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## Sunray DX Oil Co. v. Helmerich & Payne, Inc: Omissions of Material Facts in Corporate Proxy Statements

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SUNRAY DX OIL CO. v. HELMERICH & PAYNE, INC.:  
OMISSIONS OF MATERIAL FACTS IN CORPORATE  
PROXY STATEMENTS

The impact of federal securities acts on corporate law and behavior is increasingly being recognized.<sup>1</sup> This impact perhaps is felt most often in situations concerning disclosure of information by a corporation to its shareholders. The last few years have seen a tremendous growth in litigation involving dissemination of allegedly false and misleading information. One reason for this is that more people are investing more money than ever before in corporate securities. As corporate structures become more and more complex, these people are watching their investments closer and are demanding greater and more accurate information. Another major reason for the increase in such litigation is that federal courts have by interpretations greatly expanded the protection offered investors by the Securities and Exchange Commission rules and regulations.<sup>2</sup>

This article will be concerned with decisions dealing with one particular source of information which flows from cor-

<sup>1</sup> See Ruder, *Pitfalls in the Development of a Federal Law of Corporations by Implication Through Rule 10b-5*, 49 NW. U.L. REV. 185 (1964); *Shareholder Derivative Suits Under Sections 10(b) and 14(a) of the Securities Exchange Act*, 18 STAN. L. REV. 1339 (1966); Kaplan, *Corporation Law and Securities Regulation*, 18 BUS. LAW. 868 (1963). 12 U. CHI. L.S. RECORD 34 (1964); Lohf, *The Corporation Law of the Securities Acts: Federal Rights of Corporations*, 36 U. COLO. L. REV. 76 (1963).

<sup>2</sup> The United States Supreme Court has ruled that private parties are afforded a right to relief under the proxy rules. *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964). For a discussion of the impact of the *Borak* case on federal securities law see 78 HARV. L. REV. 1146 (1965) and *Shareholder Derivative Suits Under Sections 10(b) and 14(a) of the Securities Exchange Act*, 18 STAN. L. REV. 1339 (1966).

poration to shareholder: statements made in proxy solicitations.

The Securities Exchange Act of 1934<sup>3</sup> authorizes the Securities and Exchange Commission to promulgate rules and regulations which corporations must follow when disclosing information to shareholders and/or prospective shareholders.<sup>4</sup> The primary purpose of the 1934 Act was to promote fairness to both sellers and purchasers of securities.<sup>5</sup> This purpose should be borne in mind by any court trying to interpret the rules under the Act. Rule 14a-9(a)<sup>6</sup> promulgated by the Commission states in part:

No solicitation subject to this regulation shall be made by means of any proxy statement . . . containing any statement which . . . is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy . . . .

A recent case construing, or perhaps misconstruing, this rule was decided by the Court of Appeals for the Tenth Circuit. The case, *Sunray DX Oil Co. v. Helmerich & Payne, Inc.*<sup>7</sup>, provides an excellent starting point for a discussion of Rule 14a-9.

In January of 1968, Sunray announced to its stockholders a proposed merger agreement with Sun Oil Company. In February of 1968, Sunray and its associates were successful bidders on an off-shore tract in the Santa Barbara channel

<sup>3</sup> 15 U.S.C. § 78a (1934).

<sup>4</sup> 15 U.S.C. § 78n (1934).

<sup>5</sup> S. REP. NO. 792, 73rd Cong., 2d Sess. 2-3 (1934).

<sup>6</sup> 17 C.F.R. § 240.14a-9(a) (1968).

<sup>7</sup> 398 F.2d 447 (10th Cir. 1968).

with a bid of \$38,380,032.00.<sup>8</sup> The Santa Barbara property was designated as Tract 401. Union Oil Company was the successful bidder for the lease on Tract 402, which adjoined Tract 401, with a bid of \$61,418,000.00.<sup>9</sup> Union Oil Company commenced drilling soon thereafter and on March 19 announced that it had made a "major oil discovery" in the first well drilled upon Tract 402.<sup>10</sup> On March 19 and 20, Sunray mailed to each of its stockholders a notice of a stockholder's meeting to vote on the merger and solicited voting proxies from those stockholders unable to attend the meeting. One week before the proposed stockholder meeting, Helmerich & Payne, Inc., Sunray's largest single shareholder, com-

<sup>8</sup> This bid was \$6,000,000.00 in excess of the previous high bid for an offshore lease. Sunray acquired a 32½% interest in the lease amounting to \$12,500,000.00. Brief for appellant at 2, 5, Sunray DX Oil Co. v. Helmerich & Payne, Inc., 398 F.2d 447 (10th Cir. 1968).

