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Regulation FD: SEC Reestablishes Enforcement Capabilities over Selective Disclosure.

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RECENT DEVELOPMENT

REGULATION FD: SEC REESTABLISHES ENFORCEMENT CAPABILITIES OVER SELECTIVE DISCLOSURE

JOHN P. JENNINGS

I. INTRODUCTION

Integrity and fairness represent the hallmarks of America's stock markets.[1] The ability of a securities scheme to attract investment efficiently depends largely on investors believing that they are "getting a fair shake."[2] Indeed, investors must have confidence that they have the same opportunity to maximize profits and minimize losses as everyone else in the market.[3] Since the 1930s, Congress and the Securities Exchange

1. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:11 (Supp. 2000) (relating that the legislative intent of the antifraud provisions contained in Securities Act of 1933 was to "protect the 'perception of fairness and integrity in the securities markets'"), WL SECFEDCORP § 19:11.

2. *See* Jeffrey M. Laderman et al., *The Epidemic of Insider Trading*, BUS. WK., Apr. 29, 1985, at 78 (quoting SEC Chairman Levitt: "If the investor thinks he's not getting a fair shake, he's not going to invest, and that is going to hurt capital investment in the long run"), 1985 WL 2073217.

3. *See* Daniel J. Kramer, *Speaking to the Market Under SEC's Proposed Rules*, N.Y.L.J., May 12, 2000, at 1 (relating the positions of selective disclosure critics), WL 5/12/2000 NYLJ 1, (col. 1); *see also* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (restating the advantage that an

Commission ("SEC") have sought to achieve this confidence by promoting equal opportunity for investors.[4] As a result, American markets currently attract more than two-thirds of available foreign capital.[5] While the viability of U.S. companies represents the underlying attraction of foreign investment, confidence that investors will not be defrauded constitutes another major consideration.[6]

Staggering communication technology improvements have also contributed to this trend.[7] As such, the Internet allows real-time trading in financial markets around the world, from virtually any location.[8] Because foreign investors have access to American markets that exude integrity and fairness, the Internet continues to produce a windfall of opportunity for viable companies.[9] However, the economies of foreign countries, particularly developing countries, suffer because these nations often fail to regulate their financial systems in a manner that makes investors comfortable putting money into their countries' economies.[10] In fact, in some

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investor possesses when trading on nonpublic information), WL 11/16/2000 NYLJ 5, (col. 1).

4. *See* Letter from Roger D. Blanc, Chair, Subcommittee on Market Regulation, to Jonathan G. Kate, Secretary, Securities and Exchange Commission (Oct. 3, 1997) (stating that "[t]o a large degree, the reputation of the U.S. securities markets for reliability and fairness is a direct result of the Congress's legislation, and the Commission's regulation and surveillance of the markets and market participants during the six decades since the enactment of the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934"), WL SC41 ALI-ABA 13; *see also* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 174 (Anchor Books 2000) (1999) (suggesting that the most important innovation in America's capital markets was the adoption of uniform accounting principles, and that foreign capital markets should adopt the same tact).

5. *See* Martin Crutsinger, *IMF: America Is Risk to Markets*, AP ONLINE, Sept. 11, 2000 (noting that although American markets are home to 30% of total foreign capital investment, they have attracted a substantially increased percentage of foreign capital in the last year), 2000 WL 26674397.

6. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW app. B4 (Supp. 2000) (providing insight, by way of congressional testimony, into the pillars of stability in America's financial markets), WL SECFEDCORP app. B4. "The strength and stability of our nation's securities markets depend on investor confidence in the integrity, fairness and efficiency of these markets. To maintain this confidence, investors must have effective remedies against those persons who violate the antifraud provisions of the federal securities laws." *Id.*

7. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 50 (Anchor Books 2000) (1999) (remarking on the unprecedented levels of communication that have been facilitated by innovations in computerization and miniaturization).

8. *See id.* at 124 (reporting that individuals can participate in global investing from the comforts of their bedrooms through online brokers).

9. *See id.* at 140 (referring to the proliferation of the Internet as a means of globalizing the stock market).

10. *See, e.g.*, THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 172 (Anchor Books 2000) (1999) (noting that investors removed their capital from South Korean mar-

instances, regulatory deficiencies have acted as the catalyst for economic crises, partly because investors can move money out of a country's economy within a matter of minutes.[11] The flow of capital out of these countries has prompted a restructuring of financial systems geared towards the two-pronged goal of retaining domestic capital and attracting foreign investment dollars.[12]

In order to maintain a competitive edge vis-à-vis its foreign counterparts, the United States must continually refine its financial systems to maximize fairness and integrity.[13] Accordingly, in the year 2000, the SEC's enforcement crosshairs zeroed in on the long-standing practice of "selective disclosure."[14] At its most basic level, selective disclosure allows a limited segment of the investing public access to important information related to a company's financial performance.[15] Further, as a

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kets when it was discovered that the country had only $10 billion in reserves, rather than the $30 billion asserted by officials); Yu Donghui, *China Reverses Decrease in Foreign Capital Inflow*, WORLD NEWS CONNECTION, July 28, 2000 (remarking that the United States and European countries have improved their investment climates, thereby "reduc[ing] the flow of capital to developing countries"), 2000 WL 26004505.

11. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 112 (Anchor Books 2000) (1999) (recounting the 1997 events surrounding the Malaysian financial crises, which had been "ravaged by global and local investors"); Jacqueline Irving, *Spotlight Falls on Africa's Struggling Bourses*, AFR. NEWS, Oct. 26, 2000 (noting that companies without developed stock exchanges often seek direct foreign investment rather than short-term investment in the stock markets because of the volatility associated in unestablished stock markets), LEXIS, Nexis Library, News Group File.

12. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 173 (Anchor Books 2000) (1999) (reporting the changes South Korea made to entice investors to return capital to that country's markets, including the daily e-mail transmission to global investors detailing the country's currency reserves); Abdul Imoyo, *Stock Exchange Conference a Democratic Dividend for Nigeria*, AFR. NEWS SERVICE, Aug. 15, 2000 (relating that Nigeria must strive to achieve a market that operates "according to international standards of fairness, equity and transparency" in order to "be attractive to foreign investors"), 2000 WL 25340425; Jacqueline Irving, *Spotlight Falls on Africa's Struggling Bourses*, AFR. NEWS, Oct. 26, 2000 (reporting the statements of a United Nations official: "If you have stronger companies that have greater access to capital for their growing businesses then there is the potential for creating more sustainable jobs which can also lead to a reduction in poverty"), LEXIS, Nexis Library, News Group File.

13. *Cf.* Yu Donghui, *China Reverses Decrease in Foreign Capital Inflow*, WORLD NEWS CONNECTION, July 28, 2000 (outlining China's strategy to make its markets more amenable to foreign investment in light of America's improvements to its capital systems), 2000 WL 26004505.

14. *See* Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (reporting the SEC's intention to end the cozy relationship between issuers and analysts), WL 2/7/00 Nat'l L.J. B10, (col. 2).

15. *See* Herbert S. Wander, *Developments in Securities Law Disclosure*, SF05 ALI-ABA 441, 583 (2000) (recounting a recent disclosure by retailer Abercrombie & Fitch to Lazard Freres that its previous earnings estimates were overly optimistic), WL SF05 ALI-

result of judicial interpretations of pre-existing securities regulations, these select individuals may, and often do, trade securities without legal ramifications based on the information before such information reaches the investing public.[16]

Nevertheless, the SEC views the practice of selective disclosure as clearly antithetical to the purpose of securities regulations.[17] In fact, the SEC has always considered the practice of selective disclosure illegal.[18] Although existing federal securities regulations ostensibly prohibit selective disclosure, the SEC recently promulgated Regulation FD,[19] a measure anticipated to reign in the disclosure of material nonpublic information to a privileged few.[20] "FD" stands for "Fair Disclosure."[21] The SEC intends Regulation FD to level the playing field between those parties privy to material nonpublic information before its public dissemination and those who are not.[22] In essence, Regulation FD requires that if an issuer unintentionally discloses material nonpublic information to a select audience, the issuer must take every reasonable step to release the information to the investing public either within twenty-four hours or before the next day of trading begins, whichever occurs later.[23] Addition-

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ABA 441. Relying on this information, clients of Lazard Freres subsequently traded on this information before it became public. *Id.*

16. *See id.* at 582 (noting the Supreme Court's decisions in *Chiarella v. United States* and *Dirks v. SEC* that an individual may communicate material nonpublic information, or even trade on that information, unless to do so would be a breach of fiduciary duty to the issuer).

17. *See* Jim Connolly, *New SEC Fair Disclosure Rule Has Insurers' Lips Sealed*, NAT'L UNDERWRITER – LIFE & HEALTH, Nov. 6, 2000, at 40 (noting the SEC's position that selective disclosure erodes investors confidence in the fairness and integrity of the securities markets); Robert Herz, *Learning to Live with Regulation FD*, 27 SEC. WK. 8 (2000) (concluding that, in the SEC's opinion, selective disclosure is counterintuitive to the "fundamental tenets" of America's capital markets).

18. *See* Steven E. Bochner & Jason S. Frankl, *Suggestions for Best Practices Under Regulation FD*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 1, Oct. 2000 (reporting that the SEC categorizes selective disclosure as a form of "tipping"), WL 4 No. 5 GLWSLAW 1.

19. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738-39 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.100–.103).

20. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (providing the purpose of the new rule that took effect October 23, 2000).

21. *Id.*

22. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 1 (indicating that the regulation is intended to ensure equal access to market information for all participants), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

23. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,723-24 (Aug. 24, 2000).

ally, the regulation provides guidance for those issuers who *intend* to disclose material nonpublic information in a nonpublic manner.[24]

Still, the global considerations previously mentioned are not the sole driving force behind the SEC's actions. The SEC has long viewed the practice of selective disclosure as harmful to America's markets.[25] Arthur Levitt, SEC chairman at the time of the regulation's enactment, believed strongly in protecting the individual investor.[26] In addition, the lobbying efforts of groups that benefit from the elimination of selective disclosure also influenced the SEC's promulgation of Regulation FD.[27]

This Recent Development focuses on the potential effects Regulation FD will have on the participants in America's capital markets and on the markets themselves. Part II discusses the practice of selective disclosure and the inability of existing securities regulations to prohibit such practices. Part III addresses the specific requirements of Regulation FD, as well as potential trouble areas caused by the regulations interplay with other securities rules and regulations. Part IV provides popular suggestions for compliance circulating among securities practitioners and industry groups. Part V discusses the touchstones of controversy related to the selective disclosure regulation. Finally, Part VI concludes with an assessment of the practical effects that Regulation FD will have on the securities industry.

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24. *See id.* (requiring issuers to disclose public information simultaneously with, or preceding, a disclosure of material nonpublic information).

25. *See* Jay H. Perlman & Lawrence T. Greenberg, The Internet Reformation: Gutenberg and Martin Luther On Wall Street, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 9, July 2000 (indicating that the need for Regulation FD is premised on the SEC's belief that the practice of selective disclosure erodes investor perceptions of the integrity and fairness of the markets), WL 4 No. 2 GLWSLAW 9.

26. *See* Judith Schoolman, *Levitt Leaving Early Next Year as SEC Chairman*, N.Y. DAILY NEWS, Dec. 21, 2000, at 71 (characterizing Levitt as a "champion of the individual investor"), 2000 WL 29596738; Sam Ali, *Retiring SEC Chief Has Earned "Place of Honor, Distinction,"* KNIGHT-RIDDER TRIB. BUS. NEWS, Dec. 21, 2000 (reporting that efforts to make the securities market more user-friendly for consumers are the hallmarks of the former SEC Chairman), 2000 WL 31019325.

27. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (stating that a vast majority of commenters on the regulation were individual investors "who urged—almost uniformly" that the SEC adopt Regulation FD), 2000 WL 1197687.

II. SELECTIVE DISCLOSURE

"The behind-the-scenes feeding of material nonpublic information from companies to analysts is a stain on our markets."[28]

A. *The Role of the Securities Analyst*

Although states began regulating securities markets with "Blue Sky laws" as early as 1911,[29] the modern era of American securities regulation began with the enactment of the Securities Act of 1933[30] ("Securities Act") and the Securities Exchange Act of 1934[31] ("Exchange Act"), precipitated by the stock market crash of 1929.[32] Full disclosure represents one of the guiding principles of federal securities regulation.[33] The regulations presume that full disclosure provides investors with confidence that the market will establish a fair and accurate stock price based on publicly available information.[34] By establishing this fair and accurate

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28. Herbert S. Wander, *Developments in Securities Law Disclosure*, SF05 ALI-ABA 441, 584 (2000) (relating the thoughts of SEC Chairman Arthur Levitt), WL SF05 ALI-ABA 441.

29. *See* JAMES BURK, VALUES IN THE MARKETPLACE: THE AMERICAN STOCK MARKET UNDER FEDERAL SECURITIES LAWS 170 (1988) (stating that Kentucky was the first state to enact a "blue sky" law). The purpose behind blue sky laws was to weed out the "worthless" securities and to discourage swindlers from engaging in schemes designed to defraud investors. *See generally* LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 9 (3d ed. 1995). As the popularity of the corporate form increased, states became more and more concerned with the protection of their citizens from fraudulent transactions perpetrated by out-of-state corporations. *Id.* The basic scheme of blue sky laws involved registration of all securities issued or transferred within the state. *Id.* at 12-13.

30. 15 U.S.C. § 77 (1994).

31. 15 U.S.C. § 78 (1994).

32. *See* LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 9, 24-7 (3d ed. 1995) (explaining that "Blue Sky" laws existed prior to the 1929 crash); STUART BANNER, ANGLO-AMERICAN SECURITIES REGULATION, CULTURAL AND POLITICAL ROOTS, 1690-1860 at 199-201 (1998) (providing a sequential development of securities laws); *see also* Rayne Wolfe, *SEC Fair Disclosure Rule Puts Businesses on Edge*, PRESS DEMOCRAT (Santa Rosa, Cal.), Nov. 19, 2000, at E1 (pointing out the origins of the Securities and Exchange Commission), 2000 WL 24342329.

33. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976) (stating that the Securities Act of 1933 is designed to promote full disclosure of important information to the investing public); *see also* J. Robert Brown, Jr., *Corporate Communications and the Federal Securities Laws*, 53 GEO. WASH. L. REV. 741, 741-42 (1985) (asserting that securities regulation is effected primarily through disclosure requirements).

34. *See* H.R. REP. NO. 100-910 (1988), *reprinted in* 1988 U.S.C.C.A.N. 6043, 6045 (reasoning that an individual investor may hesitate to invest in a stock market if he "feels it is rigged against him").

price, full disclosure ultimately reduces the potential for securities fraud, including the market fluctuations and problems associated with fraud.[35]

The complexity of corporate disclosure requirements, while contributing to the integrity of the markets, often results in unintelligible public information, even to experienced investors.[36] As a result, the securities analyst acts as an intermediary between the markets and potential investors.[37] Analysts provide investment advice in the form of "analyst reports."[38] These reports, at least ostensibly, represent the "mosaic" of publicly available information gathered and interpreted by the analyst with the ultimate goal of providing investment guidance to clients.[39]

The securities issuer relies on the accuracy of an analyst's report because these reports produce investor expectations on how a particular issuer will perform.[40] When an issuer's actual performance or other

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35. *See* Randall v. Loftsgaarden, 478 U.S. 647, 664 (1986) (explaining that the purpose of various antifraud provisions is "to deter fraud and manipulative practices in the securities markets, and to ensure full disclosure of information material to investment decisions").

36. *See* Sam Ali, *Retiring SEC Chief Has Earned "Place of Honor, Distinction,"* KNIGHT-RIDDER TRIB. BUS. NEWS, Dec. 21, 2000 (remarking that the top SEC official, despite his financial services background, finds "the whole process of wading through financial statements and prospectuses frustrating and confusing"), 2000 WL 31019325.

37. *See* Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (arguing that analysts are a critical intermediary between the company and the markets), 15 No. 6 CORPCOUN1; *see also* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (reporting that the SEC is aware that an analyst's role is to "seek out bits and pieces of corporate information not generally known to the" public), WL SECFEDCORP § 19:18.

38. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (noting that analyst reports include corporate information often disclosed through conference calls of private conversations), WL 3/16/2000 NYLJ 5, (col. 2); *see also* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (adding that, prior to the Internet, analysts reports were integral in promoting the stability of the markets), 2000 WL 6997676.

39. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (noting that bits and pieces of nonmaterial information are often woven together to form a collectively material mosaic), WL SECFEDCORP § 19:18; *see also* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 4 (discussing the information channels that are available to an analyst, including the issuer's customers, suppliers and competitors), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

40. *See* Donald R. Nelson, *Costco Pays the Price for Profits*, PUGET SOUND BUS. J., June 2, 2000, at 86 (asserting that investor expectations are defined by analysts and not the companies themselves), 2000 WL 16494991; *Get Ready for the Regulation FD Shakedown Cruise*, PR NEWS, Sept. 11, 2000 (reporting that analyst estimates can affect an issuer's stock price because investors often view them as a harbinger of things to come), 2000 WL 4139083.

events cause the stock to deviate from the estimates contained in analysts' reports, volatile trading in the issuer's stock often follows, translating into steep changes in the price of the stock.[41] The more volatile a company's stock remains, the more difficulty that company can expect in securing additional capital in the future.[42] Therefore, protecting the company's best interest often means implementing measures calculated to contribute to the accuracy of analysts' reports.[43] Correspondingly, analysts rely on accurate information to further their own means—providing sound and profitable investment advice translates into attracting and retaining clients.[44]

In theory, analysts develop their reports based on information gleaned from publicly available information.[45] In reality, however, the SEC believes that analyst reports often result from direct communications with the issuer.[46] These communications take many forms, but the goal remains the same—the issuer wants to match analyst estimates with actual company performance, reducing the opportunity for volatile trading in the company's stock.[47] For example, an analyst may develop a written evaluation of the company's prospects based on public information and then deliver the evaluation to the company's officials for review before

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41. *See, e.g.*, Donald R. Nelson, *Costco Pays the Price for Profits*, PUGET SOUND BUS. J., June 2, 2000, at 86 (reporting that an issuer missed analyst earnings estimates by one penny per share, resulting in lost market capitalization of $4 billion in a single day), 2000 WL 16494991. Interestingly, the issuer simultaneously announced that profits had increased by ten percent. *Id.*

42. *See Try Raising the Dividend to Maximize Shareholder Value*, INVESTORS DIG., Jan. 5, 2001 (postulating that a volatile stock price may raise questions as to whether management is doing a good job), 2001 WL 8989499.

43. *See Get Ready for the Regulation FD Shakedown Cruise*, PR NEWS, Sept. 11, 2000 (explaining that issuers often review drafts of analyst reports in an effort to insure their accuracy), 2000 WL 4139083.

44. *See* Tom Lauricella, *What's an Analyst To Do?*, SMARTMONEY, June 2000 (noting that the best analysts are those that are more successful in routinely issuing accurate earnings reports than their peers), 2000 WL 2095347.

45. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (relating the language of the NYSE Listed Company Manual), WL SECFEDCORP § 19:18. "A competent analyst depends upon his professional skills and broad industry knowledge in making his evaluation and preparing his reports and does not need the type of inside information that could lead to unfairness in the market place." *Id.*

46. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (reporting that the SEC believes that analyst predictions are often arrived at via issuer guidance), 2000 WL 6997676.

