

The SEC's Regulation FD – Fair Disclosure

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I. Introduction

On October 23, 2000, the Securities and Exchange Commission's (the "Commission") new rules banning selective disclosure went into effect.¹ Regulation FD² (for "fair disclosure") was adopted to address what the Commission perceived to be the systemic problem of companies selectively disclosing material, nonpublic information to Wall Street insiders at the expense of individual investors,³ which in the Commission's view, leads to a "loss of investor confidence in the integrity of our capital markets."⁴ The new rules provide that when an issuer, or a person acting on its behalf, selectively discloses material, nonpublic information to securities market professionals or holders of the issuer's securities where it is reasonably foreseeable that the holders will trade on the basis of the information, then the issuer must make public disclosure of the information – simultaneously, if the disclosure was intentional, or promptly thereafter, if the disclosure was unintentional.

As proposed,⁵ Regulation FD was very broad, and its scope would have extended to all of the communications that approximately 15,000 public companies have with third parties on a daily basis. As adopted, Regulation FD is narrower – for example, it exempts

¹ The Commission adopted Regulation FD on August 10, 2000 in a 3-to-1 vote. Commissioner Laura Unger dissented. On October 11, 2000, the Commission denied a request for extension of the effective date to December 29, 2000, which was submitted by the National Investor Relations Institute ("NIRI"). See Letter from Jonathan G. Katz, Secretary, Securities and Exchange Commission, to Louis M. Thompson, Jr., President and Chief Executive Officer, NIRI (October 11, 2000) at <http://www.sec.gov/news/gofd.htm>.

² Release Nos. 33-7881, 34-43154, IC-24599, 65 Fed. Reg. 51716 (Aug. 24, 2000) (the "Release"). A copy of the Release can be obtained at the Commission's website <http://www.sec.gov/rules/final/33-7881.htm>. In addition to selective disclosure, the Commission unanimously adopted two rules involving insider trading, which are outside the purview of this outline: (1) whether liability depends on a trader's "use" or "knowing possession" of material, nonpublic information; and (2) when the breach of a family or other non-business relationship will give rise to liability under the misappropriation theory.

³ The Commission's press release announcing adoption of Regulation FD stated that it "would end the practice of selective disclosure whereby officials of the public companies provide important information to Wall Street insiders prior to making the information available to the general public." Press Release, Securities and Exchange Commission, "Commission Votes to End Selective Disclosure" (Aug. 10, 2000) at <http://www.sec.gov/news/endsecdi.htm>.

⁴ Release, 65 Fed. Reg. at 51716.

⁵ Release Nos. 33-7787, 34-42259, IC-24209, 64 Fed. Reg. 72590 (Dec. 28, 1999) (the "Proposing Release"). A copy of the Proposing Release can be obtained at the Commission's website <http://www.sec.gov/rules/proposed/34-42259.htm>. Regulation FD follows Release No. 33-7606 (Nov. 3, 1998) as amended by Release No. 33-7607A (Nov. 13, 1998), 63 Fed. Reg. 67174 (File No. S7-30-98) (Dec. 4, 1998) (the "Aircraft Carrier Release"), which contained proposals that pertained to selective disclosure. For a discussion of selective disclosure under the Aircraft Carrier Release, see the comment letter, dated September 28, 1999, submitted by the Committee on the Federal Regulation of Securities of the Section of Business Law of the American Bar Association.

communications with selected groups, such as the press, customers and suppliers, and rating agencies and communications made in connection with most registered securities offerings – but it is much more complicated in operation than the proposal, and represents a fundamental change in the Commission’s approach to selective disclosure.⁶ The changes which narrowed the scope of the proposed regulation were in response to 5,925 comment letters.⁷

In responding to Regulation FD,⁸ companies should first comprehensively review their current disclosure practices – from one-on-ones with analysts and private meetings with large shareholders to earnings calls, press releases and road shows for public and private offerings. Will companies limit the information they provide to analysts⁹ or expand the amount and scope of information they disclose to the public? Will they continue to hold private discussions with market professionals and investors? Will they reduce the total amount of information they release to the marketplace? Each company faces a range of options – which carry differing levels of risk – in deciding how to comply with Regulation FD. The spectrum ranges from publicly disclosing all information under all circumstances to restricting disclosure to only the information that is required to be disclosed. Unlike other regulations, these new rules may not result in a “one size fits all”

⁶ Regulation FD changes the Commission’s approach:

- ~~///~~ from enforcement on a case-by-case basis to regulation applicable to all domestic public companies;
- ~~///~~ from Commission speeches exhorting companies to adopt best practices to regulation that mandates disclosure policy for the marketplace;
- ~~///~~ from approaching selective disclosure as a form of insider trading that violates Rule 10b-5 under the Exchange Act to comprehensive regulation of domestic public companies under Section 13(a) of the Exchange Act, which covers periodic reports, like Form 10-K, Form 10-Q and Form 8-K; and
- ~~///~~ from a concern about sporadic instances of selective disclosure to a conclusion that “everybody does it” and selective disclosure undermines investor confidence in the integrity of our securities markets.

See, for example, the Fact Sheet: Selective Disclosure and Insider Trading Rule Proposals, provided by the Commission at its open meeting on December 15, 1999 at which it authorized publishing proposed Regulation FD for comment; and Chairman Levitt’s Opening Statement (“Opening Statement”) (Aug. 10, 2000), which may be found at <http://www.sec.gov/news/extra/enseldi.htm>.

⁷ See Sharon Zamore, Jacob Lesser, Officer of General Counsel, Securities and Exchange Commission, Summary of Comments on Proposed Rulemaking on Selective Disclosure and Insider Trading (July 27, 2000) (unpublished summary, on file in the Public Reference Room at the Commission).

⁸ See the Investor Relations Survey on Regulation FD Practices conducted by Thomson Financial/Carson, dated October 6, 2000.

⁹ See, e.g., Heather Timmons, This “Full Disclosure” Rule Could Mean More Secrets, Bus. Wk., Oct. 9, 2000, at 198.

response. Each company should evaluate Regulation FD on the basis of its current disclosure practice as well as the goals it wishes to achieve in corporate communications.

The National Investor Relations Institute recently conducted a survey on the impact of Regulation FD on corporate disclosure practices (the “NIRI Survey”).¹⁰ Based on data from 577 companies collected as of February 16, 2001, the NIRI Survey indicates that, of the companies surveyed, 28% provide more information to the public than they did before Regulation FD went into effect, 24% provide less information and 48% provide the same amount of information. In addition, 5% of the companies surveyed report that they are conducting a greater number of one-on-ones with the investment community than they did before Regulation FD went into effect, 74% are conducting the same number of one-on-ones and 11% are cutting back. Of the companies that conduct one-on-ones, 54% cover earnings-related topics in the one-on-ones. With respect to reviewing drafts of analysts’ earnings models: before Regulation FD, 81% of the companies reviewed them; after Regulation FD, 53% review them. The decrease may be due, in part, to the fact that 47% of the companies surveyed report that after FD, fewer analysts are requesting them to review drafts of analysts’ earnings models.¹¹

In addition, the American Bar Association Task Force on Regulation FD recently surveyed members of the Committee on Federal Regulation of Securities, the Committee on Corporate Governance and the Committee on Small Business from April 4, 2001 to April 23, 2001 in order to determine how FD is working from the standpoint of in-house counsel and outside practitioners (the “ABA Survey”).¹² Of the 62 respondents, 45% reported that their clients disclose more information to the public than they did before FD went into effect, and 50% thought that the quality of their clients’ disclosures is the same as it was before FD. In addition, 77% of the respondents reported that before FD went into effect, most of their clients conducted one-on-one meetings with analysts; after FD, only 27% reported that most of their clients continue to conduct one-on-ones. As for giving advice on materiality: before FD, less than 50% of the respondents stated that clients had asked their advice on materiality either all the time or sometimes; after FD, almost 90% of the respondents are asked questions on materiality either all the time or sometimes.¹³

¹⁰ National Investor Relations Institute, Corporate Disclosure Practices Survey 2001, available at <http://niri.org/publications/cdps2001.pdf> (March 7, 2001).

¹¹ Aside from the NIRI Survey, in terms of the number of actual disclosures, the fourth quarter of 2000 witnessed a 58% increase from the fourth quarter of 1999 in pre-announcements of earnings, a fact attributable by some to, in part, Regulation FD. See Jonathan R. Laing, Horror Story: Are the serial earnings slashings almost over on Wall Street?, Barron’s, Dec. 11, 2000, at 26 (noting that companies “with market-moving earnings news seem far quicker to disclose it than in the past”).

¹² The Preliminary Results of the FD Survey are attached to this Outline as Appendix B.

¹³ The Association for Investment Management and Research surveyed analysts and investors for their views on Regulation FD in February 2001. The survey can be found at <http://www.aimr.com/pressroom/fjnews/fjnewsltr.html#6>. The Securities Industry Association is

The NIRI Survey, the ABA Survey and other statistics and articles in the press show that the transition to a Regulation FD environment may be more evolutionary than revolutionary. It may also be marked by trial-and-error as companies and market participants experiment¹⁴ with various techniques and strategies to attempt to both comply with Regulation FD and achieve their corporate communications goals, particularly in dealing with analysts. For example, as the NIRI Survey indicates, Regulation FD has prompted many companies to disclose more information to the marketplace and an approximately equal number of companies to disclose less. Correspondingly, there are reports of a wide range of legal advice being given to issuers, with some attorneys advising clients “not to say anything to anyone about anything” and other attorneys encouraging clients to be “fully open” to the investment community.¹⁵

This evolutionary process will include participation by the Commission and its Staff as they attempt to address concerns informally – through speeches and participation at conferences – and formally through Staff interpretations. It is likely that more questions will arise over time and that the answers to questions may change as Regulation FD’s meaning is clarified, experience is gained and consensus is achieved. While disconcerting, this process may have the positive effect of bringing Regulation FD into a practical, real world reality.¹⁶

Demonstrating its commitment to monitor FD’s performance, the Commission conducted a public roundtable on April 24, 2001 to address the impact of Regulation FD on issuers,

also conducting a survey on Regulation FD, the results of which should be available in the near future.

¹⁴ Experiments have already begun and include: procedural Form 8-Ks, in which an issuer files a Form 8-K stating that all future Regulation FD disclosures will be posted on the issuer’s website; and announcements that prior to the company’s quarterly blackout or quiet period, the public can continue to rely on the company’s forward-looking statements unless the company affirmatively publishes a notice stating otherwise. The procedural Form 8-K does not comply with FD for a number of reasons, not the least of which is that the website posting is not an adequate means of dissemination. While the “good until cancelled” announcement complies with Regulation FD, the issuer may have assumed a duty to update that requires a public announcement immediately when any of the forward-looking statements in the outlook are no longer operative. This assumption of a duty to update may be far more onerous than what Regulation FD would otherwise require.

¹⁵ Gregory J. Millman, Reg FD’s Leveling Effect, Financial Executive, Jan./Feb. 2001, at 34 (quoting Michael Rosenbaum, President of the Financial Relations Board, a Chicago-based investor relations firm). See also Interview with Richard Sherlund, Goldman, Sachs analyst (CNBC television broadcast, Dec. 8, 2000) (stating that major law firms are telling companies to say less rather than more).

¹⁶ See Commissioner Laura S. Unger, Speech to Glasser LegalWorks Conference in New York City (Oct. 27, 2000).

analysts and investors. A number of participants stressed that the Commission should assess and balance the costs and benefits of FD and should also minimize the rule's overbreadth and mitigate its unintended costs and consequences.¹⁷ Other participants pointed out that recent market volatility may be attributable, at least in part, to the fact that since FD went into effect, many companies do not provide earnings information between quarterly conference calls out of concern of violating FD. Still other participants emphasized that FD had eliminated selective disclosure, that the benefits of the rule outweighed its costs and that even though the rule may have some "potholes," they can be filled.¹⁸ And still others believed that FD did not need any change.¹⁹

In addition to testimony at the roundtable, a number of organizations submitted letters to the Commission, including The Bond Market Association.²⁰ The Bond Market Association pointed out that FD has had unintended effects on issuers with publicly traded high-yield debt that do not also have publicly traded equity. FD has increased the cost and the time of the offering process for these issuers and has hampered communications with debt analysts. Faced with the competing demands from equity analysts and FD compliance costs, these issuers are less inclined to provide debt analysts with the relevant information they need.

It is too early to discern the effect of the roundtable and the surveys that are being and have been conducted on the Commission. The Commission has been presented with various accounts of the differing impact of FD on differently-situated issuers, which could potentially lead the Commission to issue interpretations or take other measures to modify the rule. Moreover, with vacancies on the Commission, including a permanent Chairman, and reports of enforcement investigations being conducted, the future of FD at the Commission has yet to be determined.

This outline first describes the Commission's reasons for – and the elements of – the rule and then discusses the effects Regulation FD may have on liability, dealing with analysts, capital-raising transactions, mergers and acquisitions, and disclosure practices and procedures. After discussing Regulation FD, the outline discusses Rule 10b-5 liability in the context of selective disclosure, which is not changed by the Regulation. Finally, the

¹⁷ John Huber's Statement to the SEC Roundtable on Regulation FD is attached as Appendix C of the Outline.

¹⁸ Testimony of George Kim Johnson, General Counsel, Public Employees' Retirement Ass'n of Colorado, to the SEC Roundtable (Apr. 24, 2001).

¹⁹ Testimony of Tom Gardner, Co-Founder and Chairman, The Motley Fool, to the SEC Roundtable (Apr. 24, 2001).

²⁰ See Letter from The Bond Market Association to Chairman Laura S. Unger (Apr. 20, 2001), available at <http://www.bondmarkets.com/regulatory/redfdletter.shtml>.

outline summarizes the advice proposed by a number of firms when Regulation FD was adopted on how companies should respond and adapt to Regulation FD.²¹

II. Regulation FD

A. The Commission gave three reasons for adopting Regulation FD.

1. Selective disclosure leads to a loss of investor confidence in the integrity and fairness of our capital markets.
 - a. The Release uses the example of an investor seeing dramatic changes in a stock price and “only later” learning of the information that was responsible for the change. To the Commission, this can result in investors questioning “whether they are on a level playing field with market insiders.”²² To others, it raises the issue of whether Regulation FD is intended to establish parity of information between Wall Street and Main Street.
 - b. To the Commission, investors lose confidence in the fairness of the markets because of selective disclosure, which resembles insider trading. In both, an “unerodable information advantage” is gained from access to a corporate insider, rather than from hard work or analysis.²³
 - c. The Commission believes that recent high-profile reports of companies selectively disclosing material information, leading to significant profit or loss avoidance for analysts and their clients, erodes investor confidence in the fairness of the market.²⁴
 - d. Protection of investor confidence is important in today’s highly volatile markets. “[T]he impact of . . . selective disclosure appears to be much greater in today’s more volatile, earnings-sensitive markets.”²⁵ The practice is reported to be widespread at small-growth companies, where companies break poor-performance news to analysts to prevent a sharp reaction by the volatile market.

