

Wall Street v. Main Street: The SEC's New Regulation FD and Its Impact on Market Participants

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“High-quality and timely information is the lifeblood of strong, vibrant markets. It is at the very core of investor confidence.”¹

INTRODUCTION

Just as Wall Street once rumbled in response to the implementation of Section 11 of the Securities Act of 1933 (“Securities Act”),² again, those same tremors are felt in answer to the Securities and Exchange Commission’s (“SEC”) new Regulation Fair Disclosure (“Regulation FD”).³ Although Wall Street’s projection that Section 11 would destroy the market for public offerings was an overstatement, Section 11 liability has shaped the registration process. Likewise, Regulation FD⁴ is unlikely to completely chill the disclosure of information by public companies; rather, it will merely shape communications between companies and investment professionals.

On October 23, 2000, the SEC’s new rules prohibiting selective disclosure took effect.⁵ Regulation FD was adopted to address what the SEC perceived to be the

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† This Article has been prepared for informational purposes and does not constitute legal advice on any specific matters. Publication of this Article does not create a lawyer-client relationship and readers should not act upon this information without seeking professional guidance.

1. Arthur Levitt, Chairman’s Statement to Sec. & Exch. Comm’n on Regulation Fair Disclosure (Aug. 10, 2000), at <http://www.sec.gov/news/extra/seldisal.htm> [hereinafter Levitt].

2. 15 U.S.C. § 77 (1994). Section 11 of the Securities Act of 1933 establishes liability for fraudulent registration statements. If a registration statement is false or misleading, purchasers in a registered offering may recover damages from enumerated participants in the offering. Wall Street professionals predicted that § 11 would destroy the market for public offerings. The professionals’ predictions have been proven incorrect, and § 11 has shaped the roles of company officials, directors, underwriters, lawyers, and accounts in the registration process. See 15 U.S.C. § 77k (1994); see also *Barns v. Osofsky*, 373 F.2d 269 (2d Cir. 1967). Likewise, many investment professionals fear that Regulation FD will have a chilling effect on companies’ disclosure of information to the public and have a dramatic impact on securities markets.

3. Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000).

4. *Id.*

5. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249). In addition to the rules regarding selective disclosure, the SEC adopted two rules involving insider trading, which are outside the purview

problem of public companies selectively disclosing material nonpublic information to Wall Street professionals at the expense of Main Street individual investors.⁶ The new rules provide that when an issuer or person acting on the issuer's behalf selectively discloses material nonpublic information to certain enumerated persons, the issuer must make public disclosure of that same information.⁷ Public companies must now respond by implementing strategies for disclosing information to Wall Street professionals. Only time will tell what impact Regulation FD will have on Wall Street, Main Street, and in corporate headquarters.

This Article provides an analysis of Regulation FD and its impact on communications between companies and market participants. Part I of this Article discusses the background leading to the adoption of Regulation FD and the concerns surrounding selective disclosure. Part II analyzes the elements of Regulation FD. Part III addresses the effects Regulation FD will have on Wall Street professionals. Part IV focuses on Regulation FD's impact on individual investors' access to information. Finally, Part V considers Regulation FD's effect on public companies and provides some guidance for disclosing information.

I. BACKGROUND

Full and fair disclosure of material information by issuers to the market is the cornerstone of the federal securities laws.⁸ Through the mandatory disclosure system of the Securities Exchange Act of 1934 ("Exchange Act"),⁹ Congress intended to promote the disclosure of complete and honest information to facilitate efficient securities markets.¹⁰ However, federal securities laws do not generally require public disclosure of information concerning corporate developments at the moment they occur.¹¹ Rather, the Exchange Act requires periodic reporting of specific information on a regular basis, and some issuers are required to report certain events soon after they occur.¹² In the absence of a specified duty to disclose, the Exchange Act does not require an issuer to disclose all material events as soon as they occur, therefore

of this Article. *See id.*

6. *See id.* SEC Chairman Arthur Levitt, and his crusade against selective disclosure spearheaded the adoption of Regulation FD. The new regulation was passed three to one, the dissenting vote coming from Commissioner Laura Unger. Michael Schroeder & Randall Smith, *Disclosure Rule Cleared by the SEC*, WALL ST. J., Aug. 11, 2000, at C1.

7. 17 C.F.R. §§ 243.100-.103.

8. *See* H.R. REP. NO. 73-1383, at 11 (1934). The concept of fair public markets is built upon the theory that the judgments of buyers and sellers concerning the fair market price of a security brings about a just price. Selective disclosure of material information obstructs the operation of fair price valuation.

9. Securities and Exchange Act of 1934, 15 U.S.C. § 78 (1994).

10. S. REP. NO. 73-792, at 10-11 (1934); *see also* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 (proposed Dec. 28, 1999).

11. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,592.

12. *Id.* at 72,591; *see also* Timely Disclosure of Material Corporate Developments, Securities Act Release No. 5092, 35 Fed. Reg. 16733 (Oct. 15, 1970) (examples include the Exchange Act required filings on Forms 10-K, 10-Q, and 8-K).

allowing issuers some control over the precise timing of important corporate disclosures.¹³ With the adoption of Regulation FD, the SEC addresses the practical problem of public companies making selective disclosure of material information to small groups of Wall Street professionals before making broad disclosure to the investing public.

Through the adoption of Regulation FD, the SEC intends to eliminate public companies' selective disclosure of important nonpublic information to Wall Street before making full disclosure of the same information to Main Street. When issuers selectively disclose material information, those in possession of the information prior to the public release are capable of making profits or avoiding losses at the expense of the uninformed. The SEC takes the position that the practice of selective disclosure leads to the public's loss of confidence in the integrity of capital markets.¹⁴ When material information travels only to a privileged few and that information is used to profit at the expense of Main Street investors, the integrity of America's securities markets is at risk. Main Street investors who observe drastic changes in securities prices and only later receive the material information responsible for the changes are not on a level playing field with Wall Street insiders.

The SEC provides three guiding reasons for the adoption of Regulation FD.¹⁵ The first is that selective disclosure leads to a loss of investor confidence in the integrity and fairness of capital markets.¹⁶ Selective disclosure resembles insider trading in that select individuals gain an informational edge from their access to corporate insiders, rather than from skill and diligence.¹⁷ Recent high-profile reports of public companies' selective disclosure of material information that led to significant profit or loss avoidance for Wall Street have eroded investors' confidence in the fairness of the securities markets.¹⁸ Protection of investor confidence is important and the impact of selective disclosure is significant in today's highly volatile, earnings-sensitive securities markets.¹⁹

13. See Timely Disclosure of Material Corporate Developments, Securities Act, 35 Fed. Reg. at 16,733. See generally Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,593.

14. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

15. *Id.* at 51,716-17.

16. *Id.* at 51,716.

17. *Id.* There is a significant resemblance to the "tipping" standard of insider trading liability set forth in *Dirks v. SEC*, 463 U.S. 646, 653-64 (1983). As presented in the proposing release, the SEC believes that *Dirks* imposed undue analytical burdens in prosecuting tips to Wall Street analysts under an insider trading theory. Enforcement under the insider trading theory is constrained by the requirement that the insider benefitted from disclosing information. Regulation FD addresses the problem of selective disclosure by establishing an issuer reporting requirement, rather than treating it as insider trading. See Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,595.

18. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716. Chairman Arthur Levitt raised the issue of market integrity, calling the practice of selective disclosure a "stain on the markets." Chairman Arthur Levitt, Speech to the Economic Club of New York, N.Y. (Oct. 18, 1999), at <http://www.sec.gov/news/speeches/spch304.htm>.

19. See Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,592. The practice of

Second, the SEC is concerned with nonpublic material information being used to curry favors with Wall Street analysts. Regulation FD was adopted to address the potential for public companies to treat information as a commodity to be used to gain favor with analysts or institutional investors.²⁰ The concern is that analysts may be pressured to produce favorable reports about a company or alter their analysis in order to have continued access to information.²¹ Analysts who publish negative views of a company's securities may run the risk of being cut-off from corporate officials and phone conversations or meetings in which competing analysts have access.²² It is the SEC's position that Regulation FD's prohibition on selective disclosure promotes fair analysts' reports. Analysts are now less inclined to slant their reports in order to protect business relationships. The SEC believes the pressure on Wall Street analysts is reduced by Regulation FD's restriction on selectively disclosing material information to favored analysts.²³

The third reason the SEC has adopted Regulation FD is that technological developments have made it much easier for the broad dissemination of information; therefore, selective disclosure is no longer necessary to maintain efficient markets.²⁴ In the past, issuers had to rely on market analysts to serve as information intermediaries due to technological limitations. With the recent developments in the technology industry, selective disclosure is no longer necessary to disseminate material information to the investing public.²⁵ The SEC encourages the use of live transmissions of conferences and annual meetings via closed-circuit television or Internet webcasting, listen-in telephone conferences, and company Web sites as a means of corporate disclosure.²⁶ Therefore, "technological limitations no longer provide an excuse for abiding the threats to market integrity that selective disclosure

selective disclosure is reported to be widespread at small-growth companies, where companies disclose poor performance news to Wall Street analysts to prevent a sharp reaction by the whole market. Chairman Arthur Levitt stated, "[W]e have placed such a premium on short-term results that even the most modest change in earnings provokes a dramatic market response." Kate Berry, *SEC's Levitt Discusses Issues About Analysts*, WALL ST. J., Apr. 14, 1999, at C1.

20. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716.

21. *Id.* at 51,717; see also Justin Schack, *The Mounting Price of Fame*, INST. INVESTOR 43 (Oct. 2000) ("Top corporate executives are pressing investment houses more than ever for favorable research if they want to win any banking business; analysts who don't toe the line can find themselves walking the streets.").

22. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718.

23. Selective Disclosure and Insider Trading, 64 Fed. Reg. at 72,593.

24. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717.

25. *Id.* The SEC assumes that a more democratic market is a more efficient market. Rather than adopting a trickle down approach of issuer-to-analysts-to-investor, Regulation FD attempts to eliminate the informational advantage Wall Street has over Main Street. Due to the reduction in technology costs, broad disclosure to investors on a real time basis is feasible. See *id.*

26. *Id.* While recommending the use of technological developments for disclosing information, the SEC does not adopt the position that the Internet, by itself, would satisfy the public dissemination requirements of the new Regulation FD. See *id.*; see also *infra* Part II.F. (discussing Regulation FD's public disclosure requirements).

represents."²⁷

The SEC's release²⁸ proposing the adoption of Regulation FD ignited public comment.²⁹ A majority of these comments originated from Main Street investors who supported the adoption of Regulation FD.³⁰ While Regulation FD had gained the support of many Main Street investors, others were concerned about the new rule's impact on the flow of information.³¹ Notwithstanding the SEC's noble intentions of curtailing the selective disclosure of information, Regulation FD may have a pervasive impact on corporate disclosure practices and significantly risks muffling the flow of information to the markets. Wall Street professionals believe that securities markets benefit from a constant flow of communications between issuers and analysts.³² Due to the revolution in securities information technology, individual investors have rapid access to these communications. However, the SEC feels that selective disclosure is a significant problem and there is a need to prohibit the practice in order to bolster investor confidence in the integrity of the securities markets.³³

Some commentators (predominantly Wall Street professionals) contend that Regulation FD is an inappropriate response to the issue of corporate disclosure.³⁴ These commentators do acknowledge the problem of selective disclosure; however, they suggest that existing insider trading laws be used to enforce actions that involve abusive selective disclosure.³⁵ The SEC believes otherwise, because the uncertainties posed by insider trading laws afford considerable protection to insiders who selectively disclose information to analysts.³⁶ In attempting to provide clear guidance

27. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717.

28. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590.

29. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717. Approximately 6000 comment letters were received by the SEC in response to the release proposing the adoption of Regulation FD. *Id.*

30. *Id.* Reasons for Main Street's support of Regulation FD include: selective disclosure places investors at a disadvantage and is similar to traditional insider trading; investors do not rely exclusively on Wall Street research; the "online" revolution allows investors to conduct their own research; and investors are concerned with the concept of information gatekeepers. Public comments can be viewed on the SEC Web site, <http://www.sec.gov>.

31. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718.

32. See *id.*

33. *Id.* at 51,716.

34. *Id.* at 51,718. See examples in comment letters of the Securities Industry Association, Sullivan and Cromwell, the Association for Investment Management and Research, Merrill Lynch, and the New York City Bar Association, which are available on the SEC Web site at <http://www.sec.gov>.

35. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718. Under the law established in *Dirks*, an insider trading violation occurs when (1) the tipper breaches a fiduciary duty by communicating material nonpublic information, (2) the tippee knows of the breach, and (3) the tipper receives some benefit. *Dirks v. SEC*, 463 U.S. 646, 646-47 (1983).

36. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,593 (proposed Dec. 28, 1999). Under *Dirks* the insider must breach a fiduciary duty to the issuer to be liable for insider trading. This is a high hurdle to clear when attempting to prove that an insider's regular

for corporate officials, rather than stretching existing law and risking inconsistent results, the SEC (through its rulemaking function) has adopted Regulation FD to address the problems presented by selective disclosure.³⁷

The SEC has made clear that it realizes the possibility that Regulation FD may have a chilling effect on the disclosure of information by public companies.³⁸ Commentators widely agree that efficient market performance is served by more, not less, disclosure of information by public companies. For this reason, the SEC has attempted to tailor Regulation FD to balance the competing interests of Wall Street and Main Street.³⁹ Regulation FD provides clear rules prohibiting selective disclosure and encouraging broad public disclosure of information.⁴⁰ Through the adoption of Regulation FD, the SEC attempts to "promote full and fair disclosure of information by issuers and enhance the fairness and efficiency of [capital] markets."⁴¹ Only time will tell whether Regulation FD will enhance market efficiency or chill the flow of information to public markets. In Part II, this Article will analyze the elements of Regulation FD and discuss their application.

II. ANALYSIS OF REGULATION FD

Regulation FD presents a new enforcement approach to regulating selective disclosure through the adoption of issuer disclosure rules, which create duties under

communications with analysts are a violation of insider trading laws. *See Dirks*, 463 U.S. at 662. Moreover, the SEC has stated that enforcement actions charging selective disclosure as a form of insider trading would have a far greater consequence leading to a chilling effect on issuers than the impact of Regulation FD. *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,718 n.16.

37. *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,718.

38. *Id.* The "chilling effect" refers to the situations in which corporate officials find it increasingly difficult to determine when a disclosure of information would be subject to enforcement under Regulation FD, and consequently they minimize communications with outsiders and analysts. *Id.*; see also Letter from Michael S. Caccese, Senior Vice President, General Counsel and Secretary, Association for Investment Management and Research, to Jonathan Katz, Secretary, United States Securities and Exchange Commission (Aug. 8, 2000) at <http://www.sec.gov/rules/proposed/s73199/caccese1.htm>; Letter from Carlos M. Morales, Merrill Lynch & Co., Inc., to Jonathan Katz, Secretary, United States Securities and Exchange Commission (May 5, 2000), at <http://www.sec.gov/rules/proposed/s73199/morales1.htm>.

39. *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,719.

40. *Id.* The SEC did not intend to "impede ordinary-course business communications or expose issuers to liability for non-intentional selective disclosure unless the issuer fails to make public disclosure after it learns of it." *Id.*

41. *Id.*

sections 13(a)⁴² and 15(d)⁴³ of the Exchange Act.⁴⁴ It is not an antifraud rule and it is not intended to create duties under the antifraud provisions of the federal securities laws.⁴⁵ As adopted, Regulation FD has narrowed the scope of the proposed rule,⁴⁶ although questions remain concerning its application.⁴⁷ This Part provides an analysis of the application of Regulation FD through a discussion of the: (1) basic requirements; (2) issuers affected; (3) personnel covered and the scope of communications; (4) concept of materiality; (5) timing of required public disclosures; (6) method of public disclosures; (7) Securities Act of 1933 issues; and (8) liability issues.

A. Basic Requirements of Regulation FD

Regulation FD consists of four rules that provide the fundamental guidelines for

42. Securities and Exchange Act of 1934, 15 U.S.C. § 78m(a) (1994) (requiring expressed issuers to disclose and file information that the SEC prescribes as "necessary or appropriate for the proper protection of investors and to insure fair dealing").

43. *Id.* § 78o(d) (requiring certain issuers to disclose and file information that is necessary for public interest and the protection of investors).

44. In the case of a closed-end investment company the duty to disclose and file information is created under Section 30 of the Investment Company Act of 1940. *See* 15 U.S.C. § 80a-30 (1994 & Supp. 1999). The SEC's authority to adopt Regulation FD is found in 15 U.S.C. §§ 78c, 78i, 78j, 78m, 78o, 78w, 78mm, and 80a-29.

45. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726. Through Regulation FD, the SEC approaches the perceived problem of selective disclosure by creating an issuer-reporting requirement, rather than treating it as a form of manipulative conduct or insider trading.

46. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590 (proposed Dec. 28, 1999).

47. In order to prevent the possibility of inappropriate liability and to guard against the chilling effect on the release of corporate information, the SEC modified Regulation FD from its proposed release form. The following are summaries of the SEC's five primary modifications: (1) narrowed the scope so that it does not apply to communications with all outsiders, rather, it applies only to communications with market professionals and holders of the issuer's securities under circumstances when it is foreseeable that they will trade on the information; (2) narrowed the issuer's personnel covered to senior officers and persons who regularly communicate with the market; (3) expressly provided that a violation of Regulation FD will not result in an antifraud violation; (4) clearly established the scienter standard as knowing, or reckless in not knowing, that information disclosed was material and nonpublic; (5) expressly provided that a violation of Regulation FD will not affect an issuer's eligibility for short-form registration or resales under Rule 144. Other significant modifications from the proposed Regulation FD include the express exclusions of communications made in connection with most registered securities offerings and the elimination of foreign governments and foreign private issuers from the coverage of Regulation FD. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,719-20; *see also* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590.

the disclosure of nonpublic material information by public companies.⁴⁸ Rule 100⁴⁹ of the Regulation presents the formal rule regarding selective disclosure. Under Rule 100,

[w]henver an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to . . . [certain enumerated persons] . . . the issuer shall make public disclosure of that information . . . [s]imultaneously, in the case of an intentional disclosure; and . . . [p]romptly, in the case of a non-intentional disclosure.⁵⁰

48. See Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000).

49. *Id.* § 243.100.

50. *Id.* The full text of Rule 100 reads as follows:

(a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in § 243.101(e):

(1) Simultaneously, in the case of an intentional disclosure; and

(2) Promptly, in the case of a non-intentional disclosure.

(b)(1) Except as provided in paragraph (b)(2) of this section, paragraph (a) of this section shall apply to a disclosure made to any person outside the issuer:

(i) Who is a broker or dealer, or a person associated with a broker or dealer, as those terms are defined in Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a));

(ii) Who is an investment adviser, as that term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); an institutional investment manager, as that term is defined in Section 13(f)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(f)(5)), that filed a report on Form 13F (17 CFR 249.325) with the Commission for the most recent quarter ended prior to the date of the disclosure; or a person associated with either of the foregoing. For purposes of this paragraph, a "person associated with an investment adviser or institutional investment manager" has the meaning set forth in Section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)), assuming for these purposes that an institutional investment manager is an investment adviser;

(iii) Who is an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or who would be an investment company but for Section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a-3(c)(7)) thereof, or an affiliated person of either of the foregoing. For purposes of this paragraph, "affiliated person" means only those persons described in Section 2(a)(3)(C), (D), (E), and (F) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3)(C), (D), (E), and (F)), assuming for these purposes that a person who would be an investment company but for Section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a-3(c)(7)) of the Investment Company Act of 1940 is an investment company; or

(iv) Who is a holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information.

The basic elements of Regulation FD require that when a public company makes an intentional disclosure of material nonpublic information to enumerated persons, the company must do so in a manner which simultaneously provides the information to the general public.⁵¹ Alternatively, when selective disclosure is non-intentional, the company must publicly disclose the released information promptly after it knows that the information was material and nonpublic.⁵²

This Article will now analyze the primary elements of Regulation FD that function to define the scope of its application.

