In the

Supreme Court of the United States

TSC INDUSTRIES, INC., et al.,

Petitioners,

v.

NORTHWAY, INC.,

Respondent.

No. 74-1471

Washington, D.C.
March 3, 1976

Pages 1 thru 39

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TSC INDUSTRIES, INC., et al., Petitioners, v. NORTHWAY, INC., Respondent.	No. 74-1471

Washington, D. C.,

Wednesday, March 3, 1976.

The above-entitled matter came on for argument at 2:15 o'clock, p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice

APPEARANCES:

JOSEPH N. MORENCY, JR., ESQ., Price, Cushman, Keck, Mahin & Cate, 8300 Sears Tower, 233 South Wacker Drive, Chicago, Illinois 60606; on behalf of the Petitioners.

HARRY B. REESE, ESQ., 357 E. Chicago Avenue, Chicago, Illinois, 60611; on behalf of the Respondent.

C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We'll hear arguments next in 74-1471, TSC Industries against Northway.

Mr. Morency, you may proceed whenever you're ready.

ORAL ARGUMENT OF JOSEPH N. MORENCY, JR., ESQ.,

ON BEHALF OF THE PETITIONERS

MR. MORENCY: Mr. Chief Justice, and may it please the Court:

I shall not try to maintain the level of interest, or even to make comparisons with respect to the very challenging patent case the Court has just heard. Although I'll admit my colleagues and I have thought of several ways in which it might be done.

[Laughter.]

MR. MORENCY: I would also state that I have made arrangements with the Marshal to reserve approximately ten minutes for rebuttal.

This case began in 1969, on December 4th, in the afternoon preceding the December 5, 1969 stockholders' meetings of TSC Industries, Inc., and National Industries, Inc.

That was a swap of the assets of TSC for securities of National Industries, which were passed through to the holders of the TSC stock.

The issue now before this Court is whether, on the summary judgment record, and under the limitations of Rule 56

of the Federal Rules of Civil Procedure, the Seventh Circuit could properly find that the omission of four actual matters from the 80-page proxy statement was so serious, so important as to make the entire proxy statement violative of Rule 14a-9. 14a-9 is a rule promulgated by the SEC which prohibits the making of a misleading or false statement of a material fact, and authorizes --

QUESTION: Mr. Reich [sic], it does seem to me that there may be one common element, though perhaps you may not see it that way, between the prior case and yours, and that is an inquiry, perhaps, as to what's a question of fact and what's a question of law.

Is there any generally accepted standard in the Courts of Appeals or in this Court as to whether a question of materiality, such as the Court of Appeals and the district court passed on here, is generally a question of law or a question of fact?

MR. MORENCY: Mr. Justice, I think that is rather well understood, and I think a question of materiality is a question of fact.

It may become a question of law when the court finds that all reasonable men would agree on whether a matter is so important or not. And this is the basis on which the Seventh Circuit decided these various questions on the summary judgment record.

QUESTION: Judge McLaren's holding was, in effect, that it was reasonably debatable, so he denied summary judgment.

MR. MORENCY: That is true. Judge McLaren found that certain important facts were missing as to some matters. He found that key facts were hopelessly in dispute as to other matters. And therefore he concluded that the requisite summary judgment finding could not be made; that is, that there were no material disputed issues of fact. He could not make such a finding, and therefore he concluded he could not give plaintiff its partial summary judgment on the issue of liability.

Plaintiff sought that partial summary judgment on the issue of liability solely on the basis of Rule 14 -- or, rather, Section 14 of the 1934 Act, and the SEC proxy rules promulgated thereunder.

Now, you are right, Mr. Justice, I did not think of that connection. But primarily I think because various Courts of Appeals, who have considered the issue, have so decided it. We cite a number of cases to that effect, one of which is the Johns Hopkins case, another of which is Rogen v. Ilikon.

When this case was filed, the complaint charged that this was a steal, that National Industries, in collusion with TSC directors dominated by National Industries, it was said, had conspired together to sell off this valuable business of TSC at a grossly inadequate price.

However, there was no motion for a temporary restraining order in this case, filed the day before the shareholders' meetings.

After two and a half years of discovery, apparently no fraud could be found and established, and the plaintiff, a private holding company, called Northway, Inc., filed a motion for partial summary judgment on the issue of liability only, predicated entirely on omissions from the proxy statement, with the single exception no longer material here, and charged that under the proxy rules the proxy statement was rendered fatally defective because of these omissions.

The Court of Appeals found, and so did the district court, that all of the required disclosures had been made. So the case was considered below on the question whether the omissions were of such magnitude and such seriousness as to render the proxy statement disclosures actually made of the required matters false or misleading. Once again reference to Rule 14a-9.

These alleged omissions, serious omissions, really fell into two areas.