²¹ Appendix A of the outline provides hypothetical fact patterns that illustrate the operation of Regulation FD and the Catch 22s that can result when other aspects of the federal securities laws are involved.

²² Release, 65 Fed. Reg. at 51716.

²³ See id.

²⁴ See id. In 1999, Chairman Levitt raised the issue of market integrity, calling the practice of selective disclosure “a stain on our markets.” Chairman Levitt, Speech to the Economic Club of New York, N.Y. (Oct. 18, 1999) (transcript available at <http://www.sec.gov/news/speeches/spch304.htm>).

²⁵ Proposing Release, 64 Fed. Reg. at 72592.

Chairman Levitt noted, “[w]e have placed such a premium on short-term results that even the most modest changes in earnings provokes a dramatic market response.”²⁶

2. Material information is used to curry favor with analysts.
 - a. Regulation FD is designed to address another threat to the integrity of our markets: “the potential for corporate management to treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors.”²⁷ Likewise, there is the corresponding reaction that analysts may feel pressured to slant their analysis of a company in order to ensure continued insider access.²⁸ Chairman Levitt has also expressed concern that companies use analysts to promote sales of stock. “[A]nalysts’ employers expect them to act more like promoters and marketers than unbiased and dispassionate analysts. Our review of the relationship between companies and the analysts who follow them indicates that analysts, all too often, are falling off that tightrope on the side of protecting the business relationship at the cost of fair analysis. We believe that these pressures would be reduced if issuers were clearly prohibited from selectively disclosing material information to favored analysts.”²⁹
 - b. While an analyst may put himself or herself at risk of being cut-off from access to corporate officials or from conference calls if he or she is too negative toward the company, most public companies believe analysts have the upper hand in the fencing match on the tightrope.
 - c. As the fencing match between companies and analysts continues in the FD environment, new techniques, such as embargoes, may develop that comply with Regulation FD, yet nevertheless give analysts an advantage over the public.

²⁶ Kate Berry, SEC’s Levitt Discusses Issues About Analysts, Wall St. J., Apr. 14, 1999.

²⁷ Release, 65 Fed. Reg. at 51716.

²⁸ See Justin Schack, The Mounting Price of Fame, Institutional Investor, Oct. 2000, at 43 (“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.”).

²⁹ Proposing Release, 64 Fed. Reg. at 72592. The reference to “tightrope” is to the Second Circuit’s decision in SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 9 (2d Cir. 1977), in which the court analogized the relationship between a company and a financial analyst as a “fencing match conducted on a tightrope.”

3. Selective disclosure to analysts is not required for efficient markets.
 - a. Because technological developments have made it much easier for issuers to disseminate information broadly, the Commission believes that analysts are no longer needed to serve as information intermediaries.³⁰ Accordingly, “technological limitations no longer provide an excuse for abiding the threats to market integrity that selective disclosure represents.”³¹
 - b. As Commissioner Isaac C. Hunt, Jr. stated in a recent speech, “The mechanisms by which our markets become efficient are changing... . Institutions and analysts’ brokerage firms are no longer the primary means by which our markets achieve efficiency.”³² Because technology has made the costs of universal disclosure substantially less than in the past, more disclosure to more investors on a real time basis is increasingly feasible. The Release encourages the use of live transmission of annual meetings and conferences via closed-circuit television or Internet

³⁰ The Release embodies the philosophy that to be efficient, a market must be free and democratic. Rather than a “trickle down” approach from companies to analysts to investors, Regulation FD attempts to eliminate the informational disadvantages individual investors have against institutional investors. While Regulation FD’s approach has a populist appeal and may make analysts work harder to arrive at their conclusions, it has a higher probability of resulting in uncertainty, market surprises and increased volatility, all of which are contrary to the efficient market theory. *See, e.g.,* Molly Williams and Robert McGough, New Disclosure Rules Mean More Legwork Ahead for Analysts, Wall St. J., Sept. 25, 2000, at C1 (“The SEC’s new regulation on selective disclosure . . . will make it much harder for companies to privately guide analysts into lowering or raising their estimates. The result is likely to be less accuracy from analysts in making estimates and more earnings surprises, as companies make disclosures to the whole world, rather than filtering news through a select few.”). Furthermore, increased volatility in stock prices may raise option prices. *See* Erin E. Arvedlund, Cost of Openness: Reg FD Could Raise Option Prices, Barron’s, Oct. 30, 2000, at 2000 WL-BARRONS 28967040 (“With imperfect information, analysts’ earnings estimates and ‘whisper numbers’ will likely be all over the map. The wider the range, the more volatile the stock may trade, and the pricier options may be.”).

In addition to the adjustment period companies can expect to experience, analysts will also undergo a transition period. While analyst reports could become more meaningful as analysts do more work, there could also be a greater divergence in analyst views and increased tension between analysts and issuers. Moreover, there could be even greater emphasis on “whisper numbers.”

³¹ Release, 65 Fed. Reg. at 51717.

³² Commissioner Isaac C. Hunt, Remarks given at the 26th Annual Cleveland Securities Law Institute on Securities Regulation, Cleveland, Ohio (Feb. 28, 2000) (transcript available at <http://www.sec.gov/news/speeches/spch349.htm>).

webcasting, listen-only telephone conferences, and company websites as new media for corporate disclosure.³³

- c. While technological advances will continue to provide more information more quickly to the individual investor, only the analyst makes a life's work of studying and reacting to this information on a daily basis. Technology should not be used as a device to displace the analyst as the investor's advisor. While Richard H. Walker, the Commission's Director of Enforcement, recently stated that the "role of the analyst remains valued and vital in our marketplace,"³⁴ Chairman Levitt, in an obvious reference to analysts two days after the Walker Speech, stated that "America's investors don't need interpreters."³⁵ It remains to be seen which of these two views of the role of the analyst will result from Regulation FD.

B. Regulation FD represents a new enforcement approach to selective disclosure.

Regulation FD "is an issuer disclosure rule," which creates duties under Sections 13(a) and 15(d) of the Exchange Act. It is not an "antifraud rule," and it is not "designed to create new duties under the antifraud provisions of the federal securities laws or in private rights of action."³⁶ As discussed in the Proposing Release, the Commission believes that Dirks v. SEC³⁷ imposed undue analytical difficulties in prosecuting tips to analysts under an insider trading theory. Enforcement under the insider trading laws is constrained by the requirement to prove that the insider benefited personally from disclosing information to the analyst. In light of this enforcement position, Regulation FD approaches the problem of selective disclosure by creating an issuer-reporting requirement, rather than treating it as a type of fraudulent conduct or insider trading. Enforcement of Regulation FD is limited to Commission action; there is no private right of action solely for a violation of

³³ While citing technological developments as a basis for adopting Regulation FD, the Commission did not endorse the Internet as a means that would, by itself, satisfy the dissemination requirements of the new rules. Rather, webcasting is sufficient only if it occurs in conjunction with another means of communications, such as a dial-in (800) number.

³⁴ 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 9 at <http://www.sec.gov/news/speeches/spch415.htm> (hereinafter "Walker Speech").

³⁵ Hon. Arthur Levitt, Chairman, Securities and Exchange Commission, Remarks on "Wall Street Week With Louis Rukeyser" (PBS television broadcast, Nov. 3, 2000).

³⁶ Release, 65 Fed. Reg. at 51726.

³⁷ Dirks v. SEC, 463 U.S. 646 (1983).

Regulation FD.³⁸ Although many believe Regulation FD instituted a new disclosure system, the Staff has stated, “Regulation FD was intended essentially to codify what we at the Commission understood to be the acknowledged best practices by issuers.”³⁹

C. Elements of Regulation FD

As adopted, Regulation FD narrowed the scope of the proposed rule, but complicated its application.⁴⁰ Regulation FD provides that when an issuer, or any person acting on

³⁸ While “Regulation FD was not designed as a trap for the unwary,” see Walker Speech at 3, the comfort to issuers from the absence of a private right of action under Regulation FD may be illusory. By imposing a duty to speak, Regulation FD affords other potential causes of action under Rule 10b-5 to private litigants, such as the duty to correct, the duty to update, and misleading or omitted statements. See Outline at Section V, infra.

³⁹ See Walker Speech at 3. Query whether the references to “best practices” in the Walker Speech and the Release mean that only the “best practices” will be acceptable under Regulation FD or whether there are “good” and “better” practices that will also be acceptable.

⁴⁰ As Chairman Levitt stated in his Opening Statement, the principal changes include:

“Narrowed Scope of the Regulation

~~§~~ The regulation will apply only to an issuer’s communications with market professionals, and holders of the issuer’s securities under circumstances in which it is reasonably foreseeable that the security holders will trade on the basis of the information. The regulation will not apply to issuer communications with the press, rating agencies, and ordinary-course business communications with the customers and suppliers.

~~§~~ The regulation will apply only to communications by the issuer’s senior management, its investor relations professionals, and others who regularly communicate with market professionals and security holders.

Rule of Disclosure that Does Not Create Private Liability

~~§~~ The regulation text makes clear that it is a disclosure rule. It does not create liability for fraud. Where the regulation is violated, the SEC could bring an administrative proceeding seeking a cease and desist order, or a civil action seeking an injunction and/or civil penalties.

~~§~~ The regulation has been revised to eliminate the prospect of private liability for companies solely as a result of a selective disclosure violation.

Requirement of Intentional or Reckless Conduct

~~§~~ The regulation requires public disclosure only where the person making the selective disclosure knows or is reckless in not knowing that the information disclosed was both material and nonpublic.

No Application to Most Registered Offerings or Foreign Issuers

~~§~~ The regulation now expressly excludes communications made in connection with most registered securities offerings.

~~§~~ The regulation does not apply to foreign issuers.

its behalf, discloses material, nonpublic information to certain enumerated persons (in general, securities market professionals or holders of the issuer's securities where it is reasonably foreseeable that the holders will trade on the basis of the information), then the issuer must make public disclosure of the information. The timing of the required public disclosure depends on whether the selective disclosure was intentional or unintentional: for an intentional selective disclosure, the issuer must make public disclosure simultaneously; for an unintentional disclosure, the issuer must make public disclosure promptly. Under Regulation FD, the required public disclosure may be made by filing or furnishing a Form 8-K, or by another method or combination of methods reasonably designed to effect broad, non-exclusionary distribution of the information to the public.

1. An issuer or any person acting on its behalf
 - a. An "issuer" is any domestic company with securities registered under Section 12 of the Exchange Act or subject to the reporting requirements of Section 15(d) of the Exchange Act, including closed-end investment companies.⁴¹
 - (1) As defined, "issuer" covers all domestic companies registered under the Exchange Act, so Regulation FD would not apply to a company's initial public offering.
 - (2) Excluded from the definition of "issuer" are foreign governments and foreign private issuers and open-end investment companies.
 - (3) An issuer which has become subject to Section 15(d)'s reporting requirements by having had a Form S-4 become effective under the Securities Act for an Exxon Capital exchange offer for debt securities is subject to Regulation FD even though the issuer's equity securities are privately held and its debt securities are not traded on a securities exchange.

No Effect on Eligibility for Short-Form Registration or Resales under Rule 144

~~See~~ A violation of Regulation FD will not disqualify a company from use of short-form registration, or affect investors' ability to resell under Rule 144."

⁴¹ See Rule 101(b). Regulation FD applies to closed-end investment companies, but not to other types of investment companies. The Proposing Release explains that Regulation FD would give little additional protection to investors in investment companies. Since investment companies continually offer their securities to the public, they are under an ongoing disclosure obligation to report material information. Further, they are not permitted to sell, redeem or repurchase their securities except at a price based on their securities' net asset value. 64 Fed. Reg. at 72597.

- b. A person acting “on behalf” of the issuer is defined in Rule 101(c) as (1) any “senior official” of the issuer; or (2) any other officer, employee or agent of an issuer who regularly communicates with (a) broker/dealers and their associated persons; (b) investment advisers, institutional investment managers, hedge funds, and their associated persons; (c) investment companies and their affiliated persons; or (d) any holder of the issuer’s securities, under circumstances in which it is reasonably foreseeable that the holder will purchase or sell the issuer’s securities on the basis of the information.
- (1) “Senior official” is defined as any director, executive officer, investor relations or public relations officer, or other person with similar functions. By this definition, Regulation FD covers senior management, investor and public relations professionals, and any and all other employees (regardless of seniority) who regularly communicate and interact with securities market professionals or securityholders of the company as part of their job responsibilities.
 - (2) While issuers are not responsible for selective disclosures made by mid-level management or junior employees, issuers cannot avoid Regulation FD by having a non-covered person make the selective disclosure. The Release notes that if a senior official directs an employee who would not otherwise be considered to be acting “on behalf” of the issuer to make a selective disclosure, then the senior official would be responsible for having made the disclosure.⁴²
- c. Regulation FD provides that any officer, director, employee, or agent of an issuer who discloses material, nonpublic information in breach of a duty of trust or confidence to the issuer shall not be considered to be acting on behalf of the issuer. Thus, an issuer is not responsible under Regulation FD when one of its employees improperly trades or tips.
- (1) A lawyer or an investment banker engaged by the issuer, or a party to a confidentiality agreement, will not be considered to act “on behalf” of the issuer if it discloses material, nonpublic information in violation of its duty of trust or confidence to the issuer, but could subject the person to insider trading liability as a tipper.

⁴² See Release, 65 Fed. Reg. at 51720.

- (2) If an issuer adopts a policy that limits which senior officials are authorized to speak to securities market professionals, a selective disclosure by a senior official who is not authorized to speak under the policy will not violate Regulation FD, but may subject the person to insider trading liability because the person has breached his or her duty of trust or confidence to the issuer.⁴³

2. Discloses material, nonpublic information

- a. Regulation FD does not define “material.” The Release states that Regulation FD will rely on the “existing definition” of materiality “established in the case law”⁴⁴ and cites with approval the Supreme Court’s opinion in TSC Industries, Inc. v. Northway, Inc.⁴⁵ In TSC Industries, the Supreme Court stated that a fact is material if “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision, or if the fact would have “significantly altered the ‘total mix’ of information made available.”⁴⁶ Materiality is determined from the viewpoint of the “reasonable investor,”⁴⁷ and not of the analyst. The Commission underscores this point in affirming that the “mosaic” theory is alive under Regulation FD.⁴⁸ An issuer may selectively disclose information that is immaterial to a reasonable investor but is significant to the analyst, whose “persistence, knowledge, and

⁴³ See Division of Corporation Finance, Securities and Exchange Commission, Manual of Publicly-Available Telephone Interpretations, Fourth Supp. (with Additional Interpretations Added December 2000) (Oct. 2000, Dec. 2000) (“Regulation FD Telephone Interpretations”), Question 14, at <http://www.sec.gov/offices/corpfin/phonits4.htm>.

⁴⁴ See Release, 65 Fed. Reg. at 51721.

⁴⁵ 426 U.S. 438 (1976).