B. Issuers Subject to Regulation FD

An "issuer" subject to Regulation FD is any company with securities registered under section 12 of the Exchange Act,⁵³ or any company subject to the reporting requirements of section 15(d) of the Exchange Act,⁵⁴ including closed-end investment companies.⁵⁵ Specifically excluded from the definition of "issuers" (therefore not subject to Regulation FD) are non-closed-end investment companies,⁵⁶ foreign governments, and foreign private issuers.⁵⁷ The SEC has exempted foreign governments and foreign private issuers from Regulation FD in a manner consistent with their existing exemption from quarterly and 8-K filings.⁵⁸ However, foreign

(2) Paragraph (a) of this section shall not apply to a disclosure made:

- (i) To a person who owes a duty of trust or confidence to the issuer (such as an attorney, investment banker, or accountant);
- (ii) To a person who expressly agrees to maintain the disclosed information in confidence;
- (iii) To an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available; or
- (iv) In connection with a securities offering registered under the Securities Act, other than an offering of the type described in any of Rule 415(a)(1)(i)-(vi) (§ 230.415(a)(1)(i)-(vi) of this chapter).

Id. Rule 101 provides the definition for certain key terms used in Regulation FD. *Id.* § 243.101.

51. *Id.* § 243.100.

52. *Id.*

53. 15 U.S.C. § 781(a) (1994).

54. *Id.* § 78o(d).

55. 17 C.F.R. § 243.101(b).

56. Regulation FD applies to closed-end investment companies; however, it does not apply to other types of investment companies. The SEC believes that Regulation FD would provide limited additional protection to investors in investment companies because these companies continuously offer securities to the public and are under ongoing disclosure obligations to disclose material information. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,597 (proposed Dec. 28, 1999).

57. 17 C.F.R. § 243.101(b) (the terms "foreign government" and "foreign private issuer" are defined at 17 C.F.R. § 230.405).

58. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,724 (Aug. 24, 2000) (to be codified at C.F.R. pts. 240, 243, and 249).

governments and foreign private issuers remain obligated under the rules of the New York Stock Exchange ("NYSE") and National Association of Security Dealers Automated Quotations ("NASDAQ") to make timely reports of material information,⁵⁹ and their disclosures remain subject to the antifraud provisions of the federal securities laws.⁶⁰

*C. Issuer Personnel Covered by Regulation FD
and the Scope of Communications*

Regulation FD provides that whenever an "issuer, or person acting on its behalf"⁶¹ selectively discloses information to any "person described"⁶² in the regulation, such issuer shall publicly disclose that information.⁶³ The issues presented are: (1) who are the personnel acting on behalf of the issuer covered by Regulation FD; and (2) who are the enumerated recipients of the selectively disclosed information covered under Regulation FD.

1. Communications by a Person Acting on Behalf of an Issuer

Under Regulation FD, a person acting on behalf of the issuer includes any "senior official of the issuer . . . or any other officer, employee, or agent of an issuer who regularly communicates with [market professionals] . . . or with holders of the issuer's securities."⁶⁴ Regulation FD covers only senior management, investor and public relations professionals, and any other employees who regularly communicate and interact with Wall Street professionals or security holders of the company as part of their employment responsibilities.⁶⁵ Therefore, issuers are not responsible for selective disclosure made by mid-level management or junior employees who do not regularly communicate with market professionals or security holders.⁶⁶ Although issuers are not responsible for selective disclosure made by mid-level and low-level employees, issuers cannot avoid liability under Regulation FD by having noncovered persons make the selective disclosure.⁶⁷ The SEC has provided that if a senior officer directs an employee not otherwise considered to be "acting on behalf" of the issuer to selectively disclose information, the senior officer will be liable for the

59. See NYSE Listed Company Manual, § 2 (2000), Nasdaq Rules 4310(c)(16) & 4320(e)(14) (2000).

60. Foreign governments and foreign private issuers are subject to antifraud provisions of the federal securities laws provided that the jurisdictional requirements are met. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724-25. Also, the adopting release notes that the SEC plans to undertake a "comprehensive review of the reporting requirements of foreign private issuers." *Id.* at 51,724.

61. 17 C.F.R. § 243.100(a).

62. *Id.*

63. *Id.*

64. *Id.* § 243.101(c).

65. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720.

66. *Id.*

67. *Id.*

disclosure.⁶⁸

Regulation FD further provides that “[a]n officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust of confidence to the issuer shall not be considered to be acting on behalf of the issuer.”⁶⁹ Hence, the issuer is not responsible under Regulation FD when an employee improperly trades or tips. As a practical matter, an investment banker or lawyer engaged by the issuer, or a party to a confidentiality agreement (for example, an agreement contained in, or accompanying, a confidential private placement memorandum) will not be considered to act on “behalf of the issuer” if he discloses material nonpublic information in breach of his duty of trust and confidence to the issuer.⁷⁰ However, the individual who violates his duty to the issuer may be subject to insider trading liability as a tipper.⁷¹

2. Communications to Enumerated Persons

The SEC designed Regulation FD to address the problem of selective disclosure made to individuals who would be expected to trade securities on the information or advise others about securities trading.⁷² Correspondingly, Regulation FD enumerates four categories of covered individuals to whom selective disclosure shall not be made unless specifically excluded from coverage.⁷³ The first category includes brokers and dealers and their associated persons.⁷⁴ The second category includes investment advisors, certain institutional investment managers, and their associated persons.⁷⁵ The third category consists of investment companies and affiliated persons.⁷⁶ The first three categories of enumerated persons will include sell-side analysts, buy-side analysts, institutional money managers, and other Wall Street professionals who are likely to buy or sell securities on the basis of selective disclosures. Finally, the fourth category of enumerated persons are holders of the issuer’s securities that are likely to trade on the basis of selectively disclosed information.⁷⁷ Regulation FD does not

68. *Id.*

69. 17 C.F.R. § 243.101(c).

70. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720.

71. *Id.*; see also *Dirks v. SEC*, 463 U.S. 646, 662-63 (1983). If an issuer adopts a policy that limits which senior officials are authorized to speak to Wall Street professionals, a selective disclosure by a senior officer who is not authorized to speak will not violate Regulation FD, but may subject that officer to insider trading liability because he breached his duty of trust and confidence to the issuer. See e.g., Division of Corporation Finance, Securities and Exchange Commission, *Manual of Publicly-Available Telephone Interpretations* Regulation FD Telephone Interpretations, Question 14 (4th Supp. Oct. 2000), at <http://www.sec.gov/interp/telephone/phonesupplement4.htm> [hereinafter *Telephone Interpretations*].

72. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,719.

73. 17 C.F.R. § 243.100(b)(1).

74. *Id.* § 243.100(b)(1)(i).

75. *Id.* § 243.100(b)(1)(ii).

76. *Id.* § 243.100(b)(1)(iii).

77. *Id.* § 243.100(b)(1)(iv).

cover persons who are engaged in ordinary course of business communications with the issuer, nor will Regulation FD interfere with disclosures to the media or government agencies.⁷⁸

Regulation FD sets out four types of disclosure that are specifically excluded from coverage, even when made to an enumerated person. The first exclusion pertains to communications made to persons who owe the issuer a duty of trust and confidence.⁷⁹ These persons include temporary insiders such as investment bankers, lawyers, and accountants.⁸⁰ The second exclusion from Regulation FD applies to persons who expressly agree to maintain the disclosed information in confidence.⁸¹ However, any misuse of the information for securities trading by persons enumerated in the first two exclusions would be covered under the “temporary insider”⁸² or “misappropriation”⁸³ theory of insider trading.⁸⁴ The SEC applies this exclusionary approach recognizing that issuers must share material nonpublic information with outsiders for legitimate business purposes.⁸⁵

The third exclusion is for disclosures made to an entity whose primary function is the issuance of credit ratings, provided the information is disclosed for the sole purpose of developing a credit rating and the ratings are publicly available.⁸⁶ The fourth exclusion from the coverage of Regulation FD pertains to communications made in connection with securities offerings registered under the Securities Act.⁸⁷ This fourth exclusion is discussed in greater detail in Part II.G.1 of this Article.

D. Materiality

Regulation FD applies to the selective disclosure of material nonpublic information about the issuer or its securities.⁸⁸ However, the regulation does not define “material” nonpublic information.⁸⁹ The SEC intends to rely on the existing definition of material nonpublic information that has developed from case law.⁹⁰ In *TSC Industries*,

78. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,718 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

79. 17 C.F.R. § 243.100(b)(2)(i).

80. *Id.*

81. *Id.* § 243.100(b)(2)(ii).

82. See 15 U.S.C. § 78j (1994); see also 17 C.F.R. § 240.10b-5 (2000); SEC v. Lund, 570 F. Supp. 1397 (C.D. Cal. 1993) (presenting the “constructive insider” and “temporary insider” theories of insider trading liability).

83. See 15 U.S.C. § 78j(b); see also 17 C.F.R. §§ 240.10b-5, 240.10b5-1; United States v. O’Hagan, 521 U.S. 642 (1997) (presenting the “misappropriation” theory of insider trading liability).

84. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,720 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

85. *Id.*

86. 17 C.F.R. § 243.100(b)(2)(iii).

87. *Id.* § 243.100(b)(2)(iv).

88. *Id.* § 243.100.

89. See *Id.* § 243.101.

90. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721.

Inc. v. Northway, Inc.,⁹¹ the Supreme Court established that a “fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important”⁹² in making an investment decision. In a later case, *Basic, Inc. v. Levinson*,⁹³ the Supreme Court provided further that information is material if there is a substantial likelihood that it “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”⁹⁴ With respect to contingent or speculative events, materiality will depend on a balancing test weighing the “indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity.”⁹⁵

Regulation FD also does not define the term “nonpublic.”⁹⁶ Rather, it relies on the judicially created securities law concept that “[i]nformation is nonpublic if it has not been disseminated in a manner making it available to investors generally.”⁹⁷ In determining whether or not a piece of information is nonpublic, the standard is whether the information has been properly released and whether public investors have had a sufficiently long period to consider the information.⁹⁸ Whether this standard is met depends on the facts and circumstances of each individual case.⁹⁹

In its adopting release, the SEC does not establish a bright-line test or an exclusive list of material items for the purposes of defining materiality under Regulation FD. However, the SEC has provided a list of information and events “that should be reviewed carefully to determine whether they are material.”¹⁰⁰ The list includes:

- 1) earnings information; 2) mergers, acquisitions, joint ventures, and tender offers; 3) significant changes in assets; 4) new product development and resource discoveries; 5) significant developments regarding customers and

91. 426 U.S. 438 (1976).

92. *Id.* at 449.

93. 485 U.S. 224 (1988).

94. *Id.* at 231-32 (quoting *TSC Industries*, 426 U.S. 438 (1976)).

95. *Id.* at 238 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968)).

96. See Regulation FD, 17 C.F.R. § 243.100-.103 (2000).

97. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249) (citing *Texas Gulf Sulphur Co.*, 401 F.2d at 854 (2d Cir. 1968) and *In re Investors Management Co.*, 44 S.E.C. 633, 643 (1971)).

98. See *In re Faberge, Inc.*, 45 S.E.C. 249, 255-56 (1973); see also *Texas Gulf Sulphur Co.*, 401 F.2d at 854-55.

99. For information to be public, it must generally be disseminated through recognized channels of public distribution such as major news networks. However, if an issuer has filed a report on EDGAR in compliance with the Exchange Act, the information furnished is public and can therefore be disseminated to a select audience so long as the issuer confirms, prior to disclosure, that the report received a filing date no later than the date of disclosure. No reasonable waiting period is required following EDGAR filing. For example, under Regulation FD, a issuer can file a report on Form 8-K via EDGAR at 10:00 A.M., receive confirmation of the filing date at 10:10 A.M., and disclose the information to a private audience at 10:11 A.M. See *Telephone Interpretations*, supra note 71, Regulation FD Telephone Interpretations, Question 6.

100. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722.

suppliers; 6) changes in control; 7) changes in management and senior personnel; 8) change in accountants or auditor notification that the issuer may no longer rely on auditor's reports; 9) bankruptcies or receiverships; and 10) events regarding the company's securities.¹⁰¹

This list should not be considered as an enumeration of per se material facts or events. Given the imprecision of the materiality standard, it is difficult to state for certain what types of information will be considered material and what types will not. It seems likely, however, that disclosures regarding the listed topics require issuers to treat such information as material.

In addition to case law, the proposing release cites to alternative SEC rules, regulations, and releases on materiality.¹⁰² It is significant that the SEC references its Staff Accounting Bulletin No. 99 ("SAB 99").¹⁰³ The SEC's discussion of materiality in SAB 99 suggests that information that would not seem to be material under the applicable case law standard may be material under SAB 99.¹⁰⁴ SAB 99, which addresses materiality for the purposes of financial statements, warns that financial items that may seem quantitatively immaterial, may be material.¹⁰⁵ In SAB 99, the SEC sets forth a materiality test that involves both quantifiable and qualitative factors.¹⁰⁶ According to SAB 99, an "[e]valuation of materiality requires a registrant and its auditors to consider *all* relevant circumstances."¹⁰⁷ The potential market reaction should be a guiding consideration in determining whether information is material.¹⁰⁸ As a practical matter, there are three situations in which the materiality standard is directly relevant to the daily operations and practices of issuers. The situations are: 1) analysts seeking guidance regarding earnings forecasts; 2) disclosure of a nonpublic piece of information that an analyst uses to complete a

101. *Id.* "This list puts the world on notice that an intentional or reckless disclosure of information falling into one of these categories is likely to draw the attention of the Enforcement Division." Richard H. Walker, Director, Division of Enforcement, Securities and Exchange Commission, Speech Before the Compliance & Legal Division of the Securities Industry Association (Nov. 1, 2000), at <http://www.sec.gov/news/speeches/spch415.htm>.

102. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721 n.38 (citing Rule 405 under the Securities Act, Rule 12b-2 under the Exchange Act, and Staff Accounting Bulletin No. 99).

103. Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45,150 (Aug. 19, 1999) (to be codified at 17 C.F.R. pt. 211) (discussing materiality for the purposes of financial statements).

104. *See id.*

105. *Id.* at 45,152.

106. *Id.* The factors considered are: 1) is the item capable of precise measurement, or is it based on an estimate; 2) does the item impact the trend in earnings or other key items; 3) is the item consequential to meeting analysts' consensus expectations; 4) does the item change results from positive to negative; 5) is the item significant to a segment; 6) is the item consequential to compliance with regulatory requirements or loan or other contractual requirements; 7) does the item affect compensation; and 8) is there significant market reaction to the information. *Id.*

107. *Id.* (emphasis in original).

108. *Id.*

“mosaic” of information that is material; and 3) issuers making judgments whether information is material.

1. Earnings Forecasts

A prevailing issue that raises concerns under Regulation FD is the industry practice of securities analysts seeking guidance from companies regarding earnings forecasts. While far broader in its application, Regulation FD was adopted primarily to deal with this precise situation. When an issuer's Chief Financial Officer (“CFO”) enters a private conversation with a securities analyst who is looking for guidance on earnings estimates, the CFO assumes a high level of risk under Regulation FD.¹⁰⁹ If the CFO privately discloses to the analyst “nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what the analysts have been forecasting, the issuer likely will have violated Regulation FD.”¹¹⁰ Affirming an earnings estimate, or *walking the street* up or down, will likely be considered as providing material information and can no longer be done privately.¹¹¹

However, there are situations, such as affirming an earnings forecast shortly after it is publicly disclosed, when the affirmation would not be considered material and therefore not in violation of Regulation FD.¹¹² For an issuer to rely on this position concerning a one-on-one conversation with an analyst shortly after a public release of information, the issuer should be certain that no additional information is disclosed and the conversation occurs immediately following the public release. As a preventive measure, issuers may want to avoid such one-on-one conversations with analysts by directing them to the information that has recently been made publicly accessible. This practice would prevent situations in which issuers are placed on the spot to make judgment calls concerning materiality, thereby taking on the risk of violating Regulation FD.

When corporate officers undertake private conversations with Wall Street professionals concerning earnings estimates and projections, they assume great risk under Regulation FD. Through the adoption of Regulation FD, issuers have been put on notice that the SEC will view with skepticism any claims that no material nonpublic information was provided in one-on-ones and other private communications with Wall Street.¹¹³ A public company is likely to face an uphill battle in proving that no material earnings information was disclosed in private

109. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,721 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249)..

110. *Id.*

111. Walker, *supra* note 101, at 6. The possible scenario where a reasonable investor would not consider the information important in making an investment decision could be an earnings call with an analyst right after the issuer has publicly disclosed information in compliance with Regulation FD. In that situation, the CFO may be able to walk the analyst up and down without violating Regulation FD because the substance of the discussion would not be a material nonpublic disclosure. *See id.*; *see also Telephone Interpretations, supra* note 71, Regulation FD Telephone Interpretations, Question 1.

112. *Id.*

113. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721-22.

communications with Wall Street, particularly if analysts adjust their forecasts following the private conversation.¹¹⁴ Moreover, the SEC specifically provides that earnings information communicated through indirect guidance is material and will be equally subject to Regulation FD.¹¹⁵

2. Mosaic Theory

Under Regulation FD, a public company cannot disclose material information by breaking it into small, nonmaterial pieces.¹¹⁶ Thus, slicing information so thin that each individual piece is nonmaterial will not work. At the same time, a company "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."¹¹⁷ In *Elkind v. Liggett & Myers, Inc.*,¹¹⁸ the Second Circuit provided that a "skilled analyst with knowledge of the company and the industry may piece seemingly inconsequential data together with public information into a *mosaic* which reveals material non-public information."¹¹⁹ In the release adopting Regulation FD, the SEC announced that the mosaic theory articulated in *Elkind* is alive and well.¹²⁰

The phrase "unbeknownst to the issuer"¹²¹ (as stated in the adopting release) is a new addition to the mosaic theory and does not appear in *Elkind*. It is unclear and unlikely that an issuer's lack of awareness is a necessary condition of the mosaic theory. In *SEC v. Bausch & Lomb, Inc.*,¹²² the court stated that "corporate management may reveal to securities analysts or inquirers non-public information that merely fills intricacies in analysis."¹²³ Therefore, it appears that an officer of the issuer can knowingly convey an immaterial fact to an analyst.¹²⁴ What an issuer must be cautious of, however, is not knowingly breaking a material piece of information down into immaterial pieces and disclosing them to an analyst in a nonpublic manner.

Further, a dichotomy exists between the reasonable investor and the sophisticated investor or analyst. An issuer may selectively disclose information that is not

114. *See id.*

115. *Id.* The SEC intended Regulation FD to apply to code terms or any other type of indirect or implied earnings guidance. Therefore, any implied guidance or code language has the same status and poses the same potential liability as a direct communication. *See id.* The Walker speech provides that using a code language is one of the cases the Division of Enforcement will be interested in pursuing. Walker, *supra* note 101, at 6.

116. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721.

117. *Id.*

118. 635 F.2d 156 (2d Cir. 1980).

119. *Id.* at 165 (emphasis added) (citing Parker, *Ethical Issues for the Financial Analyst*, in CORPORATE FINANCIAL REPORTING: ETHICAL AND OTHER PROBLEMS 165, 167 (1972)).

120. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722.

121. *Id.*

122. 565 F.2d 8 (2d Cir. 1977).

123. *Id.* at 14.

124. *See Elkind*, 635 F.2d at 165-66; *see also Bausch & Lomb*, 565 F.2d at 14-15; Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722.

important to the reasonable investor (therefore not material) and is important to a sophisticated investor or analyst.¹²⁵ The SEC has stated that “[t]he focus of Regulation FD is on whether the issuer discloses material nonpublic information, not whether an analyst, through some combination of persistence, knowledge, and insight, regards as material information whose significance is not apparent to the reasonable investor.”¹²⁶ Therefore, Regulation FD is not violated where an issuer discloses immaterial information that is significant in completing an analyst’s mosaic of information.¹²⁷

3. Judgment Concerning Materiality

An area of concern under Regulation FD is an issuer’s responsibility for officers’ judgment calls concerning whether information is material. It is inevitable that corporate officials will be placed on the spot to make judgment calls concerning materiality in response to questions asked in private conversations. In answer to this concern, Regulation FD provides that an issuer acts intentionally only if the person “knows, or is reckless in not knowing, that the information he . . . is communicating is both material and nonpublic.”¹²⁸ Therefore, an issuer will not “intentionally” violate Regulation FD unless he “knows, or is reckless in not knowing”¹²⁹ that disclosed information is both material and nonpublic.¹³⁰ This standard for intentional disclosures provides protection to corporate officials against being second-guessed by the SEC in enforcement actions for judgments concerning materiality in close cases. The dichotomy between intentional and non-intentional disclosures is addressed in the following Subpart.