47. *See* Elizabeth MacDonald, *Quarterly Mayhem: The Circus of Earnings Consensus Estimates Is out of Control*, FORBES, July 24, 2000, at 354 (explaining an instance where an otherwise profitable company's stock was "hammered" because its actual earnings per share were two cents lower than analyst expectations), 2000 WL 22273192.

making the information available to the analysts' clients.[48] The company, which benefits from accurate evaluations, may suggest changes to inaccurate areas of the report.[49] Alternatively, the company's failure to suggest changes may operate as an implied endorsement as to the accuracy of the report.[50] This report review, as well as other methods discussed herein, represent types of "selective disclosure."[51]

Selective disclosure refers to a scenario where public companies release information to securities market professionals before making the information available to the investing public.[52] The SEC asserts that, increasingly, analyst reports result from direct communication between the company and analysts, rather than the diligent review and analysis of public information. Analyst communications often include "earnings guidance" or other statements substantially related to the company's performance, such as new products or research and development achievements.[53] Some companies believe that by releasing performance results to securities analysts before releasing those same results to the

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48. *See generally Get Ready for the Regulation FD Shakedown Cruise*, PR NEWS, Sept. 11, 2000 (explaining one of the methods employed to increase the accuracy of analyst reports), 2000 WL 4139083.

49. *Id.*

50. *See* Sandra Rubin, *Harper Knew of Test Results*, NAT'L POST, Feb. 29, 2000, at 1 (reporting that a company executive failed to correct inaccurate areas of an analysts report, instead stating that "it reads well and I like it"), 2000 WL 16224861. The analyst subsequently issued a "speculative buy" rating on the company. *Id.*

51. *See* Sharon Harvey Rosenberg, *New SEC Disclosure Rule Forces Public Companies to Drop Traditional One-on-One Briefings*, BROWARD DAILY BUS. REV., Sept. 12, 2000 (relating the established practice for providing preferential access to market professionals and wealthy investors).

52. Securities Exchange Comm'n, *Fact Sheet: Regulation Fair Disclosure and New Insider Trading Rules*, (Aug. 10, 2000) *at* http://www.sec.gov/news/extra/seldsfct.htm; Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (stating that the information released typically involves events effecting the company's future performance), WL 3/16/2000 NYLJ 5, (col. 2); Paul Kedrosky, Editorial, *The Trouble with Full Disclosure: U.S. Regulation FD Has Produced an Information Chill, Not Fair Disclosure*, NAT'L POST, Nov. 4, 2000, at D11 (reporting that companies acknowledge "playing favourites" when disclosing material information), 2000 WL 28909250.

53. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (suggesting, as an example, a company's "upcoming quarterly sales or earnings"), WL 3/16/2000 NYLJ 5, (col. 2); *see also* Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (asserting that the goal of Regulation FD is to "end cozy relationships between Wall Street professionals and the companies they follow"), WL 2/7/00 Nat'l L.J. B10, (col. 2). The following excerpt demonstrates the mechanics of earnings guidance:

> While companies generally do not tell the analysts what their earnings will be, they might play a game of "20 questions." The analyst suggests a number; the company suggests it's a bit low. The analyst suggests another number; the company comments

general public, the company can avoid any potential volatile trading in their stock.[54]

B. *The Internet's Effect on the Retail Securities Industry*

The evolution of the Internet and its unique ability to provide access to information has changed the structure of the securities industry.[55] The structural paradigms of the stock markets have changed substantially as a result of communication innovations.[56] Indeed, the emergence of online brokerages and wireless communications as popular and user-friendly ways of investing in stock markets has attracted the investment dollars of many inexperienced investors.[57] Additionally, the Internet empowers individuals by giving access to most of the public information that analysts and broker-dealers have had for years.[58] In fact, the SEC and retail investors assert that individuals possess the analytical acumen necessary to gather this information and arrive at the same conclusions as securities professionals.[59]

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again. Soon, the analyst has a pretty good idea that his or her forecast is in line with the company's internal numbers.

Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D, 2000 WL 6997676.

54. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (providing that some releases provide for a less volatile swing in a securities price), WL 3/16/2000 NYLJ 5, (col. 2); *Get Ready for the Regulation FD Shakedown Cruise*, PR NEWS, Sept. 11, 2000 (explaining that issuers often consult with analysts in an effort to "walk the Street down" to lower expectations), 2000 WL 4139083; John F. Olson et al., *Letters from the Editors: Still Fencing on a Tightrope*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 2, Oct. 2000 (suggesting that the market might be better prepared if some companies released news to fewer analysts), WL 4 No. 5 GLWSLAW 2.

55. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (opining that the corporate disclosure practices have been affected by the Internet), 2000 WL 6997676.

56. *See* Jacqueline Dosick, *The Current Buzz: Will the Internet Be the End of the Stock Market as We Know It?*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 21, Aug. 1999 (announcing the Internet's destruction of Wall Street's monopoly on stock market accessibility), WL 3 No. 3 GLWSLAW 21.

57. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 51 (Anchor Books 2000) (1999) (arguing that the "democratization of technology" provides previously disconnected persons with increased accessibility to information).

58. *See* Jacqueline Dosick, *The Current Buzz: Will the Internet Be the End of the Stock Market As We Know It?*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 21, Aug. 1999 (reasoning that "the Internet levels the playing field for the small investor by providing free access to real-time quotes and by increasing transparency in the market through the dissemination of company research reports"), WL 3 No. 3 GLWSLAW 21.

59. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (relating the SEC's belief that the Internet has re-

However, other observers argue that, although the Internet provides more access to information for the small investor than before, the average individual simply does not have adequate resources to study all of the available information with the same degree of expertise as market analysts.[60] Admittedly, some individual investors have such capabilities and, to that extent, operate at a competitive disadvantage vis-à-vis the beneficiaries of selective disclosure—securities analysts and their clients.[61] Nevertheless, the majority of investors attracted to the stock market by its increased accessibility and wondrous stories of instant wealth,[62] generally do not possess the skill to decipher the meaning of the numerous bits and pieces of information related to a company's performance.[63] Ironically, while the Internet arguably has reduced the role of the securities analyst with respect to knowledgeable investors, the Internet has simultaneously provided analysts with a brand new audience—investors without the time, temperament, or expertise to digest information and use it effectively in making investment decisions.[64]

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duced the importance of the market analysts), 2000 WL 6997676. Further, media coverage of the securities markets has significantly expanded in recent years. *Id. But see* Chris O'Malley, *Nation's Top Securities Regulator Is Concerned About Longest Bull Market*, KNIGHT-RIDDER TRIB. BUS. NEWS, Dec. 16, 2000 (quoting SEC Chairman Arthur Levitt that "small investors often don't recognize that they lack the experience, resources and temperment of professional traders"), 2000 WL 30572275.

60. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (adding that external factors such as industry trends and economic conditions contribute to the average investor's inability to determine the effect of information), 2000 WL 6997676; John F. Olson et al., *Letters from the Editors: Still Fencing on a Tightrope*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 2, Oct. 2000 (questioning whether individual investors are able to distinguish important information from the mundane), WL 4 No. 5 GLWSLAW 2.

61. *See generally Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (discussing investor concerns that they do not receive all investment information available).

62. *See* Shawn Hubler, *From Party Hardy to Party Hardly in Silicon Valley*, L.A. TIMES, Dec. 12, 2000, at E1 (relating the extravagant expenditures of dot-com millionaires), 2000 WL 25926664.

63. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (recognizing that analysts provide a valuable service by "sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions").

64. *See* Chris O'Malley, *Nation's Top Securities Regulator Is Concerned About Longest Bull Market*, KNIGHT-RIDDER TRIB. BUS. NEWS, Dec. 16, 2000 (noting that many investors flirt with disaster by investing in products they do not fully understand), 2000 WL 30572275.

Competition in the securities industry has forced many brokerage companies to search for ways to provide value-added services.[65] The technological paradigm shift in the securities industry particularly has squeezed discount brokerages. Traditionally, discount brokerages facilitate the buying and selling of securities, rather than spending an inordinate amount of time analyzing information. Individual investors, however, now have access to the same public information that these brokerages have had for years, in the form of electronic SEC filings and numerous inexpensive or free research sites.[66] Additionally, increasingly knowledgeable investors have moved away from the brokerage intermediaries, opting instead to execute securities transaction through less expensive online brokerages.[67] Further, when discount brokerages attempt to provide value-added services in the form of investment analysis, the practice of selective disclosure hinders the analysis process.[68] Although discount brokerages may have skills and knowledge on par with securities analysts, investment analysis based entirely on public information does not have the same value as an analysis enhanced by selective disclosure.[69] Securities analysts given access to sensitive information related to an issuer's

65. *See* Andrew Rafalaf, *Private Equity: Web Sites Deliver Deals to the Masses*, WALL ST. & TECH., July 1, 2000 (commenting on the battle for clients between discount brokerages and full-service brokerages), 2000 WL 7469370; *see also* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 124 (Anchor Books 2000) (1999) (indicating that online brokerage fees have dropped considerably due to increased competition).

66. *See generally* EDGAR ONLINE, *at* http://www.freeedgar.com (last visited Jan. 29, 2001) (establishing an Internet portal for free access to electronic SEC filings); E*TRADE, *at* http://www.etrade.com (providing full-service brokerage capabilities) (last visited Jan. 29, 2001); CHARLESSCHWAB.COM, *at* http://www.charlesschwab.com (offering information for inexperienced investors via its "learning center") (last visited Jan. 29, 2001).

67. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 72 (Anchor Books 2000) (1999) (commenting that "democratization of technology" provides investors with access to stock information and the channels to execute trades without ever calling a broker); *see also* Garry Marr & Theresa Tedesco, *OSC Toughens Up Disclosure: New Rules Coming Next Month*, NAT'L POST, Jan. 17, 2001, at C01 (noting the trend away from using brokerage intermediaries to execute securities transactions), 2001 WL 4435229.

68. *See* Garry Marr & Theresa Tedesco, *OSC Toughens Up Disclosure: New Rules Coming Next Month*, NAT'L POST, Jan. 17, 2001, at C01 (suggesting that the emergence of the retail investor has made the practice of selective disclosure a particularly sensitive issue because they represent a "potent force" in the market that is not part of the information circle), 2001 WL 4435229.

69. *Cf.* Peter V. Letsou, *The Scope of Section 12(2) of the Securities Act of 1933: A Legal and Economic Analysis*, 45 EMORY L.J. 95, 150 (1996) (explaining that discount brokers charge lower commissions for trades because, unlike analysts, they offer no investment advice).

performance provide their analysis with a level of accuracy and insight discount brokerages find difficult to duplicate.[70]

The practice of selective disclosure has implications for three broad categories of investing groups: (1) those investors privy to selective disclosures of material nonpublic information;[71] (2) those not privy to such disclosures, but capable of analyzing the information at least as well as security professionals,[72] and; (3) those not privy to selective disclosures, but generally unable to decipher evaluative information contained in financial statements and market reports.[73]

The practice of selective disclosure presents the greatest disadvantage to those investors with the skills and knowledge to understand the value of material nonpublic information, such as discount brokerages and experienced individual investors, yet denied timely access to the information.[74] These groups argue that selective disclosure affects the integrity of the nation's capital markets by unfairly providing some investors with valuable, nonpublic information to the exclusion of others.[75] In an effort to re-establish their role in the securities scheme, discount brokers, as well as knowledgeable individual investors, lobbied the SEC to halt the practice of selective disclosure by analogizing the practice to insider trad-

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70. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (opining that retail investors will be on a level plane with analysts as a result of Regulation FD), 2000 WL 24218624.

71. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (pointing out the opportunities that selective disclosure presents for "analysts who make a business out of selective disclosure" by providing advance information to their clients), WL SECFEDCORP § 19:18.

72. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (noting that individual investors who commented on the proposed Regulation FD believed that the practice of selective disclosure "places them at a severe disadvantage in the market").

73. *See* Henry Bosch, *Still a Bumpy Playing Field*, SHARES MAG., Apr. 1, 2000, at 46 (relating the frustrations of relatively inexperienced investors, who assert that their confidence in the markets is eroded by selective disclosure), 2000 WL 2104626; Rayne Wolfe, *SEC Fair Disclosure Rule Puts Businesses on Edge*, PRESS DEMOCRAT (Santa Rosa, Cal.), Nov. 19, 2000, at E1 (listing the categories of persons that are affected by selective disclosure), 2000 WL 24342329.

74. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (questioning whether investors without adequate training will be able to extrapolate the contextual meaning of information that is publicly released by issuers), 2000 WL 6997676.

75. *See* Herbert S. Wander, *Developments in Securities Law Disclosure*, SF05 ALI-ABA 441, 584 (2000) (relating the quotes of an SEC Commissioner, indicating the SEC's suspiciousness of trading in a company's stock after, and sometimes *during*, a conference call with an analyst), WL SF05 ALI-ABA 441.

ing.[76] In promulgating Regulation FD, the SEC acknowledged the overwhelming support voiced by individual investors after announcing that it intended to address selective disclosure.[77]

C. *The Pros and Cons of Selective Disclosure*

Analysts and issuers alike widely believe that selective communications contribute to the increased accuracy of analyst reports.[78] As such, analyst reports often influence the expectations of the markets.[79] The more accurate the report, the less chance that the issuer will announce a surprise deviation from that report.[80] Obviously, a company cannot release inaccurate information, either selectively or publicly, without drawing the ire of both injured investors and the SEC.[81] A company can, however, reduce the rate at which the stock markets react to accurate, but adverse information.[82] The practice of selective disclosure allows issuers to "leak" indirectly information to the markets, causing the price of the

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76. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (arguing that selective disclosure and insider trading impact the stock market in similar ways).

77. *See id.* at 51,718 (concluding that the "overwhelming support from investors for Regulation FD demonstrates a strong perception among the investing public that selective disclosure is a significant problem"). The SEC noted that it received nearly 6,000 comments that were in favor of Regulation FD, a majority of which came from individual investors. *See id.* at 51,717; Editorial, *Most Individual Investors Haven't Heard of Reg. FD*, INVESTOR REL. BUS., Nov. 6, 2000, 2000 WL 8692727. These numbers, although impressive in their absolute form, may be misleading. *See id.* (noting that the SEC may have overstated support for Regulation FD by individual investors). It appears that the successful comment campaign conducted by investors was effected by an extremely small percentage of individual investors. *See id.* (reporting the results of a random survey that indicated that eighty-four percent of individual investors had never *heard* of Regulation FD, much less knew what it is intended to do).

78. *Cf.* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (reporting that analysts concede that post-Regulation FD reports are less precise than pre-Regulation FD reports), 2000 WL 4726628.

79. *See* Donald R. Nelson, *Costco Pays the Price for Profits*, PUGET SOUND BUS. J., June 2, 2000, at 86 (connecting investor expectations with analyst projections), 2000 WL 16494991.

80. *See generally id.* (relating the costly experiences of an otherwise profitable company after it narrowly missed analyst estimates by one cent per share).

81. *See* 15 U.S.C. § 78ff(a) (1994) (making it a federal criminal violation to file a document with the SEC that contains a materially false or misleading statement).

82. *See Get Ready for the Regulation FD Shakedown Cruise*, PR NEWS, Sept. 11, 2000 (reporting the procedures employed by issuers to lower investor expectations in a controlled manner), 2000 WL 4139083.

stock to adjust over the span of days or weeks, rather than minutes or hours.[83]

In this era of trigger-happy investors—most notably, "day-traders"—companies have added incentive to break bad news to the markets in an indirect manner.[84] As a result of technological innovations and increased accessibility to the nation's securities markets, as well as the subsequent birth of the "Electronic Herd,"[85] the importance of taking steps to prevent a run on its stock has become a tactical consideration for many companies.[86] Indeed, some observers assert that the recent stock market boom has resulted in a significant increase in the number of selective disclosures to financial analysts.[87]

D. *The SEC's Stance on Selective Disclosure*

As previously discussed, the SEC has always considered selective disclosure illegal.[88] According to the SEC, nonpublic disclosures of material information affects the integrity and underlying fairness of the markets.[89] In support of this argument, the SEC points to recently published ac-

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83. *See id.* (explaining that issuers often consult with analysts in an effort to "walk the Street down" to lower market expectations).

84. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 130-31 (Anchor Books 2000) (1999) (theorizing that day-traders, a bi-product of the Internet age, are responsible for "push[ing] . . . stocks up and down like a roller coaster"). Day-traders often trade impulsively on the smallest "whiff of news," such as when an issuer announces that its actual performance will deviate from an analyst's expectations. *Id.* at 131. In many instances, day-traders are accused of not knowing the slightest bit about the company whose securities they are buying and selling. *Id.*

85. *See id.* at 115-16 (providing a moniker for the group of investors that often move as one with the ability to significantly impact the world markets). The Electronic Herd is attributed with the power to influence the behavior of countries by virtue of their ability to decide whether to invest in the financial systems of a country. *Id.* at 116.

86. *See generally* Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (discussing the SEC mandate to restrict "selective disclosure of material information by public companies" by requiring broad dissemination), WL 6 No. 6 ANSLRR 14.

87. *See id.*

88. *See* Dan Eaton, *SEC Disclosure Regs Will Alter Firm-Investor Contact*, BUS. FIRST OF COLUMBUS, Sept. 22, 2000, at A13 (noting that although selective disclosure has always been illegal, Regulation FD clarifies the issue), 2000 WL 16492952. *But see* John F.X. Peloso, *SEC Proposals on Selective Disclosures and Insider Trading*, N.Y.L.J., Feb. 17, 2000, at 3 (reporting that selective disclosure is considered a legal practice under the Supreme Court's ruling in *Dirks v. SEC*, 463 U.S. 646 (1983)), WL 2/17/2000 NYLJ 3, (col. 1).

89. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (explaining that investors often watch the price of a stock change without apparent reason); John Hackett, *Facing Up to Broad Disclosure*, USBANKER, Dec. 6, 2000, at 51 (indicating that the SEC's assertion that the intimate relationships between issuers and analysts undermines the integrity of the markets), 2000 WL 17705571.

counts revealing that selective disclosure can significantly affect a stock price.[90] In its proposed rule, the SEC states that "[s]elective disclosure has the immediate effect of enabling those privy to the information to make a quick profit (or quickly minimize losses) by trading before the information is disseminated to the public."[91]

Selective disclosure also provides issuers with an opportunity to exert influence over market analysts.[92] The SEC worries that even among the persons designated as market professionals under Regulation FD, companies may consciously release early information to analysts who have shown an inclination to position the information in a favorable manner, thus affecting the independence and reliability of analysts' reports.[93] As a result, analysts who tell the "cold hard truth" about an issuer's performance expectations may find themselves barred from future analyst discussions with that issuer.[94]

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90. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (rejecting the assertion by commentators on the proposed regulation that selective disclosure is not as pervasive as the SEC believes); Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (providing examples where the stock price has changed by as much as 15% following selective disclosures), 15 No. 6 CORPCOUN1.

91. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 (Dec. 28, 1999); *see also* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (stating the economic rationale for Regulation FD), WL 11/16/2000 NYLJ 5, (col. 1); Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (relating that the SEC found that there is substantially increased trading in a company's stock in the days immediately following analysts' conferences and roadshows), WL 2/7/00 Nat'l L.J. B10, (col. 2).

92. *See* John Hackett, *Facing Up to Broad Disclosure*, USBANKER, Dec. 6, 2000, at 51 (recognizing that material nonpublic information is sometimes as used as a commodity "to gain or maintain favor with particular analysts or investors"), 2000 WL 17705571.

93. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716-17 (Aug. 24, 2000) (characterizing the treatment of information as a commodity poses a threat to America's markets), 2000 WL 1197687; *see also* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (indicating that analysts "who treated a company most kindly in their research reports often received the earliest and best information"), 2000 WL 6997676; Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (noting that an analyst may be inclined to "shade his or her analysis in order to cultivate" the relationship with the corporate insiders), WL 2/7/00 Nat'l L.J. B10, (col. 2).

94. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (stating how there is an incentive for analysts not to make negative statements for fear that such statements will result in lost access to selectively disclosed information); John Hackett, *Facing Up to Broad Disclosure*, USBANKER, Dec. 6, 2000, at 51 (reporting that analysts who publish negative opinions of a company's expected performance can count on being excluded from subsequent selective disclosures), 2000 WL 17705571.