<sup>9</sup> This was the largest single bid in history for an offshore lease. Brief for Appellant, *supra* note 8, at 5.

<sup>10</sup> Union Oil Company press release dated March 19, 1968, stated that:

Union Oil Company of California announced today it has made a major oil discovery in the first well drilled on a lease acquired in the recent Federal offshore Santa Barbara Channel land sale. On test, the discovery well in Block 402, OCS P-0241 No. 2, flowed at a rate of 1,800 barrels per day of 27.8 degree gravity crude oil through a ½ inch bean. Total depth of the well is 3,775 feet. The well encountered in excess of 1,000 net feet of oil sand. The sands being tested lie between 2,000 and 2,700 feet deep. Tests of other sands are planned. Union is operator for itself, Gulf Oil Corporation, Mobil Oil Corporation and Texaco, Inc. A second well on the block, OCS P-0241 No. 1 is drilling at approximately 3,500 feet. This well, which already has passed through 1,500 feet of oil sand, will be bottomed below 10,000 feet. Two 60-well drilling platforms have been ordered for installation on Block 402.

Brief for Appellant at 4, Sunray DX Oil Co. v. Helmerich & Payne, Inc., 398 F.2d 447 (10th Cir. 1968).

menced an action alleging that Sunray's failure to advise its stockholders of facts concerning Tract 401 and the information contained in the Union press release was a material omission from its proxy material.<sup>11</sup>

In order to make out a cause of action under Rule 14a-9 it is necessary to establish four items:

1. That a "solicitation" was made;<sup>12</sup>
2. That it contained an untrue statement or an omission of fact;
3. That the fact omitted or misrepresented was material; and
4. That the untrue statement or omission of fact was misleading.<sup>13</sup>

In the majority of cases concerning operation of Rule 14a-9, a problem arises in determining what is or is not a material fact. Decisions have fairly well established a material fact as one which, if known by an ordinary stockholder, would be expected to influence his vote.<sup>14</sup> This broad test of materiality is obviously developed from the definition of "mate-

<sup>11</sup> Helmerich & Payne, Inc. owned 616,000 shares of Sunray common stock which represented an investment of \$21,500,000.00. Brief for Appellant, *supra* note 10, at 5.

<sup>12</sup> See Rule 14a-1, 17 C.F.R. § 240.14a-1 (1968) defining "solicitation".

<sup>13</sup> The requirement that a proxy solicitation be misleading is expressed disjunctively from the requirement that it be false. However, only false statements that are *also* misleading should be prohibited. Of course, there is no requirement for falsity with respect to an omission of a fact. There, the only consideration is the materiality of the fact.

<sup>14</sup> See *Richland v. Crandall*, 262 F. Supp. 538 (S.D.N.Y. 1967); *Evans v. Armour & Co.*, 241 F. Supp. 705 (E.D. Pa. 1965); *Western Oil Fields, Inc. v. McKnab*, 232 F. Supp. 162 (D. Colo. 1964); *Bresnick v. Home Title & Guar. Co.*, 175 F. Supp. 723 (S.D.N.Y. 1959); *Dunn v. Decca Records*, 120 F. Supp. 1 (S.D.N.Y. 1954).

rial" in the field of tort law.<sup>15</sup> For the most part, courts have failed to draw any guidelines beyond this broad definition as to what constitutes a material fact under certain circumstances.<sup>16</sup> In the *Sunray* case, the stockholder attempted to show that such an omission was material by introducing evidence to show that the amount of oil reserves on Tract 401 was substantial when compared with Sunray's present proven reserves.<sup>17</sup> Comparisons also were made with respect to profits expected from the acquisition of such a lease. Basically, the shareholder's argument was that since the information as to the tremendous potential of Tract 401 was not known, and indeed, the lease was not even acquired until after the terms of the proposed merger agreement were announced, the value of this tract was given no consideration in determining the exchange rate for the proposed merger. The plaintiff contended that had the stockholders had the information concerning Tract 401 and Tract 402, they might have considered the exchange rate as an undervaluation of their shares and therefore would have refused to give their proxies to the management to vote for the merger.