E. Timing of Required Public Disclosures

A primary element of Regulation FD is the timing of a required public disclosure depending on whether the company has made an intentional or non-intentional selective disclosure of information.¹³¹ The required timing differs in the two following situations: 1) the issuer has made an intentional selective disclosure of information; and 2) the issuer has made a selective disclosure that was not intentional.¹³²

125. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722 (“[M]ateriality is an objective test keyed to the reasonable investor; Regulation FD will not be implicated where an issuer discloses immaterial information whose significance is discerned by the analyst.”).

126. *Id.*

127. *Id.* at 51,722.

128. Regulation FD, 17 C.F.R. § 243.101(a) (2000); *see also id.* (discussing adoption of intentional standard).

129. 17 C.F.R. § 243.101(a).

130. *Id.*

131. *See id.* § 243.100(a).

132. *Id.*

1. Intentional Selective Disclosure

As previously mentioned, a selective disclosure is intentional when a person acting on behalf of the issuer making the disclosure knows, or is reckless in not knowing, prior to making the disclosure, that the information he is providing is both material and nonpublic.¹³³ Regulation FD does not define "reckless";¹³⁴ however, the SEC has stated that it intends to rely on the prevailing judicial definition of the term.¹³⁵ Based on judicial interpretation, "reckless" is defined as "extreme departure from the standards of ordinary care"¹³⁶ and the SEC notes that "recklessness" is also determined by the specific context involved.¹³⁷ For example, the SEC provides in the adopting release that a "materiality judgement 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."¹³⁸ It is unlikely that companies engaged in good faith efforts to comply with Regulation FD will be considered reckless in making disclosures.¹³⁹

Under Regulation FD, if an issuer makes an intentional disclosure, it is required to make a public disclosure of the same information simultaneously.¹⁴⁰ Although Regulation FD does not define "simultaneously,"¹⁴¹ the *Black's Law Dictionary* definition of the word is: "two or more occurrences or happenings [that] are identical in time."¹⁴² Taken at its literal meaning, "simultaneously" means that if an issuer makes an intentional selective disclosure it must also make a public disclosure of the same information at the exact same time. If an issuer intentionally discloses material nonpublic information and fails to simultaneously make a public disclosure of that information, the issuer violates Regulation FD.¹⁴³ Conversely, if an issuer simultaneously discloses the information to the public, there is no selective disclosure violation under Regulation FD.¹⁴⁴

133. *Id.* § 243.101(a); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722.

134. *See* 17 C.F.R. § 243.100-.101.

135. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722 (citing *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568 (9th Cir. 1990)).

136. *Hollinger*, 914 F.2d at 1568.

137. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722.

138. *Id.*

139. *Id.* The Walker speech states that the recklessness standard means "[the SEC is] not going to second-guess close calls regarding the materiality of a potential disclosure. An issuer's incorrect determination that information is not material must represent an 'extreme departure' from the standards of reasonable care in order for us to allege a violation of [Regulation] FD." The Walker speech provides that using a code language is one of the cases the Division of Enforcement will be interested in pursuing. Walker, *supra* note 101, at 4.

140. Regulation FD, 17 C.F.R. § 243.100(a)(1) (2000).

141. *See id.* § 243.100-.101.

142. BLACK'S LAW DICTIONARY 1384 (6th ed. 1990).

143. 17 C.F.R. § 243.100(a)(1).

144. *Id.* (for intentional disclosures of material nonpublic information, public disclosure must be made prior to or contemporaneous with the communication of the information).

2. Non-Intentional Selective Disclosure

If a company makes a non-intentional¹⁴⁵ disclosure of material nonpublic information, it must make public disclosure of that information promptly.¹⁴⁶ Regulation FD defines “promptly” to mean

as soon as reasonably practicable (but in no event after the later of [twenty-four] hours or the commencement of the next day’s trading on the New York Stock Exchange) after a senior official¹⁴⁷ of the issuer . . . learns that there has been a non-intentional disclosure . . . of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.¹⁴⁸

Regulation FD allows prompt public disclosure to remedy a good faith mistake by an issuer. By way of illustration, if a CFO selectively discloses information to an analyst that he did not think was material, but the information causes the stock price to move, the issuer can promptly issue a press release and not violate Regulation FD.¹⁴⁹ The public release of the selectively disclosed information must be made within twenty-four hours of the initial disclosure or prior to opening the next day’s trading on the NYSE.¹⁵⁰ The opening of trading on the NYSE is used as the reference point for all issuers, regardless of whether those issuer’s shares are traded on NASDAQ or the American Stock Exchange (“AMEX”).

The requirement to make a prompt disclosure is triggered when a senior officer learns that there has been a non-intentional selective disclosure that the “senior officer knows, or is reckless in not knowing, is both material and nonpublic.”¹⁵¹ Under Regulation FD, an issuer’s requirement to promptly disclose information arises only when the following three elements are satisfied: 1) the issuer learns that information has been disclosed; 2) the issuer knows, or is reckless in not knowing, that the information disclosed is material; and 3) the issuer knows, or is reckless in

145. Regulation FD does not define “non-intentional.” However, the proposing release describes “non-intentional” as “an honest slip of the tongue, or [where] the individual mistakenly (but not in reckless disregard of the truth) believed the information had already been made public.” Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,596 (proposed Dec. 28, 1999).

146. 17 C.F.R. § 243.100(a)(2).

147. Senior official is defined as “any director, executive officer (as defined in [17 C.F.R.] § 240.3b-7 . . .), investor relations or public relations officer, or other person with similar functions.” *Id.* § 243.101(f).

148. *Id.* § 243.101(d).

149. *See id.* § 243.100(a)(2).

150. *Id.* § 243.101(d). For example, if the non-intentional selective disclosure of material nonpublic information is discovered Friday afternoon, the outer limit for making public disclosure is the commencement of trading on the NYSE on Monday. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,723 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

151. 17 C.F.R. § 243.101(d).

not knowing, that the information is nonpublic.¹⁵² The prompt disclosure rule¹⁵³ for non-intentional selective disclosures provides issuers, acting in good faith, time to determine how to respond after discovering the disclosure error. Importantly, this time clock does not begin to run until the three aforementioned elements have occurred.¹⁵⁴

F. Methods of Public Disclosure Required by Regulation FD

In the case of a non-intentional selective disclosure, the company is required to make prompt "public disclosure"¹⁵⁵ of that information.¹⁵⁶ And, as previously mentioned, in the case of intentional selective disclosure, the company is required to make simultaneous "public disclosure."¹⁵⁷ Under Regulation FD, the company has a great deal of flexibility in determining the method of required public disclosure.¹⁵⁸ Specifically, Regulation FD provides that "public disclosure" may be made by either: 1) "furnishing . . . or filing . . . a Form 8-K,"¹⁵⁹ or 2) "disseminat[ing] the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, nonexclusionary distribution of the information to the public."¹⁶⁰

1. Form 8-K Disclosure

One option issuers have when required to make a public disclosure is "filing" or "furnishing" information on Form 8-K.¹⁶¹ Issuers who decide to make public disclosure via Form 8-K must make a subsequent decision whether to "file"¹⁶² or

152. *Id.*

153. *Id.* § 243.100(a)(2).

154. *See id.* § 243.101(d).

155. *Id.* § 243.100(a).

156. *See id.* § 243.100(a), (a)(2).

157. *Id.* § 243.100(a).

158. *See id.* § 243.101(e); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,723 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

159. 17 C.F.R. § 243.101(e)(1).

160. *Id.* § 243.101(e)(2).

161. *Id.* § 243.101(e)(1). Issuers whose securities are registered under § 12 of the Exchange Act are reporting companies, and are generally required to make filings (Form 10-K annual, Form 10-Q quarterly, and Form 8-K special events) with the SEC under § 13(a) or § 15(d) of the Exchange Act. Form 8-K is a special report filed with the SEC that provides disclosure of ongoing special events that occur between the required reporting dates. Reporting companies must file a Form 8-K for specific, limited events, such as bankruptcy, significant mergers or acquisitions, or a director's controversial resignation. Form 8-K is a mechanism for issuers to provide ongoing information to the SEC and securities trading markets. Form 8-K, 5 Fed. Sec. L. Rep. (CCH) ¶ 31,002-03 (2001) (Form 8-K shall be used for current reports under § 13 or § 15(d) of the Exchange Act, filed pursuant to Rule 13a-11 or Rule 15d-11).

162. Filed information is provided under revised Item 5 of Form 8-K. 5 Fed. Sec. L. Rep. at ¶ 31,003.

“furnish”¹⁶³ the information.¹⁶⁴ If an issuer chooses to “file” the information pursuant to Item 5 of Form 8-K (Other Events and Regulation FD Disclosure),¹⁶⁵ the information will be subject to liability under Section 18 of the Exchange Act.¹⁶⁶ The “filed” information is also subject to automatic incorporation by reference into the issuer’s Security Act registration statements that are subject to liability under Sections 11¹⁶⁷ and 12(a)(2)¹⁶⁸ of the Securities Act.¹⁶⁹ Should the issuer choose to “furnish” the information under Item 9 of Form 8-K (Regulation FD Disclosures),¹⁷⁰ “it will not be subject to liability under Section 11 of the Securities Act or Section 18 of the Exchange Act for the disclosure, unless it takes steps to include that disclosure in a filed report, proxy statement, or registration statement.”¹⁷¹

In selecting this method of public disclosure, information provided on Form 8-K (whether filed or furnished) remains subject to the antifraud provisions of the federal securities laws.¹⁷² Other Exchange Act filings, such as a proxy statement¹⁷³ or a Form 10-Q,¹⁷⁴ also satisfy Regulation FD’s public disclosure requirement provided they are timely and not buried in the filing or disclosed in piecemeal fashion throughout the

163. Furnished information is provided under new Item 9 of Form 8-K. 5 Fed. Sec. L. Rep. at ¶ 31,0024.

164. The SEC stated in the adopting release that “filing or furnishing information on Form 8-K solely to satisfy Regulation FD will not, by itself, be deemed an admission as to the materiality of the information.” Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,723 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

165. The SEC specifically revised Item 5 of Form 8-K to be titled “Other Events and Regulation FD Disclosure” which allows issuers to file information under Regulation FD that may or may not be material, without precluding a later determination that the information was not material. *See id.*

166. *Id.* Section 18 of the Exchange Act is a rarely used express antifraud action, with a relaxed culpability standard, that has a confined focus on “filed” documents and a heightened reliance requirement. *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78r (1994). Section 18 is rarely used because the plaintiff must establish “eyeball reliance” on a filed document in order to prevail. However, with the widespread use of EDGAR by all market participants, Section 18 could become a popular field of litigation for plaintiffs.

167. *See supra* text accompanying note 2.

168. Securities Act of 1933, 15 U.S.C. § 771(a)(2) (1997). Under § 12(a)(2) of the Securities Act, purchasers in a securities offering may seek rescission damages from statutory sellers if the offering was conducted “by means of a prospectus or oral communication” that was false or misleading. *Id.*

169. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723.

170. Information furnished under Item 9 of Form 8-K will not be deemed “filed” for SEC purposes. 5 Fed. Sec. L. Rep. (CCH) ¶ 31,004 (2001); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723.

171. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723.

172. *Id.*

173. *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78n (1994) (Section 14 of the Exchange Act regulates proxy voting by shareholders in public corporations).

174. *See supra* text accompanying note 157.

filing.¹⁷⁵ Although filing and furnishing information to the SEC through administrative procedural mechanisms is one method of meeting the public disclosure requirement, alternative methods give issuers flexibility in choosing the means of distributing information.

2. Alternative Methods of Public Disclosure

In lieu of filing or furnishing information in Form 8-K, an issuer may disseminate the information through another method or combination of methods that are reasonably designed to provide broad, nonexclusionary, distribution of the information to the public.¹⁷⁶ These methods could include: 1) disseminating a press release through a widely circulated news or wire service such as Bloomberg, Dow Jones, PR Newswire, or Business Wire; 2) announcements made at press conferences for which adequate notice has been given and the public has been granted access; or 3) telephonic or electronic transmission of conferences for which the public has been given adequate notice and the means of access.¹⁷⁷ Regulation FD does not require the use of any particular method of disclosure.¹⁷⁸ Preferably, the SEC leaves the choice to the issuer to select a method or combination of methods that are reasonably planned to make a broad public disclosure considering the particular circumstances of the situation.¹⁷⁹

The language of Regulation FD states that an issuer can use a method "or combination of methods"¹⁸⁰ of public dissemination of information. This should be interpreted to suggest that a single method of disclosure may, or may not, be sufficient to provide broad public disclosure.¹⁸¹ Based on Regulation FD and the adopting release, it is unclear when an issuer can rely on a single method of disclosure or whether multiple public disclosures are necessary.¹⁸² The SEC does provide the following model which depicts an approved combination of methods for making a planned disclosure of material information. First, the company should issue a press release through regular media channels containing the information.¹⁸³ Second, the company should hold a conference call to discuss the announced information and notify the public by another press release or Web site posting of the time and date of the call and instructions for accessing the call.¹⁸⁴ Third, the aforementioned conference call should be open to the public either by telephone or through Internet

175. *Telephone Interpretations, supra* note 71, Regulation FD Telephone Interpretations, Question 1.

176. Regulation FD, 17 C.F.R. § 243.101(e)(2) (2000).

177. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723-24.

178. *Id.* at 51,724.

179. 17 C.F.R. § 243.101(e)(2); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

180. 17 C.F.R. § 243.101(e)(2).

181. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

182. *See* 17 C.F.R. § 243.101(e)(2); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,723-24.

183. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

184. *Id.*

webcasting, but the public need not participate in the call, which could be conducted in listen-only mode.¹⁸⁵ By following these steps, a company can use a press release to broadly disseminate information to the public and then hold a public conference call discussing the release with analysts without danger of selectively disclosing material information.¹⁸⁶

Currently, it is unclear whether webcasting and posting information on the issuer's Web site, in and of itself, constitutes a sufficient method of public disclosure under Regulation FD.¹⁸⁷ In one instance, the adopting release states that "electronic transmissions (including the use of the Internet)"¹⁸⁸ is an acceptable method.¹⁸⁹ In another instance, the adopting release states that the "posting of information on the issuer's website may not now, by itself, be a sufficient means of public disclosure."¹⁹⁰ Therefore, it is clear that posting information on an issuer's Web site can be used in combination with other methods of public disclosure—yet, the release is ambiguous about whether Web sites that are widely followed by the investing public may, by themselves, be an acceptable method of public disclosure.¹⁹¹ Issuers who choose to use their Web sites as the sole means of making a public disclosure assume the risk and burden of establishing that the method was "reasonably designed to provide broad, non-exclusionary distribution of the information."¹⁹²

While Regulation FD gives issuers flexibility in choosing an appropriate method of public disclosure (in addition to the use of a Form 8-K), it also places on them the responsibility to select methods that are "reasonably designed" to effect broad public distribution.¹⁹³ In determining whether an issuer's disclosure was "reasonably designed," the SEC will "consider all the relevant facts and circumstances, recognizing that methods of disclosure that may be effective for some issuers may not

185. *Id.* The SEC has noted that issuers should consider making the conference call or webcast available for a reasonable time after the call is held in order to allow people who missed the call or webcast to access it later. *See id.* at n.73. However, issuers should also be cautious and limit this access period to prevent staleness of the information.

186. *Id.* at 51,724.

187. *Id.*

188. *Id.* at 51,723.

189. *Id.*

190. *Id.* at 51,724.

191. *See id.* at 51,723-24.

192. Regulation FD, 17 C.F.R. § 243.101(e)(2) (2000). The SEC has stated, "As technology evolves and more investors have access to and use the Internet . . . we believe that some issuers, whose [Web sites] are widely followed by the investment community, could use such a method." Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724. From the tone that the SEC takes in this statement referring to Web site disclosure as a sole method of *public disclosure*, it seems that currently Web site disclosure, by itself, is a frowned upon method of *public disclosure*. Change in this position is expected as issuers continue to experiment with various media techniques, as Internet media technology improves, and as the public becomes more sophisticated in its use of technology.

193. *See* 17 C.F.R. § 243.101(e)(1), (e)(2); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

be effective for others."¹⁹⁴ Even generally acceptable methods of public disclosure may not be reasonable for certain issuers.¹⁹⁵ Smaller issuers should take note of the SEC's warning that, where an issuer knows that its press releases are not routinely disseminated by business wire services, it is not sufficient to make a public disclosure simply by releasing information to such wire services.¹⁹⁶ In this case, the smaller, less well-known issuer should use a different or an additional reasonably designed method of public disclosure.¹⁹⁷

When determining the reasonableness of the method of public disclosure, deviations from usual disclosure practices may well affect the SEC's judgment because the changes may not be in line with investors' expectations.¹⁹⁸ Under Regulation FD, the SEC may look skeptically upon an issuer's judgment that a last-minute webcast of quarterly earnings results would provide effective public disclosure if the issuer typically disclosed quarterly earnings in a press release.¹⁹⁹ Although ambiguity surrounds the Regulation FD requirements for making a particular public disclosure, the SEC attempts to add some clarity by providing that its judgment concerning the sufficiency of a given method is made with respect to what is reasonable in light of all the relevant facts and circumstances.²⁰⁰ There is no "one size fits all" standard for public disclosure. Rather, the issuer must choose methods of disclosure based on the particular circumstances of the situation.²⁰¹

G. Application of Regulation FD to Securities Act Issues

The adoption of Regulation FD raises issues concerning the interplay of the disclosure requirements of the Securities Act and the new selective disclosure prohibitions.²⁰² The concern is whether Regulation FD applies to disclosures made by a reporting issuer in connection with an offering under the Securities Act.²⁰³ If that is the case, the public disclosure requirement of Regulation FD may cause issuers to violate Section 5²⁰⁴ of the Securities Act.²⁰⁵ The question is whether the public

194. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

195. *See id.*

196. *Id.* For some issuers, Form 8-K may very well be the only sure way of complying with the Regulation FD *public disclosure* requirement. *See id.*

197. Different or additional methods of *public disclosure* include 1) furnishing or filing a Form 8-K; 2) providing the information to local media; 3) posting the information on the company Web site; or 4) using a local service that distributes the information to a variety of media outlets. *See id.*

198. *Id.*

199. *Id.*

200. *Id.*

201. *See id.* at 51,723.

202. *See* Securities Act of 1933, 15 U.S.C. § 78e (1994) (Section 5 of the Securities Act); *see also* Regulation FD, 17 C.F.R. § 243.100-.103 (2000).

203. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

204. 15 U.S.C. § 77e. Section 5 places restrictions on the type of disclosures that issues can make during the registration process.

205. *Id.* Section 5 governs the release and delivery of information during the registration

disclosure obligation under Regulation FD directly conflicts with the disclosure mandates of the Securities Act.²⁰⁶ The specific Securities Act issues addressed are: (1) Regulation FD's application to registered offerings; (2) Regulation FD's application to unregistered offerings; and (3) Regulation FD's impact on issuers' eligibility for short-form registration and Rule 144.²⁰⁷

1. Registered Offerings

With a few exceptions,²⁰⁸ Regulation FD does not apply to disclosures released in connection with securities offerings that are registered under the Securities Act. The SEC has determined that apprehensions about selective disclosure of information in connection with registered offerings should not be handled by superimposing Regulation FD over the current regulatory regime imposed by the Securities Act.²⁰⁹ Further, under the Securities Act, the required disclosure standard and the liability provisions substantially limit any considerable opportunity for a company to selectively disclose information in connection with a registered offering.²¹⁰ The key effect of this exemption is to exclude investor roadshows and other marketing efforts

process. Section 5 separates the registration process into three time periods: (1) during the pre-filing period the offering and sale of any security is prohibited (§§ 5(a), 5(c)); (2) during the waiting period (after the registration statement is filed, but before it is effective), sales are prohibited, and written offers are strictly regulated (§§ 5(a), 5(b)(1)); and (3) during the post-effective period, written offers remain subject to regulation and all purchasers must receive a prospectus that is in compliance with Securities Act specifications (§§ 5(b)(1), 5(b)(2)). *Id.*

206. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725; *see also* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,593 (proposed Dec. 28, 1999).

207. General Rules and Regulations, Securities Act of 1933, 17 C.F.R. § 230.144 (2000). Rule 144 establishes when control persons or holders of restricted securities can resell them into public trading markets. *Id.*

208. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

Registered shelf offerings under Rule 415(a)(1)(i), (ii), (iii), (iv), (v), or (vi) are not excluded from the operation of Regulation FD. Those offerings, which include secondary offerings, dividend or interest reinvestment plans, employee benefit plans, the exercise of outstanding options, warrants or rights, the conversion of outstanding securities, pledges of securities as collateral and issuances of American depositary shares, are generally of an ongoing and continuous nature. Because of the nature of those offerings, issuers would be exempt from the operation of Regulation FD for extended periods of time if the exclusion for registered offerings covered them. Public companies that engage in these offerings should be accustomed to resolving any Section 5 issues relating to their public disclosure of material information during these offerings.

