing war games and of producing ecological toys \((\frac{2}{3} \cdot 7 + \frac{1}{3} \cdot 1)\) is both 5. If XYZ produces war games with a 40% probability, TOFU's expected payoff from pursuing either a conventional \((40\% \cdot 10 + 60\% \cdot 3)\) or an innovative strategy \((40\% \cdot 7 + 60\% \cdot 5)\) is 5.8. Thus, neither player would want to change its randomized strategy. But if XYZ's probability to produce war games were higher (lower) than 40%, TOFU would always want to pursue a conventional (innovative) strategy; and if TOFU's probability of pursuing a conventional strategy were higher (lower) than \(\frac{2}{3}\), XYZ would always want to produce ecological toys (war games).
means to make credible negotiatory commitments. As discussed above, negotiatory statements suffer from an inherent lack of credibility: the other party to the negotiation will know that the company has an incentive to make such statements whether or not they are true. This lack of credibility makes negotiatory statements largely ineffective.\footnote{Cf. Schelling, supra note 9, at 282-84. Schelling defines a commitment as a contingent transfer cost (inhere as a contingent obligation to make a payment if the company makes a higher offer). For a commitment to be effective, it must be difficult to bring the parties to which such transfer is made into the negotiation. For that reason, a commitment, say, to pay a friend $10 million if one makes a higher offer would not be effective. Subjecting oneself to $10 million securities fraud liability, however, would be effective since such liability runs to a large class of securityholders and to the government.}

But subjecting negotiatory statements to securities fraud liability solves the negotiator's age-old problem of how to establish one's offer as a final one.\footnote{To be sure, in many contexts companies have other ways to make commitments. See, e.g., Salop, supra note 49 (observing that investment in inferior technology can create commitment not to reduce output if other firm enters industry); Schelling, supra note 9, at 287-92 (referring to reputation, use of bargaining agents, and intersecting negotiations as potential commitment devices); B. Curtis Eaton & Richard G. Lipsey, Capital, Commitment and Entry Equilibrium, 12 Bell J. Econ. 593, 594 (1981) (discussing sunk costs); Drew Fudenberg & Jean Tirole, The Fat-Cat Effect, the Puppy-Dog Ploy, and the Lean and Hungry Look, 96th Am. Econ. Ass'n Papers & Proceedings 361, 364 (1984) (discussing underinvestment); Michael Katz, Game-playing Agents: Unobservable Contracts as Precommitments, 22 Rand J. Econ. 307, 307-09 (1991) (discussing strategic compensation scheme as commitment device). Some of these methods may also be effective in creating a commitment not to renege on a negotiatory statement. To that extent, most of the analysis contained in this Article is applicable to those other devices as well. Furthermore, the structural effect described in this Part would not be qualitatively affected by any residual uncertainty over whether negotiatory or competitory lies can violate Rule 10b-5. That is to say, if there were a 20% probability that negotiatory lies could violate Rule 10b-5 as a matter of law, the expected damages from reneging on a material negotiatory statement would only be 80% of the expected damages absent such uncertainty. However, even this lower figure of expected damages may be sufficient to assure that the company will not renege on its negotiatory statements.} The effect of such liability is that a company may be exposed to substantial claims for damages if it reneges on its negotiatory statement. Securities fraud liability for negotiatory statements, therefore, has the potential to significantly alter the structure of negotiations.\footnote{Cf. James N. Morgan, Bilateral Monopoly and the Competitive Output, 63 Q. J. Econ. § 71, 376 n.6 (1949) (defining bargaining power as ability to set best price for oneself and fool other side into thinking this was one's maximum offer).}

To give an example, let us return to XYZ's statement that it will not pay more than $25 million for ABC's toy division. Assume that ABC

\footnote{A company can greatly dilute any commitment not to raise its offer by proper phraseology (e.g. by stating that it presently intends not to make a better offer). The point here is not that negotiatory statements will inevitably result in commitments not to raise one's offer, but rather that the company has the option to make such commitments if it chooses to do so. Similarly, while many statements made in the context of negotiations are not made public and would not give rise to securities fraud liability, companies that wanted to use the securities laws for strategic purposes could easily make these statements public by issuing a press release.}
believes that XYZ values the toy division "high" at $32 million, and that XYZ would be liable for $3 million in damages for securities fraud if it accepts ABC's $30 million counteroffer. The resulting game is depicted in Diagram 4. (For comparison, payoffs absent liability are marked in the diagram on the highlighted background.) As Diagram 4 shows, XYZ's payoff from accepting ABC's $30 million counteroffer drops from a gain of $2 million to a loss of $1 million in the presence of securities fraud liability.

**Diagram 4**

**Negotiatory Statement—Securities Fraud Remedy**

**XYZ Assigns High Value to Toy Division**

<table>
<thead>
<tr>
<th>XYZ's strategy</th>
<th>ABC's strategy</th>
<th>Accept $25 million offer</th>
<th>Make $30 million counteroffer</th>
<th>XYZ's payoff</th>
<th>ABC's payoff</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reject $30 m offer if made</td>
<td>Accept</td>
<td>7</td>
<td>0</td>
<td>0</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Reject</td>
<td>0</td>
<td>7</td>
<td>5</td>
<td>7</td>
</tr>
</tbody>
</table>

The drop in XYZ's payoff if it accepts ABC's $30 million counteroffer has significant implications. Absent securities fraud liability, XYZ would be better off accepting the counteroffer if its $25 million offer is rejected. But in the presence of such liability, if XYZ accepts ABC's $30 million counteroffer, it may have to pay damages to investors who bought XYZ stock at too high a price (because they assumed XYZ would pay $5 million less for the toy division) and potentially face other consequences associated with fraud liability. If the total costs to XYZ are high enough, it will pay XYZ to fulfill its threat and not accept ABC's counteroffer even though it values the toy division at more than $30 million. Thus, as a result of securities fraud liability, XYZ's statement that its $25 million offer is final becomes credible: it is in XYZ's best interest to reject the counteroffer regardless of whether XYZ attributes a high or a low value to the toy division. Since XYZ will not accept the counteroffer even if XYZ attributes the "high" value to the toy division, it is unequivocally in ABC's interest to accept XYZ's offer. In short, then, the toy division will be sold for $25 million, XYZ will gain $7 million, and ABC will gain $5 million.

The unilateral ability to make negotiatory commitments is thus an advantage. In the example, XYZ could use that ability to capture $7...
million in profits rather than merely $2 million.60 Paradoxically, XYZ
benefits despite the fact—indeed, because of the fact—that one of its con-
tingent payoffs is diminished (i.e. the payoff of accepting the $30 million
counteroffer). It is just this diminished payoff that induces ABC to ac-
cept XYZ's $25 million offer.

That it is beneficial to have the ability to make a negotiatory com-
mitment61 does, of course, not mean that it is always beneficial to make
such commitments. A company may, for a number of reasons, choose
not to make a negotiatory commitment: it may have so little information
about what "final offer" would be acceptable to the other side that it may
decide to pursue conventional bargaining instead, it may want to avoid
the negative impact on the long-term relationship created by "forcing"
concessions on another party,62 or it may worry that the other party will
reject a "final offer" in order to establish a reputation for not giving in to
hard-ball tactics.63 Even with these limitations, however, the ability to
make negotiatory commitments is clearly a useful device.

While the use of securities laws to make negotiatory commitments is
most notable, it deserves mention that securities laws can also have the

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60 Generally, under complete information, a person making a negotiatory commitment
could appropriate for herself the lesser of the amount of joint gains and of the amount of
liability she would incur for making a negotiatory lie. These gains, of course, only result be-
cause XYZ's valuation of the toy division exceeds ABC's best alternative use (and because
XYZ cannot get an equivalent toy division from another seller). In competitive markets,
where ABC could easily find another buyer for the toy divisions that values it similarly to
XYZ, the occasion for making such commitments does not arise.

61 In other circumstances, it may be undesirable to possess the ability to make a commit-
ment. The reason is that a refusal to make a commitment may act as a negative signal. For
instance, a refusal to warrant the quality of a product (a way of making a commitment that
product quality is believed to be high) may signal that product quality is low. See generally
Sanford J. Grossman, The Informational Role of Warranties and Private Disclosure About
Product Quality, 24 J. L. & Econ. 461 (1981) (discussing how warranties can be used to differ-
etiate high quality from low quality products); A. Michael Spence, Consumer Mispercep-
tions, Product Failure, and Producer Liability, 44 Rev. Econ. Stud. 561 (1977) (same); see also
text accompanying notes 92-95 infra (signalling effect of failure to make competitive commit-
ment). Producers of lower quality products would therefore be better off if no one was alow.
d to give warranties. See generally George A. Akerlof, The Market for "Lemons": Quality Un-
certainty and the Market Mechanism, 84 Q. J. Econ. 488 (1970); Charles Wilson, The Nature
of Equilibrium in Markets with Adverse Selection, 11 Bell. J. Econ. 108 (1980). Companies
are under no such disadvantage with respect to negotiatory commitments, as even "high-
value" buyers can truthfully declare they will not pay more than a low price.

62 Cf. Roger Fisher & William Ury, Getting To Yes 6-7 (1981) (maintaining that positional
bargaining may endanger relationships).