<sup>15</sup> "A fact is material if its existence or nonexistence is a matter to which a reasonable man would attach importance in determining his choice of action in the transaction in question, or the maker of the representation knows that its recipient is likely to regard the fact as important although a reasonable man would not so regard it." RESTATEMENT OF TORTS § 538 (1965).

<sup>16</sup> *But See*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), for a rather detailed discussion of the concept of a "material fact" with respect to the operation of Rule 10b-5.

<sup>17</sup> The trial court had evidence before it to find the probable reserves of Sunray's 32½% interest to be anywhere from 45,760,000 barrels, as a minimum, to 234,000,000 barrels, as a maximum, and that this tract would add anywhere from 10.5%, as a minimum, to 54%, as a maximum, to Sunray's total domestic proven oil reserves. Brief for Appellee at 2, 4, 9, *Sunray DX Oil Co. v. Helmerich & Payne, Inc.*, 348 F.2d 447 (10th Cir. 1968).

The Court of Appeals for the Tenth Circuit reversed the District Court for the Northern District of Oklahoma and found that no violation of the proxy rules had occurred. The court's basis seems to be that since the amount of oil reserves under Tract 401 could not be definitely ascertained, it could not be considered a material fact which should be disclosed to shareholders in a proxy statement. The court noted that since the reserves were merely "probable" and not "proved", any mention of them would be misleading to "any investor other than one who is an expert in the industry."<sup>18</sup> The court appears to be suggesting that the average investor does not possess the mental capacity to intelligently analyze the effect of various factors on the value of his stock. While this may or may not be true, he would certainly be in a better position to so analyze if he were at least made aware of these factors before being asked to exchange his stock in a proposed merger agreement. The court fails to discuss the definition of "material" with respect to the factual situation at hand. They have seemed to place the emphasis on whether or not the reserves were "proved" or "probable" from the company's point of view. Referring to the prior definition of material, it can be seen that the emphasis should be placed on the shareholder's point of view, and the consideration should be whether or not the shareholder would classify the information important enough to influence his vote. If the reasonable shareholder would classify the information about Union's adjoining tract as this important, then it should be immaterial whether or not the reserves under Sunray's tract should be technically referred to as "proved" or "probable". The information concerning Sunray's tract which might properly be termed as conjecture need not have even been presented to Sunray's stockholders. The *known* facts concerning only Union's adjoining tract should have been deemed material information requiring disclosure to Sunray's shareholders.

<sup>18</sup> Sunray DX Oil Co. v. Helmerich & Payne, Inc., 398 F.2d 447, 451 (10th Cir. 1968).

A case recently decided by the Court of Appeals for the Second Circuit discussed at some length the concept of "material", and that decision appears to conflict with the decision in the *Sunray* case. The case of *SEC v. Texas Gulf Sulphur Co.* was an action concerning violations of Rule 10b-5.<sup>19</sup> This rule concerns the purchase or sale of securities by "insiders" who possess certain information not yet available to the general public. However, contained in Rule 10b-5 there is language relative to the omission of a material fact which is nearly identical to the language used in Rule 14a-9.<sup>20</sup> One issue the court was called upon to resolve was the materiality of certain information possessed by employees of the defendant company. The information concerned the results of drill core tests obtained during exploratory work in connection with the search for commercially mineable ore. The ore deposits were what the Court of Appeals for the Tenth Circuit would term as "probable" and not yet "proved". As a matter of fact, the trial court concluded that the results of the drill core were "too remote . . . to have had any significant impact on the market, i.e. to be deemed material."<sup>21</sup> The Court of Appeals for the Second Circuit disagreed with this finding stating that the word "material" encompasses any fact "which in reasonable and objective contemplation *might* affect the value of the corporation's stock or securities."<sup>22</sup>

The court went on to say that "material facts include not only information disclosing the earnings and distributions of a company, but also those facts which affect the desire of

<sup>19</sup> 401 F.2d 833 (2d Cir. 1968).

<sup>20</sup> Rule 10b-5, 17 C.F.R. § 240.10b-5 (b) (1968) provides in part that it shall be unlawful for any person "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading."