Id. at n.80.

209. *Id.* at 51,725.

210. *Id.*

from Regulation FD.²¹¹

This exclusion shields issuers from Section 5 liability, because the disclosure required under Regulation FD might constitute an "offer"²¹² of securities for purposes of Section 5 of the Securities Act and would therefore subject the issuer to liability for gunjumping or a written communication that is a nonconforming statutory prospectus provided subsequent to the filing of the registration statement.²¹³ In deciding that Regulation FD is generally not applicable to registered offerings, the SEC acknowledged that the Division of Corporation Finance is currently conducting a review of the Securities Act disclosure system as it operates during the registration process.²¹⁴ The SEC goes on to state that it is more appropriate to consider the impact of selective disclosure, during the registration process, in the broader context of rulemaking under the Securities Act.²¹⁵ Regulation FD, as promulgated under the Exchange Act, is not the most efficient mechanism for regulating disclosure during the registration process. Rather, Regulation FD would act to frustrate the current application of Section 5 of the Securities Act.²¹⁶

The exemption for selective disclosure in connection with a registered public offering is available only during the time period in which the issuer is "in registration."²¹⁷ For the purposes of Regulation FD, the SEC has specifically defined when registered security offerings are considered to begin and end.²¹⁸ Disclosures that

211. *Id.*

212. Securities Act of 1933, 15 U.S.C. § 77b(a)(3) (1994) (Section 2(a)(3) of the Securities Act defines "offer" as "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.").

213. 15 U.S.C. § 77e.

214. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

215. *Id.*

216. See 15 U.S.C. § 78e; see also Regulation FD, 17 C.F.R. § 243.100-.103 (2000); Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

217. Securities Act Release No. 5180 defines "in registration" as "the entire process of registration, at least from the time an issuer reaches an understanding with the broker-dealer which is to act as managing underwriter prior to the filing of the registration statement and the period of 40 to 90 days during which dealers must deliver a prospectus." Guidelines for the Release of Information by Issuers Whose Securities are in Registration, Securities Act Release No. 33-5180, 36 Fed. Reg. 16,506 n.1 (Aug. 16, 1971).

218. 17 C.F.R. § 243.101(g) (Rule 101(g)). Regulation FD defines "security offering" as follows:

(g) Securities offering. For purposes of § 243.100(b)(2)(iv):

(1) Underwritten offerings. A securities offering that is underwritten commences when the issuer reaches an understanding with the broker-dealer that is to act as managing underwriter and continues until the later of the end of the period during which a dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated);

(2) Non-underwritten offerings. A securities offering that is not underwritten: (i) If covered by Rule 415(a)(1)(x) (§ 230.415(a)(1)(x) of this chapter), commences when the issuer makes its first bona fide offer in a takedown of securities and continues until the later of the end of the period during which

take place outside the specific time periods²¹⁹ are not considered to be in connection with a registered offering and, therefore, are not exempt from Regulation FD.²²⁰ Also, Regulation FD will apply to disclosures concerning the ordinary course of business, regardless of whether the issuer is in the process of making a registered offering.²²¹ Communications that are not made in connection with a registered offering (even though they are made within the registration period) are not exempt. Thus, a statement about projected earnings made in a conference call with Wall Street analysts would not be considered "in connection with"²²² the registered offering merely because the issuer is "in registration."²²³

2. Unregistered Offerings

Regulation FD applies to communications made in connection with unregistered offerings.²²⁴ Therefore, traditional private placements,²²⁵ offerings under Rule 144A,²²⁶ and offerings under Regulation S²²⁷ are subject to Regulation FD.²²⁸ Issuers

each dealer must deliver a prospectus or the sale of the securities in that takedown (unless the takedown is sooner terminated);

(ii) If a business combination as defined in Rule 165(f)(1) (§ 230.165(f)(1) of this chapter), commences when the first public announcement of the transaction is made and continues until the completion of the vote or the expiration of the tender offer, as applicable (unless the transaction is sooner terminated);

(iii) If an offering other than those specified in paragraphs (a) and (b) of this section, commences when the issuer files a registration statement and continues until the later of the end of the period during which each dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated).

Id. Rule 101(g), which defines "securities offering," establishes when an offering is considered to be "in registration" for the purposes for Regulation FD.

219. See text accompanying note 218 for the specific time periods as provided in Rule 101(g) of Regulation FD.

220. 17 C.F.R. § 243.100, 101(g).

221. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

222. In the adopting release the SEC provides no guidance for what constitutes a communication "made in connection with" a registered offering. Most likely, communications made to prospective investors would qualify for the Regulation FD exemption. As for other communications, the issue is currently unclear.

223. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725 n.82.

224. *Id.*

225. See Regulation D—Rules Governing the Limited Offers and Sales of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. § 230.501-508 (2000) [hereinafter Regulation D].

226. See 17 C.F.R. § 230.144A (2000).

227. See Regulation S—Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933, 17 C.F.R. § 230.901-905 (2000) [hereinafter Regulation S]. Foreign private issuers and foreign governments remain exempt

making an unregistered offering must either publicly disclose the material nonpublic information in compliance with Regulation FD or obtain a confidentiality agreement from those who receive the information.²²⁹ The SEC has advised that if an issuer selectively discloses information during an unregistered offering, with no agreement concerning confidentiality, public disclosure is required under Regulation FD.²³⁰

The dilemma this creates is that an issuer may lose a private placement exemption under the Securities Act by making a public disclosure required under Regulation FD if the disclosure is construed as a "general solicitation."²³¹ Because the required public disclosures could be construed as "general solicitation,"²³² an issuer could lose its exemption from registration by attempting to comply with Regulation FD.²³³ The SEC has made clear that issuers making unregistered offerings must consider the impact their disclosures could have on the availability of the exemptions they use.²³⁴ Issuers must pay close attention to the effects selective disclosure may have on an unregistered offering.²³⁵

In operating within the new Regulation FD regime, issuers may deal with this dilemma through the use of confidentiality agreements.²³⁶ Issuers may avoid the Regulation FD required public disclosure if those individuals who receive the information agree to maintain it in confidence.²³⁷ However, confidentiality agreements are not the dominant market practice. It is impractical to obtain confidentiality agreements in the context of private placements as many qualified institutional buyers ("QIBs") will decline to be bound by such agreements. Rather, it is likely that issuers will have to determine whether to limit the information disseminated at private placement roadshows to that information which the issuer is prepared to make public, or obtain confidentiality agreements (which is uncommon in Rule 144A transactions) from those receiving the information.²³⁸

from Regulation FD. *See supra* text at Part II.B.

228. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

229. *Id.*

230. *Id.*

231. Regulation D, 17 C.F.R. 230.502(c) (2000) (Regulation D prohibits "general solicitation" in private placement under Rule 505 and Rule 506). In most cases, "general solicitation" is prohibited in private placements of securities under the Securities Act. Issuers making a "general solicitation" in the course of a private placement will negate the availability of a Securities Act registration exemption. *See id.*; *see also* 17 C.F.R. § 230.144A; Regulation S, 17 C.F.R. §§ 230.901-.905 (2000).

232. *See* Regulation D, 17 C.F.R. 230.502(c).

233. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725.

234. *Id.* This is an area of concern for issuers planning to rely on unregistered offerings. If the public disclosure required by Regulation FD jeopardizes the exemption from registration under the Securities Act, the dilemma created could make private placements unworkable in the new Regulation FD environment. *See id.*

235. *Id.*

236. *Id.*

237. *Id.*

238. *See id.*

Although it is in contravention of commercial practice, issuers may choose to obtain express confidentiality agreements to comply with Regulation FD.²³⁹ It is not a requirement of Regulation FD that these confidentiality agreements are in writing (an express oral agreement will suffice), or obtained prior to making the disclosure.²⁴⁰ An agreement made after the disclosure is made gives the issuer an opportunity to assess the materiality of the disclosure after the fact and attempt to cure the disclosure before the recipient of the information discloses or trades on it.²⁴¹ Nevertheless, issuers that rely on confidentiality agreements as the basis for complying with Regulation FD are advised to obtain written agreements.²⁴²

The SEC provides that these written agreements should include a covenant to keep the information confidential and a covenant requiring the recipient to abstain from trading on the basis of the information.²⁴³ Investors or market professionals that enter into confidentiality agreements with the issuer may be subject to the duty to disclose or abstain from trading under Rule 10b-5.²⁴⁴ Pursuant to Rule 10b-5, the party subject to the confidentiality agreement must either disclose the material information to the public or abstain from trading while the information remains undisclosed.²⁴⁵ If the investors or market professionals breach this duty that is created by the confidentiality agreement, they "place themselves at risk of illegal tipping and insider trading."²⁴⁶

3. Short-Form Registration and Rule 144

Failure to comply with Regulation FD will not affect the issuer's ability to use Forms S-2,²⁴⁷ S-3,²⁴⁸ S-8,²⁴⁹ or Rule 144²⁵⁰ (eligibility for which is conditioned on the

239. *Id.* Any agreement to maintain confidentiality must be express. *Id.* at 51,720 n.28.

240. *Id.*

241. *See id.*

242. The existence of a written confidentiality agreement will provide hard evidence that the issuer intended to disclose the information in confidence. In an Enforcement Division investigation, a written agreement would more effectively show compliance with Regulation FD than would an attempt at proving the existence of an express oral agreement.

243. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720.

244. *Id.*

245. *See* Chiarella v. United States, 445 U.S. 222, 226-27 (1980) (citing *In re Cady, Roberts & Co.*, 40 SEC 907, 912 (1961)); *see also* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (citing *In re Cady, Roberts & Co.*, 40 SEC 907, 912 (1961)); Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720, 51,725 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

246. Walker, *supra* note 101, at 8. The new Rule 10b5-1 creates affirmative defenses from insider trading liability; however, a discussion of this issue is beyond the breadth of this Article. *See* 17 C.F.R. § 240.10b5-1.

247. 17 C.F.R. § 239.12 (2000). Form S-2 (used in short form registration) requires that the issuer be current in filing its reports for a period of at least twelve months and in some respects, at least thirty six months. *Id.* § 239.12(c)(1).

248. *Id.* § 239.13. Form S-3 (used in short form registration) requires that the issuer be current in filing its reports for a period of at least twelve months. *Id.* § 239.13(a)(3).

249. *Id.* § 239.16(b). Form S-8 (used for securities offered under an employee benefit

issuer having timely filed all Exchange Act reports).²⁵¹ The potential threat was that a failure to file a Form 8-K under Regulation FD, when no other required public disclosure was made, would destroy the availability of short-form registration and render Rule 144 resales and Form S-8 employee benefit plan offerings unavailable.²⁵² Regulation FD asserts that “an issuer’s failure to comply with the regulation will not affect whether the issuer is considered current or, where applicable, timely in its Exchange Act reports for purposes of [sales under] Form S-8, short form registration on Form S-2 or S-3, and [resales under] Rule 144.”²⁵³ The SEC has implemented this approach recognizing that Regulation FD’s application to the availability of short-form registration, resales under Rule 144, and employee benefit plan offerings would negatively affect the issuer’s ability to raise capital and penalize shareholders and employees of the company.²⁵⁴

H. Liability Under Regulation FD

Enforcement of the new Regulation FD is limited to SEC actions; hence, there is no private right of action solely for a violation of Regulation FD.²⁵⁵ The regulation consists of issuer disclosure rules that create duties for public companies under Section 13(a) and 15(d) of the Exchange Act (and for closed-end investment companies, under Section 30 of the Investment Company Act).²⁵⁶ Regulation FD is not an antifraud rule, and it does not create any new duties under the existing antifraud provisions of the federal securities laws or any new private rights of action.²⁵⁷ Specifically, Regulation FD provides that “[n]o failure to make a public disclosure required solely by [Rule 100 of Regulation FD] shall be deemed to be a violation of Rule 10b-5 . . . under the Securities Exchange Act.”²⁵⁸ Therefore, private plaintiffs cannot rely on a violation of Regulation FD as the legal basis for a private cause of action.²⁵⁹

A violation of Regulation FD will subject the issuer to an SEC enforcement

plan) generally requires that the issuer be current in filing its reports for a period of at least twelve months. *Id.*

250. *Id.* § 230.144. For resale to be valid, Rule 144 requires that the issuer has made all required filings under the Exchange Act during the twelve preceding months. *Id.* § 230.144(c)(1).

251. Regulation FD, 17 C.F.R. § 243.103 (2000).

252. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,725 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

253. *Id.* at 51,726; *see also* 17 C.F.R. § 243.103.

254. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

255. 17 C.F.R. § 243.102; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

256. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

257. *Id.* “[B]ecause a violation of Regulation FD is not an antifraud violation, it would not lead to loss of the safe harbor for forward looking statements provided by the Private Securities Litigation Reform Act of 1995.” *Id.* at 51,726 n.85.

258. 17 C.F.R. § 243.102.

259. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

action.²⁶⁰ The SEC could either “bring an administrative action seeking a cease-and-desist order[] or a civil action seeking an injunction and/or civil money penalties.”²⁶¹ Failure to furnish a Form 8-K or make an alternative public disclosure required under Regulation FD will be considered a violation for as long as the deficiency continues.²⁶² The SEC states that in enforcement actions, it will seek more severe sanctions for violations that progress for an extended period of time. Additionally, the SEC may bring actions against the individual or individuals at the company who were responsible for the violation.²⁶³ In a cease-and-desist proceeding brought by the SEC, the individual or individuals would be liable as “a cause of” the violation.²⁶⁴ Should the SEC bring an injunctive action, the individual or individuals would be liable as aiders and abettors of the violation.²⁶⁵

Issuers should closely note the SEC’s mention that Regulation FD is designed to exclude antifraud liability from actions that would be based “solely” on the failure to make a required public disclosure under Regulation FD.²⁶⁶ The existing grounds for antifraud liability under Rule 10b-5 of the Exchange Act remain applicable to the issuer’s actions.²⁶⁷ Therefore, issuers remain at risk of “tipper” liability and insider trading if “selective disclosure is made in circumstances that meet the *Dirks* ‘personal benefit’ test.”²⁶⁸ By requiring public disclosure of information, Regulation FD creates additional exposure to liability under the antifraud provisions of federal securities laws. For example, if any statements made by the issuer pursuant to Regulation FD are found to be false or misleading, or inadequate because material information was

260. *Id.* The SEC has stated that they

are not looking to frustrate the purpose of the rule—which is to promote broader and fairer disclosure of information to investors—by second-guessing reasonable disclosure decisions made in good faith, even if we don’t agree with them. Nor are we looking to test the outer limits of the rule by bringing cases that aggressively challenge the choices issuers are entitled to make regarding the manner in which a disclosure is made. There will be no [Regulation] FD SWAT teams, and I do not envision any [Regulation] FD sweeps, unless, of course, there is widespread noncompliance with the rule

Walker, *supra* note 101, at 5.

261. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

262. *Id.* at 51,726 n.91.

263. *Id.* at 51,726.

264. *Id.*; *see also* Securities and Exchange Act of 1934, 15 U.S.C. § 78u-3 (1994).

265. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726; *see also* 15 U.S.C. § 78t(e) (1994).

266. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

267. *See id.*

268. *Id.*; *see also supra* text accompanying notes 35-36. The *Dirks* “personal benefit” test for insider trading liability is stated as follows: “Whether disclosure is a breach of duty . . . depends in large part on the purpose of the disclosure. . . . Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure.” *Dirks v. SEC*, 463 U.S. 646, 662 (1983).

omitted, the issuer may be liable under Rule 10b-5 of the Exchange Act.²⁶⁹

An additional consideration for issuers is that public disclosure of material information under Regulation FD may create a "duty to update" or a "duty to correct" any statements released.²⁷⁰ Thus, any subsequent statements released by an issuer because of the duty to update or correct will not be protected by Regulation FD's Rule 10b-5 safe harbor.²⁷¹ Furthermore, in certain circumstances, an issuer's failure to make a required public disclosure under Regulation FD may give rise to liability under a duty to correct or update.²⁷² As a cautionary matter, issuers that find themselves having to make Regulation FD disclosures due to non-intentional selective disclosures should take adequate measures so that, in scrambling to make the required disclosure, they do not run afoul of Rule 10b-5 of the Exchange Act. Although the SEC establishes a safe harbor for disclosures required "solely" by Regulation FD, if an issuer's public disclosure contains a material misrepresentation or if an issuer's failure to make a public disclosure is an omission of material information, the safe harbor will not provide protection from Rule 10b-5 liability.²⁷³

III. THE EFFECTS ON WALL STREET AND MARKET PROFESSIONALS

To date, the early report card on Regulation FD displays mixed results.²⁷⁴ However, few will dispute that the SEC's new Regulation FD has directly impacted the means by which market professionals operate.²⁷⁵ Some commentators have noted that Regulation FD delivers a sharp blow to market professionals, while others are optimistic about its impact.²⁷⁶ Security analysts and institutional investors play an

269. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726. In the Regulation FD adopting release, the SEC also adopts Rules 10b5-1 and 10b5-2 that codify some of the aspects of current case law under Rule 10b-5. A discussion of the impact of these new antifraud rules is beyond the scope of this Article. *See generally id.* at 51,727-30.

270. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726; *see also In re IBM Corp. Sec. Litig.*, 163 F.3d 102, 109-110 (2d Cir. 1998) (addressing the distinction between the duty to update and the duty to correct); *Backman v. Polaroid Corp.*, 910 F.2d 10, 16-17, 21 (1st Cir. 1990) (discussing the duty to update and correct). *See generally* Robert H. Rosenblum, *An Issuer's Duty Under Rule 10b-5 to Correct and Update Materially Misleading Statements*, 40 CATH. U. L. REV. 289, 291-97 (1991).

271. *See* Regulation FD, 17 C.F.R. § 243.102 (2000).

272. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726. Also, the SEC states that "an issuer's contacts with analysts may lead to liability under the 'entanglement' or 'adoption' theories." *Id.*; *see, e.g., Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 163 (2d Cir. 1980).

273. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726.

274. Neal Lipschutz, *Disclosure Rule's Early Mixed Report Card*, DOW JONES NEWS SERV., Jan. 19, 2001, available at <http://www.ccbn.com/regulationfd/20010119.html>.

275. *See, e.g.,* Miriam Hill, *New Rule Aims to Keep Investors in the Know, But Wall Street Analysts Wonder How it Will Affect Their Work*, CHI. TRIB., Nov. 21, 2000, at C3.

276. *Id.* One commentator stated that Regulation FD "didn't do anything but [] drive a stake [through] the heart of the analysts," while another optimistically stated "that the change will not put him and other analysts out of work." *Id.*

instrumental role in information networks, and understanding this role is necessary in analyzing the impact of Regulation FD.

Sell-side analysts, who study a number of companies and industry groups, are typically associated with broker-dealer firms and investment banks.²⁷⁷ Most specialize in a particular industry and use their financial expertise to provide heavily researched investment information to customers and potential customers of their respective firms.²⁷⁸ This professional field is very competitive and a premium is placed on the accuracy of information.²⁷⁹ On a daily basis a sell-side analyst's functions consist of 1) ferreting out information concerning specific companies, 2) digesting and analyzing the information, along with other information about the given industry and the general economy, and 3) distributing the information.²⁸⁰ This investment information is targeted to customers of the analyst's firm; however, with the vast expansion of electronic financial news services, sell-side analysts' reports are rapidly disseminated to the marketplace.²⁸¹ Some sell-side analysts have a notable influence on market participants and can affect the price of a company's stock when they issue a report or recommendation.²⁸²

Buy-side analysts are typically associated with institutional investors,²⁸³ such as mutual funds and pension funds.²⁸⁴ These analysts perform the same daily functions as the aforementioned sell-side analysts; however, buy-side analysts conduct research and produce reports for the use of particular investors.²⁸⁵ Therefore, buy-side analyst information is not widely disseminated in the same manner as sell-side analyst information. Despite this fact, buy-side analysts and institutional investors play a necessary role by providing a vehicle through which Main Street investors can invest.²⁸⁶ Specifically, Main Street investors entrust their money to institutional investors due to their financial expertise, ability to obtain and evaluate information (through buy-side analysts), and economic knowledge.²⁸⁷ Through these institutional

277. See Karen M. Kroll, *Bridging the Earnings Divide*, INDUSTRY WEEK, Oct. 2001, at 27, available at LEXIS, News Library, Indwk File.