63 See Howard Raiffa, The Art and Science of Negotiations 12-13 (1982) (discussing im-
portance of reputation in repetitive games); see also R. Fisher & W. Ury, supra note 62, at 146
(suggesting it may be advisable to resist lock-in commitments on principle). Companies may
also choose not to resort to negotiatory commitments because they possess alternative com-
mitment devices preferable to commitments through exposure to securities fraud liability, or
because both parties have agreed not to use such devices in order to avoid a race to commit. See
note 57 supra, and note 122 infra.

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effect of creating substantive commitments in negotiations. Take, for example, XYZ's assertion that an 8% wage increase would jeopardize XYZ's economic survival. If XYZ filed a report with the SEC that showed declining income and market share, XYZ's union could reasonably assume that the statement was true, for potential securities fraud liability provides assurance for its accuracy. Thus, the union may be more inclined to believe XYZ's assertion even if XYZ makes no representations about its financial position in its collective bargaining agreement and the union would not be able to sue XYZ for fraud or breach of warranty.

4

b. Actual Negotiatory Statements. A review of recent press releases carried by the financial press indicates that companies periodically make negotiatory commitments. Such commitments are generally made after a period of conventional negotiations, and most commonly occur when the subject company seeks to acquire its own securities or securities of another company.

Take, for example, Beatrice's tender offer for its debt securities. As part of the tender offer, Beatrice sought consents from a majority of the debtholders to amend the indenture governing their debt securities. After extending and modifying the consent solicitation several times (necessitated, of course, by not having received the requisite consents), Beatrice

To be sure, since the union could have insisted on such a representation in the collective bargaining agreement, companies can create effective "substantive" commitments even in the absence of the securities laws. Nevertheless, the securities laws will influence the structure of the negotiation. For one, the securities laws make it easier to obtain (and make) substantive commitments. For example, the report filed with the SEC will create substantive commitments without need for any further action by XYZ or the union. Secondly, even if the union obtains a pertinent representation, the securities laws increase its reliability (by making it more costly to lie). Thirdly, the securities laws increase the probability of detection. That is, the additional enforcement power of the SEC, and the additional enforcement incentives of securityholders who may be misled by false statements, make it more likely that substantive lies by XYZ will be detected than if these "lies" were merely part of the collective bargaining agreement.

A case in point may be the well-known Texas Gulf Sulphur case. See SEC v. Texas Gulf Sulphur, 401 F.2d 833 (2d Cir. 1966). Texas Gulf Sulphur had secretly discovered huge mineral deposits. Before acquiring the land containing these deposits, Texas Gulf Sulphur released statements denying any rumors of the discovery. Given the holding of this case that Texas Gulf Sulphur may have committed securities fraud, the securities laws serve to "warrant" the truth of similar statements in the future.


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atrice publicly announced it would not further improve the terms of its offer. The next day, a sufficient number of debtholders consented to the proposed amendments. Through its public announcement, Beatrice made a credible commitment not to improve the terms of its last offer, and that may have finally convinced its debtholders to stop holding out and accept the offer.

Or consider General Cinema's recent ten-month effort to acquire financially troubled Harcourt Brace Janovich (HBJ). After several failed tender offer attempts for HBJ's stock and bonds, General Cinema announced on October 14, 1991 that it would let its tender offers expire unless the requisite number of HBJ bondholders accepted the tender offer by October 21. On October 23, General Cinema announced that the requisite number of bondholders had accepted the tender offer.

Negotiatory commitments to transactees other than securityholders can also be observed, although the commitments are less definitive. For example, the Tribune Company threatened in March 1991 to close the Daily News if the newspaper's union would not agree to make salary increased consent payment from $30 to $55 per $1,000 of debt).

67 See Beatrice Increases Consent Payments For Two Debt Issues, PR Newswire, Dec. 29, 1988, available in LEXIS, Nexis Library, Prnews File (quoting Beatrice statement that "it would not increase further the amount of any consent payment or purchase price").
72 See General Cinema Reaches 90 Percent Minimums in HBJ Bond Tender Offers, Business Wire, Oct. 23, 1991, available in LEXIS, Nexis Library, Bwire File. Note that, despite its announcement, General Cinema had extended the tender offer to October 23. General Cinema Extends HBJ Debt Tender Offers to 5:00 p.m. Today, Business Wire, Oct. 23, 1991, available in LEXIS, Nexis Library, Bwire File. Such a relatively short extension (especially in light of General Cinema's protracted efforts to acquire HBJ), unaccompanied by an improvement in the terms of the tender offer, would presumably not be sufficient to make General Cinema's earlier announcement that it would not extend the tender offer beyond October 21 materially misleading. See also Flamm v. Eberstadt, 814 F.2d 1169, 1171 (7th Cir.) (following announcement by target that $17 tender offer was unacceptable and that target would employ all its resources to defeat bid, target was acquired by another bidder for $21), cert. denied, 484 U.S. 853 (1987); Margaret Poppers, Centel Shareholders to Sue on Misrepresentation Grounds, Mergers & Acquisitions Rpt., July 13, 1992, at 1, available in LEXIS, Nexis Library, Idmmar File (reporting shareholders' claim that statements by Centel that $43 share price undervalued stock violated Rule 10b-5 after Centel management agreed to sell company to Sprint for $40 per share).
concessions to a prospective purchaser of the paper.\textsuperscript{73} By March 14, the union had made the requisite concessions.\textsuperscript{74} Similarly, Columbia Gas threatened in June 1991 that it might have to file for bankruptcy if contracts with its suppliers could not be satisfactorily renegotiated.\textsuperscript{75} Consistent with its commitment, Columbia Gas declared bankruptcy in July of 1991 when it became clear that renegotiation was not occurring in a timely fashion.\textsuperscript{76}

Thus, casual empiricism suggests that negotiatory commitments are not uncommon, particularly in the context of "negotiations" between the company and its securityholders where the commitment is likely to satisfy the standard of materiality. Nevertheless, many companies may lack sufficient awareness of the strategic potential of the securities laws as a commitment device and therefore fail to employ commitment strategies in a manner that maximizes their profits.

Both institutional structures and prior scholarly publications suggest that such a lack of awareness indeed exists. Practicing securities lawyers are most likely to possess the requisite knowledge of the securities laws that would enable them to realize their strategic potential. Yet, most regard these laws as traps for the unwary, and have developed a professional tendency to advise their clients to qualify every statement. Filings with the SEC and important press releases thus abound with weasel words such as "the company believes," "the company presently intends," or "under current circumstances."\textsuperscript{77} This professional tendency may lead practicing lawyers to overlook the strategic opportunities created by intentionally exposing oneself to liability if one fails to abide by a prior unqualified statement. Scholarly commentators as well have ne-

\textsuperscript{73} See Judith Schoolman, Daily News Sets Closing Date But Talks Continuing With Buyers, Reuters Bus. Rpt., March 4, 1991, available in LEXIS, Nexis Library, Busrpt File (reporting that paper would be closed if no agreement with purchaser reached by March 15); Maxwell Wants $1.4 Million a Week in Union Givebacks, UPI, March 8, 1991, available in LEXIS, Nexis Library, UPI File (reporting that Maxwell would not buy paper unless major labor concessions were made).


\textsuperscript{77} See, e.g., Builders Transport, Inc., Schedule 14B filed by Stanford M. Dinstein, Mar. 8, 1990, at 8 (disclosing that Mr. Dinstein "intend[s] to keep open [his] options," that he "will consider whether and at what price to make an offer to acquire the Company," and that if elected he "intend[s] to take such action as [he] then believe[s] to be in the best interest of the Company and its stockholders") (emphasis added).
glected the strategic potential of the securities laws, and advise companies to exercise great caution in communicating with their investors.\textsuperscript{78}

Securities fraud liability for negotiatory lies is thus of more than merely theoretical interest. Companies have periodically made negotiatory statements that would have exposed them to liability if they had reneged, and once companies become fully aware of the strategic potential created by such liability, they may make such commitments with increasing frequency.

2. Liability for Competitory Lies

Competitory statements can also subject companies to securities fraud liability if such statements are false and relate to an important aspect of the company's business.\textsuperscript{79} This subsection analyzes the effects of liability for competitory lies with regard to the company's strategic interaction with its competitors.

To delineate the strategic implications of liability for competitory lies, I analyze separately the effects with regard to untruthful "misleading competitory statements" aimed at deceiving competitors, and truthful "declarative competitory statements" aimed at informing a competitor about one's plans.\textsuperscript{80} As the analysis will show, the ramifications of liability differ with respect to these two kinds of competitory statements. I will then briefly examine the extent to which companies actually make competitory statements.

\textit{a. Misleading Competitory Statements.} Competitory statements may be designed to delude credulous competitors into courses of action they would not have otherwise taken. XYZ's statement that it plans to continue producing war games falls in this category: XYZ is attempting to conceal its true business strategy from TOFU in order to gain a first-mover advantage. Other examples of this type of competitory lie would be understatements of earnings designed to deter new entrants into one's

\textsuperscript{78} See, e.g., Ayres, supra note 6, at 947-59 (arguing that investors would generally prefer companies to warrant truth of their statements, but not referring to strategic benefits of truth warranty in interaction with non-investors); Macey & Miller, Good Finance, supra note 6, at 1069-70 (discussing detrimental effects of securities fraud liability in company's interaction with non-investors); see generally J. Robert Brown, Jr., Corporate Communications and the Federal Securities Laws, 53 Geo. Wash. L. Rev. 741 (1985) (warning that corporations may underestimate potential liability for less formal corporate communications).