One area related to the alleged control, which plaintiff said National had over TSC and its influence over TSC in 1969.

The other related to an alleged manipulation of prices of the common stock of National Industries, which, by

the way, was not involved in the transaction at all. The National securities that were given to the TSC holders were the National Series B Preferred Stock and National Warrants.

Now, the Seventh Circuit, in deciding the case, followed almost religiously the position of an SEC amicus brief filed with it. They followed religiously on the omissions. They did not follow the plaintiff's claim that there was a failure to properly report control or a change in control, but they did say that four omissions were serious.

The Circuit so found, but in so finding I think the Circuit discovered that it had to redefine materiality and depart from the teaching of this Court in Mills and the holdings of other Circuits, such as the Second and Fifth; and they went ahead and defined materiality by reference to relevancy of a factual matter, saying that it was sufficient as required disclosure even if it was relevant only for some stockholders.

Now, it is our position, and we believe that the legislative history and the deciding cases support the position, that Rule 14a-9, which is the catchall, is violated only when the omitted fact itself is material, and its omission makes the disclosures in the proxy statement itself false or misleading in a material respect.

There are certain key facts which we refer to in our Reply brief, and which we believe put this case in a context which makes it much easier to analyze.

Admittedly, an 80-page proxy statement is not an easy document to digest or to analyze. It is reproduced in full text in the Appendix. We have twenty copies which do not meet the Court's printing rule, but which were printed for the shareholders in '69, which we're perfectly willing to deposit with the Clerk in the interest of avoiding eyestrain for the Justices and their clerks.

But let's go back to the transaction and see what actually happened.

Unlike the finding in the Seventh Circuit, and contra the position of the Respondent here, this transaction was actually determined and defined by Blancke Noyes. Blancke Noyes was an old TSC director. His history was TSC antedated by several years. The first interest that National Industries ever had in it, in February of '69. He is a partner in a prestigious investment banking firm, and was an investment banker and is an investment banker of ability, himself. Both he and his wife are stockholdres in TSC.

It was his firm and he who analyzed the proposed transaction, as outlined by National Industries in its proposal, and said it wasn't good enough. He made a counter-proposal, which National Industries accepted without further discussion. And it was his counterproposal which became the exchange ratio in the transaction.

It was his firm that handled 195,000-share public

offering in the spring of 1969, and it was his firm in the fall of that year that handled the review of the transaction at the request of TSC and for the benefit of TSC directors and shareholders.

Now, how was the transaction adopted by this board?

Once again we find that total absence of influence by National Industries. National had five directors on this board. None of those directors voted on the October 16th meeting; the three who were present abstained.

The transaction was -- and the resolutions in respect of it were adopted by a vote of four independent disinterested directors, none of whom had any connection with National.

Here I refer to Mr. Noyes, Mr. Schaefer, who was the chief executive officer of the company, in fact although not in title, and Directors DeForst and Sharfman.

Now, where is the context in which these so-called omissions must be viewed? These ones that were so serious that they shouldn't allow the transaction to be upset.

First of all, it's clear that National Industries was not in control of the TSC in the fall of 1969. The district court said that National's alleged control was not established. The Court of Appeals agreed. Therefore, on this summary judgment record, we say it is clearcut that National is not in control of TSC.

Secondly, the terms of exchange were determined not

by National but by Blancke Noyes, the investment banker, and TSC Director.

Thirdly, the transaction itself, as far as TSC is concerned, is initiated as a result of resolutions adopted after the report of Mr. Noyes is received, both in writing and orally, by his fellow Directors at TSC.

With all of the National nominees abstaining.

Now, what's in the proxy statement?

Well, at Appendix 267, you will find it is prominently and plainly disclosed that National owned 34 percent of the TSC stock, that five of the ten Directors were National's nominees. Who these five persons were and what their jobs were at National Industries is also prominently and plainly disclosed.

The two of the -- two of the omissions which the court below said as a matter of law on the summary judgment record were so serious that reasonable men would not differ on their importance, were related to the titles of Stanley Yarmuth and Charles Simonelli.

Yarmuth was the president and chief executive officer of National Industries, and Simonelli was the director and executive vice president of National. They became directors of TSC.

When first elected, there were four National directors out of a total board of ten. And Yarmuth became the

Chairman of the Board and Simonelli became the Chairman of the Executive Committee at TSC.

Yarmuth's position as Chairman of the Board, per the By-laws, made him chief executive officer. On the record here, it is plain that he never functioned as such. His affidavit and the testimony make it perfectly clear that he didn't even know he was "the chief executive officer," until after the lawsuit was filed and discovery had begun.

As to Simonelli, the record is perfectly clear that this transaction was one in which the executive committee of this board had no power whatever. So his title as Chairman of the Executive Committee, on which he and Yarmuth served, along with a majority of three old TSC Directors, could not be very important to anyone.