Regulation FD seeks to eliminate the tactical opportunities that existed under pre-existing securities laws.[95] Prior to Regulation FD, the federal securities regulatory scheme required the prompt disclosure of certain material information by those issuers with securities either traded on a national exchange or registered pursuant to the Securities Act of 1933.[96] In addition to quarterly and annual reports, issuers were, and still are, required to file Form 8-K after a material event has occurred, generally within fifteen days.[97] Issuers, however, maintained some control over when these reports were filed. For instance, Form 8-K's fifteen day filing deadline for most material events provides an issuer with the opportunity to comply with the filing requirements while still using that information during the interim period.[98] The SEC discovered that, in many instances, securities analysts and a limited number of investors had access to Form 8-K information during the fifteen-day period before the issuer filed the report.[99]

The SEC acknowledges that selective communications contribute to the increased accuracy of analyst reports.[100] Likewise, a clear majority of

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95. *See* Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (explaining how the current law allowed for the precise timing of disclosures by corporate managers), WL 2/7/00 Nat'l L.J. B10, (col. 2).

96. *See* Sarah O'Brien, *Pssst! Can You Keep a Secret?: Analysts Get an Edge with Reg FD Loophole*, INVESTMENT NEWS, Oct. 30, 2000, at 1 (attributing the enactment of Regulation FD to complaints that companies were providing securities analysts with non-public corporate data), 2000 WL 9431214; Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (referring to the requirements imposed on companies by sections 12 and 15(d) of the Securities Exchange Act of 1934), WL 2/7/00 Nat'l L.J. B10, (col. 2).

97. *See* Exchange Act Form 8-K, Gen. Instruction B, [1998-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 31,002, at 21,992 (Oct. 6, 2000) (delineating the Form 8-K filing deadlines for various occurrences). *See generally* 17 C.F.R. §§ 249.308a & 249.310 (establishing the Form 10-Q quarterly and Form 10-K annual filing requirements, respectively, for reporting companies).

98. *See* Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (stating that "between the event's occurrence and the public disclosure . . . analysts and select investors got a preview of the information before the public received it"), WL 2/7/00 Nat'l L.J. B10, (col. 2).

99. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (noting that, for years, securities analysts and prominent investors have gained access to key corporate information before the rest of the investing public), 2000 WL 6997676; Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (explaining that the SEC's chief concern is that analysts and certain investors possess "an unerodable information advantage" when compared with other investors), WL 2/7/00 Nat'l L.J. B10, (col. 2).

100. *Cf.* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (reporting that analysts concede that post-Regulation FD reports are less precise than pre-Regulation FD reports), 2000 WL 4726628.

the investment community recognize analysts' reports as a valued commodity in this era of unencumbered and, in many cases, inexperienced individual investors.[101] Nonetheless, the SEC portrays the release of this information to a select audience as an unfair advantage.[102] The SEC argues that regular access to market information does not give analysts a "special license to ignore the insider trading proscriptions."[103]

E. *Pre-existing Antifraud Provisions*

Recent studies confirm assertions that analysts have improperly used information unavailable to the public.[104] Reportedly, analysts often communicate this information immediately to their clients, thereby allowing the client to trade on the information before release.[105] Clearly, this scenario contradicts the overarching purpose of securities regulations—promoting the integrity and the fairness of the capital markets.[106] Indeed,

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101. *See* David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference (Dec. 4, 2000) (reaffirming the valuable work that is performed by financial analysts), 2000 WL 1839227 (S.E.C.), at *2; *see also* Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (arguing that analysts are a critical intermediary between the company and the markets), 15 No. 6 CORPCOUN1.

102. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (indicating the role of the analyst, although of significant utility to the markets, does not provide the analyst with a "special license to ignore the inside, trading proscriptions"), WL SECFEDCORP § 19:18; Paul Kedrosky, Editorial, *The Trouble with Full Disclosure: U.S. Regulation FD Has Produced an Information Chill, Not Fair Disclosure*, NAT'L POST, Nov. 4, 2000, at D11 (acknowledging that Regulation FD forces companies to behave as the investing public would expect), 2000 WL 28909250.

103. 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000), WL SECFEDCORP § 19:18.

104. *See* Paul A. Ferrillo, *Looking at New Regulation FD*, N.Y.L.J., Sept. 20, 2000, at 9 (supplying examples of the changes in an issuers stock price that can occur following a selective disclosure), WL 9/20/2000 NYLJ 9, (col. 3).

105. *See* Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (reporting that trading in a company's stock often increases following a selective disclosure, leading researchers to conclude that the favored customers of the analyst are exposed to the information before it is publicly disseminated), 15 No. 6 CORPCOUN1; RALPH C. FERRARA ET AL., FERRARA ON INSIDER TRADING AND THE WALL § 7:03 (2000) (discussing the timing of broker dissemination of information to their clients); Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (noting that, for years, securities analysts and prominent investors have gained access to key corporate information before the rest of the investing public), 2000 WL 6997676.

106. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (relating that the legislative intent of the antifraud provisions contained in Securities Act of 1933 was to "protect the 'perception of fairness and integrity in the securities markets'"), WL SECFEDCORP § 19:18.

the profits realized and the losses minimized by early trading come at the expense of the other parties involved in the trade.[107] Although a strict construction of securities regulations that pre-date Regulation FD appear to provide the SEC with adequate enforcement capabilities for selective disclosure, many in the securities community generally recognize that specific decisions of the United States Supreme Court have cast doubt on the SEC's ability to pursue pre-existing avenues of enforcement.[108] Despite the SEC's objection to selective disclosure, both corporations and securities professionals increasingly recognized the SEC's position as "legally toothless."[109]

1. Rule 10b-5: An Ostensible Prohibition Against Selective Disclosure

The SEC notes that many individual investors report surprise upon learning that no laws expressly prohibit selective disclosure.[110] In its final rule, the SEC acknowledged the concerns of many individual investors, stating that "[m]any felt that selective disclosure was indistinguishable from insider trading in its effect on the market and investors."[111] Instinctively, investors point to Section 10(b) of the Exchange Act[112] and its derivative, SEC Rule 10b-5,[113] as enforcement tools against selective dis-

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107. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (discussing the inequity of trading in the securities markets based on selectively disclosed information); 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (concluding that the practice of selective disclosure "has the effect of shifting the loss from the analyst's clients to the investing public"), WL SECFEDCORP § 19:18.

108. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (describing the laws related to issuer selective disclosure as "considerably less clear" than the those that regulate insider trading).

109. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (stating that even under threat of private lawsuits or SEC criticism, a CEO inclined to reward or punish analysts was virtually free to do so), WL 3/13/00 Nat'l L.J. B5, (col. 1); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 n.7 (Aug. 24, 2000) (stating that it is widely believed that the Supreme Court's decision in *Dirks v. SEC*, 463 U.S. 646 (1983) insulated analysts from insider trading proscriptions); 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (noting that the SEC's list of permissible analyst objectives does not include the type of activity that the Supreme Court approved of in *Dirks v. SEC*, 463 U.S. 646 (1983)), WL SECFEDCORP § 19:18.

110. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000).

111. *Id.*

112. 15 U.S.C. § 78j(b) (1994).

113. 17 C.F.R. § 240.10b-5 (2000).

closure.[114] Rule 10b-5 represents the preeminent antifraud provision found in federal securities regulations.[115] The SEC asserts that Rule 10b-5 should apply to selective disclosure, but concedes that judicial interpretations of the rule have left its applicability to selective disclosure unclear and, consequently, an impractical enforcement tool.[116]

The relevant portion of Rule 10b-5 prohibits any person from engaging "in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . in connection with the purchase or sale of any security."[117] When strictly construing the language of Rule 10b-5, a colorable argument arises that when an individual trades on information received, either directly or indirectly, from an issuer, the trade acts as a fraud upon the person with whom that trade occurs.[118] The Supreme Court in 1980, however, rejected this very argument in *Chiarella v. United States*.[119]

2. *Chiarella* and *Dirks*: Requirement of Fiduciary Duty and Personal Gain

a. *Chiarella v. United States*

In *Chiarella*, the United States Supreme Court eliminated the SEC's ability to bring a Section 10(b) action when no breach of a fiduciary duty has occurred.[120] In that case, a printing company employee learned the names of companies targeted for takeover bids from documents in the

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114. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (discussing Regulation FD commenters' belief that selective disclosure is indistinguishable from insider trading).

115. *See* LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES REGULATION 398 & n.8 (4th ed. 1999) (observing that Rule 10b-5 is mentioned in over 6,500 federally reported cases).

116. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 n.7 (Aug. 24, 2000) (pointing to a Supreme Court decision that has been cast as protecting analysts from insider trading liability).

117. 17 C.F.R. § 240.10b-5(c) (2000).

118. *See* Dirks v. SEC, 463 U.S. 646, 655-56 (1983) (revealing that the SEC argued this interpretation in a case addressing selective disclosure by an investment analyst).

119. *See* Chiarella v. United States, 445 U.S. 222, 232-33 (1980) (refusing to impose a duty to disclose on a party who received information from an issuer with whom there was no fiduciary relationship or agency).

120. *See* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1590-91 (1999) (indicating that, following *Chiarella*, a breach of a fiduciary duty must exist before a duty to "disclose or abstain" arises); Oriana N. Li, Note, *United States v. Smith: The Use-Possession Debate in SEC Enforcement Actions Under § 10(b)*, 74 WASH. L. REV. 395, 406 (1999) (asserting that "mere possession of inside information" does not give rise to a duty to disclose, but that the information must have been obtained from a person who disclosed the information in breach of fiduciary duty).

possession of the printing company.[121] The employee subsequently used this information to purchase stock in the target companies, reaping profits in excess of $30,000 over the course of two years.[122] The SEC alleged that Chiarella violated Section 10(b) and Rule 10b-5.[123]

The Court rejected the SEC's rationale that Chiarella violated insider trading laws because of his strategic access to inside information.[124] The Court also rejected the argument that allowing such a person to trade on such acquired information without properly disclosing it created an inherently unfair situation.[125] The Court asserted that a failure to disclose material information before consummating a transaction violates Rule 10b-5 only when a duty exists between the person with the material nonpublic information and the issuer or its shareholders.[126]

Similarly, the Court determined that access to market information by virtue of one's strategic positioning in the securities scheme is insufficient to give rise to a duty of disclosure prior to trading on such acquired information.[127] Rather, a duty arises from the relationship between the parties.[128] The United States argued that Chiarella "breached a duty to the acquiring corporation when he acted upon information that he obtained by virtue of his [employment]."[129] The Court refused to address this argument, however, because the government had not presented the issue to the jury for consideration.[130] Learning from its mistakes, in 1983, the SEC pursued this open issue in another renowned case, *Dirks v. SEC*.[131]

b. *Dirks v. SEC*

In *Dirks*, an investment analyst learned of allegations that a California insurance company had engaged in extensive fraudulent market prac-

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121. Chiarella v. United States, 445 U.S. 222, 224 (1980). The resourceful employee was able to discover the targeted companies' names despite measures employed to hide the identity of the target corporations. *Id.*

122. *Id.*

123. *Id.* at 225.

124. *Id.* at 235.

125. *Id.* at 227.

126. *Chiarella*, 445 U.S. at 228.

127. *See id.* at 231-32 n.14 (discussing the erroneous assumptions made by the Court of Appeals in holding that a duty to disclose exists when one has "regular access to market information").

128. *Id.* at 233.

129. *Id.* at 235-36.

130. *Id.* at 236 (analyzing the jury charges and stating that "[t]he jury was not instructed on the nature or elements of a duty owed by [Chiarella] to anyone other than the sellers").

131. *See* Dirks v. SEC, 463 U.S. 646, 652 (1983) (highlighting the duty a broker owes to the SEC).

tices.[132] Dirks obtained this information from a former executive officer of the insurance company.[133] Dirks investigated the allegations and, in fact, urged the Wall Street Journal to publish the allegations.[134] Simultaneously, however, Dirks regularly discussed the allegations with his clients and investors, some of whom subsequently sold substantial holdings in the insurance company.[135] Thereafter, the company's stock price dropped from $26 per share to $15 per share before the SEC suspended trading and investigated the fraud allegations.[136]

In an SEC administrative proceeding, the judge stated that "[w]here 'tippees'—regardless of their motivation or occupation—come into possession of material . . . 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading."[137] However, the Supreme Court rejected this proposition, finding instead that Dirks did not, in fact, qualify as a tippee who owed a fiduciary duty to the issuer.[138] According to the Court, a tippee inherits the fiduciary responsibilities of a corporate insider only when the insider has provided the information in breach of a fiduciary duty.[139] In discussing what constitutes a breach of a fiduciary duty, however, the Court promulgated an additional element required to prove such a breach.[140] A corporate insider does not run afoul of his responsibilities to shareholders merely by "tipping" material nonpublic information to outsiders.[141] Rather, the insider must derive a "personal gain" from the disclosure, such as an expectation of pecuniary or reputational benefit.[142] Consequently, because

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132. *Dirks*, 463 U.S. at 649.

133. *Id.* at 648-49.

134. *Id.* at 649-50.

135. *See id.* at 649 (stating that five clients sold in excess of $16 million of the insurance company's securities).

136. *Id.* at 650.

137. *Dirks*, 463 U.S. at 651.

138. *Id.* at 655.

139. *See id.* at 660 (noting the circumstances in which a tippee assumes a fiduciary duty); *cf. id.* at 656 n.15 (stating that mere receipt of inside information does not create a "special relationship" between the tippee and the issuer's shareholders).

140. *See id.* at 667-68 (Blackmun, J., dissenting) (arguing that the majority took "another step to limit the protections provided investors by § 10(b) of the Securities Exchange Act of 1934").

141. *See id.* at 656 n.15 (stating that mere receipt of information from an insider does not create a "special relationship" between the tippee and the issuer's shareholders).

142. *See Dirks*, 463 U.S. at 662 (noting that a connection is required between the an insider and a tippee that gives rise to personal gain). "[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to the stockholders. And absent a breach by the insider, there is no derivative breach" by subsequent tippees. *Id.* The SEC attempted to

Dirks sought to reveal the massive fraudulent practices, the Court ruled that he did not receive a personal gain and, thus, did not breach a fiduciary duty to the issuer or its shareholders.[143]

Notably, the Supreme Court specifically addressed the disclosure of material nonpublic information in the context of market analysts.[144] The following language from *Dirks* represents "ground zero" for the SEC's contention that it could not regulate selective disclosure under pre-existing securities regulations:

> Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it *could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.* . . . It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.[145] [emphasis added]

III. REGULATION FD – THE SEC'S RESPONSE TO *CHIARELLA* AND *DIRKS*

"Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed."[146]

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mold its enforcement strategies in accordance with the "reputational gain" contemplated by *Dirks*. *See* SEC v. Stevens, Litig. Release No. 12813 (Mar. 19, 1991) (reporting SEC allegations that a corporate insider received a personal benefit by acting to "protect and enhance his reputation as a corporate manager"). This case was settled before it reached the courts. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 n.7 (Aug. 24, 2000). The SEC's argument in *Stevens* has been characterized as impractical, however, because nearly all disclosures, on one level or another, are likely to be motivated by a desire to maintain one's reputation. *See* Herbert S. Wander, *Developments in Securities Law Disclosure*, SF05 ALI-ABA 441, 577 (2000) (discussing the weaknesses of SEC enforcement options under *Dirks*), WL SF05 ALI-ABA 441.

143. *Dirks*, 463 U.S. at 667.

144. *Id.* at 658.

145. *Id.* at 658-59. The Court discussed the difficulties that surround an effort to distinguish between the disclosures that are permissible under the SEC's assertion that corporations may provide analysts with information to fill in the "interstices in analysis." *See id.* at 658 n.17 (arguing that companies and analysts can never be sure when they violated the SEC's policy).

146. *Id.* at 658 n.17.

A. *Goals and Purposes of Regulation FD*

Regulation FD represents the SEC's decision to heed the Supreme Court's advice, albeit seventeen years after the fact.[147] In adopting Regulation FD, the SEC chose not to adjust existing laws but to start anew.[148] Regulation FD's stated purpose evidences the SEC's desire to combat selective disclosure of material nonpublic information by company officials to securities market professionals.[149] The SEC asserts that this measure will lead to increased investor confidence in the financial markets, with the hope that Regulation FD will allow the continued expansion of America's capital markets.[150] The SEC's reasoning comports with the theory that, in this era of globalization, the transparency of an information-based system affects the ability of that market as a whole to attract and retain investment capital.[151] In recent years, the availability of real-time information has permitted investors to transfer money instantaneously from one company to another, one market to another, and even from one country to another.[152]

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147. *See* 3D HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES AND FEDERAL CORPORATE LAW § 19:18 (Supp. 2000) (concluding that the "artful" Regulation FD appears to redress the limitations imposed by the Supreme Court in *Dirks*), WL SECFEDCORP § 19:18.

148. *See id.* (noting that the SEC addressed the *Dirk* limitations in the context of tender offers by adjusting various provisions of securities laws, but that it elected to separately address selective disclosure), WL SECFEDCORP § 19:18; John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (allowing that passing information to an analyst was prohibited only when the insider benefited personally), WL 3/13/00 Nat'l L.J. B5, (col. 1).

149. *See* Shirli Weiss & Susan D. Resley, Securities and Exchange Commission Regulation FD: Answers to Frequently Asked Questions, GRAYCARY.COM (Aug. 2000), *at* http://www.graycary.com/articles/sec/sec_sum00_1.html (stating that penalties for noncompliance could range from administrative proceedings to civil actions, and/or civil penalties).

150. *See* Mike McNamee & Paula Dwyer, *How Good Is Levitt's Endgame?*, BUS. WEEK, Mar. 13, 2000, at 130 (intimating that the SEC's tactics, including Regulation FD, under Chairman Arthur Levitt coincide with the largest expansion of stock ownership ever), 2000 WL 7825145.

151. *See* Henry Bosch, *Still a Bumpy Playing Field*, SHARES MAG., Apr. 1, 2000, at 46 (suggesting that globalization has increased the opportunity for those countries whose markets are "safe and fair" to attract foreign investment), 2000 WL 2104626; *cf.* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 172-73 (Anchor Books 2000) (1999) (asserting that a lack of transparency allows the potential for an investment bubble that will burst once investors become enlightened as to the deficiencies of a market). A "bubble" is created when excessive capital is invested in unworthy markets because investors are unaware of its deficiencies. *Id.*

152. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 71 (Anchor Books 2000) (1999) (suggesting that the ability to move capital from one place to another allows investors to punish companies that do not live up to expectations).

Regulation FD applies to all companies whose shares are traded on a national exchange.[153] Additionally, companies that have filed registration statements under the Securities Act fall under Regulation FD.[154] However, the regulation does not cover most communications made by a company while preparing for or executing a public offering.[155] Regulation FD imposes an affirmative duty to disclose material nonpublic information that is intended to be, or has unintentionally been, communicated to designated market professionals.[156]

B. *Disclosure Requirements of Regulation FD*

Regulation FD requires issuers who make disclosures of material nonpublic information to an "enumerated person," intentionally or otherwise, to do so in a manner reasonably calculated to reach the investing public.[157] As with any new law or regulation, however, the potential for

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153. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5, (explaining that the regulation applies to public companies) WL 3/16/2000 NYLJ 5, (col. 2); GRAYCARY.COM, SECURITIES AND EXCHANGE COMMISSION REGULATION FD, *last visited* Oct. 14, 2000 http://www.graycary.com/articles/sec/sec_sum00_1.html (noting that companies (1) whose shares are traded on a national exchange, (2) with greater than $10 million in assets and 500 individual investors, or (3) who filed a registration statement pursuant to the Securities Act of 1933, are subject to Regulation FD).

154. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (applying Regulation FD to new issues); *see also* 15 U.S.C. § 78o(d) (1994) (requiring those issuers that have filed registration statements under the Securities Act to file "supplementary and periodic information, documents, and reports" in accordance with SEC rules and regulations); Anne Marie Dempsey, *SEC Proposes Selective Disclosure and Insider Trading Rules*, METROPOLITAN CORP. COUNS. (Mid-Atlantic Ed.), May, 2000, at 13.