\textsuperscript{79} See text accompanying notes 36-37 supra.

\textsuperscript{80} In some circumstances, a company may want to communicate certain characteristics (e.g. its profitability) other than courses of action to a competitor. Declarative competitory statements can, of course, be used as well for that purpose. For expository simplicity, I focus the analysis of declarative competitory statements about the company's course of action. Unless noted otherwise, that analysis applies equally to declarative competitory statements about other characteristics.
industry, or overstatements of supply costs in order to conceal a cheap source of raw materials.

Securities fraud liability may make it prohibitively expensive for companies to tell competitive lies. Take XYZ's statement that it plans to continue producing war games, and assume that deviating from this proclaimed plan would expose XYZ to securities fraud liability of $3 million.81 Diagram 5 illustrates XYZ's and TOFU's profits. Profits absent securities fraud liability are indicated on the highlighted background. As Diagram 5 makes evident, securities fraud liability can ensure that it will never pay for XYZ to produce ecological toys once it has announced that it will produce war games. Regardless of whether its lie induces TOFU to pursue a conventional strategy, XYZ's profits are always higher if it produces war games ($5 million versus profits of $4 million or losses of $2 million).

**Diagram 5**

**Securities Fraud Liability for Competitive Lies**

<table>
<thead>
<tr>
<th>XYZ's strategy</th>
<th>TOFU's strategy</th>
<th>Conventional Strategy</th>
<th>Innovative Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Produce War Games</td>
<td></td>
<td>5</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Produce Ecological Toys</td>
<td></td>
<td>4 7</td>
<td>-2 5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>XYZ's payoff TOFU's payoff</td>
<td></td>
</tr>
</tbody>
</table>

Furthermore, though TOFU does not gain directly from XYZ's liability, it derives substantial indirect benefits. Since TOFU knows that it does not pay for XYZ to deviate from its announced plans, it can safely adopt a conventional business strategy and earn $10 million—the highest profits available. Had there been no liability for securities fraud, TOFU would have to guess whether XYZ would stick to its charted course, and would thus not have been assured of earning $10 million.82

Liability for securities fraud can thus hurt the company and help its competitors. Once XYZ announces that it will produce war games, it

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81 Note that it would not help XYZ to show that its announcement that it planned to continue producing war games was true when made, and that it merely changed its plans. Once XYZ has made the announcement, it is obligated to correct its prior statement when it is no longer accurate. See generally Brown, supra note 78, at 759-61 (discussing duty to correct information which becomes inaccurate over time).

82 See note 92 infra.
loses the practical option of producing ecological toys—a course that would otherwise be advisable if XYZ thought that TOFU will adopt a conventional strategy.

Other commentators have also noted that securities law liability for competitive statements may harm the subject company. Jonathan Macey and Geoffrey Miller in particular argue that companies have a property right in information and that prohibiting misrepresentations may unduly infringe upon that right. Macey and Miller therefore advocate an exemption from the securities laws for lies designed to benefit shareholders.83 Ian Ayres, striking in a similar vein, advocates giving companies the option of committing themselves to truthful disclosures or announcing that their disclosures may be false.84

In many instances, however, companies can avoid these detrimental effects of securities fraud liability by not making any public representations.85 By remaining silent and saying nothing about its business strategy, the company may succeed in keeping its competitors in the dark. As such, silence would act as the functional equivalent of exempting misleading statements from securities fraud liability.86

In two sets of circumstances, however, remaining silent is not a workable strategy. The first arises when a company is subject to affirmative disclosure requirements. The second arises when a company receives "collateral benefits" from making certain truthful disclosures.

A number of provisions in the securities laws mandate that companies disclose certain information.87 For example, companies must disclose on an annual basis their revenues, profits, and assets in each of the industry segments in which they operate; the principal products they

83 See Macey & Miller, Good Finance, supra note 6, at 1063-76. Professors Macey and Miller contend that shareholders would, in a hypothetical bargain, permit a company's managers to lie with the good faith intention of furthering the interest of their shareholders. As an additional requirement to avoid liability, Macey and Miller would impose the condition that, as a result of the lie, the company's stock must trade at an artificially low level.

84 See Ayres, supra note 6, at 947-59. Professor Ayres also criticizes Macey and Miller's requirement that the misrepresentation depresses the company's stock price. Id. at 959-64. Compare Macey & Miller, Fraud-on-the-Market, supra note 6, at 1006-10 (responding to Ayres' criticism).

85 Nondisclosure of material facts, absent insider trading or affirmative disclosure duties, does not ordinarily violate the federal securities laws. See Brown, supra note 78, at 750-53.

86 To be sure, remaining silent does not advance the goal of misleading credulous competitors. Enabling companies to mislead competitors, however, is hardly a reason to modify the federal securities laws.

produce and their respective distribution channels; the names of important customers; research and development expenditures; any known trends or uncertainties that are expected to have a material impact on sales, revenues or income; and any material commitments for capital expenditures, their general purpose, and source of funding. Companies are also required to release quarterly financial statements detailing revenues, profits, assets, inventories, and cash reserves. And, after important acquisitions, companies have to file reports on the assets acquired, their purchase price, and their intended use. In sum, these mandatory disclosure provisions force a company to divulge information which otherwise might have remained confidential, thereby potentially benefiting its competitors and harming its securityholders.

In addition, silence is an inadequate option where the company would obtain “collateral benefits” from disclosing certain information truthfully. This situation arises if it would be beneficial to the company to disclose that a certain fact is true if indeed it is, but not to disclose that said fact is not true if it is not. For example, a company that has not violated the environmental laws would want to disclose that it has not, but a company that has violated the environmental laws would not want to disclose that it has. In such a situation, failure to make any disclosures effectively communicates that the fact is not true. Thus, if a company fails to deny that it has violated the environmental laws, one could deduce that the company has violated these laws. In such circumstances, silence would not be an effective means for not conveying any information.

An analogous situation is illustrated in Diagram 6 which describes the payoffs to XYZ and TOFU absent securities fraud liability. Assume that $\alpha$ (the payoff to XYZ if it produces ecological toys and TOFU adopts a conventional strategy) can take two values—60 and 35—and that only XYZ knows the value of $\alpha$. If $\alpha$ is 60, XYZ would be better off producing ecological toys if TOFU adopts a conventional strategy and war games if TOFU adopts an innovative strategy. Thus, XYZ may

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91 For instance, information about a company's revenues, inventories, and distribution channels may aid a competitor in designing an aggressive new marketing campaign. Or information about asset acquisition may tip competitors off on the company's expansion plans. See also Brudney, supra note 6, at 733 & n.11 (arguing that disclosure benefits competitors and harms company); Dennis, supra note 6, at 1212 (stating that disclosure may result in competitive injury).

92 Note that, absent securities fraud liability, remaining silent would convey no information, since one could always assert that the fact is true, even if it is not.
well decide to produce ecological toys gambling that TOFU adopts a conventional strategy.

But if \( \alpha \) is only 35, XYZ is always better off producing war games and prefers that TOFU adopt a conventional strategy. Since it is in TOFU's interest to adopt a conventional strategy if XYZ indeed produces war games, XYZ only needs to communicate credibly its actual plans to TOFU. And the securities laws can afford XYZ with an opportunity to do so: XYZ merely has to announce that it will produce war games.\(^9\)

**Diagram 6**

**Competitory Statements in Presence of Collateral Benefits**

<table>
<thead>
<tr>
<th>XYZ's strategy</th>
<th>TOFU's strategy</th>
<th>Conventional Strategy</th>
<th>Innovative Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Produce War Games</td>
<td>50</td>
<td>45</td>
<td>XYZ's payoff</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>70</td>
<td>TOFU's payoff</td>
</tr>
<tr>
<td>Produce Ecological Toys</td>
<td>( \alpha )</td>
<td>30</td>
<td>XYZ's payoff</td>
</tr>
<tr>
<td></td>
<td>30</td>
<td>50</td>
<td>TOFU's payoff</td>
</tr>
</tbody>
</table>

Since it is in XYZ's interest to signal to TOFU that it will produce war games, TOFU will deduce that XYZ will make a pertinent announcement if it produces war games. Silence, therefore, effectively signals to TOFU that XYZ plans to produce ecological toys.\(^9\)

If competitory lies were not subject to securities fraud liability, there would be no such signalling effect. XYZ could without penalty announce that it is going to produce war games but nevertheless produce ecological toys. Thus, whether XYZ makes a "war game" announcement or not, TOFU will have to guess what XYZ will actually do. Accordingly, where a company would derive collateral benefits from certain disclosures, silence will fail to leave the company's competitors in the dark and may instead result in indirect revelation of business plans which

\(^9\) If \( \alpha \) is 60, securities fraud liability would have to exceed 10 to make it unprofitable for XYZ to renege on its statement.