Yet that is the kind of thing which, at the urging of the SEC's lawyers, the Seventh Circuit said, in disagreement with the district judge who analyzed this record carefully, said was so serious, so material, so important, that the proxy statement thereby violated the basic proxy rule as to omitted material.

Now, we think that the Seventh Circuit arrived at its misconstruction of 14a-9 fundamentally in three steps.

First of all, he said, correctly we submit, that the alleged control of TSC by National was not established on the summary judgment record. Point 1.

Then they said that certain facts are persuasive indicators -- and the phrase is theirs -- persuasive indicators of control. Then they concluded that the proxy statement should have disclosed those suggestive facts which indicated a "substantial likelihood of control".

In brief, we suggest to the Court that what they did was to confuse suggestive facts, soft information, with the kind of hard information which the legislative history and the SEC's own rules tell us is to be sought, printed, and understood in a proxy statement.

Proxy statements are supposed to tell the facts the way they are. Facts which are known. Facts which are ascertainable. Not matter which is suggestive of a fact, when the ultimate fact, control, has already been postulated by the court as being not established on the summary judgment record.

This is the kind and quality of nitpicking, frankly, that --

QUESTION: Mr. Morency, you referred a couple of minutes to the summary judgment record. Is it -- all you have to maintain, I suppose, is that your opponents were not entitled to have summary judgment granted. Do you go further and contend that on the summary judgment record you would have been entitled to summary judgment, or that it was a fact question that should have been resolved by the trier of facts?

MR. MORENCY: Mr. Justice, we did not make a cross-motion. The reason we did not is evidence from Judge McLaren's order and memorandum opinion. There are, frankly, some undisposed, undecided, unresolved important factual questions in this record today.

There are questions on which, despite the fact that counsel for both sides are here in full battle array, nobody can answer with accuracy and completeness.

So we do not feel we're entitled to summary judgment, and we certainly submit they were not.

But the Court of Appeals held they were, in disagreement with Judge McLaren.

And the reason that we think the Court of Appeals made this confusing set of holdings lies in the fact that they gave the SEC amicus brief a whole lot more credit than it was due. It was prepared by the Commission's lawyers, who know the least of all about the review of proxy statements.

QUESTION: Well, the Court of Appeals didn't accept the test that the Commission proposed, did it?

MR. MORENCY: Well, the Commission didn't really propose a test in its amicus brief below.

QUESTION: Oh, it didn't. But it does here.

MR. MORENCY: Oh, it does here, and, as I read it, --

QUESTION: It poses a significant propensity test, which the Court of Appeals rejected. Is that right?

MR. MORENCY: That's true. Well, Mr. Justice White, if you can tell exactly what it is that the SEC brief in this Court says this test should be, you will have succeeded where all of my colleagues have tried and failed. Because we can't make sense out of it.

QUESTION: Well, I had thought that they suggested the significant propensity test.

MR. MORENCY: They do suggest significant propensity, and they changed the wording of Justice Harlan in the famous Mills opinion just a little bit.

QUESTION: But at least they do not -- they do not embrace the "might have" test that this Court Appeals for the Seventh Circuit used.

MR. MORENCY: No, Mr. Justice, and they do not embrace the relevancy idea that the Seventh Circuit espoused and said relevancy --

QUESTION: Well, assume that we agreed with whatever it is the SEC proposes, assume we agreed with it, and that it is different from what the Court of Appeals for the Seventh Circuit uses, what would we do?

MR. MORENCY: I think you ought to --

QUESTION: Would we -- we would vacate and remand, to use the right test, I suppose?

MR. MORENCY: I think what the Court would probably do would be to use these four omissions as examples of things

which are not material as a matter of law on a summary judgment record, announce a correct test, and remand so that the district court could go ahead with the trial.

QUESTION: Yes, but the Commission says that under any test, including its test, the judgment should be affirmed.

MR. MORENCY: Yes. And the Commission speaks with a forked --

QUESTION: As a matter of law.

MR. MORENCY: The Commission, as we point out in our Reply Brief, speaks with a forked tongue. They speak to us in October of 1975 and they tell us, in their comprehensive release on materiality, which we cite and quote at some length, what their rules are and what they follow; and yet their lawyers file briefs in this Court where they don't even mention that release.

QUESTION: Why do we need to reach the first suggestion they make? Why -- if we were to decide to remand, why wouldn't it be enough simply to clarify what is the proper basis of the evaluation? I carefully avoid the use of the word "test" here.