155. *See* 17 C.F.R. § 240.100(b)(2)(iv) (2000) (excluding disclosures made in connection with an offering registered under the Securities Act); Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,719 (Aug. 24, 2000) (stating that the SEC believes that existing securities regulations adequately govern communications made in connection with a public offering); Ellen Rosen, *Proposals on Fair Disclosure Affect 10b-5 Claims*, N.Y.L.J., Dec. 23, 1999, at 5 (reasoning that private discussions between an issuer and analysts and institutional investors are considered appropriate during IPO "road shows"), WL 12/23/1999 NYLJ 5, (col. 2); *SEC Ends Selective Disclosure and Clarifies Insider Trading Rules*, CORP. OFFICERS AND DIRECTORS LIABILITY LITIG. REP., Aug. 28, 2000, at 13 (commenting that the regulation will not apply to most public offerings). *But see* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,725 n.82 (Aug. 24, 2000) (noting that a public company can not make selective statements about its future performance simply because it is conducting a public offering at that time).

156. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (explaining that information can no longer be given to a select group of investors before it is released to the public), WL 3/16/2000 NYLJ 5, (col. 2).

157. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,719 (Aug. 24, 2000) (providing a simple statement of the regulation's requirements).

problems lie in defining the scope of key language. The following subsections dissect the nuances of Regulation FD as well as the perceived advantages and disadvantages of specific areas of the new regulation.

1. Issuer Personnel Subject to Regulation FD

One potential area of contention arises in defining which issuer personnel fall under Regulation FD. In that regard, Regulation FD covers statements by the issuer's "senior officials."[158] Further, the regulation applies to those persons authorized to make statements to the financial community on behalf of the company.[159] Predictably, directing an otherwise unauthorized person to make the communication on behalf of a person who is subject to Regulation FD cannot circumvent these provisions.[160]

Notably, Regulation FD excludes communications by certain people who disclose information in breach of a duty of trust or confidence to the company.[161] For example, Regulation FD only covers employee communications when the employee makes the statement on behalf of the company.[162] Therefore, although the employee may violate insider trading regulations, unauthorized disclosures by the issuer's employees do not trigger the applicability of Regulation FD.[163]

Significantly, Regulation FD also excludes from coverage "temporary insiders," such as the company's attorneys and accountants, when their communications violate a confidential relationship.[164] For instance, the

158. *See id.* at 51,739 (to be codified as 17 C.F.R. § 243.101(f)) (defining a senior official as "any director, executive officer, investor relations or public relations officer, or other person with similar functions").

159. *See* Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (indicating that communications made by those employees who perform investor relations functions must be in compliance with Regulation FD), 15 No. 6 CORPCOUN1.

160. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,720 (Aug. 24, 2000) (stating that liability for the prohibited communication will be imputed to the member of senior management who directed the selective disclosure).

161. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified at 17 C.F.R. § 243.101(c)).

162. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000 (recommending that employees who participate in trade shows be educated as to the limits of conversations with analysts), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

163. *See SEC Adopts Fair Disclosure Regulation*, MONDAQ BUS. BRIEFING, Nov. 24, 2000 (stating that "[e]mployees who do not routinely interact with securities professionals or shareholders would not otherwise be considered to have caused a violation of FD by disclosing" material nonpublic information), 2000 WL 9239826.

164. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified at 17 C.F.R. § 243.101(c)); *see* Dirks v. SEC, 463 U.S. 646, 655 n.14

lawyer-client duty of confidentiality represents one such traditional relationship.[165] Notably, even when such a duty does not exist on its own, under Regulation FD, parties may create by express agreement a duty of confidentiality between the issuer and the party who receives the selective disclosure.[166] These confidentiality agreements, especially those formed between the issuer and securities analysts, facilitate the continued practice of selective disclosure, albeit in a more controlled environment.[167]

2. "Enumerated Person"

A second area of potential conflict encompasses defining an enumerated person. Under Regulation FD, an enumerated person generally includes "securities market professionals or holder's of the issuer's securities who may well trade on the basis of the information."[168] Securities markets professionals include investment analysts, broker-dealers, and investment companies.[169]

Because Regulation FD only applies to communications made to people outside the issuer, the regulation does not cover disclosures to employees.[170] This exclusion comports with the minimalist approach of Regulation FD. The SEC is primarily concerned with maintaining enforcement capabilities over all insider-trading activities.[171] If the employee trades based on inside information, a Rule 10b-5 enforcement

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(1983) (recognizing that outsiders may become fiduciaries of the corporations when they are exposed to nonpublic information solely for corporate purposes).

165. *See* ABA MODEL RULES OF PROF'L CONDUCT R. 1.6(a) (1983) (stating that "[a] lawyer shall not reveal information relating to representation of a client unless the client consents after consultation").

166. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified at 17 C.F.R. § 243.100(b)(2)(ii)) (stating that Regulation FD does not apply to any "person who expressly agrees to maintain the disclosed information in confidence").

167. *See id.*

168. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,719-20 (Aug. 24, 2000) (specifying as "enumerated persons": (1) broker-dealers, (2) investment advisers, (3) investment companies and (4) securities holders who may trade on the material nonpublic information).

169. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified at 17 C.F.R. § 243.100(b)(1)).

170. *See id.* (stating that Regulation FD applies only to disclosures made to persons "outside the issuer").

171. *See* Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1191 (1995) (noting that a major SEC enforcement target is insider trading, which arguably requires a heightened fiduciary duty to satisfy due process and ideas of fairness).

proceeding becomes practically unavoidable.[172] This scenario raises problems, however, because commentators assert that analysts, in an effort to replace the information lost due to Regulation FD, will solicit employees for inside information to complete their analysis.[173] Nonetheless, if the SEC determines that the employee acted on behalf of a senior official, then the violation of Regulation FD will impute to the principal.[174]

3. Requirement That Information Be Both Material and Nonpublic

A third significant question concerns the type of information covered under the regulation. Regulation FD only applies when the communication of nonpublic information is "material," as defined by the SEC.[175] Although the regulation does not expressly define materiality, the SEC asserts that definitions developed by case law and ratified in various areas of securities regulations control.[176] Accordingly, for Regulation FD purposes, the SEC considers information material if "'there is a substantial likelihood that a reasonable shareholder would consider it important' in making an investment decision."[177] The SEC's final rule also suggests that certain types of information should be "carefully reviewed" to determine whether it qualifies as material, thereby implying that the SEC in-

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172. *See SEC's Staff Issue Some Guidance on Reg. FD*, INVESTOR REL. BUS., Nov. 6, 2000 (quoting an SEC staff member as stating that, although "Reg. FD does not apply to communications of confidential information to employees of the issuer[,] [a]n issuer's officers, directors, and other employees are subject to duties of trust and confidence and face insider trading liability if they trade or tip"), 2000 WL 8692732.

173. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (predicting that analysts will seek out retail employees to see how business is doing), 2000 WL 24218624.

174. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,720 (Aug. 24, 2000) (stating that "to the extent that another employee had been directed to make a selective disclosure by a member of senior management, that member of senior management would be responsible for having made the selective disclosure"). *See generally* 15 U.S.C. § 78t(b) (1994) (outlawing the use of an agent to perform an act that is in violation of the Exchange Act).

175. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (recognizing that Regulation FD does not prohibit the disclosure of nonmaterial information that completes an analyst's "mosaic" of information).

176. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (declaring that the regulation does not expressly define materiality); *see also* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (recognizing the nonexistence of a bright-line test), WL 11/16/2000 NYLJ 5, (col. 1); Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (providing that the proposal is "far from a bright-line test"), WL 3/16/2000 NYLJ 5, (col. 2).

177. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 448 (1976); *see* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (adopting the *TSC Industries* definition of materiality).

tends to keep a close eye on such information.[178] This non-exhaustive list includes such things as communications related to earnings information, mergers and acquisitions, new products or discoveries, and changes in control of the issuer.[179]

Importantly, the SEC calibrates the materiality determination to the "reasonable investor."[180] Although such a standard will certainly provide fertile ground for further discussion,[181] an analyst may supplement the mosaic of publicly available information, in some instances, with nonmaterial information gathered in private discussions with the issuer.[182] The SEC did not intend to nullify the efforts of analysts and investors to compile information or accumulate expertise.[183] To the contrary, the SEC intended Regulation FD to reverse the trend away from such practices.[184] Notably, an issuer may not dissect material pieces of information into individually nonmaterial communications and then pass the information to securities professionals to reconstruct into meaningful and, more importantly, material, information.[185]

Fortunately, whether information is considered nonpublic is a well-settled area of law.[186] As a result, this area has not been the topic of much discussion, either by the SEC or the securities industry. The SEC's final

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178. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (noting that while the listed items are not *per se* material, "some determinations will be reached more easily than others").

179. *Id.* (listing suggested items which provide guidance when determining materiality).

180. *See id.* (indicating that materiality is determined in the context of the "total mix" of available information). This standard initially developed in the courts, but has since been codified in provisions of both the Securities Act and the Exchange Act. *See* 17 C.F.R. §§ 230.405, 240.12b-2 (2000).

181. *See* Ellen Rosen, *Proposals on Fair Disclosure Affect 10b-5 Claims*, N.Y.L.J., Dec. 23, 1999, at 5 (noting the gray area encompassing the definition of materiality), WL 12/23/1999 NYLJ 5, (col. 2).

182. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 9 (analyzing the contours of the information that may be provided to analysts), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

183. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (stating that the continued resourcefulness of analysts is not intended to be discouraged by Regulation FD).

184. *See id.* (intimating that analysts have become overly reliant on selective disclosure in the development of their reports).

185. *See id.* at 51,721 (anticipating strict construction attacks on the determination of whether information in material or not).

186. Peter M.O. Wong, Note, *Insider Trading Regulation of Law Firms: Expanding ITSFEA's Policy and Procedures Requirement*, 44 HASTING L.J. 1159, 1169 (1993) (acknowledging that the question of what constitutes material nonpublic information is well settled in securities law).

rule, in fact, dispenses with the issue in a single statement: "Information is nonpublic if it has not been disseminated in a manner making it available to investors generally."[187]

4. Intentional and Unintentional Selective Disclosures

Regulation FD distinguishes between unintentional and intentional disclosures of material nonpublic information to a select audience.[188] The SEC considers a selective disclosure "intentional when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic."[189] When an issuer intends to disclose material nonpublic information, the SEC requires the issuer to offer a public disclosure by a method proscribed by Regulation FD either at the time of, or before, the selective disclosure.[190] As a result, when an issuer makes an intentional disclosure of material nonpublic information without a simultaneous public disclosure or is reckless in not ascertaining the material and nonpublic nature of the information communicated, Regulation FD liability invariably attaches.[191] A company should correct the failure to publicly disclose quickly, however, because the SEC considers the duration of the violation in determining a course of enforcement.[192] Thus, to a certain extent, an issuer can mitigate the penalties that the SEC pursues by disclosing its

187. *Id.* (referring to *In re* Investors Mgmt., 445 S.E.C. 633, 643 (1971)). As with the definition of "materiality," the SEC gleaned yet another definition from case law for "nonpublic." *See* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 854 (2d Cir. 1968).

188. Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10, WL 2/7/00 Nat'l L.J. B10, (col. 2).

189. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.101(a)).

190. *Id.* (to be codified as 17 C.F.R. § 243.100(a)(1)). *See id.* (to be codified as § 243.101(e)) (defining the methods of public disclosure that will satisfy Regulation FD). Technically, if a public disclosure is made prior to the selective disclosure, Regulation FD no longer applies because the information is not considered "nonpublic." *See* 65 Fed. Reg. 51,721 (Aug. 24, 2000) (defining nonpublic information as that information which has "not been disseminated in a manner making it available to investors generally").

191. *Cf.* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.100(a)(1)) (mandating that the public disclosure be made simultaneously with the intentional or reckless disclosure); *see also* Toby Weber, *Publicly Held Means Staying Private*, TELEPHONY, Nov. 20, 2000 (concluding that intentional or reckless disclosures of nonpublic information is a violation of Regulation FD), 2000 WL 7093352.

192. *See IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (noting that the SEC will consider the speed with which the company reacts to a disclosure in determining whether the disclosure was reckless), 2000 WL 8692719.

intentional or reckless violation as quickly as possible.[193] Consequently, if the issuer can make the remedial disclosure for an intentional or reckless violation of Regulation FD before investors use the information for trading purposes, then the SEC will likely forego action against the issuer.[194]

When an issuer negligently discloses material nonpublic information in violation of Regulation FD, the company must take action to disclose that information to the public before the later of twenty-four hours or the next opening of trading.[195] Although unintentional disclosures can occur in a variety of situations, such disclosures often transpire in unscripted dialogues with analysts that tend to wander into areas the company official should not discuss.[196]

5. Approved Methods for Disclosure

Regulation FD stipulates that the company may comply with the public disclosure requirement by filing Form 8-K.[197] Form 8-K reports to the SEC that a material event has occurred.[198] In a non-Regulation FD situ-

193. *Cf.* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,726 n.91 (Aug. 24, 2000) (announcing that the SEC will likely seek more severe penalties for violations that are not ended with a proscribed disclosure).

194. *See* Mark Kessel, *Manager's Journal: How to Survive the Disclosure Minefield*, WALL ST. J., Oct. 23, 2000, at A38 (reporting that the SEC will review the markets' reaction to information to determine whether it is material), 2000 WL-WSJ 26614090.

195. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (stating that proposed Rule 101(d) requires "prompt" disclosure within 24 hours from the time any senior executive knew or should have known of the disclosure), WL 3/13/00 Nat'l L.J. 85, (col. 1); Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (referring to the requirement based on inadvertent or mistaken disclosures by executives), WL 3/16/2000 NYLJ 5, (col. 2); Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (indicating that the rule treats "nonintentional" different from "intentional" disclosure), WL 2/7/00 Nat'l L.J. B10, (col. 2).

196. *See* Roger K. Harris & Leslie Haines, *Know Your Reg. FD*, OIL & GAS INVESTOR, Dec. 1, 2000, at 4952 (recommending the use of scripts in discussions with analysts to avoid disclosing material information), 2000 WL 11768686

197. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.101(e)(1)) (indicating that an issuer is required to file Form 8-K unless it has undertaken to make the public disclosure in a manner reasonably calculated to reach the investing public); Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14, WL 6 No. 6 ANSLRR 14.

198. *See* Exchange Act Form 8-K, Gen. Instruction A, [1998-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 31,002 at 21,991 (Oct. 6, 2000) (stating that Form 8-K is to be used for current reports by Section 13 and Section 15(d) reporting companies). A company whose shares are traded on a national exchange must, pursuant to Section 13 of the Exchange Act, file periodic reports with the SEC. 15 U.S.C. § 78m(a) (1994). Section 15(d) of the Exchange Act requires companies that have filed a registration statement

ation, a company must file Form 8-K within fifteen days of most material events.[199] Of course, in order to comply with Regulation FD, Form 8-K is subject to the same time limitations as other proscribed methods, making the fifteen day deadline inapplicable.

The Form 8-K method of disclosure in a Regulation FD scenario presents additional considerations for the issuer.[200] When a company files Form 8-K, the company must decide whether to report the material information under Item 5 or the recently added Item 9.[201] The SEC considers materials listed under Item 5 "filed" and available for convenient incorporation by reference into registration statements filed pursuant to Section 6 of the Securities Act,[202] thereby satisfying the company's duty to update stale or inaccurate information.[203] However, an Item 5 filing also subjects those materials to potential liability under Section 18 of the Exchange Act, which prohibits false or misleading statements in documents filed with the SEC.[204] Conversely, when an issuer provides the information under Item 9 of Form 8-K, the materials are considered "furnished" to the SEC.[205] This method satisfies the disclosure requirements

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under the Securities Act to file supplementary and periodic information with the SEC. *Id.* § 78o(d).

199. Exchange Act Form 8-K, Gen. Instruction B, [1998-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 31,002 at 21,991 (Oct. 6, 2000).

200. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (noting the potential ramifications of "filing" under Item 5 or "furnishing" under Item 9), WL 11/16/2000 NYLJ 5, (col. 1).

201. Exchange Act Form 8-K, Item 9 [1998-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 31,002, at 21,991 (Oct. 6, 2000); *see also* John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B6 (indicating that Form 8-K has been amended to include the Item 9 "furnishing" option), LEXIS, Nexis Library, News Group File.

202. 15 U.S.C. § 78f (1994).

203. *See* Exchange Act Form 8-K, Gen. Instruction B(4), [1998-2000 Transfer Binder] Fed. Sec. L. Rep. (CCH), ¶ 31,002, at 21,992 (Oct. 6, 2000) (cautioning issuers to give due regard to the accuracy of material information filed under Item 5, which is incorporated by reference into registration statements); John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B6 (warning issuers to consider filing "under Item 5 of Form 8K or to 'furnish' it under Item 9"), LEXIS, Nexis Library, News Group File.

204. *See* 15 U.S.C. § 78r (1994) (stating that liability will attach to any person who files an application, report or document with the SEC that is "false or misleading with respect to any material fact"); *see also* John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B6 (explaining the ramification of filing information under Item 5 of Form 8-K), LEXIS, Nexis Library, News Group File.

205. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,723 & n.68 (Aug. 24, 2000) (stating that issuers who choose to "furnish" information must designate the information as being provided under Item 9).

of Regulation FD while at the same time avoiding potential Section 18 liability.[206]

In addition to filing Form 8-K, the SEC also suggests various media through which an issuer can communicate the remedial public disclosures.[207] The SEC, as well as industry groups, recognize that most companies will employ the Internet and other forms of modern media in their communication strategy.[208] For example, the SEC suggests that companies use such segment-penetrating media as television, teleconferencing, or electronic transmissions via the Internet to communicate remedial public disclosures.[209] Also, the SEC suggests that the company issue a press release containing the material information for use by both public and private news media.[210] Regardless of the method used, the SEC stresses that the issuer communicate the information in a non-exclusionary manner readily accessible to the public.[211]

6. SEC Enforcement Capabilities

Because Regulation FD does not create a private cause of action, the SEC enforces the rule through several forms of judicial action.[212] First,

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206. *See* 15 U.S.C. § 78r(a) (1994) (making it unlawful for any person to file documents with the SEC that contain materially false or misleading statements).

207. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (providing a sample list of the technological innovations that have expanded issuers' ability to disseminate information).

208. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 3 (noting that 60% of companies surveyed already conduct "Webcast" conference calls), *at* http://www.niri.org/publications/alerts/ea101100.cfm; *SEC Commissioner Sees Internet Trading Equality in Near Future*, 1 No. 4 E-TRADING LEGAL ALERT 10 (July 21, 2000) (relating the comments of the SEC's Internet trading specialist, who intends to facilitate public access to "road shows" and research).

209. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (listing alternatives to a Form 8-K disclosure), WL 11/16/2000 NYLJ 5, (col. 1).

210. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 4 (advising that, although not specifically required, a press release will provide additional security), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

211. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.101(e)(2)); *see* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 1 (discussing the protocols that issuers should adopt when conducting conference calls), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

212. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.102) (stating that a violation of Regulation FD has no effect on antifraud liability under Rule 10b-5).

the SEC may seek an injunction under Regulation FD.[213] The injunction does not merely ask an issuer to comply with the law. Rather, the SEC uses the injunctive order to operate as a precursor to criminal charges in the event of further violations.[214] Alternatively, the SEC may request a cease-and-desist order.[215] Finally, the SEC may seek civil penalties for any Regulation FD violation.[216]

C. *Potential Regulation FD Ambushes*

1. Non-exclusivity of Regulation FD

The SEC structured Regulation FD to address the enforcement deficiencies that existed under prior securities regulations.[217] Accordingly, Regulation FD generally excludes from coverage those activities that the SEC can effectively deter through pre-existing antifraud provisions.[218] Most notably, current insider-trading proscriptions address selective disclosures made by a company official or "temporary insider" in breach of a duty to the issuer or its shareholders under existing laws.[219] Therefore, Regulation FD excludes such disclosures from coverage.[220] Additionally, Regulation FD also excludes communications to those persons who agree to maintain the information in confidence.[221]

Critically, compliance with Regulation FD does not exempt a company from other antifraud provisions of the securities scheme.[222] Indeed, a company should not become so concerned with Regulation FD that it

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213. *See* 15 U.S.C. § 78u(d)(1) (1994) (permitting the SEC to bring an action to enjoin acts that appear to be in violation of the Exchange Act).