278. See, e.g., *id.*

279. See Chad Bray & Phyllis Plitch, *Wall Street Companies Run Into Conflicts Under Reg FD*, DOW JONES NEWS SERV., Nov. 29, 2000, available at <http://www.ccbn.com/regulationfd/20011129.html>.

280. See, e.g., *id.*

281. See *id.*

282. See A. Gary Shilling, *Foul Disclosure*, FORBES, Jan. 22, 2001, at 152.

283. Institutional investor is defined as follows: an "organization that trades large volumes of securities. Some examples are mutual funds, banks, insurance companies, pension funds, labor unions funds, corporate profit-sharing plans, and college endowment funds. Typically, upwards of 70 % [sic] of the daily trading on the New York Stock Exchange is on behalf of institutional investors." BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 282 (5th ed. 1998).

284. Karen M. Kroll, *Talking with Wall Street*, INDUSTRY WEEK, Nov. 16, 1998, at 68, available at LEXIS, News Library, Indwk File.

285. See, e.g., *id.*

286. See Bray & Plitch, *supra* note 279.

287. See *id.*

investment opportunities,²⁸⁸ Main Street investors benefit from the information flow to buy-side analysts that produce investment recommendations.²⁸⁹

Prior to Regulation FD, the information network between issuers and analysts evolved into a specialized channel of communication. On October 23, 2000, the day Regulation FD went into effect, this channel of communication was disjointed.²⁹⁰ In the "old days,"²⁹¹ the individuals on the *Wall Street Journal's* list of all-star analysts developed special skills for gently squeezing information out of the executives at the companies they covered.²⁹² Building relationships through regular contact and schmoozing with the company's executives facilitated getting information and getting it first.²⁹³ Additionally, by providing friendly reports, some analysts developed a quid pro quo relationship with the companies they covered.²⁹⁴ For example, an analyst might slightly alter the tone of an earnings report to cast the issuer in a positive light; therefore, when the company wanted to leak earnings information, that analyst would gain a priority position over other analysts covering the issuer or the industry.²⁹⁵ Thus, it was to an analyst's advantage to be polite when reporting negative information rather than blasting the issuer or the executive officers. However, in light of Regulation FD, many of the old school analyst tactics will fail to produce the same proprietary corporate disclosure of information.

As previously established in Part II of this Article, Regulation FD was designed to prevent public companies from releasing material information to market professionals, such as analysts or institutional money managers, unless such information is broadly disseminated.²⁹⁶ It is a near unanimous consensus that market professionals feel that "Regulation FD has made their job more difficult."²⁹⁷ Analysts

288. Institutional investment opportunities provided to Main Street investors include such financial products as mutual funds, commercial bank investment plans, insurance company instruments, pension funds, labor unions funds, and investment based retirement plans.

289. Many commentators believe that security markets as a whole benefit from the efficient and accurate pricing that occurs through the informed investment decisions of institutional investors. It is the theory of security trading experts that well-informed institutional investors and analysts decrease market volatility and increase liquidity. *See* Lawrence E. Harris, *Trading and Exchanges 9-1 to 9-8, 9-16* (Aug. 2, 2000) (unpublished manuscript, on file with *Indiana Law Journal*).

290. *See, e.g.,* Bray & Plitch, *supra* note 279.

291. The "old days" refers to the time period before the October 23, 2000, effective date of Regulation FD.

292. Hill, *supra* note 275.

293. *Id.*

294. *Id.*; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,717 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

295. Hill, *supra* note 275. As this competitive practice among analysts develops, an incentive is created to release only positive reports about the company or risk losing this priority position in the informational chain. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717.

296. Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718.

297. Bray & Plitch, *supra* note 279.

are experiencing unreturned phone calls to corporate executives—calls that were previously returned within twenty-four hours.²⁹⁸ Regulation FD is forcing Wall Street professionals to rely less on relations with corporate executives and to do more leg work in producing earnings estimates.²⁹⁹ One seasoned analyst has commented that “[c]ompanies are currently unsure about how to act in this new environment, so they’re taking the safest course possible and revealing significantly less than ever before.”³⁰⁰ Previously, issuers would informally “review analyst estimates and provide ‘guidance’ to keep their numbers from getting too far afield.”³⁰¹ This provided security analysts with a more accurate picture of the financial condition of the issuer when completing their research reports. Since this practice no longer continues (within the confines of Regulation FD), analysts must adjust their practices to formulate accurate reports and earnings estimates. This Part further analyzes the role of Wall Street professionals and the positive and negative effects Regulation FD has on their job performance.

A. Positive Effects

Few will argue that Regulation FD has not had an impact on Wall Street professionals. Conversely, many will argue over the extent of that impact. One group of commentators believes that Regulation FD positively affects analysts’ job performance because it encourages competition and it levels the playing field with respect to access to information.³⁰² Now all analysts are on equal footing when competing for access to material information. Under Regulation FD, Wall Street professionals will be able to benefit from superior research and analytical skills without worrying whether other analysts possess a competitive advantage because they have been favored with selectively disclosed information.³⁰³ And, analysts are now free to provide honest, forthright opinions, absent the fear of later being denied access to selectively disclosed information.³⁰⁴

An analyst’s primary job is to estimate corporate earnings. Because investors scrutinize companies who miss earnings estimates, corporate management wants to coach analysts in order to make sure estimates reflect actual earnings. On Wall Street, this is called “guidance,” but in actuality, it is financial executives (usually the CFO) adjusting analysts’ earnings estimates to match internal corporate earnings projections.³⁰⁵ Working within the confines of Regulation FD, companies will no

298. Hill, *supra* note 275.

299. Lee Clifford, *The SEC Wants to Open the Info Vault: Regulation FD Sounds Great on Paper, But Will It Help Investors Know More About the Companies They Own?*, FORTUNE, Nov. 13, 2000, at 124.

300. *Id.*

301. *Id.*

302. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,728; *see also* Hill, *supra* note 275.

303. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,734; *see also* Levitt, *supra* note 1, at 1-2.

304. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,734.

305. *See* Gregory Zuckerman, *Cisco News Is No Friend to Market, but NASDAQ Index*

longer be able to offer “guidance” unless they publicly release it to everybody at once.³⁰⁶ Some view this as a positive for the analyst profession, stating that there “may be a return to good old-fashion research.”³⁰⁷ In fact, this is exactly what is happening as analysts are turning to more outside sources for corporate information and financial figures.³⁰⁸ Analysts are finding themselves unable to get answers from corporate executives and are therefore turning to corporate competitors, suppliers, and customers for information.³⁰⁹ In this new regulatory environment, analysts will no longer be capable of gaining a competitive edge by cultivating a “you scratch my back, I’ll scratch yours” relationship with corporate executives.

As a practical matter, many Wall Street analysts (especially the publicly touted “superstars”) have been spending more time marketing corporate finance deals and spending less time conducting serious company analysis.³¹⁰ On Wall Street, these analysts have been likened to “investment banker[s] in analyst’s clothing.”³¹¹ For example, consider a “superstar” technology industry analyst working at a prestigious Wall Street investment bank.³¹² In releasing his quarterly rankings for e-commerce companies, it is not surprising to find that six out of the seven winners were clients of the investment bank.³¹³ Equally predictable were the rankings of the twelve losers, none of whom were clients of the investment banking firm.³¹⁴ Not surprisingly, this analyst’s ranking criteria are the exact same criteria the firm uses when selecting e-commerce companies to underwrite.³¹⁵ These “investment bankers in analyst’s clothing” do not diligently construct analytical models to estimate earnings; rather, they rely on the corporate management of firm clients to feed them information.³¹⁶ On a positive note, Regulation FD works to muzzle these “cheerleading analysts” by eliminating the selectively disclosed flow of information from corporate clients of the investment banking firm.³¹⁷

The Wall Street professionals who will benefit from Regulation FD are the independent analysts who produce unbiased opinions.³¹⁸ Now that Regulation FD

Falls Only 2.13%, WALL ST. J., Feb. 8, 2001, at C1.

306. Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000). When an analyst calls a CFO for guidance, he cannot give out any material information that would raise or lower estimates. Hill, *supra* note 275. Also, he cannot even advise if he is comfortable with current estimates. *Id.*

307. Hill, *supra* note 275.

308. *Id.*

309. *Id.* Through these sources, analysts can get information and figures concerning sales, customer satisfaction, and market share. *Id.*

310. Shilling, *supra* note 282, at 152.

311. *Id.*

312. *Id.*

313. *Id.*

314. *Id.*

315. *Id.*

316. *Id.*

317. See Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716-18 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

318. See Shilling, *supra* note 282.

prohibits selective disclosure, all analysts will be provided access to information at the same time.³¹⁹ Independent, unbiased analysts who possess superior diligence and acumen will rise to the top in the new Regulation FD environment. No longer will a handful of analysts have a priority position in receiving selectively disclosed material information from corporate management.³²⁰

Institutional investors and well-seasoned individual investors are fully aware of the biases of Wall Street analysts—specifically big investment banking firms’ “cheerleading analysts”—and rely on these analysts solely as a pipeline to corporate information while conducting much of the detailed analysis themselves.³²¹ Now that Regulation FD makes the release of material corporate information publicly available at the same time, institutional investors may shift their reliance away from “cheerleading analysts” and on to diligent independent analysts.³²² Through the implementation of Regulation FD, the SEC has created an atmosphere in which analysts have equal access to information and are free to express their opinions without fear of later being denied access to material corporate information.³²³ This competitive paradigm allows market professionals who use their education, personal judgment, and expertise in analyzing financial data to flourish by placing all participants on equal footing with respect to access to information.³²⁴

B. Negative Effects

In *Dirks*, the Supreme Court explicitly recognized that “the role of market analysts . . . is necessary to the preservation of healthy markets.”³²⁵ Moreover, the Court provided that

[i]t is commonplace for analysts to “ferret out and analyze information,” . . . and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation’s securities. . . . 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.*³²⁶

In the past, it was an unquestioned assumption that securities analysts play an important intermediary role between the issuers and the investors.³²⁷ However, in a

319. See 17 C.F.R. §§ 243.100-103.

320. See *id.*

321. Shilling, *supra* note 282.

322. *Id.*

323. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,731 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

324. *Id.*

325. *Dirks v. SEC*, 463 U.S. 646, 658 (1983).

326. *Id.* at 658-59 (emphasis added) (partially drawing from the position taken by the SEC in previous Commission actions).

327. *Id.*; see also *In re Investors Mgmt. Co.*, 44 S.E.C. 633, 646 (1971).

recent speech, former SEC Chairman Arthur Levitt stated that "he didn't think investors need analysts to interpret news . . . from a company."³²⁸ The argument has surfaced that Main Street investors no longer expect to rely on research performed by analysts.³²⁹ In light of the advances in information technology and the use of the Internet, real-time corporate information can be released to the public without the use of analysts as intermediaries.³³⁰ The adoption of Regulation FD is in response to concerns that the analyst's role in the market is increasingly becoming that of a gatekeeper of selectively disclosed information rather than a necessary participant.³³¹ Due to the rise of disintermediation (investors shifting reliance from analysts to nontraditional intermediaries such as the Internet), the role of the analyst is significantly changing.³³² Supporting the position that Regulation FD has a negative impact on Wall Street analysts, SEC Acting Chairman Laura Unger (appointed as Acting Chairman on February 12, 2001) stated that "Regulation FD turns on its head the longstanding relationship between issuers and analysts."³³³

The SEC noted in the 1998 Aircraft Carrier Release that analysts "digest information . . . , put all of it into context, and act as conduits in the flow of information by publishing reports explaining the effects of this information to investors."³³⁴ However, under Regulation FD, issuers will disseminate material information to the marketplace as a whole, significantly cutting out the analyst's role as the intermediary who ferrets out and analyzes information prior to broad

328. Randall Smith, *Bids and Offers: Special Report from the Annual Wall Street Convention in Boca Raton, Fl.*, WALL ST. J., Nov. 10, 2000, at C16. This statement was made by Chairman Levitt at the annual meeting of the Security Industry Association at the Boca Raton Resort & Club in Palm Beach, Florida. *Id.* In another speech Chairman Levitt stated that "America's investors don't need interpreters." Hon. Arthur Levitt, Chairman, SEC, Remarks on "Wall Street Week with Louis Rukeyser" (PBS television broadcast, Nov. 3, 2000) (on file with *Indiana Law Journal*).

329. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts 240, 243, and 243).

330. *Id.*

331. *Id.*; *see also* Susan Pulliam, *Abercrombie & Fitch Ignites Controversy Over Possible Leak of Sluggish Sales Data*, WALL ST. J., Oct. 14, 1999, at C1; Susan Pulliam & Gary McWilliams, *Compaq Is Criticized for How It Disclosed PC Troubles*, WALL ST. J., Mar. 2, 1999, at C1.

332. *See* Susan Scherreik, *The Squawk Box Goes Public: Companies Open Up Their Wall Street Chats*, BUS. WK., Feb. 5, 2001, at 118. Specifically, because investors now have access to a great deal of real-time corporate information through Internet Web pages, conference calls, and webcasting, analysts are no longer the only possible intermediaries for accessing corporate information. *Id.*; *see also* Sue Zeidler, *Webcasters Gear Up for Earnings Under New SEC Rule*, REUTERS ENGLISH NEWS SERV., Dec. 27, 2000, available at <http://www.cbn.com/regulationfd/20001227.html>.

333. SEC Commissioner Laura S. Unger, Address at the Glasser Legal Works Conference on SEC Regulation FD (Oct. 27, 2000), at <http://www.sec.gov/news/speeches/spch421.htm> [hereinafter Unger].

334. The Regulation of Securities Offerings, Securities Act Release No. 33-7607A, 63 Fed. Reg. 67,174 (Dec. 4, 1998).

dissemination.³³⁵ Regulation FD is making analysts' jobs much more difficult. Initially, most corporate executives have responded to Regulation FD by refusing to return phone calls or speak privately with analysts.³³⁶ Conversely, executives are publicly releasing much more unimportant information—which analysts must ferret through—in fear of breaching Regulation FD.³³⁷ Although the SEC has provided that there will be no "FD Swat teams," or "FD sweeps,"³³⁸ corporate executives do not want to be made examples of by initial enforcement action and are therefore remaining tight-lipped.³³⁹

Corporate executives' tight-lipped response to Regulation FD has contributed to the decline in the accuracy of analysts' estimates.³⁴⁰ In the past, analysts' earnings estimates clustered in a tight range.³⁴¹ Following the adoption of Regulation FD, however, the standard deviation³⁴² of analysts' estimates increased considerably.³⁴³ Analysts claim that issuers are giving less earnings guidance than before the implementation of Regulation FD, and thus the accuracy of estimates is likely to vary.³⁴⁴ A seasoned analyst at one reputable institution stated that before Regulation FD was introduced, "[cooperative executives would] give you sales estimates, credit [status], [and] gross-margin trends . . . [b]ut that's no longer the case."³⁴⁵ While issuers are declining to provide on-the-spot guidance, the matter is further complicated by corporate executives publicly releasing large amounts of unimportant information that analysts must sort through and decipher.³⁴⁶

For a specific example of Regulation FD's negative impact on the accuracy of analysts' estimates, examine the case of Cisco Systems' ("Cisco") fourth quarter

335. See Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000).

336. Allison Bisbey Colter, *Fund Firms Strengthen Research Teams*, WALL ST. J., Jan. 2, 2001, at C19; see also Hill, *supra* note 275; Robert McGough & Cassell Bryan-Low, *Analysts' Earnings Estimates Are Diverging, and SEC Disclosure Rule May Why*, WALL ST. J., Nov. 2, 2000, at C2.

337. Colter, *supra* note 336.

338. Walker, *supra* note 101.

339. Bray & Plitch, *supra* note 279; see also Phyllis Plitch, *SEC Disclosure Rule Prompts Varied Corporate Spins*, DOW JONES NEWS SERV., Nov. 16, 2000, available at <http://www.ccbn.com/regulationfd/2001116.html>.

340. McGough & Bryan-Low, *supra* note 336. According to a study by BulldogResearch, a firm that tracks analysts relative performance on estimates and recommendations, analysts' accuracy has decreased by 5.3 percent since the adoption of Regulation FD. *Id.*

341. *Id.*

342. The standard deviation is a statistical measure of the distance between analysts' estimated earnings and the analysts' average estimated earnings. *Id.*

343. *Id.* ("BulldogResearch found that the 'flash estimates' for companies—that is, estimates that were changed by analysts in the four weeks before earnings were announced—grew more dispersed by 13.67 percent, which BulldogResearch says is a notable change.").

344. *Id.*

345. *Id.*

346. Colter, *supra* note 336.

earnings disappointment in 2000.³⁴⁷ Cisco's sustained growth had made it one of the surest bets on Wall Street and allowed for near perfect analyst estimates.³⁴⁸ In fact, until the fourth quarter of the year 2000, Cisco had met or slightly exceeded analysts' earnings expectations for almost seven straight years.³⁴⁹ Unfortunately, when Cisco reported their fourth quarter earnings, they fell short of the consensus of analysts' estimates.³⁵⁰ For the first time in nearly seven years, analysts inaccurately estimated Cisco's earnings.

Part of the reason for the analysts' inaccuracy can be attributed to the new Regulation FD regime. Cisco's stellar track record for meeting analysts' expectations can be partially attributed to Cisco executives providing regular earnings guidance to analysts, a process that has been smothered with the advent of Regulation FD.³⁵¹

Analysts are not only receiving less material information, they are waiting longer to receive information they seek.³⁵² Instead of directly calling a specific corporate executive to get sales estimates or earnings information, analysts listen in on conference calls and wait their turn to ask a question of management.³⁵³ This new process "has become excruciatingly painful."³⁵⁴ Analysts will listen to conference calls for two, three, and four hours sifting through corporate minutiae, looking for information they need and waiting to ask questions.³⁵⁵ For Wall Street professionals, the widely accessed conference calls are rapidly becoming a major frustration.

In the past, analysts coped with same-day conference calls; however, the calls ran shorter because fewer analysts had access, and there were not as many basic issues discussed.³⁵⁶ Previously, analysts would ask the less-relevant, basic questions in private phone conversations later with corporate management.³⁵⁷ Yet under the current Regulation FD disclosure scheme, company management is prevented from offering new material information in such private phone conversations.³⁵⁸ Instead of

347. See Zuckerman, *supra* note 305.

348. *Id.*

349. *Id.* Part of the reason for Cisco's performance in meeting or exceeding analysts' expectations can be attributed to "browbeat[ing]" one-on-one phone calls between analysts and company executives. Because back-channel "browbeating" is no longer an option under Regulation FD, companies such as Cisco will no longer be able to "walk down the Street" in the same manner. See Adam Lashinsky, *Reg FD Works: Nortel Provides Evidence* (Nov. 2, 2000), at <http://www.thestreet.com/comment/siliconstreet/1153533.html>.

350. Zuckerman, *supra* note 305.

351. *Id.* The impact of this case will be further examined with respect to individual investors in Part IV.B. of this Article.

352. Jeff D. Opdyke & Emily Nelson, *Conference-Call Crunch: New SEC Rule Turns Analysts' Rite into a Hectic Affair*, WALL ST. J., Oct. 31, 2000, at C1.

353. *Id.*

354. *Id.*

355. *Id.*

356. *Id.*

357. *Id.* See McGough & Bryan-Low, *supra* note 336.