⁴⁶ Id. at 449 (quoted in the Release); see Basic v. Levinson, 485 U.S. 224, 231(1988).

⁴⁷ Release, 65 Fed. Reg. at 51722.

⁴⁸ The “mosaic” theory was first used by the Second Circuit in Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 165 (2d Cir. 1980) (stating 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”). See Outline at Section III.A.3, infra. The mosaic theory is similar to the “pieces of a jigsaw puzzle” analogy used by the district court in SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1231 (S.D.N.Y. 1976) (stating that corporate officers and analysts may engage in a “general discussion out of which a skilled analyst could extract pieces of a jigsaw puzzle which would not be significant to the ordinary investor but which the analyst could add to his own fund of knowledge and use toward constructing his ultimate judgment”).

insight,” may enable her to use the information to complete a “mosaic” of information that, once completed, is material.⁴⁹

- (1) In addition to case law, the Release cites to Commission rules, regulations, and releases on materiality.⁵⁰ It is significant that the Commission approvingly references its Staff Accounting Bulletin No. 99 (“SAB 99”). The Commission intends by Regulation FD to extend the scope of SAB 99’s application beyond materiality in financial statements to all communications.
- (2) SAB 99 sets forth a materiality test that involves both quantifiable and qualitative factors. An issuer or an auditor may not assume the immateriality of items that fall below a percentage threshold set by management or the auditor to determine materiality.
 - (a) According to SAB 99, “evaluation of materiality requires a registrant and its auditor to consider all the relevant circumstances.”
 - (b) Also, potential market reaction should be taken into account in considering whether information is material.⁵¹
- (3) In Ganino v. Citizens Utilities Co.,⁵² the Second Circuit approved the use of SAB 99 in a non-financial statement context. Plaintiffs-shareholders alleged in their complaint that Citizens Utilities Co., a publicly traded company, fraudulently inflated its share price by, among other things, misrepresenting the source of income in its Form 10-Q for the second quarter of 1996 and deceptively underreporting fee revenue earned and received in 1995 so that it could report the fees in a later period, such as 1996, when Citizens needed to use them in order to manage earnings. Citizens had had over 50 consecutive years of increased revenue, earnings and earnings per share. Citizens moved to dismiss the complaint on the grounds that the amount of

⁴⁹ See Release, 65 Fed. Reg. at 51722.

⁵⁰ See id. at 51721, fn. 38. The Commission cites to Rule 405 under the Securities Act and Rule 12b-2 under the Exchange Act; and Staff Accounting Bulletin No. 99.

⁵¹ For a further discussion of SAB 99, see John J. Huber and Thomas J. Kim, SAB 99: Materiality As We Know It Or Brave New World For Securities Law (“SAB 99 Outline”).

⁵² Ganino v. Citizens Utilities Co., 228 F.3d 154 (2d Cir. 2000).

the fees that were allegedly misrepresented was immaterial as a matter of law since it comprised a de minimus 1.7% of Citizens' total pre-tax revenues for 1996. The district court granted the motion to dismiss, quoting a newspaper article that observed that “most auditors – and their corporate clients – define materiality as any event or news that might affect a company’s earnings, positively or negatively, by 3% to 10%... [It] has become standard practice in corporate America. Thus, if a particular charge or event doesn’t meet the 3% to 10% level, companies feel they don’t have to disclose it.”⁵³ Accordingly, the district court held that the amount at issue -- 1.7% of Citizens’ revenues for the relevant time period -- was immaterial as a matter of law and, furthermore, that the lack of change in Citizens’ stock price following the filing of the information about the source of the income in the Form 10-Q for the second quarter of 1997 was evidence of the immateriality.

The Second Circuit reversed, holding that following the Supreme Court’s decision in Basic v. Levinson, “we have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation.”⁵⁴ The Second Circuit also observed that, while SAB 99 does not have the force of law, it was “thoroughly reasoned and consistent with existing law – its non-exhaustive list of factors is simply an application of the well-established Basic analysis to misrepresentations of financial results – we find it persuasive guidance for evaluating the materiality of an alleged misrepresentation.”⁵⁵ SAB 99, the Second Circuit noted, stated that various “qualitative factors may cause misstatements of quantitatively small amounts to be material.” The Second Circuit found particularly relevant SAB 99’s statements of whether the “misstatement masks a change in earnings or other trends” and whether the “misstatement hides a failure to meet analysts’ consensus expectations for the enterprise.”⁵⁶ But for the inclusion of the 1.7% fees in revenue, the over 50-year trend of increased revenue and earnings would not have continued in 1996.

⁵³ Ganino v. Citizens Utilities Co., 56 F. Supp. 2d 222, 226 (D. Conn. 1999).

⁵⁴ Ganino, 228 F.3d at 174.

⁵⁵ Id. at 177.

⁵⁶ Id. at 175.

Endorsing and applying the principles in SAB 99 and in the case law, the Second Circuit held that the plaintiffs-shareholders had alleged material misrepresentations and that the district court erred in holding that these amounts were immaterial as a matter of law.

- b. Because the Release’s explanation of what the Commission considers to be “material” information is crucial to understanding Regulation FD and, more important, acting within its bounds, the following table quotes the two central paragraphs in the Release on materiality and analyzes each sentence. While the first paragraph describes the prohibitions of Regulation FD, the second paragraph discusses ways and persons the Commission believes will not run afoul of Regulation FD:

TEXT OF RELEASE	ANALYSIS OF TEXT
<i>Paragraph One</i>	
One common situation that raises special concerns about selective disclosure has been the practice of securities analysts seeking “guidance” from issuers regarding earnings forecasts.	While far broader in its application, Regulation FD was adopted primarily to address this precise situation.
When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD.	Although the Commission states that “material” will be defined as it has been developed in the case law, the Commission clearly indicates here that guidance to analysts on earnings estimates will be considered as providing material information.
If the issuer official communicates selectively to the analyst nonpublic information that the company’s anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD.	Although many considered providing guidance that earnings would be higher or lower than previous guidance or analyst consensus estimates as presenting a materiality issue, this sentence goes further. Affirming an estimate directly or indirectly by stating, for example, “We are on track,” can be a violation of Regulation FD as well. This sentence does not say, however, that the issuer will violate Regulation FD in every instance. There are situations, such as affirming an estimate shortly after it is publicly disclosed, when the affirmation would not be material and therefore not violate Regulation FD. ⁵⁷

⁵⁷ The Walker Speech states that “[W]alking the Street up or down is almost certainly prohibited and can no longer be done privately. I’m hard-pressed to think of a scenario where the reasonable investor would not be interested in knowing whether an analyst’s forecast is too high or low, if even by a penny, under current market dynamics.” See Walker Speech at 6. The possible scenario which

TEXT OF RELEASE	ANALYSIS OF TEXT
This is true whether the information about earnings is communicated expressly or through indirect “guidance,” the meaning of which is apparent though implied.	The Commission casts Regulation FD’s net widely to catch coded terms or any other form of “indirect” or “implied” guidance. Hence, code has the same status and poses the same potential liability as a direct statement. Query how the Commission will prove the existence of “indirect” or “implied” guidance. ⁵⁸
Similarly, an issuer cannot render material information immaterial simply by breaking it into ostensibly non-material pieces.	Slicing information so thinly such that each individual piece is so small as to be immaterial will not work. On the other hand, individually immaterial pieces of information constitute the chips to fill in the analyst’s “mosaic.” The difference between these two points is more than the intent of the speaker and goes to the very nature of the facts being disclosed.
<i>Paragraph Two</i>	
At the same time, an issuer is not prohibited from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a “mosaic” of information	The Commission announces that the “mosaic” theory articulated by the Second Circuit in <u>Elkind</u> ⁵⁹ is alive and well. ⁶⁰ The phrase “unbeknownst to the issuer” is new to the mosaic theory and does not appear in <u>Elkind</u> . However, we do not believe that

the “reasonable investor” would not consider important could be a call with an analyst right after the issuer has publicly disclosed forward-looking information in a fulsome manner in compliance with Regulation FD. In that situation, the issuer may be able to walk the analyst up or down without violating Regulation FD since the substance of the discussion would not be material. See Walker Speech at 6; Regulation FD Telephone Interpretations, Question 1 (discussed in the Outline at Section III.A.1.c, *infra*).

⁵⁸ The Walker Speech states that using code is one of the cases the Division of Enforcement will be interested in pursuing under Regulation FD.

⁵⁹ In Elkind, the court stated 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.” See Elkind, 635 F.2d at 165 (emphasis added).

⁶⁰ The Walker Speech gives the following example of mosaic information: “Many of you may have seen a television commercial in which a mutual fund company boasts that it goes to greater lengths than its competitors to take care to invest its customers’ money wisely. As an example of its diligence, the narrator relates that the fund investigated the type of fire-prevention system used by a computer company in which it was contemplating investing. As explained by the narrator, a traditional sprinkler system that would flood a warehouse could result in terrible damage to the company’s products, and presumably to its bottom line. Instead, the fund determined that the computer company employed a dry, chemical-based fire prevention system that would not damage its products.” Walker Speech at 9.

TEXT OF RELEASE	ANALYSIS OF TEXT
that, taken together, is material.	an issuer’s lack of awareness is a necessary condition to the theory. In <u>Bausch & Lomb</u> , the Second Circuit stated that the “Commission itself has recognized that corporate management may reveal to securities analysts or other inquirers non-public information that merely fills ‘interstices in analysis’ or tests ‘the meaning of public information.’” ⁶¹ Therefore, an issuer can knowingly convey an immaterial fact to an analyst. What the issuer must be careful of, however, is not to knowingly break a material fact down into immaterial pieces and provide them to an analyst in a nonpublic manner. The first technique complies with Regulation FD; the second may not.
Similarly, since materiality 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.	The Commission has established a dichotomy between the “reasonable investor” and the “sophisticated investor” or analyst, who has a combination of “persistence, knowledge and insight” (the “PKI investor”). An issuer may selectively disclose information that is not important to the reasonable investor – and hence, is not “material” – and yet is important to the PKI investor, who recognizes its significance and uses it to reach a conclusion and make a recommendation.
Analysts can provide a valuable service in sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions. We do not intend, by Regulation FD, to discourage this sort of activity.	In these two sentences, the Commission shows that it remembers the holding of <u>Dirks v. SEC</u> and, more significantly, that the Commission believes that Regulation FD is not intended to thwart the analyst activity the Supreme Court endorsed in <u>Dirks</u> . The Commission’s “mosaic” theory enables issuers, if they so choose, to selectively disclose immaterial, nonpublic information to analysts or PKI investors. The issuer’s risk is that the nonpublic disclosure of the immaterial fact to the PKI investor could later be held by a court to be material to the reasonable investor.
The focus of Regulation FD is on whether the issuer discloses material nonpublic information, not on whether an analyst, through some combination of persistence, knowledge, and insight, regards as material information whose significance is not apparent	Consistent with <u>Dirks</u> , the Commission focuses on the issuer, not the analyst. Materiality will not be decided by what the analyst, or PKI investor, considers important. Moreover, this sentence also points out that the two most important elements of Regulation FD are materiality and nonpublic status.

⁶¹ See SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 14 (2d Cir. 1977).

TEXT OF RELEASE	ANALYSIS OF TEXT
to the reasonable investor.	Both must be present before the other requirements of Regulation FD are triggered.

- c. The Release does not establish a bright-line test or an exclusive list of material items for purposes of defining materiality under Regulation FD. The Release, however, provides a list of types of information or events that the Commission believes “should be reviewed carefully to determine whether they are material.” Given the facts and circumstances nature of determining materiality, this list should be viewed solely as what the Release says it is – guidance – and should not be construed as an enumeration of material facts or events. The list consists of:
- (1) earnings information;
 - (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets;
 - (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract);
 - (4) changes in control or in management;
 - (5) changes in auditor or auditor notification that the issuer may no longer rely on an auditor’s audit report;
 - (6) events regarding the issuer’s securities – e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and
 - (7) bankruptcies or receiverships.⁶²
- d. The Release defines “nonpublic” as follows: “Information is nonpublic if it has not been disseminated in a manner making it available to investors generally.”⁶³

⁶² The Walker Speech states that 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.” Walker Speech at 5.

- (1) For information to be public, it must be disseminated through recognized channels of distribution.
 - (2) However, if an issuer has “filed” or “furnished” a report on EDGAR in compliance with the Exchange Act’s requirements, the information in the report is “public” and can therefore be disclosed to a limited audience so long as the issuer confirms, prior to making the disclosure, that the report received a filing date no later than the date of the disclosure.⁶⁴ No reasonable waiting period is required. Hence, under Regulation FD, an issuer may furnish a report on Form 8-K via EDGAR at 9:00 a.m., receive confirmation of the filing date at 9:10 a.m., and disclose the information to a limited, private audience at 9:11 a.m.
3. Disclosures to securities market professionals or securityholders
- a. Regulation FD prohibits selective disclosure of material, nonpublic information only to enumerated categories of persons:
 - (1) broker-dealers and their associated persons, such as analysts;
 - (2) investment advisers and institutional investment managers, and their associated persons;
 - (3) registered investment companies and unregistered private investment companies (such as hedge funds and some venture capital funds) and their affiliated persons; and
 - (4) holders of the issuer’s securities, if it would be “reasonably foreseeable” that the holders will trade on the basis of the information.
 - b. Certain communications to these enumerated persons are exempt under Regulation FD. The exempt communications include:
 - (1) disclosures to persons who owe a duty of trust or confidence to the issuer, such as an attorney, an investment banker or an accountant;

⁶³ Release, 65 Fed. Reg. at 51721 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854 (2d Cir. 1968); In re Investors Management Co., 44 S.E.C. 633, 643 (1971)). See Outline at Section II.C.3.g, infra, for a discussion of public dissemination as developed in the insider trading case law.

⁶⁴ See Regulation FD Telephone Interpretations, Question 6.

- (2) disclosures to persons who expressly agree to maintain the disclosed information in confidence;
 - (3) disclosures to rating agencies, provided the information is disclosed solely for the purpose of developing a credit rating and the issuer's ratings are publicly available; and
 - (4) disclosures made in connection with most securities offerings registered under the Securities Act.
 - (a) Regulation FD delineates the beginning and ending dates for underwritten and non-underwritten offerings, offerings in connection with mergers, and all other offerings. Outside of these defined time periods, the securities offering exemption will not apply.⁶⁵
 - (b) Registered shelf offerings under Rule 415 (a)(1)(i)-(vi) – which include Drips, employee benefit and option plans on Form S-8 and selling securityholder shelves -- are subject to Regulation FD. Because these offerings are of an “ongoing and continuous nature,” issuers would be exempt from Regulation FD for “extended periods of time” if the exclusion for securities offering covered them.⁶⁶
- c. The exemption created by the duty of trust owed to the issuer by an investment banker does not permit an issuer to disclose material, nonpublic information to others within the banker's firm who are

⁶⁵ Rule 101(g). Rule 101(g)(1) deems an underwritten public offering to commence when an issuer reaches an understanding with a managing underwriter. While this definition may be appropriate in certain public offerings, it is too simplistic and not practical or realistic in many other public offerings, particularly offerings off a shelf registration statement. For example, an issuer could avoid Regulation FD merely by naming the managing underwriter in the core prospectus of a universal shelf registration statement. Footnote 82 of the Release recognizes the complexity of the offering process. Forward-looking statements at regularly scheduled analyst conference calls should not be considered “in connection with an offering simply” because the issuer is making a registered offering at the same time. Given the potential for confusion between corporate communications in the ordinary course of business and those in the public offering process, the standards of Rule 139 under the Securities Act can provide guidance. There, research reports distributed with reasonable regularity in the normal course of business are not considered a Section 5 event under Rule 139(a). A similar dividing line should be followed for corporate communications. Further interpretive guidance from the Staff is therefore needed to avoid a collision between the Securities Act and Regulation FD.