MR. MORENCY: Mr. Chief Justice, I think the confusion that you have in the Seventh Circuit and the confusion evident from the amicus brief of the SEC here is a good enough reason to show you that you're going to have to use very strong language in formulating your test of materiality, or your materiality

standard, and state it in such terms that Commission lawyers, plaintiff's lawyers, we, will all understand you. Merely reversing and remanding on the ground that they didn't say it right when they said relevancy for some is enough, will not do the trick. I think, frankly, some judicial leadership is called for here, and we are hopeful this Court will provide it.

We know it's needed. It's never been decided.

I would like to reserve the balance of my time, if I may.

MR. CHIEF JUSTICE BURGER: Mr. Reese.

ORAL ARGUMENT OF HARRY B. REESE, ESQ.,

ON BEHALF OF THE RESPONDENT

MR. REESE: Mr. Chief Justice, may it please the Court:

The questions raised by the Court during Mr. Morency's argument inquire for background, perhaps somewhat for an explanation of what these four admitted documentary uncontraverted facts omitted from the proxy statement are, and what their importance may be in the decisional process of the ordinary, average and reasonable shareholder.

What is the first question which comes to mind to a shareholder when he is invited to accept or reject an exchange of securities? How will the value of my investment be affected?

QUESTION: Well, let me ask you this, if I may, --

MR. REESE: Yes.

QUESTION: -- Mr. Reese: On the same kind of fact/law distinction. Isn't the average juror probably in as good a position to evaluate what is the first thing that will come to a stockholder's mind as the average lawyer or the average judge?

MR. REESE: Yes, Mr. Justice Rehnquist, we certainly agree, and we believe that he should be afforded the opportunity to make the decision, to make the judgments about whether this is a good deal. The underlying statutory policy, as explained by this Court unanimously in Mills, is not to substitute a judicial appraisal of the merger's merits for the shareholder's actual informed vote. I think it's perhaps not too much to say that the shareholder has the right to be wrong to turn down a bad deal.

QUESTION: But if that's so, wouldn't the materiality normally be a question of fact for the finder of fact, rather than a question of law?

MR. REESE: I think, as Mr. Justice Rehnquist's question identified in the course of the last argument, matter of law is used in two distinct and very different senses. There is, first, the question of fact, the question of what happened, what occurred --

QUESTION: Historical fact.

MR. REESE: Yes. And we say that when the evidence is so overwhelming that reasonable minds cannot differ, that's a matter of law.

We also say it's a matter of law when it's a question of law, as here. When there is no dispute about what happened. The facts are admitted, the question is -- excuse me.

QUESTION: Okay. But I don't regard that as an entirely convincing answer. Because certainly in a typical negligence case, or typical common-law fraud case, you can have stipulated documents, admitted facts, and it's still regarded as a question for the trier of fact: Was the man negligent, was it material, was it misleading?

Well, why shouldn't the same principles obtain here?

MR. REESE: Perhaps, Mr. Justice Rehnquist, I can suggest that when we commit a question of that kind to a jury in a negligence case, we are saying our highest expectations in this field of behavior are the -- is the normal behavior of reasonable people. That is not the expectation under the Securities laws. The morals of the marketplace, the generally accepted standards of ordinary men had led us into a debacle, which --

QUESTION: But we commit questions of fraud in a fraud case to the jury, thinking that properly charged, as they should be, they will be able to make the assessment for themselves.

MR. REESE: The -- certain kinds of questions of fraud, common-law deceit, are ordinarily submitted to juries. When we impose a higher standard, an equitable standard imposed upon a fiduciary, requiring disclosure of all material information and all conflicts of interest, the question is decided by the judge under traditional equitable principles.

The point, I think, Your Honor, is perhaps demonstrated most clearly by precedent. Whether a fact is material is, in significant part, a question of law; if, indeed, summary judgment could never be granted on the question of materiality, then this Court's unanimous decision in Mills would not have been handed down. There the Court did indeed direct the entry of summary judgment on the question of nondisclosure in a proxy statement.

The Mills case --

QUESTION: Do you think that the Courts of Appeals have uniformly and literally applied Justice Harlan's language since then?

MR. REESE: I think there is not the -- Mr. Chief Justice, there is not the need for a revision of principles which this Court laid down clearly six years ago, which it reconfirmed without question in the subsequent decision in Affiliated Ute Citizens vs. United States, and I think that the question as to --

QUESTION: Well, I'm not sure that was my question.

MR. REESE: Well, what I hoped to lead into was the question of the Seventh Circuit's decision in this case, and its relationship with, for example, the Gerstle opinion which used a somewhat different phrasing.

In the first place, if I may, before addressing that particular question, I would note that there are in the record here and in the briefs offered a variety of tests or standards or measures or evaluation of materiality. The government in this situation has not, I think, -- and this is in partial response to a question of Mr. Justice White -- has not adopted the test that was rejected by the Seventh Circuit.