358. Regulation FD, 17 C.F.R. § 243.101(e) (2000); Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts 240, 243, and 249).

one forty-five minute conference call discussing big strategic questions and market-moving information, analysts are spending half of the day listening in on less relevant information.³⁵⁹

The daily operations of an accomplished Silicon Valley equity analyst depicts the microeffect of Regulation FD on market professionals. Arriving at his office in downtown San Francisco, the analyst prepares to listen in on earnings conference calls from 5:30 A.M. until 12:15 P.M.³⁶⁰ The day before, the analyst and two associates developed a plan for covering six conference calls that are likely to overlap.³⁶¹ Ultimately, the calls do overlap and the analyst and his two associates scramble to cover all six calls, making snap judgments as to “which one is more important.”³⁶² On one conference call, the company’s CEO jokingly remarks that there were fifteen people in the room advising him on what to say.³⁶³ After seven hours of listening in on conference calls, and several hours of drafting research reports and phoning clients, the analyst’s day under the Regulation FD regime is over.³⁶⁴ Approximately six hours later it will start again. The following is a day in the life of the analyst under Regulation FD:

- 3:30 A.M. Crawls out of bed at home in Novato, Calif[ornia]. Leaves home at 4:10 A.M. to drive about 35 miles to San Francisco.
- 4:55 A.M. Morning meeting, reiterates strong buy on Kimberly-Clark.
- 5:30 A.M. – 6:30 A.M. Tupperware conference call. While on the call, also fields calls from clients and Banc of America salespeople. Disconnects early for the next call.
- 6 A.M. Estee Lauder conference call . . . disconnects early but his associate stays on.
- 7 A.M. Kimberly-Clark conference call. Disconnects early but another associate stays on.
- 8 A.M. Colgate-Palmolive conference call.
- 9:15 A.M. – 10 A.M. Calls clients and salespeople and confers with associates to swap details from the parts of calls each missed.
- 10 A.M. Dial conference call.
- 11 A.M. – 12:15 P.M. Newell conference call.
- 1 P.M. Walks to the deli across the street for a sandwich to eat at his desk.
- Afternoon. Calls clients. Revises earnings models, confers with associates about reports he’ll e-mail to clients the next morning.
- 6:30 P.M. Finishes all five reports.
- 7 P.M. Records a ‘blast voice mail,’ a message to about 350 clients.
- 7:15 P.M. Leaves the office.
- 8 P.M. Has dinner with his wife . . . , reads a few reports on the companies

359. Opdyke & Nelson, *supra* note 352; see also Unger, *supra* note 333.

360. Opdyke & Nelson, *supra* note 352.

361. *Id.*

362. *Id.*

363. *Id.*

364. *Id.*

that will report earnings the next day.³⁶⁵

Proponents of Regulation FD “argue that analysts will just have to work harder on researching their reports.”³⁶⁶ There is no doubt that analysts’ workloads will increase. The days of informal calls to the CFO seeking financial data and earnings guidance have come to a screeching halt under Regulation FD.³⁶⁷ Corporate executives are refusing to talk to analysts privately and instead are releasing a lot of unimportant information via publicly accessible conference calls and webcasts.³⁶⁸

Analysts no longer have the time to research alternative methods of valuing companies; instead, they are under increasing pressure to spend inordinate amounts of time listening in on corporate conference calls and webcasts.³⁶⁹ In response to the new regulatory environment, research studies have shown the accuracy of analysts’ estimates are decreasing and the ranges are increasing.³⁷⁰ Summarizing the impact of Regulation FD on market professionals, one commentator offered that Regulation FD does nothing but “drive a stake in the heart of the analyst.”³⁷¹

IV. THE EFFECTS ON MAIN STREET AND THE ORDINARY INVESTOR

The bull market³⁷² run of the 1990s has been one of the longest and most dramatic growth phases in the history of the stock market.³⁷³ This great bull market, which began in August 1982, has provided returns that are approximately twice the historical average.³⁷⁴ Extraordinary returns earned by Main Street investors have raised expectations to levels that are far beyond what equities have earned in the past and beyond what they are likely to earn in the future.³⁷⁵ The influx of Main Street investors has basked in prosperity due to the great advances in market averages.³⁷⁶

An examination of the historical returns of the stock market, for the period from

365. *Id.*

366. Unger, *supra* note 333.

367. Hill, *supra* note 275; *see also* Colter *supra* note 336.

368. *Id.*; *see also* Opdyke & Nelson, *supra* note 352.

369. Colter, *supra* note 336.

370. *See* McGough & Bryan-Low, *supra* note 336. The BulldogResearch study found that the actual accuracy of analysts’ estimates decreased 5.3 percent, and the range of estimates has grown more dispersed by 13.67 percent. *Id.*

371. Hill, *supra* note 275.

372. Bull market is defined as a “prolonged rise in the prices of stocks, bonds, or commodities.” BARRON’S DICTIONARY OF FINANCE AND INVESTMENT TERMS 69 (5th ed. 1998). “Bull markets usually last at least a few months and are characterized by high trading volume.” *Id.*

373. Gabrielle Gutierrez & Guy Moszkowski, CFA, *Trading Up: The Equity Markets and the New World of Electronic Trading*, EQUITY RESEARCH: UNITED STATES (SalomonSmithBarney), Oct. 5, 1999, at 5.

374. Jeremy J. Siegel, *Managing Your Expectations for Long-Term Success in the Stock Market* (2000), at http://www.siainvestor.com/html/managing_expectations.html.

375. *Id.*

376. *See id.*

1802 through 1998, reveals that the compounded annual return was 8.5 percent.³⁷⁷ During the modern financial era, from 1926 to 1998, the total annual compound return was 10.7 percent.³⁷⁸ Taking into consideration the depression-era stock market of the 1930's, and looking at just the period following World War II (1946 to 1998), the total return was 12.3 percent.³⁷⁹ Most recently, in a string of three consecutive years—1995 to 1997—the Dow Jones Industrial Average (“DJIA”)³⁸⁰ recorded gains of 36.9 percent, 28.9 percent, and 24.9 percent, respectively.³⁸¹ And, in 1998 the DJIA rose another 18.1 percent.³⁸² Due to this performance, American equity markets now serve “as the foundation and engine for *individual* [investor] savings and wealth creation.”³⁸³

Individual stock ownership in the United States has increased dramatically throughout the 1990s.³⁸⁴ The number of individual investors holding equities either directly, through mutual funds, through supplemental retirement accounts, or through defined contribution plans continues to increase.³⁸⁵ Currently, 51.8 percent of all individuals who are household heads, or spouses of household heads, own stock.³⁸⁶ This is the first time—since statistical information concerning individual investor trends has been recorded—that this proportion of shareownership exceeds 50 percent.³⁸⁷ The number of Main Street shareholders increased by approximately 15 million between 1995 and 1998.³⁸⁸ At the end of 1998, 33.8 million individual investors owned stock directly, 26.8 million owned stock through an equity mutual fund, 33.9 million owned stock through a self-directed retirement account, and 48.3

377. *Id.* Economist and Professor of Finance, Jeremy Siegel, calculated these figures from information gathered in a study of stock returns since 1802. *See id.*

378. *Id.*

379. *Id.*

380. The Dow Jones Industrial Average is a “price-weighted average of 30 actively traded [blue chip] stocks, primarily industrials like Alcoa, General Motors, and IBM but including American Express, Coca-Cola, McDonald’s, . . . , Walt Disney and other service-oriented firms. Prepared and published by Dow Jones & Co., it is the oldest and most widely quoted of all the market indicators.” BARRON’S DICTIONARY OF FINANCE AND INVESTMENT TERMS 595 (5th ed. 1998).

381. Siegel, *supra* note 374.

382. *Id.*

383. Letter from Richard A. Grasso, Chairman, New York Stock Exchange, to the public (Feb. 14., 2001), at <http://nyse.com/marketinfo/chairmanletter.html>.

384. *See* New York Stock Exchange, *Shareownership in the Late 1990s: Evidence From the Survey of Consumer Finances*, available at <http://nyse.com/marketinfo/study1.html> (“The Survey of Consumer Finances [“SCF”] is an ongoing survey conducted by the Survey Research Center at the University of Michigan on behalf of the Federal Reserve Board.”).

385. *Id.* The SCF shows that there were 84.0 million individual shareowners in 1998. “This represents a 21% increase from 69.3 million in 1995 and, a 61% increase from 52.3 million in 1989.” *Id.*

386. *Id.*

387. *Id.*

388. *Id.*

million owned stock through a defined contribution plan.³⁸⁹ In sum, the last decade has provided for the most substantial expansion of shareholder population in market history—a trend that is likely to extend into the foreseeable future.³⁹⁰

The dramatic increase in the number of individual investors has led to the contention that “Wall Street and Main Street [have become] one in the same.”³⁹¹ With the insurgence of Main Street market participants and the high-growth bull market environment, in 1994 through 1998, “the average annual share volume growth on the NASDAQ and NYSE was 28 percent and 23 percent, respectively.”³⁹² Online and discount brokers have provided individual investors quick and cost-effective means of accessing equity markets. The average retail broker commission in 1994 was about \$280 per trade.³⁹³ In 1999, the average retail broker commission was less than \$70, with the deepest discounts offered by online services reaching as low as \$7 per trade.³⁹⁴ Competition among broker-dealers and the growth of online brokers have

389. *Id.* According to the SCF:

The “grand total” number of individuals who own stock is less than the sum of the number who own stock in each way. For example, while 33.8 million individuals own stock directly and 26.8 million own stock through equity mutual funds held outside retirement plans, the total number of stockholders who owned stock *either* directly or through equity mutual funds was 48.5 million. . . . This total reflects the fact that of the 26.8 million equity mutual fund owners, 12.1 million also owned stock directly. The total number of shareholders owning stock in either way was therefore $33.8 + 26.8 - 12.1 = 48.5$ million.

The incremental number of shareowners who own stock through self-directed retirement plans . . . is 27.3 million, even though 39.9 million owned equity through some form of self-directed retirement plan. This reflects the overlap of 6.6 million individuals who owned stock through a self-directed retirement plan and also held stock directly, or through an equity mutual fund, or through both of these alternative channels.

Finally, the incremental number of individuals who own stock through a defined contribution retirement plan, . . . is 8.2 million. This *incremental* value is low, even though 48.3 million individuals held some equity through defined contribution plans, because of the substantial overlap between those who hold equity through this channel and through the other channels considered

Id.

390. *Id.* The following four factors suggest that the recent market growth will continue for the foreseeable future: (1) the increase in the availability of self-directed retirement accounts; (2) the rapid growth in the number of equity mutual funds; (3) stock options are becoming increasingly common in compensation packages; and (4) the aging and increasing life span expectancies of the U.S. population. *Id.*

391. Grasso, *supra* note 383 (“Today, half of all shareholders have annual family incomes of less than \$57,000.”).

392. Gutierrez & Moszkowski, *supra* note 373, at 5.

393. *Id.* at 6.

394. *Id.*

made it cheaper for increasing numbers of Main Street investors to take on Wall Street. Moreover, the SEC's new Regulation FD has leveled the playing field further by granting Main Street access to material corporate information on an equal footing with Wall Street.³⁹⁵

But, is the adoption of Regulation FD a positive or negative change for Main Street investors? Former SEC Chairman Arthur Levitt was the driving force against the practice of selective disclosure.³⁹⁶ His sustained crusade to implement Regulation FD was prompted by a number of press reports released between 1995 and 1999.³⁹⁷ Levitt's victory has granted Main Street the right to access corporate information at the same time as Wall Street.³⁹⁸ The initiative of Regulation FD is to democratize the investment process and include Main Street while eliminating the situations where Wall Street wields the power of information.³⁹⁹

The SEC's preoccupation with Main Street is evidenced by Levitt's opening comments the day Regulation FD was adopted:

High quality and timely information is the lifeblood of strong, vibrant markets. It is at the core of investor confidence. But when that information is used to profit at the expense of the investing public, when that information comes by way of favored *access* rather than by acumen, insight, or diligence, we must ask, "Whose interest is *really* being served?"⁴⁰⁰

Acknowledging that every investor should be provided access to the same information in order to maintain equitable markets, the query remains whether Regulation FD is the most efficient mechanism to achieve such objectives.

A. Positive Effects

During the SEC's comment period for Regulation FD, many Main Street "investors expressed frustration with the practice of selective disclosure, believing that it place[d] them at a disadvantage in the market."⁴⁰¹ Other comments provided that today's individual investor does not rely solely on research and analysis

395. See Regulation FD, 17 C.F.R. §§ 243.100-103 (2000); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

396. Michael Schroeder & Randall Smith, *Disclosure Rule Cleared by the SEC*, WALL ST. J., Aug. 11, 2000, at C1.

397. *Id.*; see also Pulliam, *supra* note 331; Pulliam & McWilliams, *supra* note 331; Randall Smith, *Conference Calls to Big Investors Often Leave Little Guys Hung Up*, WALL ST. J., June 21, 1995, at C1.

398. See 17 C.F.R. §§ 243.100-103; see also Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716.

399. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716; see also Levitt, *supra* note 1.

400. Levitt, *supra* note 1 (emphasis in original). "[I]nvestor interests have conditioned every decision made by this Commission since 1993." *Id.*

401. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717.

performed by Wall Street professionals as was common in the past.⁴⁰² Clearly, with the progression in information technology, specifically the Internet, individual investors have greater access to corporate information than ever before.⁴⁰³ The explosion of popularity in the stock market has increased the demand and expectation for the direct delivery of information to Main Street.⁴⁰⁴ With the adoption of Regulation FD, individual investors have won access to the release of material corporate information at the same time that Wall Street professionals gain access.⁴⁰⁵ The impact on Main Street is *positive* in that all investors—no matter how big or small—have access to the same material information at the same time, thereby leveling the “battlefield.”⁴⁰⁶

It is the SEC’s position that Regulation FD will benefit individual investors by providing fairness in securities markets as a whole.⁴⁰⁷ The practice of selective disclosure, in itself, damages investor confidence in the fairness and integrity of securities markets.⁴⁰⁸ “When selective disclosure leads to trading by the recipients of the disclosure or trading by those whom these recipients advise, the practice bears a close resemblance to ordinary ‘tipping’ and insider trading.”⁴⁰⁹ The economic impact of insider trading and selective disclosure is essentially one and the same.⁴¹⁰ In both practices, a select group gains an informational advantage and subsequently uses that advantage to profit at the expense and detriment of the uninformed.⁴¹¹ A recent study found evidence that private analyst conference calls (also referred to as one-on-ones) with issuers were directly associated with increased return volatility, trading volume,

402. *Id.* at 51,717 n.10.

403. With the revolutionary gain in popularity the stock market has realized, individual investors have been bombarded with twenty-four hour television news programs, media commercials and print advertisements, and online Web sites, all of which educate investors and facilitate market investments. *Id.*

404. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717.

405. *See* Regulation FD, 17 C.F.R. §§ 243.100-.103 (2000); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715.

406. *See* Smith, *supra* note 328. Specifically, SEC Chairman Arthur Levitt has stated that “he didn’t think investors need analysts to interpret news such as earnings ‘guidance’ from a company.” *Id.*

407. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731.

408. *Id.* The most often referenced example of disclosure is that of Abercrombie & Fitch (“A&F”). In October of 1999, a high ranking executive officer at A&F allegedly informed an analyst at Lazard Freres (one of A&F’s underwriters in its 1996 Initial Public Offering), that third-quarter sales figures were going to be lower than expected. Over the next three days Lazard Freres allegedly informed clients of the sales figures and advised them to sell their shares in A&F. During that time the stock price fell 15% and A&F did not report the news. Five days later A&F issued a press release highlighting the shortfall in sales figures. *See* Pulliam, *supra* note 331, at C1.

409. *Id.* *See generally* United States v. O’Hagan, 521 U.S. 642, 649-66 (1997) (presenting the misappropriation theory of insider trading); Dirks v. SEC, 463 U.S. 646, 655-64 (1983) (presenting the “tipping” theory of insider trading).

410. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731.

411. *Id.*

and trade size.⁴¹² These results have been interpreted to suggest that material information was provided in analyst conference calls and that large investors likely took advantage of the selectively disclosed information.⁴¹³ Therefore, it is plausible that individual investors equate selective disclosure with insider trading and thus question the integrity and fairness of the markets.⁴¹⁴

The *specific* harm to individual investors resulting from selective disclosure is highlighted in empirical studies that have shown that transaction costs increase when select market participants possess material nonpublic information.⁴¹⁵ In response, however, Regulation FD works to diminish selective disclosure and benefit individual investors through reducing trading costs.⁴¹⁶ Further market studies have shown that insider trading and selective disclosure reduce liquidity⁴¹⁷ and increase volatility⁴¹⁸ to the detriment of uninformed traders.⁴¹⁹ The SEC is cognizant of the preceding detrimental effects that selective disclosure may have on individual investors and has

412. Richard Frankel et al., *An Empirical Examination of Conference Calls As a Voluntary Disclosure Medium*, 37 J. ACCT. RES. 133, 143-55 (1999).

413. *Id.* at 154-66. Other commentators have disputed the reliability of the assumptions in this study; however, the SEC believes the assumptions are reasonable. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731 n.144.

414. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716.

415. Lawrence R. Glosten and Paul R. Milgrom, *Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders*, 14 J. FIN. ECON. 71 (1985); see also Itzhak Krinsky & Jason Lee, *Earnings Announcements and the Components of the Bid-Ask Spread*, 51 J. FIN. 1523, 1524-27 (1996); Albert S. Kyle, *Continuous Auctions and Insider Trading*, 53 ECONOMETRICA 1315, 1316 (1985); Charles M.C. Lee et al., *Spreads, Depths and the Impact of Earnings Information: An Intraday Analysis*, 6 REV. FIN. STUD. 345, 353-55 (1993).

416. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731.

417. With respect to securities markets, *liquidity* is defined as the:

ability to buy or sell an asset quickly and in large volume without substantially affecting the asset's price. Shares in large blue-chip stocks like General Motors or General Electric are liquid, because they are actively traded and therefore the stock price will not be dramatically moved by a few buy or sell orders. However, shares in smaller companies with few shares outstanding, or commodity markets with limited activity, generally are not considered liquid, because one or two big orders can move the price up or down sharply. A high level of liquidity is a key characteristic of a good market for a security or a commodity.

BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 329 (5th ed. 1998).

418. With respect to securities markets, *volatility* is defined as a "characteristic of a security, commodity, or market to rise or fall sharply in price within a short-term period."

BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 691 (5th ed. 1998).

419. See Michael J. Fishman & Kathleen M. Hagerty, *Insider Trading and the Efficiency of Stock Prices*, 23 RAND J. ECON. 106, 107-18 (1992); see also Kyle, *supra* note 415, at 1315-17; Michael Manove, *The Harm from Insider Trading and Informed Speculation*, 104 Q. J. ECON. 823, 828-35 (1989).

provided Regulation FD in retort.⁴²⁰ The intention of Regulation FD is to positively benefit Main Street investors by curtailing the practice of selective disclosure—thereby increasing liquidity, reducing volatility, and reducing the overall cost of trading.⁴²¹

It is the view of the SEC, the Supreme Court, and Congress that individual investors will lose confidence in the integrity of securities markets that they believe are unfairly rigged against them.⁴²² The loss in confidence, therefore, is likely to hurt the market performance due to individual investors' unwillingness to infuse capital into a corrupt system. If these investors believe the market to be systematically populated with participants trading on the basis of selectively disclosed information, a percentage of individual investors will refrain from trading to avoid informational disadvantages.⁴²³ Thus it appears that the practice of selective disclosure damages investor confidence in the fairness and integrity of the markets and subsequently injures Main Street investors by creating an inequitable atmosphere that discourages investment.⁴²⁴

Regulation FD embodies the philosophy that securities markets, to be efficient, must be free and democratic. Rather than a trickle-down approach from issuers to analysts to Main Street, Regulation FD attempts to eliminate the informational advantage Wall Street professionals have over individual investors.⁴²⁵ With the emergence and progression of online investing through the use of such mechanisms as Alternative Trading Systems ("ATSs")⁴²⁶ and the Small Order Execution System

420. Regulation FD, 17 C.F.R. § 243.100-.103 (2000); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731; Levitt, *supra* note 1.

421. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731.

422. *United States v. O'Hagan*, 521 U.S. 642, 658-59 (1997); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716-17; H.R. REP. NO. 100-910 at 8 (1988), *reprinted in* 1998 U.S.C.C.A.N. 6043, 6045 ("The investing public has a legitimate expectation that the prices of actively traded securities reflect publicly available information about the issuer of such securities. . . . [T]he small investor will be—and has been—reluctant to invest in the market if he feels it is rigged against him."); *see also* Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 355-57 (1979).

423. *See* Barbara Bader Aldave, *Misappropriation: A General Theory of Liability for Trading in Nonpublic Information*, 13 HOFSTRA L. REV. 101, 121-24 (1984).

424. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716-17, 51,731.

425. *Id.* at 51,716; Molly Williams & Robert McGough, *New Disclosure Rules Mean More Legwork Ahead for Analysts*, WALL ST. J., Sept. 25, 2000, at C1.