<sup>21</sup> 258 F. Supp. 262, 283 (S.D.N.Y. 1966).

<sup>22</sup> *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968).



investors to buy, sell, or hold the company's securities."<sup>23</sup> This concept of a "material fact" as used in Rule 10b-5 arguably should not be different from that used in Rule 14a-9. It would seem that any fact considered material if within the knowledge of an "insider" trading in the securities would likewise be considered material if not disclosed to a shareholder in a proxy solicitation. The investor needs to be made aware of information which might affect the value of the company's securities, not only when he goes to purchase those securities, but also when he is asked to exchange them in a merger agreement. The injustice which might possibly result from a corporation's withholding information when soliciting proxies is certainly as great as that injustice resulting from an "insider's" trading on the basis of not yet publicized information. Therefore, the standard determining a "material fact" should be the same for both situations. If the purpose of the Exchange Act is truly to "promote fairness to both sellers and purchasers of securities",<sup>24</sup> this purpose would seem to be better served by the interpretation the Court of Appeals for the Second Circuit gives to the word "material" than that given it by the Court of Appeals for the Tenth Circuit.

In *Sunray*, the court noted that the Securities and Exchange Commission had "approved" the proxy material before it was sent to the stockholders.<sup>25</sup> The decision seemed to indicate that because of this "approval" the proxy material was found by the Commission to be true and accurate and not to be false or misleading. The court also indicated weight should be given to the fact that the Commission had not taken action to prevent the use of such material.<sup>26</sup> In reality, neither of these positions is tenable, and the Commission itself has disagreed

<sup>23</sup> *Id.*

<sup>24</sup> S. REP. No. 792, *supra* note 5.

<sup>25</sup> *Sunray DX Oil Co. v. Helmerich & Payne, Inc.*, 398 F.2d 447, 449 (10th Cir. 1968).

<sup>26</sup> *Id.* at 452.

with both of them. Indeed, Rule 14a-9(b),<sup>27</sup> promulgated by the Commission, specifically provides:

[T]he fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders.

As to the second position, there are reasons wholly apart from any considerations of the accuracy or completeness of the material contained in proxy statements which might explain the Commission's failure to bring an action of its own in any particular case. The Supreme Court, in discussing these reasons, has said:

The Commission advises that it examines over 2,000 proxy statements annually and each of them must necessarily be expedited. Time does not permit an independent examination of the facts set out in the proxy material and this results in the Commission's acceptance of the representations contained therein at their face value, unless contrary to other material on file with it.<sup>28</sup>

This would seem even more applicable in the case of an omission as opposed to a false statement. In the latter case the Commission might have opportunity to discover the inaccuracy of an affirmative statement, while in the former case it would be nearly impossible to carefully check each proxy solicitation for omissions. Once a violation of the proxy rules is alleged, the court should make an objective inquiry into such allegation, and the fact that the Commission previously has examined such material should be given no weight whatsoever. Despite the positions taken by the Commission and the Supreme Court, lower federal courts continue to point

<sup>27</sup> 17 C.F.R. § 240.14a-9(b) (1968).

<sup>28</sup> J. I. Case Co. v. Borak, 377 U.S. 426, 432 (1964).

out the fact that the Commission has not taken any action to prevent the use of such material.<sup>29</sup> It would therefore seem that a violation of Rule 14a-9 is more likely to be found to have occurred when the Securities and Exchange Commission is the plaintiff in the action as opposed to when a private party is seeking enforcement of the provision. Such a result is extremely undesirable, and the courts should make every effort to see that this does not come about.

Confusion concerning operation of Rule 14a-9 is by no means limited to determining what is or is not a material fact. In *J. I. Case Co. v. Borak*,<sup>30</sup> the Supreme Court determined that private parties have a right to bring suit for violations of S.E.C. proxy rules. But the lower courts have been in disagreement over *which* private parties may maintain such an action. For example, should misrepresentations give rise to a cause of action only to shareholders who gave proxies to management in reliance upon such misrepresentations? Or should any shareholder be able to complain of such deception in proxy solicitations? The first of the two interpretations seems to be inconsistent with the federal policy of investor protection, for those most likely to be duped would seem least likely to discover the fact of their deception, and those not personally misled are still apt to suffer injury from such misrepresentations. Therefore, more effective protection would be achieved if any shareholder could complain of deception in proxy solicitations.<sup>31</sup>

The courts also have struggled with application of proxy

<sup>29</sup> See *Mack v. Mishkin*, 172 F. Supp. 885 (S.D.N.Y. 1959); *Sherman v. Posner*, 266 F. Supp. 871 (S.D.N.Y. 1966); *Shvetz v. Industrial Rayon Corp.*, 212 F. Supp. 308 (S.D.N.Y. 1960).