\(^9\) If \( \alpha \) is 60 and XYZ could make a commitment to a mixed strategy, XYZ’s optimal commitment would be to produce war games with a probability marginally higher than 40%. Such a commitment would lead TOFU always to adopt a conventional strategy, see note 56 supra, and thus yield XYZ an expected payoff marginally below 56.
the company would have preferred to keep confidential.95

b. **Declarative Competitory Statements.** Liability for securities fraud also affects the ability of a company to communicate certain information to competitors. Because false competitive statements may expose a company to securities fraud liability, such statements can credibly communicate one's plans to a competitor96 and affect its behavior. The

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95 If XYZ had more than two potential business plans to choose from, silence may be partially, though not fully, revealing of XYZ's plans. That is, XYZ's failure to announce a business plan it will pursue may indicate that XYZ will not pursue certain of its business plans, but may still fail to indicate which plan XYZ will pursue. For example, assume that XYZ and TOFU each have three potential business plans (board games, baby toys, or electronic toys, and conventional, intermediate, or innovative strategies, respectively) with the following payoff structure:

<table>
<thead>
<tr>
<th>TOFU's strategy</th>
<th>Conventional</th>
<th>Intermediate</th>
<th>Innovative</th>
</tr>
</thead>
<tbody>
<tr>
<td>XYZ's strategy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board Games</td>
<td>50 + $\alpha$</td>
<td>50</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>50</td>
<td>110</td>
<td>5</td>
</tr>
<tr>
<td>Electronic Toys</td>
<td>50</td>
<td>50 + $\alpha$</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>110</td>
<td>50</td>
<td>5</td>
</tr>
<tr>
<td>Baby Toys</td>
<td>5</td>
<td>5</td>
<td>55</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
</tbody>
</table>

This game has three Nash Equilibria: (i) XYZ always produces baby toys and TOFU always adopts an innovative strategy; (ii) XYZ produces each of board games and electronic toys with 50% probability and TOFU pursues a conventional and intermediate strategy with 50% probability; and (iii) XYZ produces each of board games and electronic toys with a probability of 50/(190 + $\alpha$) each and otherwise baby toys and TOFU pursues a conventional and intermediate strategy with a probability of 20% each and an innovative one with a 60% probability. See note 56 supra for an explanation of the concept of Nash Equilibrium.

Depending on how high $\alpha$ is, XYZ will either prefer the first Nash Equilibrium with a payoff of 55 each to XYZ and TOFU, or the second Nash Equilibrium with expected payoffs of 80 to TOFU and 50 + $\alpha$/2 to XYZ. The third Nash Equilibrium, with an expected payoff of (5450 + 55 $\alpha$)/(190 + $\alpha$) to XYZ and 35 to TOFU would be inferior to one or both of the other equilibria.

XYZ (but not TOFU) knows the size of $\alpha$ and can either announce which business plan it will pursue or make no announcement. If $\alpha$ is less than 10, XYZ prefers the first Nash Equilibrium and should announce that it will produce baby toys. If $\alpha$ is greater than 10, XYZ prefers the second Nash Equilibrium. But in that case, XYZ does not want to announce whether it will produce board games or electronic toys, but rather wants to keep TOFU guessing. Thus, a failure to announce its business plan is partially revealing in that it indicates that XYZ will not produce baby toys, but fails to indicate whether XYZ will produce war games or electronic toys.

96 Declarative competitive statements are thus structurally similar to negotiatory statements. Both kinds of statements serve to commit the person making the statement to a certain course of action.
existence of securities fraud liability therefore may benefit the company that makes the competitive statement.

Declarative competitive statements can be the flip side of the silence option in the presence of collateral benefits. The presence of collateral benefits prevented XYZ from effectively concealing from TOFU that $\alpha$ was 60 and that it planned to produce ecological toys. A declarative competitive statement would permit XYZ to communicate credibly to TOFU that $\alpha$ is 35 and that XYZ plans to produce war games. In Diagram 6, both the company (XYZ) and the competitor (TOFU) would benefit from such a declarative competitive commitment. That is, XYZ's announcement that it would produce war games leads to the high payoff for both XYZ (50) and TOFU (100).

In other situations, however, the ability to make competitive commitments may hurt the competitor. Assume, for example, that both XYZ and TOFU consider producing ecological toys, and that both expect high profits from that product line, but only if they are the sole company producing ecological toys. If both XYZ and TOFU produce ecological toys, both will suffer small losses.\footnote{97} XYZ (and TOFU) can either play it safe and not produce ecological toys, or produce such toys and risk suffering losses if the other company produces them as well. But if XYZ can expose itself to sufficient securities fraud liability, it can preempt TOFU by announcing that it will produce ecological toys even if TOFU also decides to produce ecological toys.\footnote{98} If TOFU knows that XYZ will produce ecological toys, it will refrain from producing such toys since it would suffer losses if both companies produce them. Thus, the declarative competitive statement would enable XYZ to capture for itself the profits from the ecological product line and reduce TOFU's opportunity to seize these profits.

In sum, declarative competitive statements can enable a company to coordinate its actions with the actions of its competitors or to preempt actions of its competitors. In either case, companies can use declarative statements to their strategic advantage.

\footnote{97} This payoff structure is analogous to the "grab the dollar" game. See J. Tirole, supra note 53, at 436; see also Giacomo Bonanno, Location Choice, Product Proliferation and Entry Deterrence, 54 Rev. Econ. Stud. 37 (1987) (discussing choice of location to deter entry by competitors).

\footnote{98} Another way to make commitments is to incur "sunk costs," for example by spending several million dollars to build a new plant designed for the production of ecological toys. See Eaton & Lipsey, supra note 57, at 593. The ability to make competitive commitments through the securities laws can also enhance a company's ability to make commitments through sunk costs. That is, a company can communicate credibly the fact that it has incurred sunk costs by simply announcing that it has done so, subjecting itself to securities fraud liability if it has not.
c. Actual Competitory Statements. An empirical determination of the extent to which companies actually make declarative or misleading competitive statements is difficult. Since competitive statements are defined as statements intended to induce action or forbearance by competitors, and since the intent of the company is generally not evident from the statement itself, it is difficult to determine whether a particular statement is competitive.

Nevertheless, many statements made by companies relating to their profits and revenues, their amount of products sold, or their modernization and expansion plans are undoubtedly of interest to competitors. Because the securities laws provide assurances to a company's competitors that these statements are accurate, it would be surprising if none of these statements were intended to communicate information to competitors.

Additionally, at least in the context of merger negotiations, there is strong evidence that companies actually make competitive statements. In the past, many companies have falsely denied that they were engaged in preliminary merger negotiations. Several courts and commentators have concluded that such false denials are generally intended to sidetrack other companies that might interfere in such negotiations by starting a bidding war, but were not directed toward the company's shareholders. Prior to 1988, federal circuit courts concluded that false denials of preliminary merger negotiations could not give rise to securities fraud liability. The lack of liability for companies engaged in such negotia-


100 See, e.g., Basic Inc. v. Levinson, 485 U.S. 224, 227 n.4 (1988) (claiming, on three occasions, that company was not aware of developments that would result in unusual trading activity and price movements and/or that company was not engaged in merger negotiations); Greenfield v. Heublein, Inc., 742 F.2d 751, 754 (3d Cir. 1984) (claiming that company was not aware of any reason for unusual trading activity).

101 See Basic, 485 U.S. at 234; see also Flamm v. Eberstadt, 814 F.2d 1169, 1176 (7th Cir. 1987); Brown, supra note 78, at 782-92 (observing that managers fear that premature disclosures may jeopardize continuation of negotiations); Macey & Miller Good Finance, supra note 6, at 1066-70, 1074-76 (making similar claims).

102 See Greenfield, 742 F.2d at 758-59 (holding that preliminary merger negotiations are not
tions allowed them to make misleading competitive denials without fear of sanction. But, by the same token, lack of liability makes it more difficult for companies that are not engaged in negotiations to make credible denials because they are precluded from making credible declarative statements. However, the Supreme Court's decision in Basic Inc. v. Levinson, which held that false denials of merger negotiations could result in liability, turned things upside down. Companies engaged in merger negotiations lost their ability to make misleading statements, and companies not engaged in negotiations gained the ability to make credible denials.

In sum, many corporate communications are of great interest to competitors. Securities fraud liability for false competitive statements helps assure competitors that these communications are not materially false or misleading. Liability can thus prevent a company from misleading its competitors. But companies can also exploit such liability to make strategic commitments to their competitors.

III
THE DESIRABILITY OF LIABILITY FOR NEGOTIATORY AND COMPETITIVE LIES

A. Negotiatory Statements

As explained in Part II, an individual company can benefit from the presence of federal securities fraud liability for negotiatory lies because liability enables the company to make negotiatory commitments. But it does not follow that liability for negotiatory lies is desirable from the social perspective. To be sure, a company may gain by extracting concessions through negotiatory commitments. But, by the same token, the company's transactees, who have to make these concessions, lose.
This Section analyzes to what extent the ability to make negotiatory commitments is socially desirable, and whether an appropriate exemption for negotiatory statements should be carved out of the securities laws. I conclude that an exemption from the anti-fraud provisions for negotiatory statements would be conceptually desirable, and its implementation practicable.