⁶⁶ Rule 100(b)(2)(iv); see Release, 65 Fed. Reg. at 51725, fn. 80.

not subject to such a duty (for example, sell-side analysts), and, by the same token, an issuer will not be deemed to have disclosed material, nonpublic information to such persons in its dealings with the banker.

- d. The Release makes clear that Regulation FD does not cover disclosures to the press or ordinary-course business communications with persons, such as customers or suppliers.⁶⁷ Even if the journalists or the customers or suppliers are securityholders of the issuer, Regulation FD would not apply because it prohibits selective disclosure to securityholders only if it would be “reasonably foreseeable” that the holder will trade on the basis of the information. The Release states that it would not be foreseeable for an issuer “engaged in an ordinary-course, business-related communication” to expect such holder to trade on the basis of material information obtained in his representative capacity. And if such holder did so, he could be subject to liability under the misappropriation theory of insider trading.⁶⁸
- e. An issuer may disclose material, nonpublic information to its employees (who may also be securityholders) without making public disclosure of the information. The Commission notes that Regulation FD “applies to disclosures made to ‘any person outside the issuer.’ Regulation FD does not apply to communications of confidential information to employees of the issuer.”⁶⁹ Since the employees are subject to duties of trust and confidence, they would face insider trading liability if they trade or tip.⁷⁰
- f. Regulation FD exempts disclosures made to “a person who expressly agrees to maintain the disclosed information in confidence.”⁷¹ According to the Release, an “express” confidentiality agreement need not be in writing and need not be obtained before making the disclosure. “An agreement obtained after the disclosure is made, but before the recipient of the information discloses or trades on the basis of it, will be sufficient. In this manner, an issuer that has mistakenly made a selective disclosure of material, nonpublic information may try to avoid any harm resulting from the selective disclosure by obtaining from the

⁶⁷ See Release, 65 Fed. Reg. at 51719.

⁶⁸ See *id.* at 51720, fn. 27.

⁶⁹ See Regulation FD Telephone Interpretations, Question 13.

⁷⁰ For an example of this scenario, see Hypothetical #11 in Appendix A.

⁷¹ Rule 100(b)(2)(ii).

recipient of that disclosure an agreement not to disclose or trade on the basis of the information.”⁷² Since neither Regulation FD nor the Release defines what “express” means, there are two ways to analyze the term: contract law principles; and Staff statements. The Staff’s position in this area may change as more experience is gained under Regulation FD.

- (1) Contracts are often spoken of as “express” or “implied in fact.” When parties manifest their agreement by language, the contract is said to be “express.” When it is manifested by conduct, it is said to be “implied in fact.”⁷³ The distinction is formalistic and usually unimportant to whether there was a meeting of the minds.⁷⁴ The important point is the clarity of expression used to indicate agreement.⁷⁵ For example, if a private placement memorandum (a “PPM”) is delivered in a sealed envelope that is clearly marked with a legend stating, “By opening this PPM, you agree to keep this information confidential,” and the recipient opens the PPM, or if the PPM’s legend states, “By clapping your hands three times, you agree to keep this information confidential,” and the recipient claps her hands three times (and there is no other reason why she would do so), then the act of opening the PPM or clapping one’s hands should qualify as an “express” confidentiality agreement because the parties have clearly expressed their intent to be so bound.
- (2) In the Staff’s view, an express agreement requires a meeting of the minds, an oral or written acknowledgement

⁷² Release, 65 Fed. Reg. at 51720, fn. 28.

⁷³ See John D. Calamari & Joseph M. Perillo, Contracts §1-12 (3d ed. 1987).

⁷⁴ The Second Restatement of Contracts states that the “distinction involves . . . no difference in legal effect, but lies merely in the mode of manifesting assent.” See Restatement (Second) of Contracts §4 cmt. a (1981). Indeed, language can be confusing, and conduct can be very clear. Furthermore, many contracts are partly “express” and partly “implied in fact.” For example, if A telephones a plumber to come to A’s house to fix the shower, it may be inferred that A has agreed to pay the plumber a reasonable fee for his services although nothing is said of this. If the plumber arrives and fixes the shower, it may be inferred that the plumber expects payment for his services although nothing is said of this.

⁷⁵ As Professor Corbin observed, “The distinction between an express and an implied contract . . . is of little importance, if it can be said to exist at all. The matter that is of importance is the degree of effectiveness of the expression used. Clarity of expression determines the reasonableness of understanding and eases the court’s problem in case of dispute.” See 1 Arthur L. Corbin & Joseph M. Perillo, Corbin on Contracts §1.19 (rev. ed. 1993).

on the part of the person assuming the duty to keep the information confidential. While this affirmative expression of agreement can be manifested in numerous ways, the Staff does not believe that merely turning the page of a PPM or other similar conduct is sufficient to constitute an express agreement.

- (3) Regulation FD does not require an express confidentiality agreement to contain an additional statement that the recipient agrees not to trade on the basis of the information.⁷⁶
 - (4) An acknowledgement that the recipient of material, nonpublic information will not use the information in violation of the federal securities laws does not constitute an express confidentiality agreement under Regulation FD. Rather (and simply), the recipient must expressly agree to keep the information confidential.⁷⁷
 - (5) Entering into an express confidentiality agreement may subject the analyst to potential insider trading liability as a temporary insider if the analyst trades or tips on the basis of the material, nonpublic information. Rule 10b5-1(c)(2) offers a solution to multi-service financial institutions. The institution has to have reasonable policies and procedures, such as Chinese Walls, in place and working to safeguard against material, nonpublic information passing from those subject to confidentiality agreements to other persons in the firm, such as the persons on the trading desk.⁷⁸
- g. Embargoing information – i.e., selectively disclosing material, nonpublic information to the recipient who agrees not to disclose the information until public disclosure is made or for a certain period of time – is a variation of the express confidentiality agreement and, as such, qualifies for exemption under Regulation FD. During the period of the embargo, the recipient, whether a journalist, an analyst or an investor, owes a duty of trust and confidence to the issuer and can be viewed as a temporary insider of the issuer.⁷⁹

⁷⁶ See Regulation FD Telephone Interpretations, Question 10.

⁷⁷ See *id.*, Question 11.

⁷⁸ See Rule 10b5-1(c)(2). For a discussion of this rule, see Outline at III.E.4, *supra*.

⁷⁹ See *SEC v. Lund*, 570 F. Supp. 1397, 1402 (C.D. Cal. 1983).

- (1) Issuers may choose to disclose material, nonpublic information to analysts in advance of public dissemination to give analysts additional time to digest and analyze the information as well as to draft a report or prepare other responses to the information (such as buy or sell recommendations). In so doing, issuers could reward analysts at the possible expense of other market participants because once the embargo is lifted, analysts would be able to act upon the information more quickly than other market participants who were not privy to the embargoed information in advance, absent any restrictions in the confidentiality agreement. The difference in reaction time to the information could result in economically significant gains and losses.
- (2) From the analyst's perspective, the embargo means that the disclosed information must be kept in confidence until the information has been publicly disseminated or for a certain period of time, but the analyst will have additional time to prepare responses to the information. Although an analyst may not disclose the information to a client during an embargo, the analyst may nonetheless try to anticipate clients' reactions to the information by having a computer program ready to execute market orders as soon as the embargoed information has been publicly disseminated. If the analyst breaches the confidentiality agreement by disclosing the information to a client, "the analyst may be liable for illegal tipping if the client trades."⁸⁰
- (3) Questions remain, even though embargoes, as express confidentiality agreements, are exempt from Regulation FD. These questions include:
 - (a) Once the embargo is lifted, when may analysts act upon the selectively disclosed information? Under Regulation FD, information is public when "disseminated in a manner making it available to investors generally."⁸¹ Absent any other duty or obligation, it would seem that, post-embargo, analysts would be able to act upon the information as soon as the information becomes public. However, if analysts are construed as "temporary

⁸⁰ See Walker Speech at 8.

⁸¹ See Release, 65 Fed. Reg. at 51721.

insiders” of the issuer for having entered into a “special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes,”⁸² they may be subject to Rule 10b-5 liability for trading prior to the time the information has been received and reacted to by the marketplace.⁸³ Under Rule 10b-5, as the Second Circuit noted in SEC v. Texas Gulf Sulphur Co., “[b]efore insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public.” Furthermore, “where the news is of a sort which is not readily translatable into investment action, insiders may not take advantage of their advance opportunity to evaluate the information by acting immediately upon dissemination.”⁸⁴ Consequently, the question of when analysts may act upon the selectively disclosed information once the embargo is lifted may depend upon the nature of the information and other facts and circumstances. While the court in Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc. stated, “[i]t is rather doubtful that disclosure is instantaneously achieved upon release of the information to the press,”⁸⁵ query whether the same statement is relevant in the Internet age.

- (b) Another open question concerns the scope of the recipient’s use of the material, nonpublic information during the embargo. For example, if the issuer is in the computer hardware business and selectively discloses to an analyst under an embargo that its fourth quarter revenues are expected to decrease significantly, it is unclear whether the analyst may use the information before the embargo ends to sell the stock of the issuer’s competitors, on the theory that the issuer’s revenue downturn is

⁸² See Dirks v. SEC, 463 U.S. 646, 655 fn. 14 (1983).

⁸³ See Lund, 570 F. Supp. at 1402.

⁸⁴ See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854, 854 n.18 (2d Cir. 1968).

⁸⁵ See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F. Supp. 264, 279 (S.D.N.Y. 1972), aff’d, 495 F.2d 228 (2d Cir. 1974).

most likely a sector-wide downturn. While such trading does not violate Rule 10b-5, it could potentially cause a sell-off in the sector generally, thereby affecting the issuer as well as the issuer's competitors. This question can be addressed in the embargo agreement between the issuer and the recipient of the information.

- h. Any misuse of material, nonpublic information by persons who owe a duty of trust or confidence to the issuer, or who have expressly agreed to keep such information in confidence would be covered under either the "temporary insider" or the misappropriation theory of insider trading.⁸⁶
- i. Although disclosures to persons enumerated in Regulation FD that are made in connection with most registered securities offerings are exempt from Regulation FD, communications that are not made "in connection" with a registered offering are not exempt.⁸⁷
 - (1) For example, footnote 82 of the Release states that an issuer's material disclosures in a regularly scheduled analyst call would not be considered to be made "in connection" with a registered offering "simply because the issuer was in the midst of a registered offering at that time."⁸⁸
 - (2) In contrast, communications at road shows should be considered as being made "in connection" with a registered securities offering and would be exempt from Regulation FD.
- j. Selective disclosure to securityholders is prohibited when it is "reasonably foreseeable" that the securityholder will trade on the basis of the information. Although this is a vague standard, the Release offers some guidance, stating that "it ordinarily would not

⁸⁶ Rule 10b5-2 clarifies insider trading law by expressly defining the circumstances under which a person has a duty of trust or confidence for purposes of the misappropriation theory of insider trading. Rule 10b5-2 states that a duty of trust or confidence exists "whenever a person agrees to maintain information in confidence" or whenever there is a "history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material, nonpublic information expects that the recipient will maintain its confidentiality," among other circumstances.

⁸⁷ Rule 101(g)(1) defines "in connection with" solely for purposes of Regulation FD.

⁸⁸ Release, 65 Fed. Reg. at 51725, fn. 82.

be foreseeable for the issuer engaged in an ordinary-course business-related communication with ... [a securityholder] to expect the ... [securityholder] to buy or sell the issuer's securities on the basis of the communication."⁸⁹ Moreover, the Release assumes that the issuer will know whether or not a person is a holder of its securities when such may not be the case. Nor does Regulation FD identify the type of holder – whether record or beneficial. Without clarification, Rule 100(b)(1)(iv) could be very broad indeed.

4. The issuer must make public disclosure
 - a. Regulation FD provides for two types of adequate public disclosure:
 - (1) File a report under Item 5 of Form 8-K or “furnish” a report under Item 9 of Form 8-K that is not deemed “filed”; or
 - (2) Any other method (or combination of methods) reasonably designed to provide broad, non-exclusionary distribution of the information to the public.

Regulation FD does not require use of a particular method of non-Form 8-K disclosure but leaves the decision to the issuer to choose methods that are reasonably calculated to make an effective, broad and non-exclusionary public disclosure, given the particular facts and circumstances of each disclosure.

- b. If an issuer chooses to “file” the information pursuant to Item 5 of Form 8-K, the information will be subject to liability for misleading statements under Section 18 of the Exchange Act.⁹⁰ The information also will be subject to automatic incorporation by

⁸⁹ Id. at 51720, fn. 27.

⁹⁰ Section 18 of the Exchange Act provides that “[a]ny person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration statement . . . which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading.” Section 18, the rarely used, express liability provision of the Exchange Act, requires “eyeball reliance” to be shown by the plaintiff. With widespread use of EDGAR and no ability for domestic issuers to make paper filings, Section 18 could become a fertile field of litigation for filings under Item 5 of Form 8-K.

reference into the issuer's Securities Act registration statements, which are subject to liability under Sections 11 and 12(a)(2) of the Securities Act. If an issuer chooses instead to "furnish" the information under Item 9 of Form 8-K, it will not be subject to liability under the Section 11 of the Securities Act or Section 18 for the disclosure, unless it takes steps to include that disclosure in a filed report, proxy statement, or registration statement. All disclosures on Form 8-K, whether filed or furnished, will remain subject to the antifraud provisions of the federal securities laws.

- (1) Issuers must designate in the Form 8-Ks whether they are "filing" pursuant to Item 5 or "furnishing" pursuant to Item 9.
 - (2) Form 8-K has been amended to provide that neither filing nor furnishing information on Form 8-K solely to satisfy Regulation FD will, by itself, be deemed an admission as to the materiality of the information.⁹¹
- c. Exchange Act filings other than a Form 8-K, such as a Form 10-Q or a proxy statement, satisfy Regulation FD's public dissemination requirement so long as they are timely, and the disclosures are brought to the reader's attention and are not buried in the filing or made in piecemeal fashion throughout the filing.⁹²
- d. The Release is unclear as to whether webcasting, in and of itself, constitutes a method that provides "broad, non-exclusionary distribution of the information to the public."⁹³ On the one hand, the Release states that "electronic transmission (including use of the Internet)" is an acceptable method.⁹⁴ This viewpoint is supported by the Release's description of the "best practices" for

⁹¹ See Release, 65 Fed. Reg. at 51723.