<sup>30</sup> 377 U.S. 426 (1964).

<sup>31</sup> For a discussion of the merits of permitting only persons actually misled to bring suit for violation of Rule 14a, see Comment, *Private Actions and the Proxy Rules: The Basis and the Breadth of the Federal Remedy*, 35 U. CHI. L. REV. 328, 341-44 (1964); 51 IOWA L. REV. 515 (1966).

rules to minority stockholders. There generally has been some feeling that the rules should not be applied as strictly against minority stockholders as they should when the misrepresentation is made by management. This theory was expressed by Judge Rifkind:

Furthermore, it is a letter by a minority stockholder in opposition to the management. That factor does not constitute a license to lie but it does afford the reasonable expectation that under-statement or exaggeration will be answered—a condition not always to be anticipated when the communication reviewed issues from the management.<sup>32</sup>

Neither Congress nor the Commission has seen fit to exempt a minority shareholder from the operation of the proxy rules, and for the courts to attempt to do so would seem to be a judicial infringement upon the legislative province. This reasoning by courts places a heavy burden upon management to reply to false statements made in the proxy material of minority shareholders. Logic dictates that the company should have rights equal to the rights of any minority shareholder under proxy rules. It should be of no concern to the courts whether misrepresentations were made by management or by a minority shareholder. The minority shareholder who uses false statements in solicitations of proxies should not escape the operation of Rule 14a-9 merely because the management might see fit to reply to such statements.

With respect to a related issue, at least one court has held that no matter from which source the misleading statements originate, if the shareholders are actually informed of the true facts from any other source, a cause of action should not lie under Rule 14a-9.<sup>33</sup> Such reasoning defies explanation since the test is whether the statement itself contains mate-

<sup>32</sup> SEC v. Okin, 48 F. Supp. 928, 930 (S.D.N.Y. 1943), *aff'd*, 137 F.2d 862 (2d Cir. 1943).

<sup>33</sup> See *Bresnick v. Home Title Guar. Co.*, 175 F. Supp. 723 (S.D.N.Y. 1959).

rial omissions or false information and *not* whether the shareholders are actually misled after considering all the information at their disposal.

The final question presented here with respect to the problem of *which* private parties have standing under the proxy rules concerns the situation in which the defendant owns more than enough stock to carry any proposed resolution. In such a situation the defendant argues that since misrepresentations will have no effect on the outcome of the voting, the plaintiffs should not be allowed to maintain such an action. In 1965 the District Court for the Southern District of New York upheld this ridiculous contention in the case of *Barnett v. Anaconda Co.*<sup>34</sup> The court granted a motion to dismiss because the defendant owned seventy-three percent of the stock. One year later the District Court for the Eastern District of New York completely disagreed with the result reached in the *Barnett* case. In *Laurenzano v. H. Einbender*<sup>35</sup> the court criticized the *Barnett* decision, saying:

The meeting does not become nugatory and dispensable because one stockholder owns enough shares to carry any resolution and can be expected to vote in favor of his own resolutions . . . . The meeting must be held and the stockholders must receive a truthful proxy statement.<sup>36</sup>

Thus inconsistent definitions of "a material fact" have been given by the various circuit courts of appeals and by district courts within the same circuit. Such inconsistency makes it difficult, if not impossible, for a shareholder to confidently rely on past judicial decisions in this area of the law. Federal courts need to develop uniform guidelines concerning operation of the securities rules so that the congressional purpose of investor protection will be carried out. These guidelines should be liberally drawn so that the class of in-

<sup>34</sup> 238 F. Supp. 766 (S.D.N.Y. 1965).

<sup>35</sup> 264 F. Supp. 356 (E.D.N.Y. 1966).

<sup>36</sup> *Id.* at 362.