426. ATSs, which include Electronic Communication Networks ("ECNs"), can be defined as "quasi-stock exchanges that electronically match orders and provide low-cost and fast executions." Gutierrez & Moszkowski, *supra* note 373, at 3. "Established [ECNs] such as Instinet and POSIT have been around for years, but new systems have recently emerged with the rise in trade volumes, new technological advancements, and favorable SEC regulations promoting exchange modernization." *Id.*; *see also* NSDA Rule Making: SuperMontage Release No. 34-43863, 66 Fed. Reg. 8020 (Jan. 26, 2001); *see also* Alex Frew McMillan, *SEC OKs SuperMontage: Approve NASDAQ Plan to Display Best Buy and Sell Orders, Including Prices from ECNs*, CNNFN, Jan. 10, 2001, at

("SOES"),⁴²⁷ individual investors are increasingly utilizing direct access to the markets.⁴²⁸ The contention is that today's individual investor—who utilizes the increasing number of resources provided for making and executing investment decisions—is a more educated investor.⁴²⁹ Accordingly, Regulation FD recognizes the advancement in individual investors' acumen and operates to eliminate information gatekeepers who simply regurgitate information that has been selectively disclosed to them.⁴³⁰

Presented with the similarities between selective disclosure and insider trading, the SEC believes that Regulation FD will provide individual investors benefits that are similar to those provided by insider trading regulations.⁴³¹ Regulation FD is designed to promote fair disclosure of information to all investors, and increase Main Street's confidence in market integrity.⁴³² By enhancing investor confidence in securities markets, Regulation FD will encourage widespread individual investor participation, enhance market efficiency, increase liquidity, and decrease volatility.⁴³³ The SEC has "bet the store"⁴³⁴ that Regulation FD will work to benefit Main Street investors by placing them on equal footing with Wall Street professionals with respect to access of material corporate information.⁴³⁵

http://money.cnn.com/2001/01/10/investing/wires/super_wg/.

427. SOES is defined as the "computerized *Small Order Entry (or Execution) System* used by NASDAQ, in which orders for under 1000 shares bypass brokers and are aggregated and executed against available firm quotes by market makers on the NASDAQ system." BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 574 (5th ed. 1998) (emphasis in original).

428. HARVEY I. HOUTKIN & DAVID WALDMAN, SECRETS OF THE SOES BANDIT: THE ORIGINAL ELECTRONIC TRADER REVEALS HIS BATTLE-TESTED TRADING TECHNIQUES 1-10 (1998).

429. *See id.* Attitudes towards the financial markets have changed in the recent past. Individual investors used to rely heavily on financial professionals as intermediaries when making investment decisions. Today, through the barrage of stock market propaganda, there is a festering attitude that "housewives and truck drivers" can compete with Wall Street professionals. *See id.* at 1-24. Currently, there are even individual investors paying \$5,000 apiece to take a four-week trader training course. "The trend is your friend. Trade with your head, not with your heart. Don't chase stocks." These are the catch phrases that are being spewed to educate individual investors in preparation for competition with Wall Street professionals at firms like Merrill Lynch. Alex Frew McMillan, *What It Takes to Trade: At All-Tech, It's Money, and the Feeling You're Smarter than the Rest*, CNNFN, Sept. 1, 1999, at http://money.cnn.com/1999/09/01/investing/daytrade_class/.

430. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,717.

431. *Id.* at 51,731.

432. *Id.* at 51,716-17, 51,731; *see also* Levitt, *supra* note 1.

433. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,731.

434. Unger, *supra* note 333.

435. *Id.*; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716-17; Michael Schroeder & Randall Smith, *Disclosure Rule Cleared by the SEC*, WALL ST. J., Aug. 11, 2000, at C1.

B. Negative Effects

Although the SEC has “bet the store” that Regulation FD will work, Acting Chairman Laura Unger has “bet her house”⁴³⁶ that it will not.⁴³⁷ The SEC intends Regulation FD to benefit individual investors by limiting the practice of selective disclosure and creating a level playing field.⁴³⁸ However, it is possible that the negative impact of Regulation FD will offset the positive effects that individual investors perceive.⁴³⁹ In analyzing the efficiency of securities markets, the fundamental concept of the Efficient Capital Market Hypothesis (“ECMH”)⁴⁴⁰ provides that securities traded in primary markets absorb—and reflect in their prices—new information with great speed and accuracy.⁴⁴¹ Applying the ECMH, it is plausible to conclude that Regulation FD creates a façade of market efficiency and integrity while in effect it works against individual investors’ best interests.

The most frequently referenced concern is that Regulation FD will have a chilling effect on the disclosure of information by issuers.⁴⁴² The practical problem arises because issuers are unable to determine when information is subject to Regulation FD and thus they scale back their disclosure.⁴⁴³ Rather than making judgment calls about whether the disclosure of information would be material,⁴⁴⁴ an issuer is more likely to withhold the information in order to avoid potential liability.⁴⁴⁵ Moreover, companies that do not wish to talk with analysts can use Regulation FD as a means to delay the release of information.⁴⁴⁶ The chilling effect that Regulation FD has on

436. Unger, *supra* note 333.

437. *Id.*

438. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,716-17.

439. *See id.* at 51,716-18; *see also* Unger, *supra* note 333.

440. The ECMH is a widely debated theory that security prices in primary markets reflect all *available* information about a given security with such speed that even sophisticated investors cannot profit from trading on newly available information. The ECMH holds that security prices in primary markets fully reflect all available information. Specifically, “prices act as if everyone knows the information.” William H. Beaver, *Market Efficiency*, 56 ACCT. REV. 23, 35 (1981) (emphasis in original); *see also* Basic, Inc. v. Levinson, 485 U.S. 224, 246 (1988); Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 550-55 (1989); Marvin G. Pickholz & Edward B. Horahan, *The SEC’s Version of the Efficient Market Theory and Its Impact on Securities Law Liabilities*, 39 WASH. & LEE L. REV. 943, 947-49 (1982).

441. Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 770-72 (1985).

442. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718; *see also* Judith Burns, *Impact of SEC Fair Disclosure Rule Still Debated*, DOW JONES NEWS SERV., January 25, 2001, available at <http://www.ccbn.com/regulationfd/20010125.html>.

443. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718.

444. Under Regulation FD, the issuer will have to make the determination whether a piece of information is material and therefore subject to the regulation. Regulation FD, 17 C.F.R. § 243.100 (2001).

445. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,718.

446. Unger, *supra* note 333.

issuers negatively impacts Main Street because less absolute disclosure makes for fewer informed investment decisions.⁴⁴⁷ If Regulation FD limits the practice of selective disclosure, but in so doing makes all investors less knowledgeable about companies' performance, it will not create fairer, more efficient markets.

In examining the early impact of Regulation FD in regard to its actual chilling effect, a recent survey shows that a great majority of public companies have made policy and procedural adjustments.⁴⁴⁸ Most notably, many companies responded that "they are no longer giving earnings guidance between quarters."⁴⁴⁹ When companies clam-up between quarters, and refuse to give guidance to the market, individual investors are deprived of information that may affect their portfolio's performance. One corporate officer explained, "[W]e are no longer answering questions about how the quarter is going or whether or not we are tracking to guidance."⁴⁵⁰ In the early stages of Regulation FD's existence, there is evidence of a chilling effect on the disclosure of information.⁴⁵¹ Issuers are cautious when making decisions concerning the disclosure of information due to the fear of becoming the SEC's poster child for the enforcement of Regulation FD violations. Consequently, Regulation FD has chilled the flow of information that reaches Main Street.

The chilling effect eliminates the trickle-down dissemination of information that was previously filtered through analysts to Main Street investors.⁴⁵² Wider ranges of earnings forecasts and greater volatility in stock prices demonstrate the direct impact of these self-imposed quiet periods.⁴⁵³ Under Regulation FD, corporate officials are encouraged to remain silent "until they absolutely have to speak."⁴⁵⁴ Subsequently,

447. See Burns, *supra* note 442.

448. A survey conducted by Thomson Financial/Carson Global Consulting of companies spread across industries and market capitalization found that 81 percent of issuers have made policy and procedural changes in response to Regulation FD. Lipschutz, *supra* note 274. Another survey shows that 90 percent of companies have made or are planning to make policy and procedural changes regarding the release of information. Staff and Wire Reports, *Investors Earn Fair Access: Fair Disclosure Requires Companies to Give Public Same Data As Investors*, CNNFN, Oct. 23, 2000, at <http://money.cnn.com/2000/10/23/markets/disclosure/index.htm>.

449. Lipschutz, *supra* note 274. Regulation FD does not forbid giving earnings guidance as long as the issuer, or any person acting on its behalf, publicly discloses any material nonpublic information regarding that issuer or its securities simultaneously, in the case of an intentional disclosure, and promptly, in the case of a non-intentional disclosure. 17 C.F.R. § 243.100.

450. Lipschutz, *supra* note 274. Another corporate officer stated: "We have discontinued quarterly previews. Each [publicly accessible] quarterly conference call includes earnings guidance for the next quarter and for the current year, and no earnings guidance is given between conference calls." *Id.*

451. *Id.*; see also McGough & Bryan-Low, *supra* note 336; Scott Bernard Nelson, *Share and Share Alike: The SEC Aims for Fairer Distribution of Information to All Investors*, BOSTON GLOBE, Nov. 12, 2000, at XX; Plitch, *supra* note 339.

452. See Hill, *supra* note 275.

453. *Id.*; see also McGough & Bryan-Low, *supra* note 336.

454. Unger, *supra* note 333.

when they do speak, the disclosure is released to the marketplace as a whole rather than being filtered down through information channels.⁴⁵⁵ While Regulation FD provides for a democratic approach to the dissemination of information,⁴⁵⁶ it also provides a high probability of earnings uncertainty, market surprises, and increased volatility, all of which are contrary to an efficient market.⁴⁵⁷

Because Regulation FD prohibits issuers from offering private guidance to analysts—guidance which in turn is filtered throughout the market—the result is likely to be less accuracy in analysts' reports and more earnings surprises.⁴⁵⁸ Instead of slowly leaking information into the market and allowing for a gradual price adjustment, the broad public dissemination acts as a bombshell on stock prices.⁴⁵⁹ With all investors responding to earnings forecasts and public releases at the same time, the markets will suffer from more severe price swings.⁴⁶⁰ Individual investors will be tempted to buy or sell at inopportune times, thereby executing at increased trading costs due to excessive volatility.⁴⁶¹ The direct harm to Main Street is that individual investors may get caught in sudden price swings and suffer personal losses from trading at inappropriate times.⁴⁶²

Specific examples of Regulation FD creating an environment susceptible to increased price volatility include Intel's recent one-day 22% (September 22, 2000) decline in share price.⁴⁶³ Other examples of increased volatility and severe price swings due to Regulation FD's public disclosure requirements include: Home Depot (29% decline on October 12, 2000); Globalstar (60% decline on October 30, 2000); VA Linux (42% decline on November 6, 2000); and Ann Taylor (30% decline on November 30, 2000).⁴⁶⁴ When companies issue broad press releases warning of earnings shortfalls—which have not previously been filtered into the market by analysts—a barrage of short-term selling is certain to occur.⁴⁶⁵ Furthermore, rumors concerning earnings performance announcements could fester and cause volatility to remain extended.⁴⁶⁶ This negatively affects Main Street because individual investors can get stuck selling stock (which later rebounds) under value, thereby decreasing

455. *Id.*

456. Regulation FD, 17 C.F.R. § 243.100 (2000); Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716-18 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249).

457. Williams & McGough, *supra* note 425.

458. Erin E. Arvedlund, *Cost of Openness: Reg. FD Could Raise Option Prices*, BARRON'S, Oct. 30, 2000, at 63.

459. Hill, *supra* note 275.

460. Alex Frew McMillan, *Reg FD's Fallout: Access to Company Guidance Will Be Good in the Long Run. Short-term Unclear*, CNNFN, Nov. 14, 2000, at http://money.cnn.com/2000/11/14/investing/q_regfda/index.htm.

461. *Id.*

462. Hill, *supra* note 275; Lipschutz, *supra* note 274.

463. Unger, *supra* note 333.

464. Shilling, *supra* note 282, at 152 (arguing that analysts failed to predict volatility even before the enactment of Regulation FD).

465. *See* Hill, *supra* note 275.

466. *Id.*

investment income.

Expanding upon the example of Cisco's recent failure to meet analysts' earnings forecasts (examined in Part III.B of this Article⁴⁶⁷), this failure also represents an example of increased volatility arising from Regulation FD's prohibition against issuers "walking the Street down."⁴⁶⁸ On February 7, 2001, the day that Cisco announced fourth quarter earnings a penny short of estimates, the stock fell 13 percent.⁴⁶⁹ In addition, "its trading was frenzied: Cisco's share volume topped 279.3 million shares, the second-heaviest day ever for a NASDAQ issue."⁴⁷⁰ The record for the heaviest day ever is held by Intel, with 308.7 million shares traded on September 22, 2000 (the same day as the aforementioned 22% decline in Intel's share price).⁴⁷¹ This evidence supports the theory that companies, which now divulge information to a wide public audience in compliance with Regulation FD, spark volatility in trading activity to the detriment of individual investors. Main Street is at a disadvantage because large institutional traders are more likely to have the resources to respond more rapidly and efficiently to the increase in market volatility.⁴⁷²

A subsequent concern is that individual investors are not equipped to interpret corporate information that has not been processed by Wall Street professionals.⁴⁷³ Now that Main Street has gained the right to equal access of material information, individual investors are now forced to perform the tasks of professional analysts.⁴⁷⁴ It is possible that this effect of Regulation FD will lead Main Street to react before the information has been placed in the proper context. Under Regulation FD, issuers will disseminate material information to the market as a whole, absent the benefit of analysts ferreting out and processing its relevance.⁴⁷⁵ An individual investor, for example, may believe that a company raising prices is a positive sign. However, most analysts would immediately inquire whether the company was attempting to offset rising costs.⁴⁷⁶ Critics of Regulation FD warn that individual investors are likely to

467. See *supra* text accompanying notes 340-43.

468. Cisco's stellar track record for meeting analysts' expectations can be partially ascribed to Cisco executives' practice of providing regular earnings guidance to analysts, a process that has been smothered with the advent of Regulation FD. Until the fourth quarter of the year 2000, Cisco had met or slightly exceeded analysts' earnings expectations for almost seven straight years. Unfortunately, when Cisco reported their fourth quarter earnings, they fell short of the consensus of analysts' estimates. See Zuckerman, *supra* note 305, at C1.

469. *Id.* at C1, C9 (stating that Cisco's fourth quarter earnings "came in at 12 cents a diluted share, a penny short of estimates").

470. *Id.* at C1.

471. *Id.*; see also Shilling, *supra* note 282, at 152.

472. McMillan, *supra* note 460.

473. See Staff and Wire Reports, *supra* note 448; Unger, *supra* note 333.

474. Unger, *supra* note 333 ("Discussing the role of analysts, the Supreme Court noted in *Dirks* that '[i]t is the nature of [analysts'] judgments about companies and their securities, 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.' Yet Regulation FD seeks to accomplish exactly that result.").

475. *Id.*

476. See Hill, *supra* note 275.

get tangled in volatile price swings and execute trades at inappropriate times or on misunderstood information.⁴⁷⁷

Many have commented that individual investors no longer need analysts and market professionals to interpret corporate information.⁴⁷⁸ Alternatively, many others hold that analysts play an important role by digesting and placing in context corporate information, and acting as conduits in the flow of information to the individual investor.⁴⁷⁹ Considering individual investors' recent returns in the prosperous bull market,⁴⁸⁰ it seems as though Main Street is making wise investment decisions.⁴⁸¹ Since 1991, for example, the average individual investor's annual return has ranged from 11.4 % to 17.9 %.⁴⁸² This performance record justifies the conclusion that individual investors no longer need interpreters to act as gatekeepers of corporate information.⁴⁸³ However, an alternative interpretation may attribute individual investors' success to the overall bull market run of the 1990s, rather than to their own skill and astuteness in interpreting corporate information.⁴⁸⁴ Obviously, during the most prosperous growth phase in market history, individual investors were capable of making profitable investment decisions.⁴⁸⁵ However, working within the Regulation FD environment, are individual investors capable of making efficient decisions in a downturn, bear market⁴⁸⁶ economy, absent professional analysts to ferret out, analyze, and report relevant information?

It seems likely that Main Street's ability to decipher corporate data would suffer in deteriorating market conditions—especially in a bear market—without the analytical assistance of Wall Street professionals. The simple and powerful explanation for the belief that individual investors no longer need market professionals to interpret corporate information is overconfidence.⁴⁸⁷ Main Street investors are overconfident about their abilities, their knowledge, and their future prospects for investment returns. Individual investors seem to attribute their successes to their own abilities, even when such self-attribution is not fully warranted.⁴⁸⁸ Recent

477. See McMillan, *supra* note 460.

478. See Smith, *supra* note 328.

479. See *Dirks v. SEC*, 463 U.S. 646, 658-59 (1983); see also *In re Investors Mgmt. Co.*, 44 S.E.C. 633, 646 (1971); *The Regulation of Securities Offerings*, 63 Fed. Reg. 67,174 (Dec. 4, 1998); Unger, *supra* note 333.

480. See *supra* text accompanying notes 352-66.

481. See Siegel, *supra* note 374; Gutierrez & Moszkowski, *supra* note 373, at 5-9.

482. Brad M. Barber & Terrance Odean, *Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors*, 53 J. FIN. 773, 775 (2000).

483. See *Selective Disclosure and Insider Trading*, 65 Fed. Reg. 51,715, 51,716-17 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249); see also Levitt, *supra* note 1.

484. See Siegel, *supra* note 374.

485. See *supra* text accompanying notes 372-90.

486. Bear market is defined as a "prolonged period of falling prices. A bear market in stocks is usually brought on by the anticipation of declining economic activity, and a bear market in bonds is caused by rising interest rates." BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 50 (5th ed. 1998).

487. See Barber & Odean, *supra* note 482, at 790-94.

488. See *id.* (presenting the models of investor overconfidence, including self-attribution

investment success resulting from prosperous market conditions has fostered overconfidence in individual investors' abilities to analyze information.⁴⁸⁹

In application, Regulation FD works to undermine previous methods by which corporate information progressed through the market (from companies to analysts to investors).⁴⁹⁰ Individual investors are now forced to perform the interpretive role previously assumed by professional analysts because Regulation FD diminishes the fundamental functions of financial analysts that the Supreme Court recognized in *Dirks* as "necessary to the preservation of a healthy market."⁴⁹¹ By adopting Regulation FD, the SEC has leveled the playing field in the battle for corporate information, but in doing so, it has negatively affected individual investors by chilling the flow of information, increasing volatility, and jeopardizing the ECMH (by way of disturbing the *available*⁴⁹² information in the market).

V. PUBLIC COMPANIES' COMPLIANCE WITH REGULATION FD

With the adoption of Regulation FD, issuers must respond by adjusting disclosure policies to fit within the confines of the new SEC rule. Regulation FD encourages public companies to review, revise, and implement updated policies concerning the release of material information.⁴⁹³ Although Regulation FD does not require issuers to adopt formal written policies and procedures to comply with the new rule, such action is well advised.⁴⁹⁴ As the SEC states in the adopting release, "[T]he existence of [a disclosure policy], and the issuer's general adherence to it, may often be relevant to determining the issuer's intent with regard to a selective disclosure."⁴⁹⁵ Therefore, a written policy will be pertinent to deciding whether an issuer is reckless in making a selective disclosure of material information and, thus, subject to liability under Regulation FD.⁴⁹⁶

Conversely, failure to adopt a written policy is likely to be considered a negative factor when determining an issuer's liability under Regulation FD.⁴⁹⁷ When enforcing

bias).

489. *Id.*

490. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716-19 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249); see also Regulation FD, 17 C.F.R. §§ 243.100-103 (2001); Williams & McGough, *supra* note 425.

491. *Dirks v. SEC*, 463 U.S. 646, 658 (1983).

492. The ECMH functions on the theory that security prices in primary markets reflect all *available* information about a given security with such speed that even sophisticated investors cannot profit from trading on newly available information. See Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 554, 571-72 (1984).

493. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721, 51,726 n.90.

494. See 17 C.F.R. §§ 243.100-103; see also Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726 n.90.

495. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726 n.90.

496. See *id.*

497. A written policy is relevant in demonstrating to the SEC an overall corporate awareness of the general principle that selective disclosure is prohibited and, moreover, is likely to increase corporate credibility through an effective implementation and enforcement

Regulation FD, it is clear that the SEC, in assessing an issuer's intent with regard to a selective disclosure, will consider whether an issuer has an appropriate policy in place and if they generally adhere to it.⁴⁹⁸ To comply with Regulation FD, public companies should implement written policies and procedures with regards to the disclosure of material nonpublic information. This Part addresses the practices that, at a minimum, public companies should consider when developing and implementing a written policy.