⁹² See Regulation FD Telephone Interpretations, Question 5. In April 2001, the Staff responded to questions concerning the dissemination of annual reports and conducting annual meetings. For purposes of the annual report, registrants need to evaluate the methods of dissemination. Use of a variety of methods will assure compliance with Regulation FD. Since the annual meeting is subject to Regulation FD, a registrant that does not simultaneously webcast the meeting should be mindful of disclosing material, nonpublic information at the meeting.

⁹³ Rule 101(e)(2).

⁹⁴ "As a general matter, acceptable methods of public disclosure for purposes of Regulation FD will include press releases distributed through a widely circulated news or wire service, or announcements made through press conferences or conference calls that interested members of the public may attend or listen to either in person, by telephonic transmission or by other electronic transmission (including use of the Internet)." Release, 65 Fed. Reg. at 51723-51724.

public disclosure.⁹⁵ On the other hand, the same section of the Release which contains the statements that appear to endorse webcasting as a separate means, states that “posting of information on an issuer’s website may not now, by itself, be a sufficient means of public disclosure”⁹⁶ Thus, while it is clear that webcasting can be used in combination with other methods and can be the sole source of a notice for a conference call, the Release can be read both ways on whether webcasting, not accompanied by a press release containing substantive disclosure or an (800) number, open to the public, constitutes an adequate means for disseminating a conference call.⁹⁷

- (1) Given the cost difference between webcasting and an unlimited access (800) number as well as the consequences of failure to comply with Regulation FD, webcasting should be considered a separate method that complies with Regulation FD’s dissemination requirement, especially if it is accompanied by a timely press release adequately providing notice to the public of how to access the webcast. Public company practice is already heading in this direction.
- (2) The Staff’s view of webcasting appears to be based on the fact that not everyone has a computer, and therefore, not everyone can access a webcast. The Staff’s current position is that for a regular earnings conference call that is webcast, a company would need to publish a press release containing notice as well as the substantive disclosure of information to be covered by the call. If information is disclosed on the conference call that is reasonably related to the disclosure in the release, Regulation FD would not be violated. The Staff is uncomfortable if matters not covered by the press release are disclosed in a conference

⁹⁵ “First, issue a press release, distributed through regular channels containing the information; Second, provided adequate notice, by a press release and/or website posting, of a scheduled conference call to discuss the announced results, giving investors both the time and date of the conference call, and instructions on how to access the call; and Third, hold the conference call in an open manner, permitting investors to listen in either by telephonic means or through Internet webcasting.” Id. at 51724.

⁹⁶ Id.

⁹⁷ Query whether having the webcast available to the public for a certain period of time after the conference call would constitute a satisfactory means of dissemination if the notice for the conference call itself was deficient or the information in the conference call was not disseminated in accordance with Rule 101(e)(2).

call communicated solely by a webcast. There are facts and circumstances, such as the announcement of a merger, in which the press release need not contain the substantive disclosure. The Staff has also stated that it would not find a webcast that is adequately noticed to be a very appealing fact pattern for an enforcement case.

- (3) For Regulation FD to be workable, public companies have to be able to comply in a cost-effective manner. Not only is webcasting cost-effective, but it provides the simultaneity Regulation FD requires for intentional statements. It also permits a senior official on a conference call to answer a question without concern of violating FD and thus promotes the full-disclosure-on-a-level-playing-field purpose of Regulation FD. If webcasting is not a separate means of compliance, companies could charge for public access to an (800) number since everyone has access to a telephone, or could take other steps to comply with the rule, such as not having conference calls or taking a different view as to what constitutes material information. On balance, the webcast is an important safety valve to reach a workable regulation. Without it, the best practices described in the Release could become the only practice, the cost of which would be shouldered by companies and their shareholders.
 - (4) Providing notice of a conference call, as Regulation FD requires, can be satisfied by posting the notice on the issuer's website only.⁹⁸
- e. An issuer cannot satisfy Regulation FD's public dissemination requirement by opening a meeting or a conference call to all of its securityholders, but not to the public generally.⁹⁹
 - f. The mere presence of the press at a meeting to which the public is not invited or otherwise present does not necessarily mean that the meeting satisfies FD's public dissemination requirement. Whether or not the meeting will be deemed public would depend, among

⁹⁸ As the Release instructs, "provide adequate notice, by a press release and/or website posting, of a scheduled conference call" (emphasis added). See Release, 65 Fed. Reg. at 51724.

⁹⁹ See Regulation FD Telephone Interpretations, Question 4.

other things, on when, what and how widely the press reports on the meeting.¹⁰⁰

- g. The Release approves the use of (800) call-in numbers, which are toll-free, as a means for permitting the public to access an analyst or a conference call; however, the Release is silent as to whether a regular long-distance number, which is not toll-free, would satisfy Regulation FD's public disclosure requirement. The only distinction between the two methods is cost, and given that most mediums for disseminating information require some payment by the recipient – e.g., monthly fees for cable television and Internet access and telephone service, daily or subscription costs for newspapers – it would seem to be a distinction without a difference.
- h. Filing a “procedural” Form 8-K – a one-time report in which the issuer states that subsequent disclosures deemed appropriate in light of Regulation FD will be posted on its website – does not comply with Regulation FD's public dissemination requirement.¹⁰¹
 - (1) The putative rationale under Regulation FD for this form of a procedural 8-K is that filing a Form 8-K is per se adequate dissemination. Hence, if the Form 8-K states that future disclosures will be made only on the issuer's website, then the website also qualifies as an adequate method of public dissemination.¹⁰²
 - (2) Procedural 8-Ks are problematic under Regulation FD. The Release states that an “issuer's posting of new information on its own website would not by itself be considered a sufficient method of public disclosure.”¹⁰³ Yet, under a procedural 8-K, the material, nonpublic information is disclosed only on the website. Directing the public to a website via a Form 8-K does not address the

¹⁰⁰ See Regulation FD Telephone Interpretations, Question 16.

¹⁰¹ See Walker Speech at 3.

¹⁰² Altera Corp. has used a variation of the procedural Form 8-K by substituting a press release for a Form 8-K directing the public to its website. In its October 16, 2000 press release announcing third-quarter earnings, Altera stated it would post updates for its fourth quarter on its website on October 31 and November 28. The public could also receive the updates by calling Altera's investor relations department. It is unlikely that this form of public dissemination satisfies Regulation FD. See Dinah Wisenberg Brin, Did Altera's News Post on Web Meet New Disclosure Rule?, Dow Jones Newswires, Nov. 1, 2000.

¹⁰³ See Release, 65 Fed. Reg. at 51724 (emphasis added).

Commission's concern that currently, insufficient public access to, and use of, computers and the Internet disqualify a website from serving as the sole medium of public dissemination under Regulation FD. Indeed, an issuer cannot do indirectly what the Commission states cannot be done directly. Should the Commission change its position on websites and deem a website to be an adequate means of dissemination, then a procedural Form 8-K would be unnecessary.

- (3) Some issuers have recently experimented with a variation of the procedural 8-K, substituting a press release notice for a Form 8-K and improving the substance of the notice to provide the date and time on which the material, nonpublic information will be posted on the website. This variation has the same analytical problems that the procedural 8-K has.¹⁰⁴
- (4) The Commission states that as “technology evolves and as more investors have access to and use the Internet . . . we believe that some issuers, whose websites are widely followed by the investment community, could use such a method [by itself].”¹⁰⁵ Indeed, the Commission has already approved the sole use of websites for posting notices of conference calls. We expect change in this area as issuers continue to experiment with various media techniques, technology improves, the public becomes more sophisticated in its use of various media and technology, and consequently, the Staff accepts additional methods or combinations of methods as adequate dissemination.
 - i. The Release sets forth an approved model for making a planned disclosure of material information, which involves a combination of different forms of media:
 - (1) First, the issuer should issue a press release, distributed through its regular channels, which contains the material information;

¹⁰⁴ “One method of disclosure that the SEC specifically states will not of itself satisfy Regulation FD is the mere posting of information on a company’s website.” Gibson, Dunn & Crutcher, SEC Adopts Regulation FD to Restrict Selective Disclosure, *The Securities Reporter* (ABA Section of Business Law Committee on Federal Regulation of Securities), Fall 2000, vol. 5, issue 3, at 12.

¹⁰⁵ Release, 65 Fed. Reg. at 51724.

- (2) Second, the issuer should hold a conference call and notify the public, by another press release and/or website posting, of the time and date of the call, and instructions on how to access the call; and
 - (3) Third, the conference call should be open to the public, either by telephone or through Internet webcasting,¹⁰⁶ but the public need not participate and the call may be conducted in listen-only mode.
- j. Other than filing or furnishing the information on Form 8-K or using the Commission's proposed disclosure approach outlined above, there is no per se acceptable method or methods of public disclosure applicable for all issuers. Press releases distributed through a widely circulated news or wire service, press conferences, or conference calls that are open to the public (whether by attendance or telephonic or electronic means) are generally acceptable.
- (1) Issuers must provide "adequate" notice of conference calls and the means for accessing them. An adequate advance notice under Regulation FD must include the date, time and call-in information for the conference call. Public notice should be provided a "reasonable" period of time ahead of the conference call. The time period for a notice may be shorter when unexpected events occur and when the information is critical or time sensitive.¹⁰⁷ A press release or a posting on a website constitutes an adequate form of notice.¹⁰⁸ If an issuer intends to make a transcript or a replay of the conference call available on the issuer's website, the Commission encourages issuers to indicate in the notice how, and for how long, such record will be available to the public.

¹⁰⁶ The Commission believes that the issuer should consider making the conference call available to the public for some "reasonable period of time" after the call occurs to enable people who missed the call to access it later; however, issuers should limit this period to avoid "staleness" of the information. See Release, 65 Fed. Reg. at 51724, fn. 73. However, leaving the webcast on the issuer's website can result in potential liability issues under the Securities Act if the issuer is making a public offering of its securities. The Staff could take the position that the webcast that is open to the public is a prospectus even though it is exempt from Regulation FD.

¹⁰⁷ See Regulation FD Telephone Interpretations, Question 3.

¹⁰⁸ See Release, 65 Fed. Reg. at 51724.

- (2) For a pure notice-only press release, issuers may want to consider stating in their notice that forward-looking information may be discussed in the conference call, rather than enumerating or describing the topics that will be discussed on the call.
 - (3) It is unclear whether disclosure to the media absent a press release will satisfy the obligations for public disclosure because there is no way to be certain whether, when and in what manner the media will distribute the information.
- k. Even generally acceptable methods may not be reasonable methods of disclosure for certain issuers. The Commission states that if an issuer knows that its press releases are not routinely carried by major business wire services, then a press release, in and of itself, may not be sufficient public disclosure for that issuer.
 - l. One method may not be sufficient. The Commission states that it may not always be possible or desirable for an issuer to rely on a single method of disclosure.
 - m. Similarly, an issuer's deviation from its standard practice for making public disclosures may affect the Commission's determination as to whether a method chosen in a particular case is reasonable.
 - n. In addition to Regulation FD, the listing agreements of self-regulatory organizations ("SROs"), such as the New York Stock Exchange ("NYSE") and the National Association of Securities Dealers Automated Quotation System ("Nasdaq"), require companies to issue press releases to announce material developments and impose their own timing requirements.
 - (1) The NYSE Listed Company Manual provides that "a listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities"¹⁰⁹ by means of a press release. The NYSE is expected to affirm its reliance on press releases to comply with its rules.
 - (2) The NASD Manual provides that "except in unusual circumstances, the issuer shall make prompt disclosure to the public through the news media of any material information that would reasonably be expected to affect the

¹⁰⁹ See New York Stock Exchange Listed Company Manual, para. 202.05.

value of its securities or influence investors' decisions and shall, prior to the release of the information, provide notice of such disclosure to Nasdaq's Market Watch Department."¹¹⁰

- (3) Accordingly, even if a press release may not be a reasonable method of distribution of information for a particular issuer, it may nonetheless be required by the company's listing agreement. The Release states that it does not "intend Regulation FD to alter or supplant the SRO requirements."¹¹¹

5. Simultaneously, in the case of an intentional disclosure

- a. For disclosure to be "intentional," the individual either must know, or be reckless in not knowing, that the information he or she is communicating is both material and nonpublic.¹¹²

- (1) By requiring that the individual know, or be reckless in not knowing, that a fact is material, Regulation FD appears to be setting the liability bar very high. The Commission states that in the case of an intentional selective disclosure attributable to a mistaken determination of materiality, liability "will arise only if no reasonable person under the circumstances would have made the same determination."¹¹³

- (a) This bar to liability under Regulation FD could be lowered if the individual consults with legal counsel prior to making the selective disclosure. For example, in the context of private offerings, the Release advises that "[b]efore an exempt offering begins, issuer's counsel should advise the client of the potential complications that selective disclosure of material nonpublic information could raise."¹¹⁴ If a senior official consults with legal counsel, however, and the counsel advises the senior official

¹¹⁰ See National Association of Securities Dealers Manual, Rules 4310(c)(16), 4320(3)(14) and IM-4120-1.

¹¹¹ See Release, 65 Fed. Reg. at 51724, fn. 70.

¹¹² Rule 101(a).

¹¹³ See Release, 65 Fed. Reg. at 51722 (emphasis added).

¹¹⁴ See id. at 51725.

as to the materiality of a piece of information, then the senior official may know of its materiality, and could therefore become liable for the selective disclosure unless he/she simultaneously discloses it to the public.

- (b) Issuers may be forced to choose between consulting with legal counsel or relying on the “no reasonable person would have made the same determination” standard.
- (2) Regulation FD does not define “reckless,” and the Release relies on the prevailing definition of the term in the federal courts. “Recklessness” is usually defined as the “extreme departure from the standards of ordinary care,”¹¹⁵ and the Release suggests that “recklessness” is also determined by the context involved. For example, the Release notes that a “materiality judgment that might be reckless in the context of a prepared written statement would not necessarily be reckless in the context of an impromptu answer to an unanticipated question.”¹¹⁶
- (3) A good-faith effort by an issuer to comply with Regulation FD is unlikely to be considered to be reckless, even if hindsight suggests that a particular disclosure (or lack thereof) was unwise. The Commission dryly observes that a “pattern of ‘mistaken’ judgments about materiality would make less credible” a claim of unintentional disclosure.¹¹⁷
- (4) The Walker Speech states that recklessness means “we’re 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 standards of reasonable care in order for us to allege a violation of FD.”¹¹⁸

¹¹⁵ Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991) (cited in the Release for the definition of “recklessness”, 65 Fed. Reg. at 51722, fn. 56).

¹¹⁶ Release, 65 Fed. Reg. at 51722.