There is a critical difference. The government is speaking of a significant propensity to affect the judgment of a reasonable shareholder.

The test, the significant propensity test, which the Seventh Circuit was rejecting was a significant propensity to change the outcome of the vote.

What the -- I think that the Court of Appeals opinion must be read in the light of that Court's experience with these questions and the arguments which were presented, which the Court was addressing in the terms in which those arguments were made.

QUESTION: Do you think Justice Harlan's language was directed at primarily other judges, or was it cast in terms to be used as an aid to the triers of fact?

MR. REESE: Their -- in cases where there is an issue of what occurred, an issue of fact in the historical sense, perhaps that formulation would be an appropriate instruction to be submitted to the jury, along with the determination of what occurred.

But I think it serves both as a guide to lower courts and, in appropriate cases where there are fact issues, for instructions to a jury.

If the Court of Appeals for the Seventh Circuit had been reversed in Mills, Judge Swygert was a member of that panel, the reason for reversal was that panel's holding that liability was not established without a factual determination of the probability that a truthful proxy statement would have produced a different result.

QUESTION: Getting back to Mills for a moment, --

MR. REESE: Yes, sir.

QUESTION: -- Mr. Reese, I sent for it, and I notice that, at least as I read Footnote 4 on page 381 of Justice Harlan's opinion, he says that the respondents asked the Court to review the conclusion of the lower courts that a proxy statement was misleading in a material effect, but this Court refused to pass on it because it wasn't raised by the petition.

Is that consistent with your answer that -- earlier -- that the Court must have decided that the statement was

material as a matter of law?

MR. REESE: Yes, I think it is, Mr. Justice Rehnquist, on this ground: There is a difference between this Court's scouring the record to determine whether the facts omitted from the proxy statement and found to be established without genuine controversy in the lower courts, whether those facts were properly found and existed without genuine controversy.

This Court declined to consider that question. But this Court did directly address the question of what is the test, what is the standard; that was an essential step in the Court's concluding that the Seventh Circuit erred in denying summary judgment, and in this Court's remanding the case with the direction that summary judgment must be entered.

The Court was laying down, if you will, a formula, saying these are the elements that must be established to impose liability in a proxy case. One of those elements is the omission of facts which are material, in the sense that they might have been considered important to a reasonable shareholder.

QUESTION: But this Court didn't review --

MR. REESE: This propensity -- excuse me.

QUESTION: This Court didn't review that holding in Mills.

MR. REESE: This Court made that determination. I

was quoting the language of Mr. Justice Harlan's opinion --

QUESTION: But that was the test the Court of Appeals used.

MR. REESE: I think -- I think not, Mr. Justice White.

QUESTION: Well, I mean the panel, the panel. In that case --

MR. REESE: Oh, in that case.

QUESTION: In Mills. They said that the Court of Appeals had used the wrong standard.

MR. REESE: Yes. Yes.

QUESTION: And imposed the standard which you just recited.

MR. REESE: That is right. A standard which requires -- and I can take it directly from the --

QUESTION: And the Court of Appeals in this case, at least purported to follow that rule that you stated from Mills.

MR. REESE: Yes. They were careful -- they were careful to put aside any possibility of a requirement of a showing, an independent proof of reliance or causation or probability.

QUESTION: And they thought they were differing, whether they were or not, but at least they thought they were differing with the Second Circuit?

MR. REESE: I think perhaps so, although Judge Friendly, in the Gerstle case, had granted summary judgment, even though he chose to state it somewhat differently.

QUESTION: But the panel -- no, but the panel here thought they were differing with him.

MR. REESE: I think -- yes, I think that is clear. What they were principally rejecting, Your Honor, was the argument which was presented, advanced in terms of significant propensity. That -- those words, that phrase was used as the catch phrase. And the building block for an argument, you had to look to whether the case would have -- the vote would have come out the other way.

QUESTION: Well, do you accept what the Securities and Exchange Commission suggest in their amicus brief in this Court?

MR. REESE: Yes. Yes, we do, Your Honor. We have no quarrel with any of the tests, the standards, the phrasings of materiality which have been offered, except one -- except one, which plainly invites this Court simply to overrule Mills. On page 14 of Petitioner's Reply Brief, they ask this Court to announce a standard that imposes a heavy burden -- this is the top of page 14 -- to show that the fact omitted, because of its obvious significance, almost certainly would have turned the shareholders' vote the other way.

That's almost precisely what the Seventh Circuit

said in --

QUESTION: Now, here's what the Court of Appeals -- here's what the Securities and Exchange Commission says here: To the contrary it believes -- I guess the Commission believes -- that Mills announced the following criterion for determining when facts submitted for a proxy statement are material: Whether the admitted facts have an significant propensity to affect the judgment of a reasonable shareholder in deciding how to vote.