214. *See id.* (allowing the SEC to provide evidence concerning a possible violation to the Attorney General, "who may in his discretion, institute the necessary criminal proceedings under this title").

215. *See id.* § 78u-3(a) (delineating the circumstances under which the SEC may order an issuer to cease to violate the Exchange Act and, further, to require the issuer "to take steps to effect compliance").

216. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,726 (Aug. 24, 2000) (discussing the enforcement options the SEC has with respect to Regulation FD).

217. *See id.* at 51,718 (suggesting that the prior enforcement measures would be inappropriate under the current insider trading laws).

218. *See id.* at 51,738 (to be codified at 17 C.F.R. § 243.100(b)(2)) (listing Regulation FD exclusions).

219. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,719 (Aug. 24, 2000).

220. *See id.* at 51,738 (to be codified as 17 C.F.R. § 243.100(b)(2)(i) (excluding from regulation those persons who owe a duty of trust or confidence to the issuer).

221. *Id.* § 243.100(b)(2)(ii).

222. *IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000, 2000 WL 8692719.

ignores other securities regulations.[223] Under some circumstances, for instance, a company has an affirmative duty to disclose information, and a failure to do so results in a securities violation.[224] In these instances, a hasty decision to withhold information in order to comply with the selective disclosure regulation could result in much more severe degree of liability than that which would have been available under Regulation FD.[225]

2. Analysts' "Mosaics of Information"

Regulation FD also prohibits companies from breaking information down into nonmaterial bits of information and delivering it piecemeal to securities analysts.[226] Importantly, a company will not be in violation of the regulation if collectively nonmaterial pieces of information are instrumental in helping an analyst to complete its mosaic of analysis.[227] As a prophylactic measure, companies should provide only historical information in detail and avoid providing specific information with respect to present and future earnings.[228]

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223. *See id.* (reporting that companies run the risk of violating other securities regulations in their efforts to comply with Regulation FD).

224. *See id.* (noting that a company's duty to correct or update public information may require the disclosure of the information in a public manner). Clearly, the duty to update or correct information should be considered before Regulation FD compliance is contemplated. If such a duty exists, then Regulation FD requirements are immaterial because the decision whether or not to selectively disclose information should never be reached. Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5, WL 11/16/2000 NYLJ 5, (col. 1).

225. *Compare* 15 U.S.C. § 78t-1(a) (1994) (establishing a private cause of action against a person with whom a plaintiff executes a securities transaction while the person is in possession of material nonpublic information in violation of the Exchange Act), *with* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,739 (Aug. 24, 2000) (to be codified at 17 C.F.R. § 243.102) (rejecting the existence of a private cause of action under Regulation FD). The federal courts have long recognized the existence of a private cause of action under Rule 10b-5. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (explaining that despite the lack of an express private remedy, it is well established that there exists a private cause of action under Rule 10b-5).

226. *IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (reporting that such a scenario would attract the SEC's attention if the analyst's clients benefit from the information being reconstructed in the form of investment advice prior to the public release of the analyst's report), 2000 WL 8692719.

227. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (reporting that information that assists an analyst in research may be selectively disclosed as long as it is not material), WL 11/16/2000 NYLJ 5, (col. 1).

228. *See IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (providing a general procedure for avoiding the provision of a material "mosaic" of information to securities analysts), 2000 WL 8692719; *see*

Some contradictory language appears in the SEC's final rule with respect to the materiality standard applicable to an analyst's mosaic. As previously discussed, the SEC calibrates Regulation FD's materiality standard to the "reasonable investor."[229] Under Regulation FD, the SEC classifies information as material if there is a substantial likelihood that a reasonable investor would consider the information important in making her investment decisions.[230] In certain instances, the information contained in an analyst's report may be ascribed to the "reasonable investor," thereby significantly affecting the determination of whether information is material or not.

The SEC states that "an issuer is not prohibited from disclosing a nonmaterial piece of information to an analyst, even if, *unbeknownst to the issuer*, that piece helps the analyst complete a 'mosaic' of information that, taken together, is material."[231] As a result, when an issuer is unaware of either an analyst's research or the conclusions gleaned therefrom, the issuer may freely communicate nonmaterial information to the analyst in reliance of the "reasonable investor" standard. Nevertheless, a problem arises when an issuer becomes aware of the contents of an analyst's mosaic, which often contains information "not generally known" to the investing public. Under this scenario, the issuer may not communicate information the issuer knows will provide important missing pieces to the mosaic, regardless of whether the information, by itself, would satisfy the "reasonable investor" standard. Consequently, if an issuer knows that otherwise nonmaterial information will play a vital role in assisting the analyst to complete the mosaic, the issuer may not provide the information on a selective basis. Thus, when an issuer becomes aware of the substance of an analyst's mosaic, the SEC's final rule has the practical effect of attributing the skilled analysis of a market professional to a "reasonable investor." This scenario can potentially occur when a company reviews an analyst's report before the report's relèase to the public. Therefore, companies should realize that by simply engaging in the review of analyst reports, the company will likely be deemed to be "aware" that information will be important to an analyst's mosaic of information.

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also Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (allowing that the issuer can disclose nonmaterial information).

229. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (providing that Regulation FD is "keyed to the reasonable investor").

230. *Id.*

231. *Id.*

3. Rule 10b-5

Regulation FD creates duties only under Section 13(a) and Section 15(d) of the Exchange Act.[232] Therefore, a violation of Regulation FD does not necessarily result in a violation of Rule 10b-5.[233] Although a violation of Regulation FD does not result in a *per se* violation of Rule 10b-5, an entity can violate both Regulation FD and Rule 10b-5.[234] Further, in some instances, an issuer's attempts to comply with Regulation FD may effectively make it easier for the SEC or a private plaintiff to establish a Rule 10b-5 violation.[235]

When an issuer fails to publicly disclose material nonpublic information within the time proscribed, the SEC considers Regulation FD's applicability to continue until such time as the issuer publicly discloses the information.[236] In order to end the Regulation FD violation, the issuer must make a public disclosure that reveals the issuer's failure to disclose material nonpublic information. In certain instances, a Regulation FD remedial disclosure satisfies multiple elements of a 10b-5 cause of action.[237]

For example, if a company issues a press release and then subsequently selectively discloses material nonpublic information, either intentionally or unintentionally, the subsequent remedial disclosure required by Regu-

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232. *See* Scott J. Davis, *Liability Under Sections 10, 18 and 20 of the Securities Exchange Act of 1934*, 1198 PLI/Corp. 723, 781-82 (Oct. 2000) (discussing briefly the effect of Regulation FD on Rule 10b-5 liability).

233. *See id.* (explaining that no private cause of action arises from a violation of Regulation FD).

234. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,726 (Aug. 24, 2000) (asserting that "if an issuer's report or public disclosure made under Regulation FD contained false or misleading information, or omitted material information, Rule 102 would not provide protection from Rule 10b-5 liability").

235. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (raising concerns that a remedial disclosure under Regulation FD may conclusively establish that prior public disclosures were misleading), WL 3/16/2000 NYLJ 5, (col. 2).

236. *Cf.* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,726 n.90 (Aug. 24, 2000) (discussing the implications of failing to make a timely public disclosure after making the selective disclosure).

237. *Compare* 17 C.F.R. § 240.10b-5(b) (2000) (making it unlawful for any person to fail "to state a material fact necessary in order to make [previous] statements . . . not misleading"), *and* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (holding that a Rule 10b-5 cause of action will not lie unless the conduct was intended by the issuer), *with* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.100(a)(1)) (requiring issuers, in the case of an intentional disclosure, to essentially admit that it neglected to publicly disclose material information). In *Hochfelder*, the Court noted that it was irrelevant whether the issuer knew it was violating securities laws, as long as it intended to do the act. *Hochfelder*, 425 U.S. at 193.

lation FD may reveal that the press release omitted material information, thereby exposing the company to Rule 10b-5 liability.[238] Thus, the materiality requirement is established by the combination of the press release and subsequent remedial disclosure. If the SEC or a private plaintiff establishes that the issuer made the disclosure intentionally or recklessly, then liability under Rule 10b-5 will be practically unavoidable because Rule 10b-5's "scienter" requirement is established.[239]

Additionally, when a company has a duty to update or correct information, a failure to publicly disclose such information may lead to Rule 10b-5 liability.[240] If the company further decides to selectively disclose the information to securities professionals, as opposed to keeping the information secret, then the company will violate Regulation FD as well.[241]

IV. COMPLIANCE

Regulation FD initiated an extensive paradigm shift with respect to selective disclosures by corporations.[242] Corporate attorneys are scrambling to develop procedures and policies aimed at preventing a Regulation FD scenario.[243] Regulation FD will likely require extensive involvement of corporate counsel in every phase of analyst communications until there has been further dissertation by the SEC or the courts.[244]

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238. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (explaining, by way of example, the interplay between Regulation FD and Rule 10b-5), WL 3/16/2000 NYLJ 5, (col. 2).

239. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201 (1976) (holding that the acts contemplated by Rule 10b-5 require more than a showing of negligence, thus establishing the requirement of scienter in a Rule 10b-5 cause of action).

240. *See IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (discussing the interaction between Regulation FD and Rule 10b-5), 2000 WL 8692719; Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (providing an example of the interaction between Regulation FD and Rule 10b-5), WL 11/16/2000 NYLJ 5, (col. 1).

241. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, *at* 5 (delineating a scenario wherein a company can be in violation of both Rule 10B and Regulation FD), WL 11/16/2000 NYLJ 5, (col. 1).

242. *See id.* (asserting that Regulation FD will significantly effect corporate disclosure procedures); Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (reporting that Regulation FD "squashes" the entire paradigm of selective disclosure), 2000 WL 4726628.

243. *See* John Schmeltzer, *Sharp Reaction to Full-Disclosure Rule*, CHI. TRIB., Oct. 24, 2000, at 3 (relating the reason for requesting a delay in the effective date of Regulation FD, so that companies could develop procedures and policies to comply with the new regulation), 2000 WL 3724656.

244. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (noting that "counsel will move from the position of Rosencrantz and Guildenstern, waiting in the wings, to that of Hamlet at center stage"), WL 3/13/00 Nat'l L.J. B5, (col. 1).

Most industry observers agree that issuers should engage in a "cautionary mode" during one-on-one discussions with analysts and investors.[245]

Since the adoption of Regulation FD, industry groups have conducted extensive training programs in an effort to educate issuers about Regulation FD's intricacies.[246] Similarly, SEC staff members have participated in public conferences intended to address confusion about Regulation FD.[247] Additionally, numerous law firms have sent advisory letters to clients, as well as placed their compliance recommendations on web sites

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245. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (noting that the regulation is likely to cause corporate officers to be cautious in discussion with analysts), WL 3/16/2000 NYLJ 5, (col. 2); Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (recommending that while a complete aversion to communications with analysts and investors is impractical, companies should proceed with caution), WL 6 No. 6 ANSLRR 14; Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 4 (stating that private discussions will continue to be an important component of investor relations), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

246. *See* Sharon Harvey Rosenberg, *New SEC Disclosure Rule Forces Public Companies to Drop Traditional One-on-One Briefings*, PALM BEACH DAILY BUS. REV., Sept. 12, 2000, at A1 (discussing the issuance of client advisories by investment professionals and lawyers); Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 1 (providing suggestions for compliance with the regulation), *at* http://www.niri.org/publications/alerts/ea101100.cfm; *see also SEC Declines NIRI's Request for an Extension to Reg. FD*, PR NEWSWIRE, Oct. 12, 2000 (reporting NIRI's efforts to educate issuing companies' officials), WL 10/12/00 PR Newswire 14:13:00.

247. *SEC Denies NIRI's Request for an Extension to Reg. FD*, PR NEWSWIRE, Oct. 12, 2000, WL 10/12/00 PR NEWSWIRE 14:13:00. Despite the SEC's efforts, however, Regulation FD opponents argued that the format and selective location of these conferences did not provide adequate guidance. *Id.* Ironically, NIRI's complaints amount to an accusation that the SEC is guilty of selective enlightenment—a clever analogy to the very conduct (selective disclosure) that Regulation FD is intended to prohibit. *Compare SEC Denies NIRI's Request for an Extension to Reg. FD*, PR NEWSWIRE, Oct. 12, 2000 (arguing that SEC efforts to address confusion regarding Regulation FD "should be in a written format, preferably in a press release and/or on their website and not in selective forums"), *with* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,723 (Aug. 24, 2000) (providing that the "public disclosure" required by an earlier version of Regulation FD could be effected by "distributing a press release through a widely disseminated news or wire service"). The SEC interpretive release also provides that posting the required disclosure on the company's web site, although not by itself sufficient to meet the disclosure requirements of Regulation FD, can be part of a program that may collectively meet such requirements. Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5, WL 11/16/2000 NYLJ 5, (col. 1); *see* Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (noting that companies may not use their web site as the exclusive method of public dissemination), 15 No. 6 CORPCOUN1.

for public consumption.[248] The following sub-sections represent a compilation of the more popular compliance suggestions by the SEC, industry groups, and securities practitioners.

A. *Corporate Training*

Corporate counsel should thoroughly train management regarding the disclosure of information.[249] Counsel must provide all senior management with an explanation of the fact-specific nature of what constitutes material information.[250] Further, company officials should be encouraged to approach corporate counsel with any question regarding whether the disclosure will violate Regulation FD, particularly until the SEC defines the intricate contours of the regulation.[251] Finally, counsel should provide a detailed and, perhaps, hyperbolic explanation of the possible ramifications that could arise upon a Regulation FD violation.[252]

B. *Issuer Disclosure Policies and Procedures*

1. Persons Authorized to Speak to Investing Community

Many attorneys suggest that companies limit the number of persons authorized to speak to investors, analysts, and the media.[253] Regulation

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248. *See* Lisa I. Fried, *Selective Disclosure; Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (recognizing that practioners' advisements to corporate executives encourage companies to exercise good judgment and caution), WL 3/16/200 NYLJ 5, (col. 2). *See generally SEC Proposes New Selective Disclosure and Insider Trading Rules*, TH&T Client Bulletin (Jan. 20, 2000), *at* http://www.tht/com/client_bulletin_012000_SEC_new-trading-rules.htm (providing an overview of the SEC's proposals and suggesting that publicly-held companies review their practices for compliance); Louis M. Thompson, Jr., *SEC Passes Regulation Fair Disclosure*, NIRI Executive Alert, *at* http://www.businesswire.com/ACF5D53-R1.htm (Aug. 16, 2000) (outlining the SEC's Regulation FD while providing guidance for compliance); Shirli Weiss & Susan D. Resley, *Securities and Exchange Commission Regulation FD: Answers to Frequently Asked Questions*, Gray Cary. Technology's Legal Edge (discussing various aspects of Regulation FD), *at* http://www.graycary.com/articles/sec/sec_sum00_1.html (Aug. 2000).

249. Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (recommending that senior management be sensitized to the SEC's new selective disclosure rules), WL 6 No. ANSLRR 14.

250. *Id.*

251. *Id.*

252. Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14, WL 6 No. 6 ANSLRR 14.

253. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (suggesting that the appointment of a corporate spokesperson is the most effective method of controlling selective disclosure), WL 11/16/2000 NYLJ 5, (col. 1); *see also* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (advising that limiting the number of authorized personnel for disclosure purposes is prudent), WL 3/13/00 Nat'l L.J. B5, (col. 1); Lisa I. Fried, *Selective Disclosure:*

FD permits companies to designate those authorized to speak about a company's financial performance, and some observers further recommend that a company appoint a single person for this purpose in the company's written disclosure policy.[254] As previously mentioned, communications by persons not authorized to speak with securities professionals do not result in a violation of Regulation FD.[255] As a result, companies can expect analysts to pursue these individuals in attempts to replace the information that Regulation FD likely will remove from analysts' resources.[256] At present, the law remains unclear as to whether unauthorized statements by a person authorized to speak to analysts will enjoy immunity from liability.[257]

2. Limiting Analyst Communications

In addition to authorizing specific speakers, a company may also choose to institute an "analyst blackout policy."[258] Essentially, to insti-

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Proposed SEC Regulation Raises Compliance Issues, N.Y.L.J., Mar. 16, 2000, at 5 (suggesting that attorneys should educate corporate clients on how to identify material information), WL 3/16/2000 NYLJ 5, (col.2); Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (advising that companies review and adjust their internal controls regarding the persons who are authorized to speak on the companies' behalf), WL 2/7/00 Nat'l L.J. B10, (col. 2).

254. *See* John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B6 (suggesting that a limited number of people be authorized to address analyst inquiries), LEXIS, Nexis Library, News Group File; Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (recommending that a clear line of authority be established and that preferably one person be designated to communicate with the financial community), WL 6 No. 6 ANSLRR 14; Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 7 (adding that employees unauthorized to speak with analysts and investors be warned against participating in such an activity), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

255. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (discussing a prudent compliance procedure wherein the number of people authorized "to make disclosures on behalf of the corporation" is limited), WL 3/13/00 Nat'l L.J. B5, (col. 1). *But see* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (noting that selective disclosure by directors and officers (or their agents) will result in liability for a breach of trust), WL 11/16/2000 NYLJ 5, (col. 1).

256. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 4 (recommending that employees who participate in trade shows be educated as to the limits of conversations with analysts), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

257. *See* John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B5 (shedding light on additional concerns that companies should consider addressing), LEXIS, Nexis Library, News Group File.

258. *See* Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (asserting that the risk of

tute an effective blackout policy, a company should prohibit all communications with analysts for a designated period prior to earnings announcements.[259] This cautionary measure, although not required by Regulation FD, prevents inadvertent disclosures that may be construed as both nonpublic and material.[260] Furthermore, companies that choose to adopt an analyst blackout should designate a standard duration for all blackouts.[261] By adhering to a stated policy consistently, companies can avoid speculation among the investing community as to the importance of the forthcoming announcement.[262]

3. Administrative Procedures for One-on-One Analyst Discussions

a. Scripted Communications

The use of boilerplate or scripted answers to anticipated questions concerning future earnings and performance estimates constitutes an additional safeguard against violating Regulation FD.[263] These scripts should result from a collaborative effort between counsel and company officials.[264] Alternatively, the issuer may request that analysts submit relevant questions in writing so that the issuer may carefully craft answers designed to avoid a Regulation FD violation.[265]

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unlawful communications are minimized by halting analyst communications altogether), WL 6 No. 6 ANSLRR 14.

259. *Id.*

260. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 8 (indicating that the duration of a "quiet period" is generally about three weeks), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

261. *See id.* (noting that whatever duration a company chooses, it should remain unchanged).

262. *See* Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (allowing that "scripts" could minimize the possibility of disclosure), WL 6 No. 6 ANSLRR 14.

263. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (indicating that even scripted answers must be accompanied by the company's good judgment), WL 3/16/2000 NYLJ 5, (col. 2); Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (noting that, to the extent practicable, practitioners should address all anticipated questions and approve all scripts several hours before a conference call), WL 6 No. 6 ANSLRR 14.

264. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (recommending that the issuers be involved in the scripting process), WL 11/16/2000 NYLJ 5, (col. 1).

265. Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5, WL 11/16/2000 NYLJ 5, (col. 1).

b. Presence of Counsel or Investment Relations Officer

Another preventive scheme involves the presence of counsel or an investor relations officer (IRO) at all meetings involving securities professionals.[266] With respect to IROs, the company should ensure that the IRO is intimately familiar with all aspects of corporate developments—whether that information is publicly available or not.[267] In reality, the presence of an IRO may be more practical than the presence of counsel. No attorney wants to tackle the unenviable task of making on-the-spot decisions without a full understanding of the company officials "awareness" with respect to the analyst's mosaic.[268] Under Regulation FD, the SEC may consider otherwise nonmaterial information to be material if the company official knows that the information is critical to an analyst's evaluation.[269] Additionally, the corporate officers may cringe at the idea of having business discussions harnessed by the non-business concerns of counsel.[270]

c. Recording Conference Calls

Some practitioners recommend that companies record conference calls.[271] Likewise others suggest that the company make these recordings available in real-time through the company's web site for the benefit of investors unable to hear the conversation.[272] Companies that choose this

266. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 4 (recommending that an investor relations officer (IRO) be present for private discussions between a company official and a Regulation FD "enumerated person"), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

267. *See id.* (asserting that companies cannot afford to keep IROs in the dark in the Regulation FD era).

268. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (explaining that in house counsel will not enjoy having to make "sensitive judgments under these time constraints"), WL 3/13/00 Nat'l L.J. B5, (col. 1).

269. *Cf.* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (indicating that issuers are not prohibited from providing nonmaterial information that completes a mosaic of information as long as issuer is unaware that such information is vital to the analysis).

270. John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (describing the awkward scene where in house counsel will have to continually interrupt the chief officer with warnings about the materiality of the information being discussed), WL 3/13/00 Nat'l L.J. B5, (col. 1).

271. Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (favoring group presentations which are accessible by the public over non-public presentations to individual investors or analysts), WL 6 No. 6 ANSLRR 14.

272. *See* John F. Olson et al., *Letters from the Editors: Still Fencing on a Tightrope*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 2, Oct. 2000 (relating that, in

method of compliance should understand that the SEC might consider this accommodation as a "written" communication, raising other issues such as additional filing requirements and increased exposure to liability.[273] Corporate counsel should, when practical, review these recordings for potential selective disclosures.[274] Additionally, for communications in the gray area, counsel should provide continual constructive criticism to company officials concerning the proper way to address such issues in the future.[275]

d. Internal Disclosure Procedures

Selective disclosure by a person not authorized to speak to the investment community does not trigger Regulation FD liability. When the company learns of such unauthorized disclosures, however, the company has a duty to publicly disclose that information in compliance with Regulation FD.[276] Otherwise, the company runs the risk of the SEC accusing the company of ratifying the actions of an employee.[277] As a result, the company should instruct all employees to refrain from making such disclosures to anyone remotely connected with the investment commu-

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addition to opening conference calls to the public, companies are being advised to preserve "oral" communications for the benefit of other investors), WL 4 No. 5 GLWSLAW 2.

273. *Id.* (raising additional issues that may present themselves as a result of a company's attempts to comply with the spirit of Regulation FD), WL 4 No. 5 GLWSLAW 2.

274. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (realizing that attorneys may not be able to realistically review all such recordings), WL 3/16/2000 NYLJ 5, (col. 2).

275. Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (recommending that scripts be prepared for conference calls and that they be continually updated as new issues emerge), WL 6 No. 6 ANSLRR 14.

276. *Cf.* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.100) (narrowing the application of Regulation FD to issuers and persons acting on behalf of issuers). A "person acting on behalf of an issuer" includes all senior officials and "any other officer, employee or agent of an issuer who regularly communicates with [market professionals]." *Id.* at 51,739 (to be codified as 17 C.F.R. § 243.101(c)).

277. *See* MODEL PUNITIVE DAMAGES ACT § 6 (1996) (declaring the imputation of liability to an employer when employee misconduct occurs and the employer, "with knowledge of its wrongful nature, directed, authorized, participated in, consented to, acquiesced in or ratified the conduct of the employee").

nity.[278] Further, the company should establish communication channels designed to uncover unauthorized statements by employees.[279]

4. Earnings Guidance

The SEC's comments regarding "earnings guidance" by companies disheartened many securities practitioners and industry groups.[280] Analysts routinely make earnings estimates based on a company's expected performance over the course of a particular period. Analysts often attempt to confirm the accuracy of these predictions towards the end of a particular period by contacting the issuer's officials.[281] The SEC, in its final rule, expressly states that these discussions take on a high risk of violating Regulation FD.[282] The issuer may encounter such a risk by stating that the analyst's earnings estimate is lower, higher, or even the same as actual earnings.[283]

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278. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 7-8 (recommending that employees who participate in trade shows be educated as to the limits of conversations with analysts), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

279. *See* Editorial, *Fair Disclosure Leaves Analysts Wanting More*, INVESTOR REL. BUS., Nov. 20, 2000 (relating the concerns of a major pharmaceutical company, which warned employees of its duties under Regulation FD even though disclosures by those employees are generally not covered), 2000 WL 8692688.

280. *See* Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (relating the SEC's pronouncement that when a company engages in a private discussion regarding the accuracy of earnings forecasts, the company "takes on a high degree of risk under Regulation FD"), WL 6 No. 6 ANSLRR 14. Many opponents assert that Regulation FD, as proposed, did not contemplate inclusion of these private discussions between an issuer and analysts. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 1 (reporting that many practitioners were surprised that the SEC's final rule contained restrictive language related to earnings guidance), *at* http://www.niri.org/publications/alerts/ea101100.cfm; *see also SEC Denies NIRI's Request for an Extension to Reg. FD*, PR NEWSWIRE, Oct. 12, 2000 (relating the NIRI request that the SEC delay the effective date of Regulation FD from October 23, 2000 to December 29, 2000, to allow companies to re-evaluate their disclosure practices regarding earnings guidance), 10/12/2000 PR NEWSWIRE 14:13:00.

281. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (discussing the mechanics of issuer-analyst discussions), 2000 WL 6997676.

282. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (describing the application of Regulation FD to the long-standing practice of earnings guidance).

283. *Id.* (offering several forms of questionable communication, such as express advice, indirect guidance, or dissemination of material information proffered through broken nonmaterial pieces); *see* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (asserting that confirmatory statements, such as, "I would not be troubled by that" may be in violation of Regulation FD),

The National Investor Relation Institute ("NIRI") recommends a set of guidelines that issuers should implement with respect to earnings guidance practices.[284] First, the company should only provide analysts guidance when the information relates to public information, industry-related information, or nonmaterial information.[285] Clearly, this solution presents a circuitous problem as to defining public information and, more challenging, what constitutes nonmaterial information. In the spirit of the approach endorsed by a majority of commentators, however, companies should negotiate gray areas cautiously.

Second, companies should consider providing forward-looking statements about the company's expected performance.[286] NIRI asserts that Regulation FD does not prohibit an issuer from making confirmatory statements about *its own* predictions in every instance, although it may not comment on predictions generated by an analyst at any time.[287] As such, companies should ensure that these communications comply with the SEC's safe harbor for forward-looking statements, contained in Section 21E of the Exchange Act.[288] Although Regulation FD does not affect the safe harbor directly, the regulation does amplify the

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WL 11/16/2000 NYLJ 5, (col. 1). In order to avoid providing a confirmatory answer in violation of the regulation, the SEC recommends that the issuer simply state, "[n]o comment" in response to such requests. *Id.* Companies should also consider halting the practice of reviewing analyst reports except with respect to historical performance or business description. *Id. But see* DIV. OF CORP. FINANCE, MANUAL OF PUBLICLY AVAILABLE TELEPHONE INTERPRETATIONS (4th Supp. 2000) (implying that an issuer may selectively confirm its own forecasts when such a confirmation does not convey material information). However, if a sufficient amount of time has elapsed between the time of the forecast and the later confirmation, then this may be construed as a communication about the actual performance of the company. *Id.*

284. Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 2, *at* http://www.niri.org/publications/alerts/ea101100.cfm.

285. *Id.*

286. *Id.* at 2-3.

287. *See id.* (distinguishing an issuer's options in the case of its own predictions versus those of an analyst).

288. *See* 15 U.S.C. § 78u-5(c) (Supp. 1995) (establishing the requirements that must be met in order to avoid liability in a private action for a misleading forward-looking statement). Essentially, if the misleading statement or omission is immaterial or is accompanied by sufficient cautionary statements, then the issuer will be in compliance with the safe harbor. *Id.* § 78u-5(c)(1)(A) & (B); Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 3 (stating the importance of accompanying predictions with language specifically tailored to the risk factors of such predictions), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

consequences of failing to comply with Section 21E.[289] In the event that the predictions contained in forward-looking statements become inaccurate, the company should make timely corrections.[290] Companies should not state that it will update material information, however, lest a duty arise to continue doing so.[291]

Third, for those companies that engage in a preliminary review of analyst reports, the company should limit comments to correcting errors of historical fact, informing the analyst of helpful and publicly available information, and providing clearly nonmaterial information.[292] As discussed earlier, the practice of reviewing analyst reports raises problems because the final rule contemplates that the SEC may apply the standard for materiality differently in these instances.

5. Confidentiality Agreements

Notably, Regulation FD provides no legal repercussions for analysts who misuse selectively disclosed information.[293] The regulation does, however, provide issuers with a prophylactic alternative through which the issuer may continue to provide analysts with material nonpublic information when the analyst meets certain conditions.[294] Specifically, the regulation excludes from coverage communications made to persons who have expressly agreed to maintain the information in confidence.[295] Thus,

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289. *See* Elizabeth Kitslaar, *Regulation FD: Practical Implications and Recommendations*, ANDREWS SEC. LITIG. & REG. REP., Nov. 8, 2000, at 14 (discussing the increased importance of forward looking statements in the Regulation FD era, and asserting that a failure to comply with the safe harbor provisions of 78 U.S.C. § 78u-5 may also result in a violation of Regulation FD), WL 6 No. 6 ANSLRR 14.

290. Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 3, *at* http://www.niri.org/publications/alerts/ea101100.cfm.

291. *See id.* (asserting that although updating material changes is a good business practice, companies should avoid committing to such a practice).

292. *Id.* NIRI reports that many companies are eliminating the practice of reviewing analyst reports for fear that such a review is an implicit endorsement of the report. *Id.*

293. *See id.* at 10 (warning companies, particularly those with only a few analysts following them, that the pressure to continue to provide earnings guidance will come from people for whom there are no sanctions).

294. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 4 (suggesting that IROs could be present or on the phone), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

295. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified as 17 C.F.R. § 243.100(b)(2)(i)).

an issuer may implement the use of confidentiality agreements with securities professionals and other parties privy to selective disclosure.[296]

Although the SEC does not require that confidentiality agreements be in writing, best practices demand that such a writing be obtained.[297] The parties must expressly agree that any material nonpublic information discussed between the parties shall remain in confidence.[298] The parties may secure an agreement either before or after the issuer makes a material nonpublic disclosure.[299] One should note, however, that an issuer's ability to coerce an analyst into such an agreement is severely diminished after the disclosure occurs.[300]

Parties to a confidentiality agreement often limit the duration of the agreement for a specific time period, such as twenty-four hours.[301] This temporary "embargo" provides the company an opportunity to discern whether it has made an unintentional selective disclosure.[302] Such a method proves particularly useful in unscripted discussions that may wander into unexpected areas of the company's performance.[303]

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296. *See* Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10 (describing the regulation's allowed use of confidentiality agreements), WL 2/7/00 Nat'l L.J. B10, (col. 2).

297. *See id.* (reporting that the SEC believes that confidentiality agreements will govern corporate communications under Regulation FD); *see also* United States v. Chestman, 947 F.2d 551, 570-71 (2d Cir. 1991) (en banc) (indicating that a unilateral instruction not to trade on information imposes no fiduciary duty on the instructed party to abstain from trading). In fact, the SEC is contemplating the development of a standard confidentiality agreement for communications involving material nonpublic information. Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10, WL 2/7/00 Nat'l L.J. B10, (col. 2). Analysts are also creating confidentiality agreements so that they can be made aware of what they agree to.

298. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,720 (Aug. 24, 2000).

299. *See id.* at n.28 (adding that the agreement must be executed before the recipient of the information either trades on or discloses the information); John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B6 (noting that an unintentional disclosure is best remedied by convincing the analyst or investor to expressly agree to keep the information confidential), LEXIS, Nexis Library, News Group File.

300. *See* John C. Coffee, Jr., *Tackling New Reg. FD*, NAT'L L.J., Sept. 18, 2000, at B6 (suggesting that an issuer can threaten to cut off future communications with the analyst, but that the analysts may still resist agreeing to keep the information confidential), LEXIS, Nexis Library, News Group File. The value of the information to the analyst is significantly decreased when it agrees to keep the information confidential because the analyst cannot pass the information on to the client.

301. Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5, WL 11/16/2000 NYLJ 5, (col. 1).

302. *Id.*

303. *Cf. id.* (asserting that scripted conferences allow companies to avoid making unintentional disclosures in the first place).

Some commentators question whether securities analysts will willingly enter into such an agreement.[304] Conceivably, if an analyst properly obtains material nonpublic information from a source other than the issuer and that information falls under an earlier confidentiality agreement, the analyst must refrain from using that information to its advantage.[305] Given the early effects of Regulation FD on the flow of information from companies to analysts, however, analysts may be more willing to enter into confidentiality agreements to ensure the continued flow of important information.[306] Furthermore, confidentiality agreements have proven particularly useful when the analyst fails to assemble a mosaic of public information that provides the development of a reliable report—for instance, when an analyst obtains conflicting information.[307] Although the analyst's clients will not be privy to selectively disclosed information in this instance, the analyst's report will enjoy continued viability by virtue of the report's increased accuracy.[308]

Confidentiality agreements represent somewhat of a safe-harbor for issuers.[309] Although Regulation FD purports to eliminate the evils associated with selective disclosure, the regulation does not completely bar selective disclosure.[310] Theoretically, a company could enter into a valid

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304. *See* Sarah O'Brien, *Pssst! Can You Keep a Secret?: Analysts Get an Edge with Reg FD Loophole*, INVESTMENT NEWS, Oct. 30, 2000, at 1 (speculating that analysts will not sign agreements that restrict their ability to act on information received by a source other than the issuer), 2000 WL 9431214.

305. *See id.* (casting doubt on the reality of confidentiality agreements).

306. *See id.* (relating the opinion of general counsel for the Securities Industry Association, a proponent of securities analysts, who stated "that getting embargoed information is better than not getting it at all").

307. *Contra* RALPH C. FERRARA ET AL., FERRARA ON INSIDER TRADING AND THE WALL § 7:08 (2000) (indicating that the regulation will "chill" corporate disclosure, by making the information for release too abstract), WL INSIDETRADE S 7.08; Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (noting that the estimates used to forecast quarter earnings will not be as accurate), 2000 WL 4726628.

308. *See* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (reporting that analysts concede that post-Regulation FD reports are less precise than pre-Regulation FD reports), 2000 WL 4726628.

309. *See* Editorial, *SEC's Staff Issue Some Guidance on Reg. FD*, INVESTOR REL. BUS., NOV. 6, 2000 (intimating that obtaining an agreement from an analyst to maintain information in confidence is "sufficient" to allow companies to provide analysts with material nonpublic information), 2000 WL 8692732.

310. *See* RALPH C. FERRARA ET AL., FERRARA ON INSIDER TRADING AND THE WALL § 7:08 (2000) (recognizing that Regulation FD is not merely intended to prohibit selective disclosure, but rather to side-step the *Dirks* "personal benefit" test); Sarah O'Brien, *Pssst! Can You Keep a Secret?: Analysts Get an Edge with Reg FD Loophole*, INVESTMENT NEWS, Oct. 30, 2000, at 1 (noting that some analysts are seizing upon the apparent loophole in Regulation FD that allows a company to share material nonpublic information with anyone who agrees to keep the information "under his hat"), 2000 WL 9431214.

confidentiality agreement with any number of securities professionals and continue to selectively disclose material nonpublic information.[311] Essentially, confidentiality agreements distance the company from a potential violation of Regulation FD by shifting potential liability to the analyst.[312] As a result, all parties to a confidentiality agreement will often benefit, albeit not to the same extent as in the pre-Regulation FD era.

Securities analysts who agree to enter into confidentiality agreements enjoy benefits not afforded the general public. Importantly, securities analysts who receive material nonpublic information ahead of the general public have the opportunity to analyze the information and make appropriate investment decisions.[313] The analyst must delay the execution of those investment decisions only until such time that the company adequately disseminates the information to the investing public.[314] Of course, the use of a confidentiality agreement precludes the communication of material information to the analyst's clients for trading purposes, which significantly reduces the competitive advantage that analysts enjoyed in the pre-Regulation FD era.[315]

Just as analysts benefit from confidentiality agreements, issuers enjoy benefits other than simply comporting with Regulation FD. Most obviously, issuers benefit from the increased accuracy of the report. Indeed, an accurate report minimizes volatile trading because the actual performance of the company matches analyst expectations.[316]

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311. *See* Sarah O'Brien, *Pssst! Can You Keep a Secret?: Analysts Get an Edge with Reg FD Loophole*, INVESTMENT NEWS, Oct. 30, 2000, at 1 (discussing how nonpublic information could be disclosed to analysts beforehand, as long as the analyst agrees to keep the information confidential), 2000 WL 9431214.

312. *See* Editorial, *SEC's Staff Issue Some Guidance on Reg. FD*, INVESTOR REL. BUS., NOV. 6, 2000 (reporting that companies can continue to selectively disclose important information to persons who agree to keep the information in confidence, and who could face potential insider trading charges for failing to do so), 2000 WL 8692732.

313. *See* Tom Sweeney, *SEC's Proposal Puts End to Selective Disclosure*, NAT'L L.J., Feb. 7, 2000, at B10, WL 2/7/00 Nat'l L.J. B10, (col. 2). Although the opportunity for securities professionals to benefit from selective disclosure is greatly reduced by Regulation FD, it is not completely eliminated. *See id.*

314. *See* Robert A. Prentice, *The Internet and Its Challenges for the Future of Insider Trading Regulation*, 12 HARV. J.L. & TECH. 263, 276 (1999) (intimating that the information must be in the public domain for an adequate amount of time to allow the investing public to "digest" it).

315. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716-17 (Aug. 24, 2000) (discussing the market leading to the introduction of Regulation FD).

316. *See* Lewis D. Solomon & Howard B. Dicker, *The Crash of 1987: A Legal and Public Policy Analysis*, 57 FORDHAM L. REV. 191, 249 n.443 (1988) (attributing the crash of 1987 in part to "inexpensive and timely information" that was available at the time of the crash).

Despite the increased accuracy of reports, confidentiality agreements also have some detriments. In particular, confidentiality agreements will deprive issuers of the ability to deliver bad news to investors in an indirect manner, thereby removing the potential for exaggerated market reactions to adverse information.[317] Because companies can no longer indirectly leak information to the markets via selective disclosure, an investor's ability to react quickly to news releases will gain particular importance.[318] As a result, most analysts expect more volatile markets under Regulation FD.[319] Ironically, the group that Regulation FD purports to protect, the individual investors, represents the least likely segment of the investing public to have the resources to expend on monitoring each news release and performing the timely analysis required to place the individual on par with institutional investors.[320] This situation, of course, provides non-full service brokerage firms with both the incentive and the opportunity to provide the type of value-added service needed to attract and retain clients.[321]

Nevertheless, the operational viability of confidentiality agreements remains suspect. For example, published reports recount instances where information communicated under the auspices of a confidentiality agreement nonetheless reached the market.[322] This reality has prompted observers to predict that a black market for information will develop in the wake of Regulation FD.[323]

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317. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (allowing that selective disclosure can lead to market volatility that would otherwise be avoidable).

318. *See New SEC Disclosure Rules May Create "Black Market" for Information*, PR NEWSWIRE, Oct. 23, 2000 (suggesting that an underground information market will result from Regulation FD), WL 10/12/00 PR Newswire.