¹¹⁷ See id. at 51722, fn. 57. Indeed, the Walker Speech states that “we’ll be on the lookout for situations involving multiple violations that an issuer claims were non-intentional.” See Walker Speech at 6.

¹¹⁸ See Walker Speech at 4.

b. If the issuer makes an intentional disclosure, it must make public disclosure of that information “simultaneously.” Regulation FD does not define “simultaneously,” and the dictionary definition of the word means occurring at the same time or exactly coincident. Taken at its literal meaning, “simultaneous” means that if an issuer makes an intentional selective disclosure, it has no public disclosure remedy; otherwise, if an issuer “simultaneously” disclosed the material information to the public, there would be no selective disclosure problem in the first instance.

6. Promptly, in the case of an unintentional disclosure

a. If a company makes an unintentional disclosure,¹¹⁹ it must make public disclosure of that information “promptly.” Regulation FD defines “promptly” to mean as soon as reasonably practical, but in no event after the later of 24 hours or the commencement of the next day’s trading on the New York Stock Exchange after a senior official learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.¹²⁰

b. “Prompt” public disclosure offers issuers a remedy for good faith mistakes. In the typical situation, if a senior official selectively discloses information that he or she did not think was material, but the information causes the stock price to move, then the issuer can issue a press release within 24 hours and not run afoul of Regulation FD.

D. Potential Liability Exposure

Regulation FD is an issuer disclosure rule that creates duties for domestic public companies under Sections 13(a) and 15(d) of the Exchange Act (and for closed-end investment companies, under Section 30 of the Investment Company Act). Regulation FD is not an antifraud rule, nor does it create any new duties under the antifraud provisions of the federal securities laws or any new private rights of action. By requiring public speech, however, Regulation FD may indirectly create additional exposure under other provisions of federal and state securities laws.

¹¹⁹ Regulation FD does not define “unintentional.” The Proposing Release describes the word as “an honest slip of the tongue, or because the individual mistakenly (but not in reckless disregard of the truth) believed the information had already been made public.” 64 Fed. Reg. at 72596.

¹²⁰ Rule 101(d).

1. Violation of Regulation FD may subject the issuer to an enforcement action¹²¹ by the Commission, either in the form of an administrative proceeding seeking a cease-and-desist order or a civil action seeking an injunction and/or money damages.¹²²
 - a. The Commission will bring an enforcement action only for knowing or reckless conduct, and not for mistaken materiality determinations that were not reckless.¹²³
 - b. A failure to file or otherwise make required public disclosure will be considered a violation for as long as the failure continues. The Commission states that in enforcement actions, it will seek more severe sanctions for violations that continue for a longer period of time.¹²⁴
2. In addition, the Commission could bring an action against the individual(s) of the issuer who were responsible for the violation. In a cease-and-desist proceeding, the individual(s) would be liable as “a cause of” the violation.¹²⁵ If the Commission chose to bring an injunctive action, the individual(s) could be liable as aiders and abettors of the violation.¹²⁶
3. Failure to comply with Regulation FD will not by itself disqualify an issuer from using short-form registration for securities offerings or affect security holders’ ability to resell pursuant to Rule 144 of the Securities

¹²¹ The Walker Speech summarizes Enforcement’s policy on liability under Regulation FD: “Let me be clear. We 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 FD SWAT teams, and I do not envision any FD sweeps, unless, of course, there is widespread noncompliance with the rule, which I do not anticipate.” Walker Speech at 4.

¹²² See Release, 65 Fed. Reg. at 51726.

¹²³ See id. at 51718. The Walker Speech states that the Commission will be “on the lookout for two types of violations.” The first is “egregious violations involving the intentional or reckless disclosure of information that is unquestionably material.” The second is “cases against those who deliberately attempt to game the system either by speaking in code, or stepping over the line again and again, thus diminishing the credibility of a claim that their disclosures were non-intentional.” See Walker Speech at 5.

¹²⁴ See Release, 65 Fed. Reg. at 51726, fn. 91.

¹²⁵ See Section 21C of the Exchange Act.

¹²⁶ See Section 20(e) of the Exchange Act.

Act.¹²⁷ Of course, disclosure may have to be made to bring a registration statement current or to meet the current information requirements of Rule 144(c).

4. Regulation FD explicitly provides that failure to make a public disclosure required solely by Regulation FD will not be deemed a violation of Rule 10b-5.¹²⁸ If any statements made by an issuer under Regulation FD are found to be false or misleading, or inadequate because material information is omitted or not fully disclosed, the issuer may be liable under Rule 10b-5.
5. Public disclosure of material information pursuant to Regulation FD may create a duty to update or correct, and subsequent statements issued because of the duty to update or correct will not be protected by Regulation FD's Rule 10b-5 safe harbor.¹²⁹
6. Section 18 of the Exchange Act would create liability for false or misleading information "filed" – but not "furnished" -- on Form 8-K in compliance with Regulation FD. Also, liability may exist under Section 11 and Section 12 of the Securities Act when the filed Form 8-K is incorporated by reference into a registration statement.
7. An issuer may also potentially lose a private placement exemption under the Securities Act by making the public disclosures required by Regulation FD if the disclosure could be construed as a general solicitation.¹³⁰

¹²⁷ Rule 103.

¹²⁸ Rule 102.

¹²⁹ For a discussion of the duty to correct and the duty to update, see Outline at Section V.A, *infra*.

¹³⁰ See Release, 65 Fed. Reg. at 51725. It would be anomalous if an issuer making a private placement loses its exemption from registration because it is also trying to comply with Regulation FD. Such a Catch-22 could result in issuers deciding not to make the public disclosure. If issuers are "damned if they do and damned if they don't," Regulation FD will not be workable. Given Rule 135c under the Securities Act, the Commission by rule or the Staff by interpretation should clarify that the disclosure does not constitute an offer or sale under Section 5 of the Securities Act. Of course, there may be certain types of disclosure that are so egregious as to constitute a general solicitation, but for the most part, the disclosure can be crafted and put into an Item 9 Form 8-K so as to avoid the loss of an exemption. The Commission was sensitive to the loss of availability of Form S-3 and Rule 144 and should be similarly sensitive to the loss of an exemption from registration.

8. Regulation FD does not preempt the field of “tipper” liability under Rule 10b-5, “if a selective disclosure is made in circumstances that meet the Dirks ‘personal benefit’ test.”¹³¹
9. An issuer’s contacts with analysts, including the review of draft research reports or discussion of analyst models, could lead to liability under the entanglement or adoption theories.¹³²

III. Effects of Regulation FD

Regulation FD has caused companies, investment banks, market participants and investors to reexamine how they communicate with each other.¹³³ Each entity’s analysis depends, in part, on its own circumstances, such as its industry, how often it comes to the capital markets, what its current corporate communications practice is, as well as what its goals are and what its aversion to risk is.

A. Effect on Guidance to Analysts

1. Private discussions with analysts seeking guidance about earnings forecasts take on “a high degree of risk under Regulation FD.”¹³⁴ The Commission warns that an issuer would violate Regulation FD by selectively disclosing that its earnings are expected to be higher or lower than, or even the same as, what analysts have forecasted.¹³⁵ This would be true even if the information about earnings is not expressly stated, but is instead implied. This means that it could be highly problematic for issuers even to confirm that nothing has changed in a component of their earnings models (a common form of guidance). Likewise, it could be a problem to tell an analyst that the company is comfortable with his or her estimates or to cite the “street consensus” as to future earnings with approval. The Commission’s discussion indicates that most guidance, explicit or implied,

¹³¹ Release, 65 Fed. Reg. 51726. For a discussion of “tipper” liability, see Outline at Section V.C, *infra*.

¹³² *See* Release, 65 Fed. Reg. at 51726. For a discussion of the “entanglement” and “adoption” theories, see Outline at Section V.B, *infra*.

¹³³ Although not discussed in the Release, Regulation FD may also affect independent public accountants. Section 10A of the Exchange Act provides that if, during an audit, an issuer’s independent public accountant detects or becomes aware of information indicating that an illegal act has or may have occurred, such as a violation of Regulation FD, then the accountant must determine whether it is likely that an illegal act has occurred and, if so, (1) determine and consider the possible effect of the illegal act on the issuer’s financial statements, (2) inform the issuer’s management and (3) assure that audit committee or the board of directors if there is no audit committee is adequately informed of the illegal act.

¹³⁴ Release, 65 Fed. Reg. at 51721.

¹³⁵ *Id.* (emphasis added).

to analysts regarding financial forecasts or models can be considered material information under Regulation FD.

- a. As before adoption of Regulation FD, issuers must take care not to entangle themselves with the analyst's report or to adopt the report as their own.
- b. It is still permissible for a company to review a proposed draft of an analyst's report and correct matters of fact that are in the public record. Venturing into commenting on the analyst forecast or his/her model may be another matter altogether.
- c. An issuer may selectively confirm a forecast it has previously made to the public without triggering Regulation FD's public dissemination requirement so long as the confirmation is not material.¹³⁶ In deciding whether the confirmation is material, the Walker Speech states that issuers need to address three related questions:¹³⁷
 - (1) "First, where are they in the earnings cycle? It is generally safer to confirm guidance in the first half of a quarter than in the second, unless intervening events have occurred since the last public disclosure that could reasonably raise a question whether earnings would be affected.
 - (2) "Second, how much time has passed since the public guidance was given? If an issuer privately confirms guidance an hour or a day after it has been disclosed publicly, such a confirmation would not likely be material, unless perhaps the issuer is at the very tail end of the quarter.
 - (3) "Finally, issuers must ask whether anything important has happened in the interim period between the initial estimate

¹³⁶ By contrast, several companies have adopted a "Good Until Cancelled" policy of publicly confirming their forecasts on a continual basis. For example, Intel Corp. posts its quarterly projections on its website and states that "[p]rior to the start of the Quiet Period [which begins towards the end of Intel's fiscal quarter] . . . the public can continue to rely on the . . . [projections] on the website as still being Intel's current expectations on the matters covered unless Intel publishes a notice stating otherwise" (emphasis added). See Intel's website at <http://www.intel.com/pressroom>. By adopting this policy, Intel may have created an additional duty for itself: to update or correct its projections on a continual basis – i.e., at all times – until the start of its Quiet Period.

¹³⁷ See Walker Speech at 6. These points are based on Question 1 of the Regulation FD Telephone Interpretations.

and the confirmation that would likely cause a reasonable investor to question the continued accuracy of the initial estimate. If so, a confirmation could be material.”¹³⁸

- d. To respond to Regulation FD, issuers are considering including more forward-looking information in earnings press releases or in conference calls meeting Regulation FD’s dissemination requirements; and if the issuer makes its own forecast for a future period, how and under what circumstances the issuer will update the forecast.
- (1) If this approach is followed, the forecasts in press releases should be consistent with the issuer’s periodic reports under the Exchange Act. Many issuers include a forward-looking section in their regular Management’s Discussion and Analysis (“MD&A”) disclosure entitled “Factors Affecting Future Operating Results.” Such forward-looking additions to traditional historical disclosures should be considered as a place for issuers to disclose publicly subjects that they may otherwise wish to talk to analysts or investors about privately.
 - (2) The timing of updating the quarterly forecast presents much more complicated issues. The spectrum of alternatives ranges from: not updating during the quarter until the next earnings press release is issued to updating periodically during the quarter. The theory for periodic updates is that if the affirmation of the forecast could be a separate material fact six to eight weeks after it is originally published, the periodic update could serve a dual purpose: a public update in compliance with Regulation FD; and a way to be able to speak with analysts after the periodic update without triggering a separate public disclosure requirement each time it is done. While this approach complies with Regulation FD, it has downsides: the competition will know how the issuer is progressing during the quarter; black-out periods around the time of the affirmation press release may have to be imposed just as they were applied at the time of the original press release; the quiet period at the end of the quarter may have to be extended; and the issuer’s business may not lend itself to a progress report during the quarter – for example, the

¹³⁸ See id.

company may realize a high percentage of its sales in the last week of the quarter.

2. The Commission has warned that “an issuer cannot render material information immaterial simply by breaking it into ostensibly non-material pieces.”¹³⁹
3. Selectively disclosing non-material information to an analyst is permissible under Regulation FD, even if the analyst is able to use the “non-material” information to complete a “mosaic” of information that, taken together, is material.¹⁴⁰ The Commission has established a dichotomy between the “reasonable investor” and the analyst or PKI investor, who has a combination of “persistence, knowledge and insight.”¹⁴¹ An issuer may selectively disclose information that is not important to the reasonable investor – and hence, is not “material” – and yet can be important to the PKI investor, who recognizes its significance and uses it to reach a conclusion and make a recommendation. The Commission states that Regulation FD is not intended to discourage analysts who “can provide a valuable service in sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions.”¹⁴²
 - a. The Commission’s “mosaic” theory enables issuers, if they so choose, to selectively disclose immaterial, nonpublic information to analysts or PKI investors, but at the risk of making the correct ex ante judgment as to whether a reasonable investor would later find the information material.
 - b. The Commission has reaffirmed the mosaic theory. Whether described as a chip in a mosaic or a piece in a jigsaw puzzle, this theory was first described by the Commission in the 1971 action, In the Matters of Investors Management Co.,¹⁴³ and subsequently articulated by the district court and then the Second Circuit in the 1977 case of Bausch & Lomb and further elaborated in the 1980 case of Elkind v. Liggett & Myers, Inc.¹⁴⁴ However, in its

¹³⁹ See Release, 65 Fed. Reg. at 51721.

¹⁴⁰ See id. at 51722.

¹⁴¹ Id.

¹⁴² Id.

¹⁴³ In the Matters of Investors Management Co., Securities and Exchange Release No. 9267 (July 29, 1971) [1970-1971 Transfer Binder] Fed. Sec. L. Rep. Paragraph 78,163 at 80,521 (CCH).

¹⁴⁴ Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980).

description of the mosaic theory, the Release seems to have enlarged the theory's boundaries by indicating that issuers may exploit the difference between reasonable investors and PKI investors, but by how much more is unclear.

- (1) In Investors Management Co., the Commission “recognize[d] that discussions between corporate management and groups of analysts which provide a forum for filling interstices in analysis, for forming a direct impression of the quality of management, or for testing the meaning of public information, may be of value.”
- (2) In Bausch & Lomb, the district court stated that the “available guidance, scanty as it was, suggested that corporate officials should conduct themselves reasonably and that this standard would permit general discussion out of which a skilled analyst could extract pieces of a jigsaw puzzle which would not be significant to the ordinary investor but which the analyst could add to his own fund of knowledge and use toward constructing his ultimate judgment.”¹⁴⁵
- (3) On appeal, the Second Circuit in Bausch & Lomb stated that the “Commission itself has recognized that corporate management may reveal to securities analysts or other inquirers non-public information that merely fills ‘interstices in analysis’ or tests ‘the meaning of public information.’”¹⁴⁶
- (4) In Elkind, the Second Circuit stated 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.”¹⁴⁷

- c. The Commission's approval of the mosaic theory in the Release is consistent with its stated rationale for adopting Regulation FD – that investors lose confidence in the fairness of the marketplace when they know that other participants may exploit advantages from their access to “corporate insiders,” and not from “hard work

¹⁴⁵ SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1231 (S.D.N.Y. 1976).