A. Expand Disclosure in Periodic Reports

As a general practice, issuers should expand the scope of disclosure in annual and quarterly reports to include the topics that they expect to cover in communications with investors and analysts.⁴⁹⁹ The suggested place for such expanded, forward-looking disclosure is in the Management's Discussion and Analysis ("MD&A")⁵⁰⁰ section of periodic reports.⁵⁰¹ Specifically, the disclosure should appear in the MD&A subsection titled "Liquidity"⁵⁰² or an introductory overview section called "Outlook,"⁵⁰³ "Future Operations,"⁵⁰⁴ or a similar title.⁵⁰⁵ By expanding the scope of disclosure in SEC reports, issuers will be less constrained in their private communications because much of what they wish to discuss will already be public information.⁵⁰⁶

A corollary issue is Regulation FD's application to communications at roadshows. Whether Regulation FD applies depends on the nature of the issuer.⁵⁰⁷ Regulation FD

of the policy. *See id.* at 51,721, 51,726 n.90. Also, a written policy provides more substantive and credible evidence than would nonwritten policies and procedures.

498. *Id.* at 51,726 n.90.

499. *Id.* at 51,726. *See generally supra* text accompanying notes 176-92.

500. Regulation S-K, 17 C.F.R. § 229.303 (2001) (information required by Item 303 of Regulation S-K).

501. *E.g.*, Form 10-K, 5 Fed. Sec. L. Rep. (CCH) ¶ 31,104 (Jan. 9, 2002); Form 10-Q, 5 Fed. Sec. L. Rep. (CCH) ¶ 31,033 (Feb. 24, 1999).

502. 17 C.F.R. § 229.303(a)(1) (Regulation S-K, Item 303).

503. *See id.* § 229.101 (Item 101, Description of Business).

504. *See id.*

505. *See, e.g., id.* § 229.303(a) Instruction 7 (quantitative and qualitative disclosures about market risk).

506. *See* Regulation FD, 17 C.F.R. § 243.100 (2000). As discussed in Part II.D.2. of this Article, the SEC affirms in the adopting release the "mosaic" theory, which should allow issuers to provide greater detail to analysts and investors on areas of interest to them as long as the big picture has previously been disclosed to the public. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,722 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249). For example, if the issuer's MD&A section of the issuer's Form 10-Q discloses the allocation of \$400 million in budgeted capital expenditures for the next two years, it *may* be permissible in the absence of special circumstances to disclose to an analyst in a one-on-one that the budget is roughly \$50 million per quarter over the same period.

507. *See* 17 C.F.R. §§ 243.100-101.

generally does not apply if the roadshow is for a registered primary offering.⁵⁰⁸ Alternatively, if the roadshow is for a *secondary offering* or an *unregistered offering*, Regulation FD would apply unless the issuer is not a reporting company under the Exchange Act, a foreign private issuer, or a foreign government.⁵⁰⁹ Therefore, issuers that hold roadshow meetings to sell securities in private placements (such as high-yield bond financing and Rule 144A transactions⁵¹⁰) may be restricted in what they discuss unless previous public disclosures already cover, or can be amended before the start of or during the roadshow to cover, the topics that investors and analysts will want to discuss.⁵¹¹ To avoid selective disclosures in the context of private placements, public companies should expand the scope of public disclosures in periodic reports so that they are consistent with roadshow and private presentations.⁵¹²

B. Authorize and Educate Issuer Representatives

Because Regulation FD covers disclosures made by senior officials, or any other officers, employees, or agents who regularly communicate with Wall Street, issuers should formally designate and limit the individuals who are permitted to communicate regularly with securities market professionals or shareholders.⁵¹³ Considering the increased responsibility that Regulation FD places on such representatives, issuers should consider who these authorized spokespersons should be and limit their number.⁵¹⁴ Once the disclosure team is selected, the members should be educated about the types of communications that are permitted under Regulation FD. Also, authorized spokespersons should be kept well informed about all corporate

508. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,725. The regulation of roadshows in connection with registered primary offerings remains essentially where it was prior to the adoption of Regulation FD. It should be noted, however, that the SEC staff has forced some issuers, because of potential Section 5 concerns, to place in the prospectus information that has leaked from roadshows into the press. *See id.* at 51,726.

509. *See* 17 C.F.R. § 243.101(b).

510. 17 C.F.R. § 230.144A (2001) (covering private resales of securities to qualified institutional buyers).

511. *See* 17 C.F.R. § 243.100.

512. *See id.* §§ 243.100-103.

513. *See id.* § 243.101(c).

514. *See id.*; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,720 (Aug. 24, 2000) (to be codified at 17 C.F.R. pts. 240, 243, and 249). The issuer's written disclosure policy should define a disclosure team, members of which will: (1) serve as a liaison for inquiries about Regulation FD and materiality issues; (2) be present during contacts with analysts and investors; (3) maintain a record of information covered; and (4) determine whether material nonpublic information is inadvertently disclosed. The disclosure team should include in-house counsel, the CFO, investor relations representatives, public relations representatives, and any other person designated as a primary interface with Wall Street or the investor community. The issuer's Regulation FD disclosure policy should further provide that only authorized spokespersons may engage in discussions with securities market professionals, shareholders, and investors. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720-21, 51,721 n.44.

developments, thereby enabling them to anticipate and respond to inquiries. All nonauthorized employees should be instructed to direct inquiries from market professionals and securities holders to a designated spokesperson.

Company spokespersons will be responsible for making quick determinations about whether a potential disclosure involves material nonpublic information.⁵¹⁵ In making that decision, the authorized representative must know what information the issuer has previously disclosed and what analysts and the media have said about the company and its competitors. Thus, it is important that spokespersons stay abreast of what corporate information is *public* in order to adequately make on-the-spot materiality assessments.⁵¹⁶ It is suggested that all authorized spokespersons be periodically briefed on corporate developments and the subsequent requirements under Regulation FD concerning that information. Specifically, the company representatives should be instructed as to the status of the corporate information with respect to Regulation FD's "materiality"⁵¹⁷ and "nonpublic"⁵¹⁸ standards. Issuers should highlight those topics that will always be considered off limits for nonpublic discussion, such as rumors of possible business combinations and guidance on earnings estimates.⁵¹⁹

Issuers should also consider, in given situations, requiring more than one authorized representative to participate in conversations with analysts and institutional investors. This precautionary measure can help develop a protective record by having a third party present for all corporate disclosures. Having a variety of company spokespersons present will facilitate swift determinations concerning materiality and, if necessary, will provide support in defending such judgments.

C. Monitor for Non-Intentional Disclosure

When implementing policies and procedures, issuers should consider strategies to determine whether and when material nonpublic information has been disclosed.⁵²⁰ Regulation FD requires issuers to respond promptly to non-intentional disclosures of material nonpublic information⁵²¹—in most cases, within twenty-four hours after the issuer learns that material nonpublic information has been selectively disclosed.⁵²² The company's new policies and procedures should cover how and when a necessary

515. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,720-21.

516. See *id.*

517. See *supra* Part II.D.

518. See *supra* text accompanying notes 109-11.

519. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721; see also Walker, *supra* note 101; *supra* text accompanying note 101.

520. Ideally, public companies will implement a procedure to be followed in the event that a *covered person* mistakenly makes a non-intentional disclosure of material nonpublic information. This practice is likely to facilitate a more efficient, *prompt* public disclosure of the information mistakenly disclosed. See Regulation FD, 17 C.F.R. §§ 243.100, .101(c)-.101(e) (2000).

521. *Id.* § 243.100(a)(2).

522. *Id.* §§ 243.100(a)(2), .101(d); see also Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722-23.

public disclosure should be made, and when coordination with investor relations/public relations personnel and outside counsel is required.⁵²³

Public companies should also consider monitoring their stock price after one-on-ones or analyst conference calls. Movement in the stock price immediately following private communications with market professionals in which the issuer spokesperson disclosed information determined to be immaterial could be a telling indication that the spokesperson may have been wrong, thereby requiring prompt public disclosure.⁵²⁴

In determining whether prompt public disclosure is required under Regulation FD, advice from issuer's counsel is appropriate, especially if the issuer chooses to file information on Form 8-K.⁵²⁵ Depending on the circumstances, the issuer may wish to avoid public disclosure by attempting to obtain an after-the-fact confidentiality agreement from the recipient of the mistakenly disclosed information.⁵²⁶ Accordingly, the first step an issuer should consider is to ask the recipient of the disclosure to expressly agree—ideally in a written agreement⁵²⁷—not to disclose or trade on the basis of the information.⁵²⁸ If a confidentiality agreement is subsequently negotiated, the issuer will have no obligation to *promptly* disclose the information.⁵²⁹ If no satisfactory confidentiality agreement can be reached, the issuer will have an obligation to make *prompt* public disclosure of the mistakenly released information.⁵³⁰

The full spectrum of options available to issuers will be foreclosed if procedures are not in place to quickly respond to a non-intentional selective disclosure. The appropriate corporate officials and legal representation must be expeditiously alerted of an event triggering a possible Regulation FD public disclosure. Therefore, it is advisable that public companies implement an internal procedure to monitor and respond to situations where an authorized representative mistakenly makes a non-intentional disclosure of material nonpublic information.

D. Evaluate the Means of Public Disclosure

When making a public disclosure, issuers must be sensitive to what constitutes a

523. See 17 C.F.R. §§ 243.100(a)(2), .101(d); see also *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,722-23.

524. See 17 C.F.R. §§ 243.100(a)(2), .101(d); see also *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,722-23.

525. See *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,723. Form 8-K is used to report material happenings. Form 8-K, 5 Fed. Sec. L. Rep. (CCH) ¶ 31,001-04 (2001). See *supra* text accompanying notes 161-71 (addressing the considerations involved in deciding whether to “file” or “furnish” information on Form 8-K).

526. Rule 100(b)(2)(ii) of Regulation FD excludes from coverage communications made “[t]o a person who expressly agrees to maintain the disclosed information in confidence.” 17 C.F.R. § 243.100(b)(2)(ii).

527. See *supra* note 242.

528. See *supra* note 242; see also *Selective Disclosure and Insider Trading*, 65 Fed. Reg. at 51,720 n.28.

529. See 17 C.F.R. §§ 243.100(a)(2), .100(b)(2)(ii).

530. See *id.* §§ 243.100(a)(2), .100(b)(2)(ii).

“broad, non-exclusionary distribution of the information to the public.”⁵³¹ Issuers must select a method of public disclosure that is designed to provide a broad dissemination of the information.⁵³² Press releases, press conferences, and conference calls are viable solutions to the public disclosure requirements of Regulation FD.⁵³³ Increasingly, press conferences and conference calls are becoming accessible to the public either in person, through the Internet, or over the telephone.⁵³⁴ Notably, because Regulation FD does not require that public participants be entitled to ask questions or participate, the press conferences or conference calls can be conducted on a listen-only basis for members of the general public.⁵³⁵ Although Regulation FD does not require the use of any particular method of disclosure,⁵³⁶ the language suggests that a single method of disclosure may or may not be sufficient to provide broad public disclosure.⁵³⁷ Therefore, it is advised that issuers intending to make public disclosures via press conferences or conference calls give adequate notice of such events either by press release, posting of notice on the issuer’s Web site, or by furnishing the information on a Form 8-K.⁵³⁸ The notice must inform the public as to the time and place of the event and the means for accessing the conference or call.⁵³⁹

An alternative means of dissemination is posting the information itself on the issuer’s Web site, which, standing alone, is not likely to constitute adequate public disclosures.⁵⁴⁰ Therefore, it is recommended that posting information on an issuer’s Web site be used in combination with other methods of public disclosure.⁵⁴¹ Issuers who use their Web sites as the sole means of making a public disclosure assume the risk and burden of establishing that the method was reasonably designed to provide broad, nonexclusionary dissemination of the information.⁵⁴² Issuers who utilize press releases to disclose information must examine whether or not their press releases are carried by major wire services.⁵⁴³ If not, a press release, by itself, is not likely to be considered adequate public disclosure under Regulation FD.⁵⁴⁴ Smaller issuers should take note: where an issuer knows that its press releases are not routinely disseminated

531. *Id.* § 243.101(e)(2).

532. *Id.*

533. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

534. *See* Scherreik, *supra* note 332, at 118.

535. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724 n.71.

536. *Id.* at 51,724.

537. *See id.*

538. *See id.*; *see also supra* note 525.

539. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

540. *Id.*

541. *Id.*

542. *See id.* The SEC has stated that “[a]s technology evolves and as more investors have access to and use the Internet . . . we believe that some issuers, whose [Web sites] are widely followed by the investment community, could use such a method.” *Id.* From the tone that the SEC takes in this statement referring to Web site disclosure as a sole method of *public disclosure*, it seems that currently Web site disclosure, by itself, is a frowned upon method of *public disclosure*. *See id.*

543. *Id.*

544. *See id.*

by business wire services, it is not sufficient to make public disclosure simply by releasing information to such wire services.⁵⁴⁵

Although Regulation FD provides issuers the opportunity to adequately disclose information on Form 8-K, issuers should be cautious in doing so, given that Form 8-K filings present other liability issues.⁵⁴⁶ There is no one-size-fits-all standard for making a public disclosure; rather, issuers must select a method of disclosure based on the particular circumstances of their situation.⁵⁴⁷ When making a planned public disclosure, issuers should use a combination of methods designed to effect broad public dissemination of the information. First, the company should issue a press release through news wire service containing the information.⁵⁴⁸ Second, if the issuer intends to hold a conference call to discuss the disclosed information, it should "provide adequate notice, by a press release and/or website posting," of when the call will be held and how it can be accessed.⁵⁴⁹ Finally, the issuer should permit members of the public to listen in on the conference call either by telephone or Internet.⁵⁵⁰ In following this procedure, issuers are able to discuss the released information on conference calls without the fear that they will be engaged in improper selective disclosure in violation of Regulation FD.⁵⁵¹

E. Develop a Procedure for Communicating with Analysts

Operating within the confines of the new Regulation FD environment, issuers must evaluate and decide how to deal with analysts.⁵⁵² Corporate officials should anticipate the scope of communications that are likely to occur during private sessions with analysts, with other market professionals, or at investor conferences.⁵⁵³ Expounding on topics and issues that are already covered in public disclosures will generally be acceptable because such details will not involve material nonpublic information.⁵⁵⁴ Also, providing information at a broad and general level to market professionals and investors is permissible if proper disclosure has previously been made at an appropriate level of materiality and generality.⁵⁵⁵ However, allowing disclosure to venture into topics not covered at the general level in public releases can raise concerns under Regulation FD.⁵⁵⁶

With the threat of becoming the SEC's poster child for the enforcement of

545. *See id.* For some issuers, Form 8-K may very well be the only "sure" way of complying with the Regulation FD public disclosure requirement. *See id.* at 51,723-24.

546. *See id.* at 51,723; *see also supra* text accompanying notes 161-76.

547. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,724.

548. *Id.*

549. *Id.*

550. *Id.*

551. *Id.*

552. *Id.* at 51,722.

553. *See id.*

554. *See* Regulation FD, 17 C.F.R. § 243.100(a) (2000).

555. *See supra* note 506.

556. *See* 17 C.F.R. §§ 243.100(a), .101(e)(2); *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721.

Regulation FD, issuers must consider whether to continue granting one-on-one meetings and telephone calls with analysts and other market professionals. Some legal counsel may recommend the discontinuance of one-on-ones until the uncertainty surrounding Regulation FD has cleared. However, provided that a company implements appropriate policies and procedures for the public disclosure of information within the constraints of Regulation FD, this is not necessary.⁵⁵⁷ The importance for public companies to relay information to Wall Street professionals as well as Main Street investors is well recognized, and issuers should not place themselves at a competitive disadvantage by cutting off one-on-one communications with financial analysts. Regulation FD provides sufficient safeguards that enable well-groomed corporate officers and trained spokespersons to continue meeting with analysts without excessive concern of violating Regulation FD and becoming subject to SEC sanctions.⁵⁵⁸

In choosing to continue holding one-on-ones with analysts and market professionals, issuers must take special care to avoid nonpublic discussions of earnings.⁵⁵⁹ Specifically, one-on-ones and private communications with analysts for the purpose of giving earnings guidance are not advisable.⁵⁶⁰ When earnings are projected to come in below—or above—expectations, a broadly disseminated earnings warning press release is the suggested disclosure approach in light of Regulation FD.⁵⁶¹ If it is the issuer's corporate practice to provide earnings guidance to analysts concerning future results, and the issuer intends to continue such practice, the issuer must simultaneously provide the earnings guidance to the public.⁵⁶²

It is suggested that issuers, who regularly participate in unscripted private communications with analysts, develop a list of "off-limits" topics of discussion that pose substantial risks under Regulation FD.⁵⁶³ For scheduled private conversations and one-on-ones, the issuer's representatives and spokespersons should determine in advance the topics that the analyst wants to cover and limit discussion to such matters.⁵⁶⁴ Moreover, authorized spokespersons should decline to answer questions

557. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,726 n.90; see also generally 17 C.F.R. §§ 243.100-103.

558. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,722. Such safeguards include the requirement that an impermissible disclosure be *knowing or reckless* and the issuer's ability to rectify a non-intentional selective disclosure by *promptly* making a public disclosure of the information. See *id.* at 51,722-23.

559. *Id.* at 51,721; see also Walker, *supra* note 111.

560. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721; see also *Telephone Interpretations*, *supra* note 71, at Question 1. This manual may be viewed at <http://www.sec.gov/interp/telephone.shtml>.

561. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721.

562. 17 C.F.R. § 243.100(a)(1) (stating that issuers must make *simultaneous* public disclosure of any material nonpublic information that is *intentionally* released).

563. See Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721 n.44.

564. *Id.* at 51,722. Prior to a scheduled interaction with a Wall Street professional or inventor representative, the issuer's authorized spokesperson should take an inventory of any company information that may be deemed *material nonpublic* information. Following such internal examination the spokesperson should decide and red flag, prior to the scheduled

that are outside the purview of planned discussions and that raise potentially material issues.⁵⁶⁵ Finally, following private discussions and one-on-ones, authorized representatives should review any statements made and assess whether any material nonpublic information was inadvertently released, thereby triggering prompt public disclosure under Regulation FD.⁵⁶⁶

CONCLUSION

Now that the SEC's new Regulation FD is in effect, every Wall Street professional, Main Street investor, journalist, lawyer, and policy theorist has a distinct opinion about its impact on market conditions. Every constituency has a differing viewpoint, ranging from Wall Street's complaints of increased volatility, decreased liquidity, and diminishing visibility of corporate earnings to Main Street's praise of finally being on par with analysts at Merrill Lynch or fund managers at Fidelity. This Article provides an analysis of the elements of Regulation FD as well as a summary of the potential impact that the SEC's new rules will have on market participants. And, as a final point, this Article asserts that Regulation FD's impact is overstated. The implementation of Regulation FD has come and gone and securities markets have survived.

Regulation FD is unlikely to completely chill the disclosure of information by public companies; rather, it will merely shape communications between companies and investment professionals. However, corporate counsel has instilled the fear of God in issuers, and the understandable goal for companies during the introductory phase of Regulation FD is to avoid becoming the SEC's enforcement test case. Until the SEC pins up a poster child, caution will reign. Yet, as ambiguities surrounding Regulation FD are clarified and issuers gain experience operating in the new environment, the collateral impact on Wall Street and Main Street will gradually decline.

Just as the market adapted to Section 11 of the Securities Act and numerous other rules promulgated by the SEC, market participants must adjust their practices to operate within the Regulation FD regime. Analysts must rely less on corporate earnings guidance and do more diligent legwork. Individual investors, now on a level playing field, must be proficient in analyzing the simultaneous release of corporate information. Until market participants adjust to the new environment, there remains a very real down side—more earnings surprises due to inaccurate analyst reports and greater volatility due to investors' inaccurate interpretation and implementation of corporate information. Only time will tell how long it will take capital markets to adjust to the implementation of Regulation FD. However, this Article presents the theory that the uproar will pass sooner rather than later, and that Wall Street professionals will contrive new ways to get better information than the information available to Main Street investors. Simply stated, Wall Street will always have an

interaction, information that is off limits for discussion. During the scheduled interaction, should a red flag topic arise in a question presented by the market professional, the authorized spokesperson shall decline to answer such a question. *See id.* at 51,722, 51,722 n.44.

565. *See id.* at 51,721; *see also* Walker, *supra* note 111.

566. *See* 17 C.F.R. §§ 243.100, .101.

edge over Main Street.