319. *See SEC Declines NIRI's Request for an Extension to Reg. FD*, PR NEWSWIRE, Oct. 12, 2000 (explaining that as companies modify their disclosure policies, market volatility will increase), WL 10/12/00 PR Newswire 14:13:00.

320. *See* Matthew J. Dennis, *Fair Disclosure Rule Not Without Loopholes*, CRAIN'S CLEV. BUS., Sept. 25, 2000, at 31 (suggesting that publicly disseminating material information via SEC filings benefits alert institutional investors and analysts.), 2000 WL 7683271.

321. *See generally* Stuart Kahan, *The Registered Representative Route*, THE PRACTICAL ACCOUNTANT, Mar. 1, 2000 (discussing various services provided to clients of full-service broker dealers), 2000 WL 12050738.

322. *See* Valerie Venck, *Regulator Dislikes Selective Disclosure by France Telecom*, WALL ST. J. EUR., Dec. 21, 2000, at 11 (reporting that a French law similar to Regulation FD failed to keep information disclosed in confidence from reaching that country's capital markets), 2000 WL-WSJE 27829100.

323. See *Regulation FD Likely to Accelerate Contraction in Wall Street Research Coverage*, BUS. WIRE, Oct. 12, 2000 (suggesting that Regulation FD will serve as a catalyst for brokerage analysts to provide information for a "broad[er] spectrum of publicly held companies"), WL 10/12/00 Bus. Wire 18:17:00.

V. REGULATION FD PERSPECTIVES

The intensely debated selective disclosure regulation has evoked both emotional and sensible declarations by both sides of the Regulation FD argument. Concern has arisen that, although Regulation FD may successfully reduce the information gap between institutional investors and individual investors, the regulation may ultimately spawn more problems than it solves.[324] In particular, the securities bar points to the excessive ambiguity in the language of the regulation that creates difficulty for companies trying to define the contours of compliance.[325] Other commentators directly attack the SEC, accusing the Commission of operating under a naïve sense of fairness.[326]

Many attorneys, however, welcome Regulation FD and the guidance that it provides for both intentional and unintentional disclosures by a company or the company's officials.[327] SEC Chairman Arthur Levitt, Jr. stated that "[i]n a time when instantaneous and free flowing information is the norm, these sort of whispers are an insult to fair and public disclosure."[328] Moreover, even opponents of Regulation FD acknowledge that institutional investors have long held a comparative advantage vis-a-vis

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324. Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5, WL 3/16/2000 NYLJ 5, (col. 2). *See* George R. Kramer, *Unintended Ills of the SEC Plan*, NAT'L L.J., Apr. 10, 2000, at A23 (stating that the regulation will act as a restriction by limiting disclosed information), WL 4/10/00 Nat'l L.J. A23, (col.4).

325. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (noting the public discussion over whether the vague language of Regulation FD will actually halt selective disclosure or cause companies to reduce the information that was provided before Regulation FD), 2000 WL 24218624; Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (noting the difficulty associated with identifying the appropriate information to disclose under the new regulation), WL 3/16/2000 NYLJ 5, (col. 2).

326. *See* Thomas G. Donlan, Editorial, *Phony Fairness: Reg. FD Will Hurt Markets and Investors*, BARRON'S, Oct. 23, 2000, at 78 (asserting that the SEC miscalculated the efficiency by which information was transmitted prior to Regulation FD), 2000 WL-Barons 22213607; Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (questioning whether the removal of analysts' information advantage will benefit individual investors), 2000 WL 6997676; Paul Kedrosky, Editorial, *The Trouble with Full Disclosure: U.S. Regulation FD Has Produced an Information Chill, Not Fair Disclosure*, NAT'L POST, Nov. 4, 2000, at D11 (indicating that despite the noble purpose of Regulation FD, 'bluntly regulating [selective disclosure] is naïve and silly"), 2000 WL 28909250.

327. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5, WL 3/16/2000 NYLJ 5, (col. 2).

328. Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (reporting that the opinions of the small investor were adopted by the SEC Chairman), 15 No. 6 CORPCOUN1.

individual investors.[329] This section discusses the various touchstones of controversy and reviews the early effects that Regulation FD has had on the securities industry.[330]

A. *Information Chill and Market Volatility*

NIRI asserts that the SEC has not given proper consideration to the effect Regulation FD will have on "today's volatile market."[331] Most Regulation FD opponents contend that the regulation will have a chilling effect on corporate disclosures resulting from a fear that the company will run afoul of Regulation FD.[332] More specifically, when a question arises as to whether a company may selectively disclose information, the company will likely err on the side of caution and keep the information confidential.[333] Thus, opponents predict that the net amount of public information will dwindle under Regulation FD. Further, critics argue

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329. *See id.* at ¶ 9 (indicating that small investors are at a tremendous disadvantage because they do not have the same access to material nonpublic information); Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (reporting that the securities bar concedes that individual investors do not have the same access to information as institutions), WL 3/16/2000 NYLJ 5, (col. 2).

330. The research contained in this Recent Development was assembled prior to February 2000. Regulation FD had been in effect for approximately three months at that point.

331. *See SEC Denies NIRI's Request for an Extension to Reg. FD*, PR NEWSWIRE, Oct. 12, 2000 (providing NIRI's position that companies need time to adjust their disclosure policies to comply with Regulation FD), WL 10/12/00 PR NEWSWIRE 14:13:00. NIRI requested a 60 day delay in the effectiveness of Regulation FD so that companies could adjust their disclosure policies and procedures, but the SEC denied the request. Press Release, SEC, *SEC Reaffirms October 23, 2000 Effectiveness Date for Regulation FD* (Oct. 12, 2000), 2000 WL 1512909 (S.E.C.).

332. *See IROs Shouldn't Overlook Other Securities Laws in Panic over Reg. FD*, INVESTOR REL. BUS., Nov. 6, 2000 (indicating that, in the short term, the selective disclosure regulation will impair communication and increase market volatility), 2000 WL 8692719; Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5, WL 3/16/2000 NYLJ 5, (col. 2). *Cf.* John F. Olson et al., *Letters from the Editors: Still Fencing on a Tightrope*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 2, Oct. 2000 (suggesting that as an alternative to an information drought, companies may choose to effect a deluge of information, and questioning whether individual investors will be able to distinguish important information from the mundane), WL 4 No. 5 GLWSLAW 2. *But see* David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference (Dec. 4, 2000) (intimating that law firms have exaggerated the "chilling effect" that will result from Regulation FD, motivated, at least in part, by a desire to generate revenue for the law firm), 2000 WL 1839227 (S.E.C.), at *1.

333. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (suggesting that CEOs should go into "cautionary mode" with disclosures when statutory exemptions are unclear), WL 3/16/2000 NYLJ 5, (col. 2).

that the resulting reduction in information increases the uncertainty and preciseness of analysts' reports, thereby leading to more volatile stock markets.[334]

Although selective disclosure clearly gives preferential treatment to a small segment of the investing community, some observers point to the benefits that the markets receive from pre-Regulation FD selective disclosures.[335] For example, prior to Regulation FD, a company that expected to fall short of previous earnings estimates could provide securities analysts with guidance that effectively informed analysts of the adverse information. As this information matriculated to the capital markets through analysts' clients, the stock price would slowly adjust to the news. Although selective disclosure cannot prevent an issuer's stock from declining, such disclosures can reduce the chance that nervous investors will exaggerate the decline by selling shares.[336]

Additionally, Regulation FD will almost certainly result in increased participation of, and pressure on, corporate in-house counsel.[337] Because the quick resolution of many Regulation FD issues will require intimate knowledge about the company, the assistance of outside counsel may be inappropriate.[338] Observers of Regulation FD suggest that in-house counsel will feel pressure, either explicit or implicit, to deliver an opinion consistent with the desires of the corporation's executives.[339]

Regulation FD proponents acknowledge that although an increase in market volatility will likely occur, the fairness that returns to the markets will outweigh this volatility.[340] Many individual investors find the idea that they will have the opportunity to receive information at the same

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334. *India: Regulation FD May Create Insiders' Black Market*, BUS. LINE (The Hindu), Nov. 5, 2000 (concluding that Regulation FD will lower valuations for some companies), 2000 WL 30106960.

335. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (discussing the effect of selective disclosure on the market).

336. *See* Thomas G. Donlan, Editorial, *Phony Fairness: Regulation FD Will Hurt Markets and Investors*, BARRON'S, Oct. 23, 2000, at 78 (noting that some companies report a decline of ten to twenty percent in a single day after investors "stampede" for the exits), 2000 WL-Barrons 22213607.

337. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (noting that in-house counsel will likely be asked to determine whether information is material and thus, object to simultaneous disclosure), WL 3/13/00 Nat'l L.J. B5, (col. 1).

338. *See id.* (allowing that in-house counsel constrained by Regulation FD).

339. *See id.* (explaining that executives may resent having their message diluted by disclosure concerns).

340. *See* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (asserting that securities analysts have had an unfair advantage for years because companies have been permitted to communicate nonpublic information to analysts), 2000 WL 4726628.

time as analysts extremely appealing.[341] Detractors, however, note the very real downside to this equal access—surprise information will "blindside" everyone equally.[342]

B. *Materiality*

The SEC failed to provide a "bright line" test as to what information qualifies as material under Regulation FD.[343] Instead, the SEC defines material as when "there is a substantial likelihood that a reasonable shareholder would consider it important" when making investments decisions.[344] Because the final determination of the "materiality" of information often occurs in hindsight, wary company officials will only hesitantly discuss matters with securities professionals.[345]

The SEC advises that questions of materiality should defer to the opinion of the issuer's in-house counsel.[346] Opponents of Regulation FD counter that the SEC's recommendation proves impractical in situations such as conference calls or private phone conversations with securities professionals.[347] Conversely, Regulation FD advocates dismiss assertions

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341. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (noting the heavy outpour of support from individual investors to Regulation FD during the comment period), 2000 WL 24218624.

342. *See id.* (noting that increased stock volatility and earnings surprises could harm analysts and individual investor alike).

343. *See* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (recognizing that no bright-line test for materiality exists under Regulation FD's current form), WL 11/16/2000 NYLJ 5, (col. 1); Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (quoting the language found in Regulation FD while predicting that problems will surface surrounding the implementation of such a vague standard), WL 3/16/2000 NYLJ 5, (col. 2).

344. Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5, WL 3/16/2000 NYLJ 5, (col. 2).

345. *See* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (suggesting that the best way to determine the materiality of information is to study the market's reaction when it is released), 2000 WL 6997676; *cf. IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (reporting that the SEC will probably not seek enforcement if the markets do not show a significant reaction to the selective disclosure), 2000 WL 8692719.

346. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (providing that company executives should consult with in-house counsel prior to making statements that might include material information), WL 3/16/2000 NYLJ 5, (col. 2).

347. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (indicating that the SEC's suggestion results in "a burden on the company and its counsel that is extraordinarily difficult to meet"), WL 3/16/2000 NYLJ 5, (col. 2); *cf. IROs Shouldn't Overlook Other Securities Laws in Panic over*

that corporate counsel will have difficulty determining the materiality of information.[348] Rather, advocates assert that problems result from companies failing to properly provide counsel with adequate guidance regarding what actions to take with respect to material information prior to the onset of a disclosure—a problem that Regulation FD purports to solve.[349]

According to the SEC, companies currently overanalyze the importance of materiality.[350] In fact, press statements by SEC officials hint that the SEC is not prepared to address the intricate contours of materiality in the context of Regulation FD in the immediate future.[351] The SEC notes that Regulation FD does not provide a basis for private liability, thus leaving the SEC with the relative autonomy to direct the development of the law in this area.[352] Accordingly, the SEC does not intend to pursue

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Regulation FD, INVESTOR REL. BUS., Nov. 6, 2000 (reporting the statements of an SEC Deputy Director of Enforcement, asserting that the SEC is not targeting marginal violations, but rather specific instances of recklessness), 2000 WL 8692719. In reality, this requirement becomes more burdensome when company executives are reluctant to subject their intended communications to review by an attorney who is predisposed to recommend that the executive not talk at all. *See id.* The threat of SEC disciplinary action directly against the attorney will likely result in the attorney becoming more conservative with respect to questions of materiality. *See* John C. Coffee, Jr., *Selective Disclosure*, NAT'L L.J., Mar. 13, 2000, at B5 (explaining that the SEC now has the authority to "deny counsel the privilege of practicing before the SEC on the ground that counsel lacked the 'requisite qualifications to represent a public corporation'" if counsel's judgment regarding materiality was in error), WL 3/13/00 Nat'l L.J. B5, (col. 1); *see also* SEC R. PRACTICE, 17 C.F.R. § 201.102(e) (2000) (providing the SEC with the authority to declare an attorney lacking of the qualifications required to represent a public corporation).

348. *See* Lisa I. Fried, *Selective Disclosure: Proposed SEC Regulation Raises Compliance Issues*, N.Y.L.J., Mar. 16, 2000, at 5 (reporting that in-house counsel are generally aware when information is material), WL 3/16/2000 NYLJ 5, (col. 2).

349. *See id.* (suggesting that corporate counsel are often confused about the actions that must be taken in order to rectify issues related to a material disclosure).

350. *See IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (providing the following SEC official's quote: "The SEC is not interested in second-guessing close judgments on material information, but clearly abusive patterns of conduct will not be overlooked."), 2000 WL 8692719; *SEC May Rethink Reg. FD If Market Falters*, INVESTOR REL. BUS., Nov. 20, 2000 (relating an SEC official's statement that the purpose of Regulation FD was never to "split hairs with companies over issues like materiality"), 2000 WL 8692691.

351. *See SEC May Rethink Reg. FD If Market Falters*, INVESTOR REL. BUS., Nov. 20, 2000 (relating the statements of the SEC's Director of Corporate Finance, noting that the release of information contemplated by Regulation FD will make the SEC "more sensible about defining materiality"), 2000 WL 8692691; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (stating that "liability will arise only if no reasonable person under the circumstances would have made the same determination").

352. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,718 (Aug. 24, 2000) (assuring issuers that they need not worry about being "second-guessed on close materiality judgments").

"close calls regarding the materiality of a disclosure,"[353] but rather, "clearly abusive patterns" of recklessness.[354]

According to the SEC Deputy Director of Enforcement, the SEC will consider four factors in determining whether a selective disclosure qualifies as reckless.[355] First, the SEC will consider the policies and procedures that an issuer has in place for preventing material disclosures.[356] Companies should distinguish between information they need to provide to analysts and information that they want to provide analysts.[357] Second, the SEC will review the speed with which the company takes action to correct the Regulation FD violation.[358] Third, the SEC will consider the impact of the violation on the markets.[359] If the market does not show a significant reaction to the selective disclosure, the SEC concedes that it will not likely bring any enforcement action.[360] Fourth, the SEC will consider the company's cooperation in any investigation.[361]

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353. *See* David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference (Dec. 4, 2000) (stating that the SEC does not intend to second guess questionable determinations), 2000 WL 1839227 (S.E.C.), at *1; *Head of SEC Enforcement Division Comments on Regulation FD*, ANDREWS SEC. LITIG. & REG. REP. 7 (Dec. 6, 2000) (attempting to reduce fears that the SEC will be reviewing every corporate disclosure), WL 6 No. 8 ANSLRR 7; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (stating that "liability will arise only if no reasonable person would have made the same determination").

354. *IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (indicating that companies should not panic over materiality considerations), 2000 WL 8692719; *see Head of SEC Enforcement Division Comments on Regulation FD*, ANDREWS SEC. LITIG. & REG. REP. 7 (Dec. 6, 2000) (discussing an SEC official's attempts to allay fears regarding plans to enforce Regulation FD), WL 6 No. 8 ANSCRR 7.

355. *IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000 (attributing the four-factor analysis to SEC enforcement deputy), 2000 WL 8692719.

356. *Id.*; *see also* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST, Oct. 11, 2000, at 8 (recommending that companies implement a written disclosure policy in light of the SEC's pronouncement that it will consider "[t]he existence of an appropriate policy, and the issuer's general adherence to it" in determining issuer intent), *at* http://www.niri.org/publications/alerts/ea101100.cfm. *But see* Dennis J. Block & Jonathan M. Hoff, *Regulation FD: New Rules for Selective Disclosure*, N.Y.L.J., Nov. 16, 2000, at 5 (recognizing that Regulation FD does not require a company to adopt such procedures), WL 11/16/2000 NYLJ 5, (col. 1).

357. *IROs Shouldn't Overlook Other Securities Laws in Panic over Regulation FD*, INVESTOR REL. BUS., Nov. 6, 2000, 2000 WL 8692719.

358. *Id.*

359. *Id.*

360. *Id.*

361. *Id.*

Finally, one should note that the SEC will also consider the circumstances surrounding the disclosure.[362] The SEC's final rule states that "[w]e recognize . . . that a materiality judgment that might be reckless in the context of a prepared written statement would not necessarily be reckless in the context of an impromptu answer to an unanticipated question."[363] Companies, however, are extremely anxious to avoid becoming the test case for Regulation FD. Consequently, most companies will likely continue to employ a cautious approach to corporate disclosures.[364]

C. *Effect of Regulation FD on the Securities Industry*

Regulation FD undoubtedly will force securities analysts to do more legwork.[365] Regulation FD proponents assert that the role of the analyst will become less important because the public will now enjoy equal access to the same information.[366] Proponents further note that today's online investors do not rely as heavily on the research and analysis provided by

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362. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (suggesting that the circumstances under which a selective disclosure is made may be important).

363. *Id.*

364. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (quoting an investment strategist as stating that "[n]o one wants to be the poster child" of Regulation FD), 2000 WL 24218624.

365. *See id.* (reporting that instead of earnings guidance from the company, analysts will be researching indirect sources of information that gauge a company's performance, such as the company's suppliers and retailers), 2000 WL 24218624; Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (noting that analysts are forced to research sales trends and knowledge of the company to perform an analysis, rather than relying on the company's selective disclosures), 2000 WL 4726628; *India: Regulation FD May Create Insiders' Black Market*, BUS. LINE (The Hindu) Nov. 5, 2000 (remarking that analysts will have to return to abandoned research methods); Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 10 (suggesting that, in the long run, Regulation FD will be beneficial because it forces analysts to return to fundamental principles of research), *at* http://www.niri.org/publications/alerts/ea101100.cfm. SEC officials, to the dismay of securities professionals, are extremely unsympathetic to analysts' plight. *See* David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference (Dec. 4, 2000) (remarking on the absurdity of complaints by analysts of the "stresses of actually having to go to company meetings"), 2000 WL 1839227 (S.E.C.) at *3.

366. *See* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (maintaining that investors utilize analysts primarily to obtain otherwise non-public information), 2000 WL 4726628. *But see* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (arguing that, given the volatility that Regulation FD is expected to bestow upon the markets, the role of professional analyst is more important than ever before), 2000 WL 6997676.

professionals as they once did.[367] Finally, Regulation FD supporters argue that historical reliance on market analysts was an artificial market effect facilitated by analysts' superior communication channels with company management.[368]

However, critics of Regulation FD heatedly contest these arguments. Specifically, critics contend that proponents base these arguments, perhaps erroneously, on the assumption that the investing public has the time, temperament, and expertise to convert public pieces of information into an accurate assessment of a company's performance.[369] Although the increased accessibility to the stock markets has spurred the amount of information available to individual investors, it is doubtful that the investing public possesses the same skill as the securities professionals.[370]

Other commentators note that securities analysts' role in the investing scheme will not necessarily diminish, but that a shake-out will almost cer-

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367. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (asserting that technological advances now facilitate "real-time" communications directly between investors and markets, reducing the need for a securities intermediary).

368. *See* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (noting that analysts' communication connections with management will be minimized under Regulation FD), 2000 WL 4726628; *see also* A. Gary Shilling, *Foul Disclosure*, FORBES, Jan. 22, 2001, at 152 (admonishing analysts who have become accustomed to relying on issuers to spoon-feed them information), *available at* 2001 WL 2183793.