I. The Social Desirability of Liability

To assess the desirability of liability for negotiatory lies, it is helpful to separate two contexts in which parties may want to exploit such liability in making negotiatory commitments. First, only one of the parties may be able to make negotiatory commitments (i.e., the securities laws create a unilateral ability to commit). Second, the securities laws may enable both parties to a negotiation to make such commitments (i.e., the ability to commit is bilateral).

a. The Unilateral Ability to Commit. As we have seen, where only one of the parties to the negotiation can make negotiatory commitments, that party will be systematically advantaged and its transactees systematically disadvantaged. For example, if only XYZ can commit itself to final offers, XYZ can appropriate a greater share of the joint gains created by the proposed purchase of the toy division from ABC.106

That the ability to make negotiatory commitments benefits some companies and harms others does, in itself, show neither that such ability is socially desirable nor that it is socially undesirable. Rather, the desirability of negotiatory commitments will primarily depend on whether such commitments make it easier for companies to arrive at beneficial agreements.

Most negotiations involve elements of what has become known as "strategic bargaining." Strategic bargaining results when parties attempt to obtain an agreement which maximizes their gains rather than simply obtaining mutually advantageous terms. In particular, a party may reject an acceptable offer in order to conclude an agreement at even better terms later.107 By trying to capture a greater share of the benefits of the agreement, parties will tend to create inefficient delays, neglect more advantageous ways to structure their agreement, and on occasion fail to

\[106\] See text accompanying notes 57-64 supra.

\[107\] See generally Schelling, supra note 9. Indeed, the use of the securities laws to make negotiatory commitments can constitute a form of such strategic bargaining.
conclude a beneficial agreement.\textsuperscript{108}

The question thus arises whether a unilateral ability to make negotiatory commitments decreases or increases the social costs of strategic bargaining. If costs are decreased, giving a party the ability to make such a commitment may be desirable. But if costs are increased, such an ability would be undesirable.

Unfortunately, the structure of negotiations in practice is too complex and analytically undeveloped to conclude whether negotiatory commitments increase or decrease overall social costs.\textsuperscript{109} To be sure, it is easy to identify specific instances where negotiatory commitments will lead to lower costs. Take, for example, the case where XYZ attributes only a low value to ABC's toy division. If XYZ cannot make a negotiatory commitment, it may not be able to convince ABC that it will not be willing to pay $30 million for the toy division. As a result, ABC may continue to insist on receiving $30 million, creating costs of delay and possibly missing the deal. But if XYZ can make a negotiatory commitment, it will set the "final offer" at a level acceptable to ABC, and ABC will quickly accept (since it knows that XYZ cannot deviate from its terms).\textsuperscript{110} However, there are other specific instances where negotiatory commitments would lead to higher social costs. The reason is, of course, that the party making the commitment may not be able to pick the level for a "final offer" that will be acceptable to the other side. If the "final offer" is not good enough, the offer will be rejected and the opportunity for a beneficial agreement eliminated.\textsuperscript{111}

Another factor in assessing the desirability of a unilateral ability to commit relates to the distributional consequences of that ability. The

\textsuperscript{108} The costs of delays resulting from strategic bargaining are illustrated by the substantial costs incurred during bankruptcy cases. See, e.g., Lucian A. Bebchuk, A New Approach to Corporate Reorganizations, 101 Harv. L. Rev. 775, 781-88 (1988) (proposing method to streamline bargaining process in order to avoid these costs). See generally Ariel Rubinstein, Perfect Equilibrium in a Bargaining Model, 50 Econometrica 97 (1982).

\textsuperscript{109} For an overview of game theoretic treatment of bargaining under incomplete information, see E. Rasmusen, supra note 7, at 236-41.

\textsuperscript{110} Negotiatory commitments will generally lead to lower costs of strategic bargaining if the party making the commitment has perfect information and the party receiving the commitment has imperfect information about the other party's valuation.

\textsuperscript{111} Assume, for example, that X values an object at 100 and believes that there is a $\frac{1}{3}$ chance that Y values the object at 131 and a $\frac{2}{3}$ chance that Y values it at 161. X can either make a negotiatory commitment or pursue conventional bargaining (in which case X expects to receive half of the joint gains). If X makes a commitment, her best strategy is a commitment to 160, yielding expected gains of 40 to X and of $\frac{2}{3}$ to Y. If X pursues conventional bargaining (and X and Y always reach agreement), both X's and Y's expected gains are 25.5. Thus, it would be preferable for X to make a negotiatory commitment at 160, even though that strategy causes social losses of $10\frac{1}{3}$. It is also apparent from the example that making a negotiatory commitment would be inefficient even if conventional bargaining involves modest costs (e.g. if X and Y reach agreement in only 90% of the cases).
general ability to make negotiatory commitments depends primarily on two factors. First, making false negotiatory statements must potentially subject one to securities fraud liability; and second, one must have occasion to make negotiatory statements that are "material" for purposes of the securities laws.

Given these two factors, several categories of market actors are likely winners and losers when we permit the securities laws to be used for strategic purposes. The most likely losers are entities that have no actively traded securities, such as individuals, closely held companies, unions, and governmental bodies. These entities are either not subject to, or would not face substantial sanctions for violations of, the anti-fraud provisions of the securities laws. Other likely losers include publicly traded diversified conglomerates. Though these conglomerates can be liable to their securityholders for material negotiatory lies, the diversified nature of their operations limits the number of occasions in which any particular negotiatory statement would be considered material.

In contrast, the most likely winners are single-industry public companies. Such companies have actively-traded securities and, given the more concentrated nature of their operations, many of its negotiations would be material. Another group of likely winners are entities that purchase their own securities or the securities of some other companies. Negotiatory lies in that context would be likely to be material and expose such entities to liability.

Unequal capacities to make negotiatory commitments may raise several concerns. The distributional consequences of such disparities may be considered undesirable, where governmental agencies, private companies, or unions are systematically disadvantaged in their negotiations with public companies. Furthermore, the benefits gained from the ability to make negotiatory commitments may induce undesirable distortions of economic decisions. That is, since companies tend to gain such benefits if they go public, and lose them as they expand into conglomerates, the availability of these benefits may, at the margin, bias companies in favor of going public or against conglomerates. Parties may there-

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112 Such entities may, however, be liable to other securityholders. See text accompanying note 114 infra.
113 For diversified conglomerates, a negotiatory statement affecting only one of its many industry segments may not be considered significant by a reasonable investor.
114 See text accompanying notes 23 and 38 supra.
115 Such distributional concerns do not arise if parties have been in a prior exchange position in which they adjusted to the benefits bestowed by the ability to make commitments. For example, in the presence of this ability, companies may have to offer a higher starting salary to their employees in order to make up for the bargaining disadvantage the union faces in subsequent wage negotiations.
116 These distortions would be undesirable if, absent such distortion, companies faced opti-
fore take socially inefficient courses of action in order to obtain the private distributional benefits arising from the ability to commit.

At the present level of use of negotiatory commitments, neither of these concerns appears to be major. But if the awareness about the utility of the securities laws to make negotiatory commitments grows, these distributional and efficiency concerns may grow in importance. More importantly, however, there is an element of artificiality in analyzing the desirability of a unilateral ability to commit. If the ability to make negotiatory commitments is socially desirable, it would be arbitrary to afford this ability only to companies with actively traded securities and only in contexts that would be regarded as “material” to the company. Rather, the ability to make negotiatory commitments arguably should be universally available, resulting in a bilateral ability to commit.\(^{117}\)

\textit{b. The Bilateral Ability to Commit}. In some circumstances, both parties to a negotiation may be able to make negotiatory commitments. Such circumstances can presently arise when two companies with actively traded securities enter into negotiations that are material to both. Such circumstances may also arise in the future if the ability to make negotiatory commitments becomes more widely available.

When the ability to commit is bilateral, more tangibly undesirable consequences ensue. In particular, if both sides can make negotiatory commitments, each will be under pressure to be the first to commit, and costly “races to commit” may become commonplace.

To illustrate the race to commit and its social costs, let us return to the XYZ and ABC negotiation. Assume that XYZ values ABC’s toy division at $28 million and believes that it is equally likely that ABC values the toy division at $24 million and at $26 million. ABC in fact values the division at $26 million and believes that is it equally likely that XYZ values the division at $28 million and $32 million.

Both XYZ and ABC can either immediately make negotiatory commitments as to the minimum price they are willing to pay or to accept for the toy division, subjecting themselves to $5 million in liability if they renege. Alternatively, XYZ and ABC can continue to negotiate conventionally; in the course of such a negotiation, XYZ and ABC would learn

\(^{117}\) For example, Congress could establish a “Firm Commitment Agency” and permit companies to irrevocably pledge to pay to that agency a specified amount if they break a negotiatory commitment.
each other's valuation of the toy division.118 Also assume, for simplicity, that offers and counteroffers must be made in full millions of dollars.119

If both sides can make negotiatory commitments, each side will have an incentive to rush to a commitment in order not to be preempted by the other side. Take ABC first. If it makes a commitment, it is optimal for ABC to offer to accept no less than $31 million. If XYZ values the division at $28 million, ABC's payoff will be $0; if XYZ values the division at $32 million, its payoff will be $5 million. If ABC does not make a commitment, it has to consider the possibility that XYZ will make a commitment. If XYZ values the division at $28 million, it will be optimal for XYZ to offer to pay no more than $25 million, yielding (again) a payoff of $0 to ABC. But if XYZ values the division at $32 million, it would offer to pay no more than $27 million, giving ABC a payoff of $1 million. Thus, ABC is better off making a commitment itself than letting XYZ make a commitment first.