Now, do you accept that?

MR. REESE: Yes, we do, Your Honor. It's the significant propensity to affect the judgment of a reasonable shareholder. We think that's, for all practical purposes in decision of concrete cases, the equivalent of this Court's formulation in Mills.

QUESTION: Of "might have". Of "might have"?

MR. REESE: Yes.

QUESTION: Mr. Reese, I think you've answered the question I was going to put, but I'll put it more specifically.

Do you perceive any distinction at all between the standard applied by the Court of Appeals and that proposed by the SEC?

MR. REESE: I do not -- I do not, Your Honor, the --

QUESTION: Do you see any difference between the standard applied by the Court of Appeals in the Seventh Circuit

and that proposed by Judge Friendly in the Second Circuit?

MR. REESE: I must confess, Mr. Justice Powell, that I think that -- that that distinction between "would" and "might" is indeed gossamer, as both Courts considered that it might be.

QUESTION: Your brief, as I recall it, presented a question before this Court largely as a factual issue, whereas the question that we took the case to decide, as stated in the Petition, related to the proper standard. What you're telling us now is it really doesn't matter which of these formulations we adopt; so far as you're concerned, you're entitled to affirmance and a judgment on the facts in this case, as I understand it.

MR. REESE: Yes, Mr. Justice Powell. I might say, of course, we took that position in opposition to certiorari from the beginning.

QUESTION: Yes. Yes.

MR. REESE: We think that the facts, uncontradicted, admitted, established, are so obviously important under these circumstances that they are beyond the reach of any nice adjustment, refinement, --

QUESTION: So that if we adopt it verbatim, the formulation of the Second Circuit, your position is that the judgment of the Seventh Circuit should be affirmed?

MR. REESE: Yes, Mr. Justice Powell, with specific --

QUESTION: Would you object to our adopting that standard?

MR. REESE: With this specific understanding, which I think was plainly understood by the author of the Gerstle opinion, who chose to use "would", that is that "would" does not introduce an element of probability which must be determined at a trial. That was the concern that Judge Swygert had with the use of "would", footnote 13 in Judge Swygert's opinion. It becomes very refined on that question, and it makes it plain that what he is concerned about is the possible connotation that "would" means there has to be a trial of the probability. Mills directly rejected that, and --

QUESTION: But Mills was -- I thought it was dealing not with the question of materiality but with the question of causation.

MR. REESE: That is correct, Mr. Justice Stewart, but --

QUESTION: And purported to make a distinction between the two, as my brother Rehnquist has pointed out, in footnote 3 -- 4, footnote 4 on page 381 of the Mills opinion.

MR. REESE: Yes, but I believe that the basic question confronting this Court was not to write an essay on causation, but to determine what elements were necessary to make a case of liability. And the Court expressly said, it is not necessary, and would be destructive of the statutory purpose,

the congressional purpose; would substitute a judicial appraisal of the merits for the shareholders' actual and informed vote.

QUESTION: Do you think --

MR. REESE: If that requirement were imposed.

QUESTION: -- analytically, in the end, that materiality and -- questions of materiality and causation kind of come together and end up to be very much the same question?

MR. REESE: I believe under -- in cases where a selling document is broadcast to the public at large, in the light of a statutory policy requiring full disclosure, seeking to encourage reliance, I think, in practice, --

QUESTION: At least the way causation has been held to be, in cases like Mills.

MR. REESE: Yes.

QUESTION: And Associated Tribe of the Ute. So long as one doesn't have to show actual reliance of any kind, then materiality and causation are very much the same thing, aren't they?

MR. REESE: Yes. And --

QUESTION: You would say on that answer that a defense of no causation would never work? If someone said, Look, I just didn't -- if the defendant said, I'm going to prove that there was no reliance, no causation, the judge

should say that's irrelevant.

QUESTION: That's right. Under Mills.

QUESTION: Because it might have been.

QUESTION: And Affiliated Ute, too.

MR. REESE: If I may answer, this Court has not confronted the question as yet, which has been decided in a number of Circuits --

QUESTION: How about the Courts of Appeals? How about trial courts? Do you know what they say in that circumstance?

MR. REESE: There is some authority that if they don't need the votes, if they have enough votes, half the vote or half the shares, so they can put it through without a proxy statement, there is some authority that in that situation the proxy statement will not have any causal relationship with the merger. That has been expressly rejected in the Second Circuit, in the case of --

QUESTION: Well, what if you were one who voted for it? And your votes were critical and passing.

MR. REESE: And --?

QUESTION: Does that make any difference?

MR. REESE: I'm sorry, perhaps I didn't make the factual premise, it is the situation where the defendant has the --

QUESTION: Well, anyway, in general, are there some

district courts or some Courts of Appeals that say that causation is a relevant issue in trials of these cases?