369. *See* Rayne Wolfe, *SEC Fair Disclosure Rule Puts Businesses on Edge*, PRESS DEMOCRAT (Santa Rosa, Cal.), Nov. 19, 2000, at E1 (revealing the depth of the average investor's stock knowledge by reporting results of a survey that indicated that only 14% of investors know the difference between a growth stock and an income stock), 2000 WL 24342329. *Compare* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (relating the SEC's belief that the Internet has reduced the importance of the market analysts), 2000 WL 6997676, *with* John F. Olson et al., *Letters from the Editors: Still Fencing on a Tightrope*, WALLSTREETLAWYER.COM: SEC. IN THE ELECTRONIC AGE 2, Oct. 2000 (questioning whether individual investors are able to distinguish important information from the mundane), WL 4 No. 5 GLWSLAW 2.

370. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (suggesting that the ordinary investor benefits from the role of the analysts, which includes wading through information and extrapolating its contextual importance); *Head of SEC Enforcement Division Comments on Regulation FD*, ANDREWS SEC. LITIG. & REG. REP. 7 (2000) (suggesting that information that might seem inconsequential to the individual investor could be of substantial importance to a person who possesses extensive knowledge about the company and its industry); *see also* Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (theorizing that having increased access to information does not necessarily translate into having greater knowledge and than the average investor has difficulty distinguishing the "'material' from the mundane"), 2000 WL 6997676; Rayne Wolfe, *SEC Fair Disclosure Rule Puts Businesses on Edge*, PRESS DEMOCRAT (Santa Rosa, Cal.), Nov. 19, 2000, at E1 (relating the thought of an SEC commissioner, who believes that the regulation "will increase volatility in the market and I'm afraid for the little guy, thinking he knows what it all means and not really understanding what it really does mean"), 2000 WL 24342329.

tainly occur within the analyst group.[371] Many observers believe that an analyst's ability to accurately predict the performance of companies based on an analysis of public information will emerge as the critical factor of an analyst's success or failure.[372] In that regard, those analysts who have relied too heavily on selective disclosure in the past and who do not presently possess the ability to provide accurate analysis will find themselves at a competitive disadvantage.[373] Until this predicted shakeout begins to take shape, however, earnings estimates will likely be "all over the board."[374]

These predictions would no doubt prove true if Regulation FD completely banned selective disclosure. As the regulation stands today, however, a proven track record for making accurate estimates based on public information may only gain importance among analysts who refuse, under all circumstances, to enter into confidentiality agreements with is-

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371. *See India: Regulation FD May Create Insiders' Black Market*, BUS. LINE (The Hindu) Nov. 5, 2000 (recognizing that analyst reliance on information received directly from a company has resulted in a deterioration in the quality of securities research), 2000 WL 30106960; John C. Coffee, Jr., *Tackling New Reg. FD*, N.Y.L.J., Sept. 18, 2000, at B6 (predicting that the regulation will "produce a transitional shake-out period"), LEXIS, Nexis Library, News Group File; Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (reporting that analysts will be doing more independent "legwork," which is likely to result in significant deviations among analysts' reports), 2000 WL 24218624; Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (noting that the average investor does not have the time to study the plethora of information that is publicly available and that professional stock analysis will be at a premium), 2000 WL 6997676.

372. *See* David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference, at *3 (Dec. 4, 2000) (surmising that reliable analysts will be a more valuable commodity as competition for "investor's ears" increases), 2000 WL 1839227 (S.E.C.).

373. *Id.* (relating a New York Times story that blasted securities analysts for "having been caught flat-footed" by a major announcement of adverse earnings results).

374. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (suggesting that those analysts who do their homework will separate themselves from those who do not), 2000 WL 24218624; *see also India: Regulation FD May Create Insiders' Black Market*, BUS. LINE (THE HINDU) Nov. 5, 2000 (remarking that independent and original research may cause divergent views of a company's potential, increasing the opportunity for stock volatility), 2000 WL 30106960; Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (asserting that accurate analyst predictions can prevent stock price volatility), 2000 WL 6997676; Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 9 (predicting that wider earnings estimates should be expected, resulting in greater volatility and higher costs of capital), *at* http://www.niri.org/publications/alerts/ea101100.cfm. In the long-run, however, a wider range of earnings estimates is welcomed by the securities industry because it is likely to decrease the consequences of a "penny miss" earnings announcement, since the actual earnings are more likely to fall within the range of analysts' estimations. *Id.* at 10.

suers. Accordingly, the determining factor in the predicted shakeout is more likely to be whether analysts acquiesce to issuer demands for confidentiality agreements.[375]

Hence, analysts can either enter into the agreement and ensure the accuracy of the resulting reports, or the analysts can attempt to arrive at the same result by analyzing public information. Of course, analysts may also explore other avenues in an effort to obtain the same information. By not entering into an agreement, analysts may freely communicate information obtained from other sources to their clients for trading purposes.[376] Conversely, a confidentiality agreement may prohibit disclosure of the same information despite the fact that the analyst obtained the information through alternative sources.[377]

The groups that stand to benefit the most from Regulation FD are discount brokerages and knowledgeable individual investors. Individual investors, also commonly known as "retail investors," will indirectly benefit from Regulation FD regardless of their level of expertise because the regulation reduces the chance that individual investors will transact with a person in possession of material nonpublic information.

Individual investor groups downplay assertions that most of its constituency remain unaware that Regulation FD exists.[378] A recent study by PaineWebber Group, Inc. indicated that eighty-four percent of individual investors have never *heard* of Regulation FD, much less know what the regulation purports to do.[379] Instead, these groups point to the effect that Regulation FD will have on individual investors. According to organiza-

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375. *See* A. Gary Shilling, *Foul Disclosure*, FORBES, Jan. 22, 2001, at 152 (arguing that analysts will either become "shills" who simply repeat the information that is provided by issuers, or "sleuths" who independently research companies and issue unbiased reports), *available at* 2001 WL 2183793. Under Regulation FD, the "shills" will only have access to material nonpublic information if they enter into a confidentiality agreement. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,738 (Aug. 24, 2000) (to be codified at 17 C.F.R. § 243.100(b)(2)(ii)) (excluding from Regulation FD those communications that are made to enumerated persons who expressly agree to keep the information in confidence).

376. Editorial, *Fair Disclosure Leaves Analysts Wanting More*, INVESTOR REL. BUS., Nov. 20, 2000 (commenting that analysts will "be out of business until the agreement ends"), 2000 WL 8692688.

377. *Id.*

378. *See* Editorial, *Most Individual Investors Haven't Heard of Reg. FD*, INVESTOR REL. BUS., Nov. 6, 2000 (suggesting that the commissioner may have overstated individual investor support for Regulation FD), 2000 WL 8692727.

379. *See* PAINE WEBBER, INC., MAJORITY OF INVESTORS UNAWARE OF NEW SEC SELECTIVE DISCLOSURE RULING GOING INTO EFFECT TODAY, http://www.painewebber.com/search_frame.htm (visited Jan. 15, 2000) (providing the results of a study conducted to ascertain investor sentiment toward Regulation FD), Editorial, *Most Individual Investors Haven't Heard of Reg. FD*, INVESTOR REL. BUS., Nov. 6, 2000 (discounting the SEC's state-

tions such as the National Association of Investors Corp., individual investors need only worry whether they have timely access to fair and accurate information, not the means by which the investor attains that information.[380]

D. *Early Effects of Regulation FD*

Regulation FD became effective October 23, 2000, and early indications support the theories of both its supporters and opponents.[381] Market volatility has closely followed Regulation FD disclosures. In some instances, those companies who complied with Regulation FD by making remedial disclosures have seen their stock price drop by as much as twenty percent in a single day.[382] Although the SEC gains fairness for individual investors, some indications suggest that subsequent Regulation FD filings further exaggerate the market dips that routinely accompany a Regulation FD disclosure.[383] Opponents point to these occurrences as

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ment that Regulation FD received overwhelming support from individual investors), 2000 WL 8692727.

380. *See* Editorial, *Most Individual Investors Haven't Heard of Reg. FD*, INVESTOR REL. BUS., Nov. 6, 2000 (refuting the allegation that individual investors are, at best, unknowledgeable about the mechanics of Regulation FD), 2000 WL 8692727.

381. *See* Thomas G. Donlan, Editorial, *Phony Fairness: Regulation FD Will Hurt Markets and Investors*, BARRON'S, Oct. 23, 2000, at 78 (relating specific instances of harm that might have been avoided but for the requirements of Regulation FD); Paul Kedrosky, Editorial, *The Trouble with Full Disclosure: U.S. Regulation FD Has Produced an Information Chill, Not Fair Disclosure*, NAT'L POST, Nov. 4, 2000, at D11 (arguing that early evidence indicates "that the solution is worse than the problem"), 2000 WL 28909250.

382. Thomas G. Donlan, Editorial, *Phony Fairness: Regulation FD Will Hurt Markets and Investors*, BARRON'S, Oct. 23, 2000, at 78; Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (reporting that stock prices have plummeted immediately following a Regulation FD dissemination of information directly to the public), 2000 WL 4726628. Companies with enormous market capitalization, including Microsoft, Motorola, and Apple, are among the companies who have made negative disclosures. *Id.*; John Hackett, *Facing Up to Broad Disclosure*, USBANKER, Dec. 6, 2000, at 51 (recounting Intel's 20% drop in stock price upon releasing adverse earnings expectations), 2000 WL 17705571.

383. *See* Thomas G. Donlan, Editorial, *Phony Fairness: Regulation FD Will Hurt Markets and Investors*, BARRON'S, Oct. 23, 2000, at 78 (stating that the severity of declines were unwarranted). An emerging demographic group of investors often make decisions, not based upon their own assessment of the information, but rather the actions of other investors. *See Get in, Get Out, Get Rich is the Creed but for Many it Spells Ruin*, EXPRESS, Aug. 4, 1999 (analogizing day-trading operations to the "basket shops" of the 1920s, where securities transactions were often based entirely on the basis of changing prices), 1999 WL 5818754. Unfortunately, the stampedes of the so-called "Electronic Herd" tend to exaggerate the effect of information. *See* THOMAS L. FRIEDMAN, THE LEXUS AND THE OLIVE TREE 131 (Anchor books 2000) (1999) (explaining that the Electronic Herd can transform limited changes into exaggerated instability). The Electronic Herd monitors the stock

validation of their fears that Regulation FD will make the capital markets "more volatile, less efficient and less hospitable to all investors."[384]

Securities analysts report receiving a significantly reduced amount of information from companies as a result of Regulation FD.[385] Analysts concede further that their reports are less precise than pre-Regulation FD reports.[386] Indeed, the most troubling outcome is the fact that analysts openly acknowledge that investors may be "blindsided" every quarter under the new regulation.[387] Industry groups acknowledge, however, that the wider spectrum of analyst expectations may desensitize investors to "penny-miss" earnings reports in the long-term, thereby contributing to the stability of the markets.[388]

The SEC appears, however, amenable to redefining the contours of Regulation FD.[389] In fact, less than a month after Regulation FD became effective, the SEC's Director of Corporate Finance acknowledged that, if the regulation causes adverse market conditions, the SEC will "do something about it."[390] Notwithstanding the confusion and uncertainty sur-

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price and actions of certain investors to determine if an investment opportunity exists rather than diligently researching available information. *See id.* at 109.

384. *See* Thomas G. Donlan, Editorial, *Phony Fairness: Regulation FD Will Hurt Markets and Investors*, BARRON'S, Oct. 23, 2000, at 78 (supplying alternative names for Regulation FD, such as Regulation SD for "sudden disclosure," Regulation V for "volatility" and Regulation CSI for "crushing small investors"), 2000 WL 22213607.

385. *See* Aram Fuchs, *Regulation FD Good for the Market*, UPSIDE TODAY, Dec. 19, 2000 (recounting an analyst's assessment on the effect of his relationship with Microsoft, the company he is charged with following), 2000 WL 4726628.

386. *See id.* (reporting that analysts have returned to extrapolating information from such indicators as industry trends in an effort to compensate for the information reduction caused by Regulation FD); Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (suggesting that Regulation FD might result in less accurate information for the entire investing community), 2000 WL 6997676.

387. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (relating an analyst's description of the information void produced by the regulation as a "black hole on corporate information"), 2000 WL 24218624.

388. *See* Louis M. Thompson, Jr., Executive Alert, *Guidance for Compliance with Regulation Fair Disclosure*, NAT'L INVESTOR REL. INST., Oct. 11, 2000, at 10 (advancing that the long-term implications of Regulation FD look promising), *at* http://www.niri.org/publications/alerts/ea101100.cfm.

389. *See SEC May Rethink Reg. FD If Market Falters*, INVESTOR REL. BUS., Nov. 20, 2000 (noting that the SEC is prepared to reassess its new selective disclosure rule), 2000 WL 8692691.

390. *See id.* (stating the SEC's intent to address the possible negative effects resulting from Regulation FD); *see also Head of SEC Enforcement Division Comments on Regulation FD*, ANDREWS SEC. LITIG. & REG. REP. 7 (Dec. 6, 2000) (reporting that the SEC Director of Enforcement acknowledges that Regulation FD has impacted the amount of information available to analysts), WL 6 No. 8 ANSLRR 7.

rounding Regulation FD, the SEC remains hopeful that the regulation will produce more forward-looking information for the investing community,[391] prompting one SEC official to proclaim, "I'm pleased to report that the sky has not yet fallen."[392]

The public discussion over the utility of Regulation FD has been well documented by the media. The SEC believes that the number of complaints received regarding Regulation FD proves inaccurate the pre-Regulation FD assertions that the problem of selective disclosure was not widespread.[393] Notably, a 1998 NIRI survey revealed that more than twenty-five percent of companies had participated in some form of selective disclosure.[394]

On the other hand, Regulation FD has paid immediate dividends to individual investors.[395] Quarterly conference calls formerly the exclusive territory of securities analysts now include individual investors via an increasing variety of media.[396] Of course, only the small segment of individual investors that have both the time and the skill to make use of the information disclosed in the call ultimately benefit. Nonetheless, these individuals represent the precise group of investors the SEC promulgated Regulation FD to protect.

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391. *See SEC May Rethink Reg. FD If Market Falters*, INVESTOR REL. BUS., Nov. 20, 2000 (explaining that the SEC intended Regulation FD to promote the release of additional information to the market), 2000 WL 8692691; David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference (Dec. 4, 2000) (indicating that SEC general counsel remains optimistic that Regulation FD will ultimately be extremely useful for the markets), 2000 WL 1839227 (S.E.C.), at *4.

392. David M. Becker, New Rules, Old Principles, Remarks at the 2000 Securities Law Developments Conference (Dec. 4, 2000), 2000 WL 1839227 (S.E.C.), at *1.

393. *See Head of SEC Enforcement Division Comments on Regulation FD*, ANDREWS SEC. LITIG. & REG. REP., Dec. 6, 2000, at 7 (relating the statements of the SEC Director of Enforcement), WL 6 No. 8 ANSLRR 7.

394. *See* Paul A. Ferrillo, *Reexamining Corporate Disclosure Practices*, CORP. COUNS., Nov. 2000, at 1 (discussing the perceived evils of selective disclosure), 15 No. 6 CORPCOUN1.

395. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (stating that quarterly earnings calls have become more open to individual investors as opposed to only the "big wigs"), 2000 WL 24218624.

396. *See* Lee Clifford, *Less-Than-Golden Rule*, FORTUNE, Nov. 13, 2000, at 434 (indicating that conference calls are being simulcast via the Internet and that companies are providing an increased amount of information on their web sites), 2000 WL 24218624; Bruce Machmeier, *Fair Disclosure or Flawed Disclosure?*, STAR-TRIB. (Minneapolis-St. Paul), Oct. 23, 2000, at 03D (reporting that an exception to the chilling effect of Regulation FD is the open conference calls companies are now conducting), 2000 WL 6997676.

VI. CONCLUSION

Contrary to the early reactions of many commentators, Regulation FD does not absolutely ban selective disclosure. The regulation simply limits the situations in which such disclosures may occur. The Supreme Court's decision in *Dirks*, as well as the SEC's final rule, provide ample evidence that the SEC recognizes the value of selective disclosure as pertains to the efficiency of the markets. The SEC is not necessarily concerned with the types of material nonpublic information a company discloses, as long as an omnipresent cloud of potential liability accompanies the information on its journey through the securities industry. Furthermore, Regulation FD does not simply attempt to prevent the release of information to a privileged few. Rather, the SEC promulgated Regulation FD to prevent the use of that information from affecting the capital markets before the information becomes available to the investing public.

The Supreme Court decisions in *Chiarella* and *Dirks* effectively stripped the SEC of its enforcement powers against tippees who trade on information received from an issuer to whom the tippee does not owe a duty of trust or confidence. Rather than attempt a regulatory attack on the Supreme Court's holdings, Regulation FD embraces those holdings and molds an appropriate remedy to the perceived evils of selective disclosure. In *Dirks*, the Supreme Court held that a party must breach some duty to the issuer or its shareholders in order to trigger the antifraud provisions of securities regulations. Accordingly, Regulation FD permits the practice of selective disclosure to continue, but only when the parties create a duty of trust or confidence by express agreement where that relationship does not exist on its own.

Throughout Regulation FD's final rule, the SEC chastises analysts for straying from fundamental analysis of public information in the development of their reports. The SEC states that analysts have become overly reliant on selective disclosures from companies. This may be nothing more than lip service, however, because the SEC simultaneously provides issuers and analysts with a schematic for openly conducting selective disclosure. Admittedly, an analyst that performs fundamentally sound analysis independent of selective disclosures will provide a more useful service to its clients because that analyst will not be restricted by a confidentiality agreement from passing its analysis on to its clients.

Much to the chagrin of securities analysts, the confidentiality agreement will undoubtedly become an integral component of the issuer-analyst relationship. Although commentators champion these agreements as Regulation FD's enormous loophole, confidentiality agreements represent the SEC's strategy for controlling selective disclosure, without expressly authorizing such disclosures.

Regulation FD does not require analysts to enter into confidentiality agreements. In fact, some analysts may refuse to enter into such agreements because of a belief that they can either obtain the information from another source or, alternatively, accurately assess publicly available information. The services of those analysts who produce accurate estimates based solely on public information will be at a premium because these analysts will pass the information along to their clients for trading purposes before the information becomes public and without running afoul of the SEC. Conversely, analysts who find themselves unable to accurately forecast the performance of issuers will likely find confidentiality agreements vital to their ability to attract and retain clients.

Companies have experienced extensive stock price volatility following Regulation FD disclosures. Anxiety over becoming the Regulation FD "poster-child" has caused companies to shy away from most communications with analysts. In the long run, however, Regulation FD will likely have a positive effect on the integrity and fairness of the securities markets.

Market professionals will implement a two-pronged approach in dealing with Regulation FD. First, analysts will operate with a renewed emphasis on fundamental research based on public information. If these efforts result in a "mosaic" of information that the analyst confidently feels represents an accurate picture of a company, then the analyst will pass investment advice along to the analysts' clients. Accordingly, these clients will safely trade on the information before the investment rating becomes public knowledge. Second, if the analyst does not feel confident that the available information presents an accurate estimation of an issuer's performance from public information, the analyst can agree to enter into a confidentiality agreement with the issuer, thereby facilitating the issuance of accurate and timely investment advice for clients after the information becomes public.

The spirit of Regulation FD, if not Regulation FD itself, is here to stay. By taking action that directly redresses an area of securities regulation the SEC believes courts have misinterpreted, the Commission may have painted itself into a corner. In its interpretive release, the SEC directly describes cases where the Commission believes the Supreme Court inconsistently interpreted the goals of securities regulations. Regulation FD provides the SEC with seamless enforcement capabilities in light of those decisions. If, however, Regulation FD becomes the disaster its opponents assert it will be, the SEC will be forced to develop a new approach or repeal the regulation altogether. The latter option may not be viable, however, because investors and analysts will likely view such a repudiation as an implied endorsement of selective disclosure. Thus, the SEC is much more likely to retool Regulation FD than repeal it.