Now take XYZ's perspective. If XYZ were to make a commitment, it would be optimal to offer to pay no more than $25 million, yielding XYZ a payoff of $3 million if ABC values the division at $24 million and of $0 if ABC values it at $26 million. Further, XYZ knows that ABC, if it makes a commitment first, would offer to accept no less than $31 million whether it values the division at $23 or $26 million, yielding to XYZ a payoff of $0. Thus, XYZ is also better off committing first than letting ABC commit first.120

ABC's and XYZ's predicament illustrates the race to commit. Both know it is in their interest to make a commitment before the other side, and both know that the other side feels the same way. Faced with the classic "use it or lose it" situation, XYZ and ABC will rush into making a commitment.

From the social perspective, however, this race to commit is likely to propel parties into making commitments earlier than is socially desirable. That is, parties will tend to make commitments even if it would

118 While this assumption is clearly unrealistic, it captures the fact that parties generally obtain information in the course of negotiations that helps them to arrive at a better agreement. Premature termination of negotiations may thus be undesirable.
119 I also assume that parties will accept offers if and only if doing so yields them a higher expected payoff than rejecting them.
120 It is easy to show that the strategies described are optimal if a commitment is made. ABC's commitment to $31 million yields an expected payoff of $3.5 and $2.5 million, respectively, if ABC values the division at $24 and $26 million. A commitment to any amount between $28 and $30 million would reduce ABC's payoff if XYZ values the division at $32 million, and not lead to acceptance if XYZ values the division at $28 million; thus any such commitment would lead to a lower expected payoff. A commitment to $27 million would always result in acceptance, but yield lower expected payoffs ($3 and $1 million, respectively) than the commitment to $31 million. Any lower commitment would further decrease ABC's payoff. Equivalent calculations for XYZ yield the strategies described above.
increase joint gains if they were to continue negotiations and acquire more valuable information. In a race to commit where such information gathering is foregone, an early commitment can kill a beneficial deal.

Moreover, a race to commit induces parties to expend excessive resources on assuring they can be the first to make a commitment. For example, it may become extremely important for a party to obtain information (such as an industry report on predicted growth rates in the toy industry) a short period of time before the other party obtains such information in order to preempt a commitment. Such wasteful expenditures will add to the social costs generated by a race to commit.

Thus, there are strong reasons to believe that a widely available ability to make negotiatory commitments is undesirable. Even under the present legal regime, there are likely to be some instances in which a bilateral ability to commit leads to a race to commit and associated wasteful expenditures. In light of the lack of any clear social benefits from negotiatory commitments, this alone may be a sufficient reason to question the application of the securities laws to negotiatory statements. Moreover, the strategic effect of the securities laws to give some entities the ability to make negotiatory commitments in some circumstances is clearly arbitrary and accidental. Thus, it would be sensible to create an exemption from the securities laws for negotiatory statements as long as such an exemption can be narrowly targeted.

2. Exempting Negotiatory Statements from the Securities Laws

Creating an exemption from the securities laws confined to negotia-

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121 This aspect of the negotiation process is formally modeled in the Appendix. In the model in the Appendix, a bilateral ability to commit will always lead to a commitment that occurs earlier than socially optimal.

122 The costs associated with a race to commit may be one reason why parties sometimes agree not to make any public statements with respect to their negotiations. For example, Texaco and Pennzoil entered into such an agreement for the settlement negotiations on Pennzoil’s $10 billion verdict against Texaco. See Texaco Pennzoil, PR Newswire, Jan. 8, 1986, available in LEXIS, Nexis Library, Prnews File (reporting that Texaco and Pennzoil agreed not to disclose information concerning proposals to settle their litigation). Similar confidentiality agreements are common in friendly merger negotiations. See, e.g., Letter Agreement between Timberjack Corp. and Rauma Acquisition Corp., Apr. 16, 1989 (stipulating that parties agree not to make any public disclosures of their negotiations unless legally required, in which case disclosing party must give prior notice of nature and reasons for disclosure) (on file with the New York University Law Review). To the extent such agreements occur, the social costs of the race to commit are reduced to the transaction costs of concluding this side agreement. See Schelling, supra note 9, at 288 (companies may enter into agreement on secrecy to avoid stalemate resulting from simultaneous commitments).

123 Since the strategic use of negotiatory commitment involves negative externalities, such an exemption should be mandatory, i.e. companies should not be permitted to opt out of the exemption and voluntarily subject their negotiatory statements to securities fraud liability. Cf. Ayres, supra note 6, at 947-64 (discussing whether liability for misstatements should be optional or mandatory).
tory statements is likely to involve few difficulties. The distinguishing characteristic of negotiatory statements is their subject matter.\textsuperscript{124} In most cases, the plain words of a particular statement and the context in which it was made will indicate whether it relates to the company's willingness to enter into a relationship with transactees. And while there would initially be some borderline cases, the number of such cases would likely get smaller as courts develop precedents. Even borderline cases could often be dealt with at the summary judgment stage.\textsuperscript{125} Thus, an exemption for negotiatory statements is desirable as well as practicable.

Such an exemption for negotiatory statements should specifically include negotiatory statements addressed to securityholders, such as Beatrice's statement that it would not increase the payment offered in its consent solicitation, or General Cinema's statement that it would terminate its attempt to acquire HBJ if HBJ's bondholders failed to accept its latest tender offer. The argument that such an exemption would dilute the overall protections afforded to securityholders and thus be contrary to the purpose of the securities laws has little merit. As this analysis has shown, a company's ability to make such statements hurts, rather than helps, its securityholders. Thus, the exemption would actually further the aim of protecting securityholders.\textsuperscript{126}

\textbf{B. Competitory Statements}

\textit{1. The Social Desirability of Liability}

The question of the social desirability of liability for competitory statements arises in two ways. If companies are liable, they lose the ability to make misleading competitory statements. As a result, they may be forced, directly or indirectly, to reveal confidential information. However, at the same time, companies gain the ability to make commitments through declarative competitory statements, which can be beneficial from the company's perspective. If companies are not liable, they can make misleading competitory statements but cannot make declarative statements. This subsection analyzes separately the desirability of liability with respect to misleading and declarative competitory statements. But as both kinds of statements are different sides of the same coin, the

\textsuperscript{124} See text accompanying note 10 supra.
\textsuperscript{125} Also note that an exemption for negotiatory lies is not likely to cause investors to be misled by a company's pronouncements. Absent securities fraud liability, investors will easily recognize negotiatory statements for what they are: tactical bargaining moves which are not to be taken at face value.
\textsuperscript{126} If one is concerned that some securityholders may rely on the accuracy of such statements even if they do not give rise to liability for securities fraud, the SEC could pass rules prohibiting companies from making negotiatory statements in a manner that would be likely to induce such reliance.
desirability of liability turns on its aggregate effect with respect to both kinds of statements.

a. Misleading Statements. As discussed above, liability for competitive statements does not force companies to divulge confidential information unless the law affirmatively requires the disclosure of such information or disclosure is induced by collateral benefits. When disclosure is affirmatively required, an exemption for misleading competitive statements boils down to a repeal of or an exemption from the affirmative disclosure requirements. There is little point in requiring companies to disclose information if that information may be false.

The merits of mandatory disclosure have been debated at great length. While this debate is important and interesting, a detailed examination of the arguments is beyond the scope of this Article. Suffice it to say that it is entirely reasonable to have some mandated disclosure requirements if one believes that there are substantial benefits from having a well-informed market, that investors are unsophisticated and need protection, or that absent disclosure requirements sufficient information will not be forthcoming.

However, the securities laws also recognize the value in allowing companies to preserve business secrets: neither Coca-Cola's secret formula nor specific scientific details of products in the development stage need to be disclosed, even though these facts would certainly be

See text accompanying note 87 supra.


See, e.g., Kahan, supra note 2, at 1005-42 (discussing benefits).


See also Regulation S-K, 17 C.F.R. § 229.101(c)(ii) (1992) (requiring no disclosure of confidential information about development of new products if such disclosure would adversely affect company's competitive position); cf. New York Stock Exchange Listed Company Manual § 202.06(A) (1983) (allowing disclosure to be delayed when it would endanger company's goals or provide information helpful to competitors).
informative to investors. The mandatory disclosure requirements reflect the regulatory balance struck between the interest in informed markets and investor protection on the one hand, and the interest in preserving business confidentiality on the other.\textsuperscript{134} While one may quarrel over whether the balance is struck correctly (or even question whether mandatory disclosure provisions are at all necessary),\textsuperscript{135} the logical way to resolve such issues is to change the mandatory disclosure provisions rather than retain them, but permit companies to make false disclosures.