¹⁴⁶ See SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 14 (2nd Cir. 1977) (quoting In the Matters of Investors Management Co.).

¹⁴⁷ Elkind, 635 F.2d at 165 (emphasis added).

or insights.”¹⁴⁸ Here, the Commission allows that under Regulation FD, issuers may reward PKI investors and analysts with important, nonpublic information not because these persons are insiders, but because they are smarter and work harder than the reasonable investor.

- d. The mosaic theory may allow issuers to provide analysts and PKI investors with a higher level of granularity on topics that are covered in more summary form in public disclosure. It can enable the analyst to drill down into a publicly disclosed fact in a one-on-one session with a senior official without the need for a simultaneous press release.

B. Effect on Private Placements

1. Regulation FD applies to communications made in connection with unregistered offerings, such as traditional private placements or Rule 144A or Regulation S offerings, and makes no distinction between oral and written statements. Consequently, an issuer must either publicly disclose the material, nonpublic information it privately discloses to market professionals or prospective investors during a private placement or the issuer must obtain a confidentiality agreement from every recipient of the information. The Release implies that if the public disclosure is not properly structured, the disclosure could render the issuer’s exemption from registration unavailable.¹⁴⁹
2. Although the Regulation exempts communications made pursuant to an express confidentiality agreement, it will be impractical to obtain these agreements in the context of private placements as many institutional investors decline to be bound by such agreements. A more productive solution in the private placement context may be to improve the quality of the written disclosure provided to private investors and to file or furnish a summary of material, nonpublic information on Form 8-K at the time the private offering memorandum is mailed to prospective investors at the

¹⁴⁸ See Release, 65 Fed. Reg. at 51716.

¹⁴⁹ The Commission has advised that if an issuer “releases material information nonpublicly during an unregistered offering with no such understanding about confidentiality, we believe that disclosure under Regulation FD is appropriate. We believe this even if, as a result of such disclosure, the availability of the Securities Act registration exemption may be in question.” *Id.* at 51725. See footnote 130, *supra*, for a discussion of the effects of this unfortunate statement in the Release. While filing the entire PPM as an Item 9 Form 8-K would constitute a general solicitation, a filing which discloses only those portions of the PPM that need to be disclosed under Regulation FD should not have any effect on the issuer’s private placement exemption. If the disclosure required by Regulation FD jeopardizes the exemption from registration under the Securities Act, the Catch 22 that would be created would make private placements unworkable in the FD environment.

start of the road show. Issuers should strive to infuse their written public disclosure with sufficient detail about the topics that analysts and investors will want to discuss at road show meetings and one-on-ones so that the answers to their general questions will be covered by public disclosure filings and the answers to their more detailed questions can be protected by the “mosaic” theory discussed above.

3. A carefully crafted “Factors Affecting Future Operations” discussion in the MD&A section of a periodic report can serve as a basis for private conversations with analysts and PKI investors. Drafters of offering documents may want to have a greater level of contact with those involved in the marketing process to ensure that the publicly filed documents more closely track the discussions at road shows and one-on-ones. Selected portions of the offering documents (such as the MD&A and pro forma financial statements or capitalization tables for the private placement) can be filed or furnished on Form 8-K without causing a general solicitation problem so long as they are drafted to delete references to the placement agent/initial purchaser and the detailed terms of the security being privately offered. Filing the private placement memo itself would not be advisable.
4. Issuers may feel more pressure under Regulation FD to “just say no” to some questions posed at road shows or one-on-ones in the context of private offerings. The extent to which marketing pressures will trump the fear of going over the line remains to be seen, but at least initially after October 23, 2000, the question-and-answer segments of road show presentations continued for all but the most seasoned issuers (who can afford to be more risk-averse) as did traditional one-on-ones with potential investors. If disclosure documents are expanded to cover the same topics that will be covered at the road show (“churn” rates, “burn” rates, budgeted capital expenditures for the next few years, the approximate date when the issuer expects to go EBITDA positive, to cite a few examples) and the same or substantially similar information is publicly filed or furnished on Form 8-K, then management should be able to make meaningful road show presentations without disclosing material, nonpublic information.
5. If investors or market professionals enter into express confidentiality agreements with the issuer, they may be subject to the duty to “disclose or abstain from trading” under Rule 10b-5, pursuant to which the person subject to the agreement must either disclose the material inside information to the public or abstain from trading in or recommending the securities concerned while such information remains undisclosed.¹⁵⁰ The

¹⁵⁰ See Chiarella v. United States, 445 U.S. 222, 226 (1980); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2nd Cir. 1968).

duty attaches because the information is furnished by the issuer in confidence and the relationship is one in which there is a contractual duty to protect the confidence. If investors or market professionals breach these agreements, they “place themselves at risk of illegal tipping and insider trading.”¹⁵¹

6. Investment bankers who are engaged by an issuer in connection with a securities offering are “agents” of the issuer. Although Regulation FD does not apply to most registered offerings, it does apply to non-registered offerings. Broker-dealers should be aware that when serving as placement agents in private placements, their investment bankers may be viewed as acting on behalf of the issuer under Regulation FD if they selectively disclose material, nonpublic information to other securities market professionals or the issuer’s securityholders.
7. Given the impact that selective disclosure may have in this context, the Commission has explicitly advised that issuers seek the advice of counsel regarding the “complications” that selective disclosure of material, nonpublic information could raise for private placements.

C. Effect on Mergers and Acquisitions and Tender Offers Subject to Regulation M-A

1. The interplay between Regulation FD and the “safe harbors” for free communications under Regulation M-A can result in requiring disclosure in mergers, acquisitions and tender offers that Regulation M-A would not otherwise have required. Moreover, registered exchange offers may be treated more favorably because of their exemption from Regulation FD than cash tender offers or cash mergers. Therefore, it is important to consider the effect Regulation FD can have on the activities of the parties involved in such transactions, particularly in the pre-public announcement stage.
2. Regulation FD does not apply to disclosures made in connection with a business combination involving the public offering of securities from the first public announcement of the transaction until completion of the vote (in the case of a merger) or expiration of the tender offer (in the case of an exchange offer).¹⁵² Unlike Regulation FD’s disclosure requirement, the

¹⁵¹ See Walker Speech at 8. For a discussion on the affirmative defense from insider trading liability for multi-service financial institutions provided by Rule 10b5-1(c)(2), see Outline at III.E.4, *infra*.

¹⁵² Rule 101(g)(2)(b). Not all communications during this period are exempt – only those made “in connection with” the registered offering. For example, the Release cautions that, “communications that a public company makes about its future financial performance in one of its regularly scheduled conference calls with analysts would not be considered to be made in connection with an offering simply because the issuer was in the midst of a registered offering at that time.” See Release, 65 Fed. Reg. at 51725, fn. 82.

Regulation M-A filing requirement relates to written communications relating to the transaction made to *any* outside person. To use Regulation M-A's "safe harbor" for oral and written communications prior to filing of the registration statement, as well as during the waiting period before effectiveness and in the post-effective period, filings must be made on the first date of use for any written communications (including notices containing only the information permitted by Rule 135 or 145(b)(1)¹⁵³) relating to the business combination that are made public or supplied to persons who are not parties to the transaction or their legal counsel, financial advisors or similar persons acting on their behalf. Thus, while Regulation FD may not compel a filing at the Commission, the same written communication would be required to be filed under Regulation M-A.

- a. Communications prior to filing the registration statement must be filed as pre-filing prospectuses (Rule 165(a)) and those used after the filing must be filed as prospectuses (Rule 165(b)). As filed, these communications will be subject to Section 12(a)(2), rather than Section 11, liability under the Securities Act. To the extent that any communication contains material information, however, the same information should also be included in the registration statement and would also be subject to liability under Section 11 of the Securities Act, as would any information incorporated by reference into the registration statement.
- b. "Written" communications required to be filed under Regulation M-A include all non-oral communications, such as electronic communications in the form of video tapes or CD-ROMs (which should be filed by means of a transcript), and would include materials disseminated by the financial advisors or information agents of the parties to the transaction to such parties' shareholders or to financial analysts, other market professionals or the press.¹⁵⁴

¹⁵³ A notice under Rule 135 of the Securities Act, typically made upon announcement of a proposed securities offering and before a registration statement is filed, is limited in the exchange offer context to, among other things, the name of the issuer, the title, amount and basic terms of the securities being offered, the anticipated time of the offering and a brief statement of the manner and purpose of the offering, the basic terms of the exchange offer, the name of the subject company and the subject class of securities sought in the offer. Rule 145(b) under the Securities Act allows for a similar pre-filing notice for stock for stock mergers. In each case, the notice will not be deemed an "offer" under Section 5 of the Securities Act.

¹⁵⁴ See Division of Corporation Finance, Securities and Exchange Commission, Manual of Publicly-Available Telephone Interpretations, Third Supp., Question 2 (July 2000) ("Regulation M-A Telephone Interpretations") at <http://www.sec.gov/offices/corpfin/phonits3.htm>.

3. Communications made in connection with stock-for-stock mergers which are exempt from registration (i.e. where the number of target stockholders are sufficiently limited to allow a private placement with resale registration rights), cash tender offers, cash mergers or proxy or consent solicitations (whether in the context of a business combination or regular or contested elections of directors, charter amendments or other corporate matters requiring shareholder approval, or “non-binding” proposals that the board take or refrain from certain actions) are not exempt from Regulation FD. Communications made in connection with a proxy or consent solicitation with respect to a negotiated stock-for-stock merger registered under the Securities Act are exempt from Regulation FD as being “in connection with” the registered offering. However, since the exemption commences “upon public announcement of the transaction,” it is problematic whether communications in connection with a hostile proxy or consent solicitation by a potential acquiror proposing a stock-for-stock transaction would be exempt, even where such person has commenced a hostile exchange offer, particularly if the offer is contingent upon the success of the solicitation or on otherwise obtaining target approval.
 - a. Regulation M-A’s “safe harbors” permit oral and written communications by bidders with respect to cash tender offers prior to actual commencement,¹⁵⁵ target companies prior to filing a recommendation statement on Schedule 14D-9, and any person engaged in a proxy solicitation – whether or not in connection with extraordinary or contested matters – before the filing and furnishing of preliminary or definitive proxy materials, so long as all “written” communications, are filed (on Form TO or Schedule 14D-9 with the box checked on the schedule indicating a pre-commencement communication, or Schedule 14A with the Rule 14a-12 box checked, as applicable) on the date of first use.
 - b. However, the failure of Regulation FD to exempt such communications means that where oral communications convey material information to market professionals or their affiliates, or stockholders, in connection with such transactions which information is not reflected in materials previously filed or otherwise publicly disclosed within the meaning of Regulation FD, Regulation M-A’s distinction between oral and written communications disappears, and the oral communication must be reduced to writing and filed.
 - (1) As a result, parties to tender offers, business combinations and proxy solicitations must monitor closely the activities

¹⁵⁵ The date of commencement means the date when the bidder first publishes, sends or gives security holders the means to tender.

of their financial advisors, information agents and proxy solicitors, all of whom may be deemed to be acting on such parties' behalf under Regulation FD. Press conferences, webcasts, financial advisors' conversations with analysts, proxy solicitors' calls to stockholders and discussions by any advisors, including counsel, with key stockholders, will have to follow the filed materials or be vetted to determine whether any material, nonpublic information is communicated.

(2) Despite the wording in the Release,¹⁵⁶ we believe that Regulation FD should not be interpreted to require disclosure of strategic information – which includes information with respect to strategy, support of specific shareholders or general level of support for the transaction or the proxy or consent solicitation.

c. In addition, if any communication, whether oral or written, made in connection with such events contains material, nonpublic information, the public disclosure must be made within the time mandated by Regulation FD. This means that written communications (and any oral communications which are planned rather than “an impromptu response to an unanticipated question”), which can be viewed as “intentional,” must be publicly disclosed simultaneously in compliance with Regulation FD, rather than on the date of first use as Regulation M-A provides, and will also be required to be filed under Regulation M-A, unless exempt therefrom or unless the filing under Regulation M-A is used to comply with Regulation FD.

4. The inclusion of “mergers, acquisitions, tender offers ... or changes in assets” and “changes in control or in management” as “types of events that should be reviewed carefully under Regulation FD to determine whether they are material”¹⁵⁷ may give rise to concerns in the early stages of planning, negotiating and implementing a business combination, tender offer or proxy or consent solicitation, particularly prior to the public announcement of the execution of an agreement or of the intention to commence or commencement of an offer or solicitation. If this language is interpreted to apply to the mere consideration that one of these events is being considered which would, if consummated, be “material” to the

¹⁵⁶ The Release states that “mergers, acquisitions, tender offers ... or changes in assets” or “changes in control or in management” are “types of events that should be reviewed carefully to determine whether they are material.” See Release, 65 Fed. Reg. at 51721.

¹⁵⁷ See id.

potential acquiror or target company, then a number of communications that routinely take place during the planning and negotiation stage could give rise to liability unless disclosed. We do not believe that Regulation FD should be read to change traditional “materiality” analyses, under which the “materiality” of an event depends on the probability of its occurrence as well the magnitude of its effect on the company, if it occurs.¹⁵⁸

- a. Preliminary communications between an issuer or a potential third party to a proxy or consent solicitation and the issuer’s stockholders may pose interpretive issues under Regulation FD.
 - (1) Rule 14a-2(b)(2) exempts the solicitation by any person, other than the issuer, of not more than ten stockholders. Thus, the safe harbor created by filing under Regulation M-A is not needed. There are many situations when a third party wishes to “test the waters” by speaking with a limited number of major stockholders before deciding to proceed with a solicitation. So long as the subject of the solicitation relates only to the target, and not the soliciting company, Regulation FD by its terms would not apply, since the material, nonpublic information imparted to the stockholder relates to the company providing the information, or on whose behalf it is provided. Likewise, if the information were material to the soliciting company, Regulation FD would not apply unless the target stockholder were also a stockholder of the provider of the information. Certain types of information, however, may be material to both, if the solicitation is successful. Again, we believe at such an early stage, that the information should not be deemed material for Regulation FD purposes because of the lack of the probability component of the materiality analysis. However, the analysis may be more difficult in situations where, as a result of testing the waters, the party is able to obtain sufficient support to assure a successful solicitation.
 - (2) Despite the lack of a specific exemption, issuers frequently sound out the opinions of significant stockholders before putting certain items to a stockholder vote. Although the subject of such communications is typically not material, it is important to remember Regulation FD when planning such communications. If it is material, the communication

¹⁵⁸ See SAB 99 Outline at Section III.

is clearly of the type (issuer to stockholder) to which Regulation FD applies, absent the ability to conclude that it wasn't reasonably foreseeable that the stockholder would trade on the basis of the information.