MR. REESE: Yes. That in those situations where the defendant already has the votes and doesn't need any proxy votes, then causation will bar any selection. There is authority to that effect, yes. It's a minority.

QUESTION: But if the plaintiff sues and the defendant says, Well, look, now that plaintiff just was never hurt by this.

MR. REESE: The -- the --

QUESTION: It isn't an individual question, it's a question of causation and --

MR. REESE: Oh, I should have -- I should have made plainer, Mr. Justice White -- I apologize. There is a whole line of cases which says that if the proxy statement did not authorize the action which caused the injury of which the plaintiff complains, there is no causal relationship; if the proxy statement merely failed to reveal some prior wrongdoing, which is not the subject of the proxy vote, there is no causal relationship.

The four admitted facts were not speaking to the question of the basis of the district court's decision, and whether the district court denied summary judgment on the ground that it found that there were factual issues.

The grounds on which the district court chose not to

grant summary judgment, I think a careful reading will disclose, don't -- don't rest on a general proposition that there are genuine issues of material fact.

First, there is the substantial premium over current market values, represented by the securities being offered to the TSC shareholders. He found -- he found that that violation did not warrant summary judgment, because he said there was no evidence in the record to show that the corrected value of the warrants -- Mr. Noyes' opinion fully explained, said those warrants were not worth the five-dollar-and-a-quarter market value that was listed in the proxy statement. It was his opinion that with the issuance of six times as many warrants, three million instead of less than half a million, there would be a substantial decline, to $3.50.

That decline abolished any -- any substantial premium, and we asserted that half -- half the opinion had been presented; the good news had been presented, the bad news had been held back.

Judge McLaren rejected that ground, because he said there was no evidence in the record to show that this revised warrant value would substantially destroy the premium.

We -- I think we're at fault in not making it clear that all that was required was simple arithmetic as applied to the exchange ratio, plugging in the market values.

When it came to the Madison National purchases of

260,000 shares of National Common Stock during the two-year period for which the market values are nicely set forth, conveniently, in the proxy statement, when Edward Merkle was on the payroll of National, receiving $12,000 a year for one day a month, a thousand dollars a day for such services as the TSC Board might call upon him to perform.

The reason for denial of summary judgment in the district court on that ground was, as a matter of law, he said there is no necessity for disclosure here, unless there was collusion, unless National and Mr. Merkle from Madison got together and agreed that they should do this.

We took the position, which we have again perhaps failed to make clear, that whether Mr. Merkle was acting in consultation with National officers or purely unilateral, his actions were called into question by his relationships with National as an employee, and there was a duty to disclose, regardless of whether a substantive violation of some other provision, some provision forbidding market rigging, was involved or not. We were not saying that the purchases were unlawful in themselves, we were simply saying that they should be disclosed. And --

QUESTION: Mr. Reese, excuse me for interrupting. The respondent owned 200 shares, as I recall. What was the market value of those shares at the time of the merger?

MR. REESE: At the time of the merger, the Preferred

Shares were --

QUESTION: I'm talking about the 200 shares that your client owned.

MR. REESE: I would have to add it up. The shares were selling at about 12, so I guess that would be about $2500.

QUESTION: Right. And what was the market value of the securities obtained by your client, oh, say, a month or a year later?

MR. REESE: If the market, with the elimination of the premium, would have been --

QUESTION: What do you mean by "elimination of the premium"?

I'm talking now about the securities your client received in the merger.

MR. REESE: The value of the Warrant was five and a quarter, as listed in the proxy statement. Mr. Noyes said that value will not hold, that market price is not a fair indicator of the value of the Warrants you will in fact receive, that it will drop to three-fifty.

Mr. Noyes was right. It did drop to three-fifty. Within --

QUESTION: Does your client still hold the securities?

MR. REESE: Yes, Your Honor.

QUESTION: What are they worth today on the market?

MR. REESE: The Warrants are worth about two dollars, they're up with the recent market surge. The Preferred is worth about fourteen dollars. The National Common, into which the Preferred is convertible at a discount, three-quarters of a share of Common, is most recently, I believe, quoted at eleven dollars.

I should explain, Your Honor, that those are all outside the record.

QUESTION: But if you take the current market of these securities today, as compared with the market pre-merger of the whole stock, what's the theoretical loss to your client, if he sold out today?

MR. REESE: The theoretical loss -- the client in a sense -- I don't mean to evade the question; but the suit is derivative.

QUESTION: I understand that.

MR. REESE: The particular loss to Northway would -- I'm sorry, Your Honor, I can't answer it directly, because we have not tried the damage question. But the --

QUESTION: Right. But the range of it. Two or three hundred dollars?