On the other hand, the argument that there should be some exemption from liability where collateral benefits induce disclosure has merit. Disclosure, in these cases, is not the result of a deliberately imposed requirement, but of the accidental fact that collateral benefits cause silence to signal the company's intentions. Thus, there is no reason to believe that the interest in informed markets and investor protection is stronger than the company's interest in confidentiality. Furthermore, the only practicable way to avoid this signalling effect is to create an exemption from liability. Thus, an exemption from securities fraud liability targeted to those instances where collateral benefits lessen a company's practical ability to withhold information is at least theoretically desirable.

b. Declarative Competitory Statements. Just as with negotiatory commitments,\textsuperscript{136} the unilateral ability to make binding declarative statements is an advantage. Accordingly, giving certain companies such abilities may have undesirable distributional consequences and, at the margin, bias them in favor of going public and against conglomeration. Additionally, bilateral abilities to make competitive commitments can result in an undesirable race to commit.

Finally, declarative statements also may make it easier for competitors to coordinate their actions. While enhanced coordination is ordinarily socially desirable, enhanced coordination among competitors often hurts consumers and results in social losses. In fact, the antitrust laws operate from the fundamental premise that interfirm competition benefits consumers,\textsuperscript{137} and view restricting the ability of competitors to coordi-
nate as an integral way to ensure competition.\textsuperscript{138} Thus, indirect coordination between competitors through the use of declarative statements may undermine the effectiveness of the antitrust laws.\textsuperscript{139} Indeed, declarative statements would be most useful to competitors, and would therefore be most attractive, when the antitrust laws prohibit express coordination.

2. \textit{Exempting Competitory Statements from the Securities Laws}

Apart from the mandatory disclosure provisions, securities fraud liability for competitory statements produces undesirable effects with respect to both misleading and competitory statements. Thus, an exception for voluntary competitory statements would be desirable if it could be narrowly targeted.

However, judicial application of such an exemption may prove to be unmanageable. The distinguishing feature of competitory statements is not their subject matter, but whether the speaker intends a competitor as the audience.\textsuperscript{140} Questions of subjective intent are notoriously difficult to resolve in simple cases; this problem is compounded by the fact that the relevant intent belongs to an organization composed of many individuals with potentially conflicting intentions.

Furthermore, the diversity of interactions between companies and their competitors means that statements regarding a wide range of subject matters will be of potential interest to competitors. As such, the exemption may be difficult to contain. As a result, an exemption for competitory statements would involve major drawbacks.\textsuperscript{141} The legal system would have to expend significant resources in determining whether a statement was addressed to competitors. Investors (and securities markets) will not know in advance whether a statement is competi-

\textsuperscript{138} See, e.g., United States v. Topco Assoc., 405 U.S. 596, 608 (1972) (finding agreements among competitors as to market allocation illegal per se).

\textsuperscript{139} Under present law, implicit coordination by consciously parallel business behavior is generally not in itself illegal. Instead, one has to show conscious parallelism coupled with a "plus factor" (such as conduct contrary to one's independent self-interest). See, e.g., E.I. du Pont de Nemours & Co. v. FTC, 729 F.2d 128 (2d Cir. 1984); see generally Thomas Vakerics, Antitrust Basics § 1.06, at 1-25 (1991). Declarative statements may make it easier for companies to engage in conscious parallel behavior.

\textsuperscript{140} See text accompanying note 11 supra.

\textsuperscript{141} As an alternative to exempting competitory statements, one could exempt all statements not required by the mandatory disclosure provisions and not intended to deceive securityholders from the anti-fraud provisions. Such a change would, however, radically diminish the reliability of information provided by companies and thus decrease the efficiency of securities markets. See Kahan, supra note 2, at 1005-17 (discussing desirability of stock market efficiency). Furthermore, even with such a change, a company could subject itself to the securities laws by trading in its securities after making the competitory statement. Thus, even after such a change, companies could make declarative competitory statements.
tory (and thus unreliable) or not (and thus reliable). Numerous erroneous court decisions will further reduce any benefits from such an exemption. In light of these problems, an exemption for competitory statements seems unadvisable.142

CONCLUSION

Liability for securities fraud can have significant, and hitherto neglected, implications on the strategic interaction between a company and its transactees and competitors. This Article has analyzed these implications from both positive and normative perspectives.

The universe of "lies" in the commercial context can be divided into three categories: negotiatory lies relating to the company's willingness to enter into a transaction; competitory lies designed to influence the actions of a company's competitors; and all other, substantive lies. Unlike substantive lies, negotiatory and competitory lies will not expose a company to liability to its transactees or competitors under the common law. But even negotiatory or competitory lies can result in liability under the federal securities laws.

At first glance, it may seem that securities fraud liability for these lies is a disadvantage to the subject company. However, companies can use the potential for liability to their strategic advantage. Liability for negotiatory lies enables a company to commit itself to a negotiating position. The threat of securities fraud claims may make it prohibitively expensive to deviate from such a position. Knowing that the company will not renege, its transactees will be inclined to accede to the company's position rather than hold out for better terms. But while liability for negotiatory lies is beneficial to the subject company, it may not be socially desirable. The benefits to the subject company are likely to be outweighed by the disadvantages to the transactees, the inefficiencies created by a race to make premature commitments, and the consequences of disparate abilities to make negotiatory commitments. Accordingly, negotiatory lies should be exempt from the anti-fraud provisions of the federal securities laws.

Liability for competitory lies can benefit a company for similar reasons. In some instances, a company will find it in its interest to commit

142 Note that the antitrust concerns created by coordination through competitory statements could be dealt with through the antitrust laws themselves. That is, courts could hold that conscious parallel business behavior reinforced by competitory statements violates the antitrust laws. See note 139 supra. Courts have prohibited companies from taking actions that have the effect of making indirect commitments to competitors. See United States v. General Electric, 1977-2 Trade Cas. (CCH) ¶ 61,660, at 72, 718-20 (E.D. Pa. Oct. 1, 1962) (entering consent decree prohibiting GE from offering price protection policies to customers and publicizing price lists, pricing policies, and performance guarantees regarding large turbo engines).
itself to take certain competitive actions—and the potential of securities fraud liability for competitory lies can enable it to do so.

But such liability can also work to the disadvantage of a company that wants to conceal confidential information from its competitors. These constraints on the ability to conceal confidential information are eased by the fact that a company can generally choose not to make any pronouncements but to remain silent. Only when silence is not a viable option will securities fraud liability inhibit a company from withholding confidential information.

As in the case of negotiatory lies, liability for competitory lies is likely to be socially undesirable, even when such liability is beneficial to the subject company. Among other reasons, the enhanced ability for coordination between competitors created by such liability may be used for anti-competitive purposes and thus impose significant costs on consumers. However, unlike negotiatory lies, competitory lies cannot easily be distinguished from other types of lies. The difficulties involved in drawing such distinctions render it unadvisable to exempt competitory statements from the anti-fraud provisions.
APPENDIX

This Appendix is designed to illustrate further the effects of a bilateral race to commit.

The Model

Assume that the negotiation process has two stages: an information gathering and exchanging stage and a haggling stage. During the information stage, both parties to the negotiation incur costs — $C_1(t)$ and $C_2(t)$ — that are an increasing function of $t$, the duration of the information stage. Assume for simplicity that unit costs are constant, i.e. that $C(t+1) - C(t) = c$.

Both parties expect that an agreement (if an agreement is reached) would provide joint benefits of $B(t)$. Let $p(t)$ be the probability of reaching an agreement. Assume that the expected benefits from an agreement $p(t) \cdot B(t)$ increase (at decreasing rates) with $t$. For example, this may be the case if the parties examine various contractual terms during the information stage. Thus, the longer the information stage lasts, the greater is the likelihood that the parties will “find” contractual terms that increase joint benefits.

After the information stage terminates, the haggling stage begins. Once parties have entered the haggling stage, they cannot return to the information stage. Parties do not incur any further costs during the haggling stage and do not further change their assessment of $B(t)$, the joint benefits of reaching agreement. During the haggling stage, the parties determine whether to reach agreement and how to divide these joint gains. Strategic bargaining may prevent parties from reaching agreement during the haggling stage even if a mutually beneficial agreement is possible.

The information stage terminates by the unilateral decision of one of the parties. At that point, either one of the parties, both of the parties, or neither of the parties may be entitled to make a “final commitment offer.” Assume for simplicity that, if the termination of the information stage is not coupled with a “final commitment offer” by either party, each party expects to receive $\frac{1}{2}B(t)$ if agreement is reached. If the termination of the information stage is coupled with a “final commitment offer,” the party making the offer expects to receive $(\frac{1}{2} + r)B(t)$ if agreement is reached, and the other party expects to receive $(\frac{1}{2} - r)B(t)$, with $0 < r < \frac{1}{2}$. The greater share of gains to the party making the “final commitment offer” reflects the gains from the strategic use of the negotiatory commitment.
The Efficient Duration of the Information Stage

Social welfare $W$ depends on the expected gains from the agreement less the costs incurred during the information stage:

$$W = p(t) \cdot B(t) - (C_1(t) + C_2(t))$$

Social welfare is maximized if the information stage continues until the benefits from higher expected gains from reaching agreement are less than the costs of continuing information gathering and exchange, i.e. until:

$$p(t+1) \cdot B(t+1) - p(t) \cdot B(t) < 2c$$

Let $p(t+1)B(t+1) - p(t)B(t) = \Delta[p(t)B(t)]$. Then, above inequality becomes:

$$\Delta[p(t)B(t)] < 2c \quad (1)$$

Case 1: Only One Party May Make a Final Commitment Offer

The party that can make the final commitment offer would want to continue with the information stage until:

$$\left(\frac{1}{2} + r\right)\Delta[p(t)B(t)] < c \quad (2)$$

and the other party would want to continue until:

$$\left(\frac{1}{2} - r\right)\Delta[p(t)B(t)] < c \quad (3)$$

Since $\left(\frac{1}{2} - r\right)\Delta[p(t)B(t)] < \left(\frac{1}{2} + r\right)\Delta[p(t)B(t)]$, the party that cannot make the final commitment offer will always be the one to terminate the information stage. At that point, the other party will make a final commitment offer. The intuition behind this result is that information is of greater use to the party that can make a final commitment offer than to the other party.