MR. REESE: I would think substantially more, Your Honor. Our expert has analyzed the value of TSC, and its shares, and the value of the National securities that were received. He has concluded that the TSC securities were under-

valued and depressed after National obtained control, and that their true value was not 12 or 13, but perhaps somewhere in the twenties, so we'd be talking about a matter of ten dollars or more per share.

QUESTION: Unh-hunh. And the respondent is a personal holding corporation?

MR. REESE: I think that's probably a grand description for a family -- a personal corporation that a retired businessman established simply as part of his estate planning and to handle his personal investments.

The grounds of Judge McLaren's opinion -- if I may resume and try to put that one to rest -- he held as a matter of law that there was no duty to disclose unless there was in fact manipulation. And that is not a determination of adjudication as to a question of fact but as to what the law requires.

My time has expired.

Thank you.

MR. CHIEF JUSTICE BURGER: Do you have anything further, Mr. Morency?

REBUTTAL ARGUMENT OF JOSEPH N. MORENCY, JR., ESQ.,
ON BEHALF OF THE PETITIONERS

MR. MORENCY: Just a very limited matter or two, if the Court please.

I would like to say, first of all, that I think we

deal effectively with this matter of the Hornblower opinion in our Reply Brief, in which we point out to the Court that in referring to a substantial premium over current market values, the Hornblower firm and Noyes referred to a premium measured by market prices at the time the exchange ratio was determined in early October.

And the premium was certainly there.

We point out in our Reply Brief that there was a premium of 22 percent for one class of stock and 17 for another, or 19 and 17.

Secondly, I think that in the discussion insufficient attention has been given to the SEC definitional effort in their brief. Admittedly, as the Justices have brought out, they do espouse essentially a Mills test at page 4, but look at page 14.

There they say they reject the restatement of torts test, which is essentially the same thing as the Mills test. That is why it was not in an effort to be coy or facetious that I suggested so strongly to the Court that that brief be read with great care, because it meets itself coming around the corner.

QUESTION: Well, it says -- it rejects a statement that a reasonable man would attach importance.

MR. MORENCY: No, I don't think, Mr. Justice White. I think, if you go to page 14 --

QUESTION: That's where I am.

MR. MORENCY: -- of the SEC brief, you will find them saying that they reject the idea that the test of materiality, which the Gerstle opinion, the Smallwood opinion, the Lewis case and others have adhered to, that is, where or not a reasonable man would attach importance to it in determining his choice of action in the transaction in question --

QUESTION: That's right, would attach; would attach.

MR. MORENCY: Un-hunh.

QUESTION: "Would" attach. That's the word they disagree with.

MR. MORENCY: I read --

QUESTION: And what they embrace is that a reasonable man "might have" or would there be a significant propensity that a reasonable man would; not that he would, as a matter of fact.

MR. MORENCY: Well, let me suggest to the Court that --

QUESTION: Well, at least that's the only difference that I can see in the test they propose and the test that they reject.

MR. MORENCY: I'm hopeful that this Court will announce a standard of materiality on which the members of the Court and the members of the bar can agree as to its meaning,

whatever your standard may be. You're well able to phrase and assemble one for yourselves. I don't purport to suggest that to you.

But I do suggest that you've got to stick with a reasonable shareholder test, and that you've got to be extremely careful in allowing the Courts of Appeals to determine, as a matter of law, that certain facts are so critical as to warrant upsetting an entire 80-page proxy statement. And that is what the Seventh Circuit did in rejecting, item after item after item, the judgments made by the district judge who went over this record with great care.

QUESTION: Well, if the district judge had come to the same conclusion that the Court of Appeals did, would you be making the same argument?

MR. MORENCY: On those nitpicking items? Yes, Your Honor, we would.

QUESTION: That's what I thought. You just don't want -- you just think judges are -- judges can make mistakes.

MR. MORENCY: Judges make mistakes; lawyers make mistakes. But I think the number of mistakes made in this area can be substantially diminished once this Court lays down a test of materiality in plain language that we can all read, and perhaps even uses the nitpicking omissions in this case as illustrations of that which is not sufficient as a matter

of law.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen.

The case is submitted -- excuse me, one more question.

QUESTION: He mentioned, Mr. Chief Justice, counsel did, the possibility that he would file copies of the proxy statement.

MR. CHIEF JUSTICE BURGER: Oh, yes.

QUESTION: Any objection to that?

[No response.]

MR. CHIEF JUSTICE BURGER: No objection, I take it.

You will leave that with the Clerk.

MR. MORENCY: We will leave the copies of the proxy statement in full print with the Cler, Mr. Chief Justice.

MR. CHIEF JUSTICE BURGER: I assumed, since there was no objection, you would do so.

[Whereupon, at 3:12 o'clock, p.m., the case in the above-entitled matter was submitted.]

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