Further, since $\left(\frac{1}{2} - r\right)\Delta[p(t)B(t)] < \frac{1}{2}\Delta[p(t)B(t)]$, the information stage will end earlier than socially optimal. More generally, efficiency depends on the relationship between each party's share of the expected gains from reaching agreement to its share of the costs from continuing the information stage. Since the ability to make a final commitment offer increases one party's share of the expected gains, parties would only act efficiently if that party also happened to bear a correspondingly higher share of the costs of continuing the information stage.

Case 2: Both Parties May Make Final Commitment Offers

If each party had complete control over the duration of the information stage, each would want to continue the information stage until:
Let the first \( t \) for which this inequality is satisfied be \( t' \). At \( t' \), each party would want to terminate the information stage and make a final commitment offer. Assume, for simplicity, that in each round, parties alternate in having the chance of being the first one to make a final commitment offer. Let the party that has that chance in round \( t' \) be party 1. If party 2 fails to make a final commitment offer in round \( t'-1 \), party 1 will make the offer in round \( t' \) and party 2 will receive \((\frac{1}{2} - r)p(t')B(t')\). However, if party 2 makes a final commitment offer in round \( t'-1 \), it would receive \((\frac{1}{2} + r)p(t' - 1)B(t' - 1)\) and save \( c \) in costs of continuing the information stage for another round. Thus party 2 would make a final commitment in round \( t'-1 \), preempting party 1's commitment in round \( t' \), if:

\[
(\frac{1}{2} - r)p(t')B(t') < (\frac{1}{2} + r)p(t' - 1)B(t' - 1) + c
\]

If party 2 would preempt party 1 in round \( t'-1 \), party 1 would, by the same logic, make a final commitment in round \( t'-2 \), preempting party 2’s commitment in round \( t'-1 \), if:

\[
(\frac{1}{2} - r)p(t' - 1)B(t' - 1) < (\frac{1}{2} + r)p(t' - 2)B(t' - 2) + c
\]

This chain continues for preceding rounds of the information stage. Thus, the information stage continues only until the first \( t \) for which the following inequality is satisfied:

\[
(\frac{1}{2} - r)p(t+1)B(t+1) < (\frac{1}{2} + r)p(t)B(t) + c
\]

This process of mutual preemption constitutes the race to commit. Inequality (4) simplifies to:

\[
(\frac{1}{2} - r)p(t+1)B(t+1) - (\frac{1}{2} - r)p(t)B(t) - 2rp(t)B(t) < c \iff (\frac{1}{2} - r)\Delta[p(t)B(t)] - 2rp(t)B(t) < c
\]

Since \((\frac{1}{2} - r)\Delta[p(t)B(t)] - 2rp(t)B(t) < (\frac{1}{2} - r)\Delta[p(t)B(t)] < \frac{1}{2}\Delta[p(t)B(t)]\), the information stage will terminate earlier than under a unilateral ability to commit and earlier than socially desirable.

More generally, it can easily be shown that a bilateral ability to commit will result in too early a termination of the information stage even if parties obtain unequal shares of the gains of reaching agreement and bear unequal shares of the costs of continuing the information stage. Let \( \alpha B(t) \) be party 1’s share of these gains if neither party makes a firm commitment offer, with \( r < \alpha < 1-r \), and let \( \beta 2c \) be party 1’s share of the costs, with \( 0 < \beta < 1 \). Thus, party 2’s share of the gains would be \((1 - \alpha)B(t)\), and its share of the costs would be \((1-\beta)2c\).

Let \( \alpha \leq \beta \). That is, party 1 will have a relatively greater (or equal) incentive to terminate the information stage since her relative share of
the costs of continuing the information stage exceeds (or equals) her relative benefits from an increased probability of reaching agreement. Substituting, in inequality (2), \( \alpha + r \) for \( \frac{1}{2} + r \) and \( \beta 2c \) for \( c \), we find that, if party 1 were the only one that could terminate the information stage and make a final commitment offer, it would terminate the information stage and make a final commitment offer if:

\[
(\alpha + r)\Delta[p(t)B(t)] < \beta 2c
\]

Let the first \( t \) for which this inequality is satisfied be \( \hat{t} \). Multiplying both sides by \( 1/\beta \) yields:

\[
[(\alpha + r)/\beta]\Delta[p(t)B(t)] < 2c
\]

If \( \alpha + r < \beta \), then \( (\alpha + r)/\beta < 1 \), and the left side of the inequality is smaller than the left side of inequality (1). Thus, party 1 would terminate the information stage earlier than socially optimal even if it had complete control over the duration of the termination stage, i.e. even absent a race to commit.

Now assume that \( \alpha + r \geq \beta \). Substituting, in inequality (4'), \( 1 - \alpha - r \) for \( \frac{1}{2} - r \) and \( (1 - \beta) 2c \) for \( c \), we find that party 2 would want to terminate the information stage in round \( t \), if it knew that party 1 would otherwise terminate in round \( t + 1 \), if:

\[
(1 - \alpha - r)\Delta[p(t)B(t)] - 2rp(t)B(t) < (1 - \beta)2c
\]

Specifically, party 2 would want to terminate in round \( \hat{t} - 1 \) if:

\[
(1 - \alpha - r)\Delta[p(\hat{t} - 1)B(\hat{t} - 1)] - 2rp(\hat{t} - 1)B(\hat{t} - 1) < (1 - \beta)2c
\]

Multiplying both sides of equation (5) by \( 1/(1 - \beta) \) yields:

\[
[(1 - \alpha - r)/(1 - \beta)]\Delta[p(\hat{t} - 1)B(\hat{t} - 1)] - [2r/(1 - \beta)]p(\hat{t} - 1)B(\hat{t} - 1) < 2c
\]

As \( \alpha + r \geq \beta \), it follows that \( 1 - \alpha - r \leq 1 - \beta \) and thus that \( (1 - \alpha - r)/(1 - \beta) \leq 1 \). Therefore, the left hand side of inequality (5') is less than \( \Delta[p(\hat{t} - 1)B(\hat{t} - 1)] \), the left hand side of inequality (1). Thus, if \( \alpha + r \geq \beta \), the information stage would also terminate earlier than socially optimal.

The same steps can be easily repeated for \( \alpha \geq \beta \). In that case, \( 1 - \alpha < 1 - \beta \) and the positions of party 1 and party 2 are reversed.

**Numerical Illustration**

Assume that each round of bargaining imposes costs of 1 on each party 1 and party 2, and that absent a firm commitment offer both expect to receive half of the joint gains of reaching agreement. If one party makes a firm commitment offer, it expects to receive 55% of the joint gains of reaching agreement, and the other party expects 45%. The expected joint gains from reaching agreement are given by the function:
From the social perspective, the parties should continue the information stage until:

\[ B(t+1)p(t+1) - B(t)p(t) < 2. \]

This will be the case at \( t = 1,250 \). At that point, expected joint gains from reaching agreement are 5,000, costs of 1,250 rounds of information gathering are 2,500, and net benefits are 2,500.

If party 1 can make a firm commitment offer, party 2 will continue the information stage only until:

\[ .45 \cdot p(t+1)B(t+1) - .45 \cdot p(t)B(t) < 1. \]

This will be the case at \( t = 1,013 \). At that point, expected joint gains from reaching agreement are 4,501, costs are 2,026, and net benefits are 2,475. Thus, the unilateral ability to make a firm commitment offer lowered net benefits by 25, or 1%.

If both parties can make firm commitment offers, they will continue the information stage only until:

\[
.45 \cdot p(t+1)B(t+1) - .45 \cdot p(t)B(t) - .1 \cdot p(t)B(t) < 1 \Rightarrow \\
.45 \cdot p(t+1)B(t+1) - .55 \cdot p(t)B(t) < 1
\]

This will be the case at \( t = 2 \). At \( t = 2 \), \( p(t)B(t) = 200 \). At \( t = 3 \), \( p(t)B(t) = 245 \). Expected benefits at \( t = 3 \) to the party not making a firm commitment offer are 110.2; expected benefits at \( t = 2 \) to the party making such offer are 110. Thus, taking into account the costs of continuing the information stage, each party would prefer to make a firm commitment offer in round 2 to being preempted in round 3.

Expected joint benefits from continuing the information stage to round 2 are 200 and costs are 4, yielding net benefits of 196. Thus, the bilateral race to commit radically reduced the duration of the information stage and lowered net benefits by more than 90%.
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