- (3) Although the issues described above can be avoided if the stockholders agree to keep the information confidential, we do not believe confidentiality agreements are likely to be a practical solution. In most "test the waters" situations, stockholders do not wish to be restricted.
- b. Advance planning for, and negotiation of, tender offers and mergers may also give rise to situations where Regulation FD could apply, absent confidentiality agreements.
- (1) In the early stages, internal planning by the acquiror or target (including management contemplating a buy-out) with financial advisors, proxy solicitors, information agents and public relations firms should be exempt as such persons fall under the category of "temporary insiders." (Note, however, that the form of confidentiality agreement contained in the advisor's engagement letter should cover information provided to the advisor by any potential bidder.) The situation may be more difficult regarding communications with potential equity partners or lenders, who owe no duty of trust or confidence absent some other prior relationship. The simple fact that a particular transaction is being considered may, under Regulation FD, be considered material, since it could move the market for the company's stock if it became public. The question may be particularly acute in a management-led leveraged buy-out ("LBO"), where the senior officials are also involved in planning the LBO. However, we believe that, at such early stages, the information should not be material because of the lack of the probability component of the materiality analysis.
 - (2) A company's determination to conduct an auction can cause its stock price to move. Although companies often announce that they have retained an investment banker to explore strategic alternatives or have decided to put the company (or a significant asset) up for sale, many companies, for varying reasons, believe a public auction can be detrimental to the sale process and therefore they conduct auctions outside of public disclosure. The early stages of "silent" auctions, may raise issues under Regulation FD, unless it is clear that each potential bidder

does not fall within the categories of persons enumerated in Regulation FD, since confidentiality agreements are typically signed only after a party indicates an interest in reviewing target material. Once a confidentiality agreement is signed, material, nonpublic information can be provided to potential bidders without raising a selective disclosure problem. However, in light of Regulation FD, it is important to insure that confidentiality extends to information concerning the auction process and negotiations as well as target information. If the transaction would be material to the potential bidder or involves the provision by the bidder of potentially material, nonpublic information, the confidentiality agreement should run both ways.

- (3) Discussions with major stockholders regarding their support for a proposed negotiated transaction, in the form of lock-ups or otherwise, prior to a public announcement may pose a separate problem, unless the stockholder is prepared to agree to keep the information confidential or the argument can be made that it is not reasonably foreseeable that such discussions will result in trading by such holders. That argument clearly applies only to a holder who is also a director, officer or employee, since he or she owes a duty of trust and confidence that would preclude trading. As a result, Regulation FD may make more problematic any discussions with stockholders not closely connected with management but whose shares are important to the success of the transaction, from the acquiror's viewpoint. This concern may result in deferring discussions with such persons to the very end of the process, at a time when any required filing under Regulation FD can be postponed until, and satisfied by, the announcement of the transaction. A more difficult strategic question is posed when the acquiror needs to lock-up stockholders, such as a founder's family members, who have disparate interests, are not employees or directors, and yet, in the aggregate, could influence the acquiror's decision to go forward with negotiating an acquisition.
- (4) After a transaction is announced, information about possible alternative transactions that is typically required to be provided to the acquiror under the no-shop provisions of the merger agreement could also be material, nonpublic information under Regulation FD, depending upon the persons on the acquiror's team to whom such information is disclosed. A simple solution is to have the

confidentiality provisions in the definitive agreement cover such information and any persons to whom the acquiror provides the information.

5. Although a description of material pending legal proceedings is still required to be provided in tender offer materials, copies of documents relating to a major development in such litigation (such as pleadings, injunctions, orders or opinions) need no longer be filed but simply supplied to the Staff on a supplemental basis.¹⁵⁹ It is possible that pleadings, depositions and answers to interrogatories could contain material, nonpublic information. If such documents are not under seal, disclosure of such information to plaintiffs could be deemed a violation of Regulation FD. Any such information provided in pleadings or answers to interrogatories, which are clearly “intentional” disclosures, would have to be publicly disclosed simultaneously with their delivery to the other parties to the litigation. Attorneys defending depositions must be aware of the issue and note any communications that could give rise to a duty to disclose.

D. Effect on Public Offerings

1. Except in certain types of shelf offerings,¹⁶⁰ Regulation FD does not apply to issuer disclosures made in connection with a registered securities offering. The key effect of this exemption is to exclude investor road show presentations and other marketing efforts from Regulation FD. In the Commission’s view, the “Securities Act already accomplishes at least some of the policy imperative of Regulation FD within the context of a registered offering.”¹⁶¹ The regulation defines the start and end dates of a registered offering and exempts disclosures made during these periods. Under Regulation FD, an underwritten offering commences when the issuer reaches an understanding with the managing underwriter and continues until the later of the period during which a dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated).¹⁶² Regulation FD also defines the start and end dates of non-underwritten offerings, which also include business combinations.¹⁶³

¹⁵⁹ Instruction to Item 1011(a)(5) of Regulation S-K.

¹⁶⁰ See Outline at Section II.C.3(b)(4)(b), supra, for a description of registered offerings that are not exempt from Regulation FD.

¹⁶¹ See Release, 65 Fed. Reg. at 51725.

¹⁶² See Rule 101(g)(1).

¹⁶³ See Rule 101(g)(2).

2. In order for the registered offering exemption to apply, the disclosure must be made “in connection” with the registered offering. The Release notes that an issuer’s material disclosures in a regularly scheduled analyst call would not be considered to be made “in connection” with a registered offering even if it happened to occur within an offering period.¹⁶⁴

E. Effect on Venture Capital Firms, Hedge Funds and Other Investors

1. Although Regulation FD focuses on issuers and their selective disclosure practices, market participants should also review their practices regarding the receipt of selectively disclosed, material information.
2. Registered broker-dealers and investment advisers are obligated by Section 15(f) of the Exchange Act to develop reasonable procedures to prevent the illegal use of material, nonpublic information. These procedures may need to be reviewed and revised in light of Regulation FD. Specifically, broker-dealers should review their policies and procedures, including Chinese Walls and restricted lists, to ensure that they safeguard against material, nonpublic information passing from those who are subject to confidentiality agreements to other persons in the firm, such as the trading desk. As stated in the Walker Speech, “Regulation FD will increase the frequency with which one part of a firm may receive material nonpublic information – for instance on an embargoed basis – that another part of the firm is prohibited from knowing or acting upon. If an analyst received material nonpublic information under an embargo, and the information passed to the firm’s proprietary trading desk, the analyst and the firm may be subject to insider trading liability.”¹⁶⁵ Broker-dealers also need to consider procedures for confidentiality agreements under Regulation FD. These procedures can range from “Just Say No” to enumerating the terms and conditions under which an analyst would agree to keep information confidential.¹⁶⁶
3. If issuers and market participants enter into confidentiality agreements – and Regulation FD encourages issuers to do so -- so doing may enhance the possibility of converting market participants into temporary insiders for purposes of Rule 10b-5. Under “tipper” liability, if an issuer discloses material, nonpublic information to an entity after securing an express agreement from the entity to keep the information in confidence, the entity may be subject to the disclose-or-refrain duty stemming from its duty to keep the information in confidence, under which the entity either must refrain from trading the issuer’s securities or disclose the nonpublic

¹⁶⁴ See Release, 65 Fed. Reg. at 51725, fn. 82.

¹⁶⁵ See Walker Speech at 8.

¹⁶⁶ See Section 15(f) of the Exchange Act.

material information. As the Supreme Court noted in Dirks, the “basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.”¹⁶⁷ This may not be a tenable situation for many venture capital firms or hedge funds, given that they owe fiduciary duties to their own shareholders or investors, which may conflict with the duty of confidentiality created by the express agreement.

4. Rule 10b5-1(c)(2) offers an answer to insider trading liability for multi-service financial institutions if the institution can demonstrate that the purchase or sale of securities was not “on the basis of” material, nonpublic information by showing first, that the person making the investment decision on behalf of the firm was not aware of the material, nonpublic information and second, that the firm implemented reasonable policies and procedures such as Chinese Walls to ensure that the individuals making investment decisions are not aware of material, nonpublic information in possession of other individuals in the firm.¹⁶⁸ Application of Rule 10b5-1(c)(2) would permit an analyst to enter into a confidentiality agreement with an issuer and the analyst’s investment banking firm to continue trading in the issuer’s securities. While Rule 10b5-1(c)(2) is an affirmative defense from insider trading liability, it represents a codification of Chinese Wall procedures, and like Rule 14e-3(b) under the Exchange Act, could permit a balancing of confidentiality agreements on the one hand and ongoing trading activity by institutions on the other in an FD environment.
5. Analysts may face secondary liability under Regulation FD for aiding and abetting an FD violation. The Walker Speech describes two of the possible scenarios. “One circumstance in which an analyst may be vulnerable is where an analyst and an issuer conspire or agree that the issuer will feed material, nonpublic information to the analyst.”¹⁶⁹

¹⁶⁷ See Dirks v. SEC, 463 U.S. 646, 655 fn. 14 (1983) (emphasis added).

¹⁶⁸ Rule 10b5-1(c)(2) provides that: “A person other than a natural person also may demonstrate that a purchase or sale of securities is not ‘on the basis of’ material nonpublic information if the person demonstrates that: (i) The individual making the investment decision on behalf of the person to purchase or sell the securities was not aware of the information; and (ii) The person had implemented reasonable policies and procedures, taking into consideration the nature of the person’s business, to ensure that individuals making investment decisions would not violate the laws prohibiting trading on the basis of material nonpublic information. These policies and procedures may include those that restrict any purchase, sale, and causing any purchase or sale of any security as to which the person has material nonpublic information, or those that prevent such individuals from becoming aware of such information.” Rule 10b5-1(c)(2)(i)-(ii). See also Rule 14e-3(b).

¹⁶⁹ See Walker Speech at 7.

Another circumstance is where the analyst threatens an issuer into disclosing material, nonpublic information. As the Walker Speech states, “I would caution analysts against trying to coerce information from an issuer by reminding the issuer that the analyst’s firm took the issuer public, has issued favorable recommendations, or supports its stock by serving as a market maker. These statements imply that if the issuer doesn’t give the analyst material non-public information, the analyst may take actions that will negatively impact the issuer’s stock price. If the issuer succumbs to this kind of pressure and selectively discloses information to avoid economic harm, the issuer will have violated FD and the analyst may have caused or aided and abetted the issuer’s violation.”¹⁷⁰

Under the second scenario, an analyst’s conversation reminding the senior official about their past experiences together may constitute coercion to the Staff. The conversation also runs the risk of misinterpretation by the senior official, who may be overly sensitive and misconstrues the analyst’s innocent statements as applying pressure. Putting analysts in this Catch 22 could result in creating further tension in the relationship between analysts and issuers. Moreover, while Regulation FD is not “primarily” directed at the analyst community,¹⁷¹ it may be a distinction without a difference to an analyst who is still subject to scrutiny and enforcement action under either of these two scenarios.

6. Given the discussion of materiality in the Release and in the Regulation FD Telephone Interpretations, it may be prudent for investment banking firms to schedule their investor conferences within the three-to-four week period of the earnings season. This approach would minimize the risk companies face with respect to discussing projections with analysts in one-on-ones and breakout sessions. The necessity for this approach depends, however, on the amount of information that is publicly disclosed by the participating companies at the time they announce earnings.

IV. Considerations for Public Companies

Regulation FD presents public companies with the opportunity to review, revise and implement a new disclosure policy. Although Regulation FD does not require issuers to adopt formal, written policies and procedures to comply with its requirements, the adopting release states that the “existence of an appropriate 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.”¹⁷² Indeed, failure to adopt a policy or procedure could be considered as a factor in determining recklessness or a lack of good faith. To comply

¹⁷⁰ Id.

¹⁷¹ Id. at 2.

¹⁷² Release, 65 Fed. Reg. at 51726, fn. 90.

with Regulation FD, companies should wish to consider the following practices, which, of course, would be molded to fit the needs and circumstances of each company:

A. Expand Disclosures in Periodic Reports.

1. Issuers may wish to expand the scope of disclosure in annual and quarterly reports to include the topics that they expect to cover in private discussions with investors and analysts. The logical place for expanded forward-looking disclosures is in the MD&A section of the periodic report. Either in a sub-section titled “Liquidity” or in an introductory overview section called “Outlook” or “Factors Affecting Future Operations” or a similar title, many issuers are already providing broad general guidance about the factors that they think will move their results in future periods. These issuers will be significantly less constrained in their private meetings because much of what they wish to discuss will already be publicly disclosed.
2. As discussed above, the Release affirms the “mosaic” theory adopted by the courts, which should allow issuers to provide greater detail to analysts and investors on subjects of interest to them as long as the big picture has already been properly disclosed to the public. For example, if the “Liquidity” section of an issuer’s MD&A discloses that budgeted capital expenditures are \$300 million over the next three 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 approximately \$25 million per quarter over the same period.
3. Issuers that need to attend road show meetings and one-on-ones to issue securities in private placements (such as high yield bond financings utilizing Rule 144A) could be restricted in what they can discuss unless their public disclosures already cover, or can be amended before the start of or during the road show to cover, the topics that analysts and investors will want to discuss. Improving the quality and scope of public disclosures so that they are consistent with the road show presentation may be a realistic way to avoid selective disclosure issues in the context of private placements for public companies.

B. Authorize and Educate Issuer Representatives

1. Because Regulation FD covers disclosures by senior officials (which include directors and executive officers, even if they do not act as company spokespersons, investor and public relations personnel) and also any other officer, employee or agent who regularly communicates with market professionals, issuers should formally designate and limit the persons whose communications could trigger Regulation FD disclosure obligations. Each issuer should focus on who these persons should be and limit their number, given the increased responsibility that Regulation FD

places upon such representatives. Once selected, they should be educated about the kinds of communications that are permitted under Regulation FD. Moreover, they should also be kept informed about corporate developments.

2. Because issuer representatives will be responsible for making quick determinations as to whether a potential disclosure involves material, nonpublic information, they will need to know what information the company has previously disclosed and, in order to assess materiality (and defend such judgments, if necessary), to know what analysts and others have said about the company and its competitors. Issuers should also consider monitoring their stock price, as movement in the stock price after a one-on-one or an analyst conference call in which the issuer discussed information which it determined was immaterial can be a telling indication that the issuer may have gotten it wrong, thereby requiring “prompt” public disclosure.
3. In given situations, issuers may also want to consider requiring more than one issuer representative to participate in conversations with analysts and institutional investors. Issuers can develop a protective record by having a third party present for all corporate disclosures. While the Commission has suggested that issuers document authorized disclosures in recognition of the fact that allegations of selective disclosure may be based on nothing more than price and trading fluctuations in the issuer’s stock over a short period of time, we do not believe taking notes is prudent.

C. Monitor for Unintentional Disclosures and Be Prepared to Respond

1. Regulation FD requires issuers to respond promptly to unintentional disclosures of material, nonpublic information – usually within 24 hours after a senior official has learned that material, nonpublic information has been selectively disclosed. Issuers should consider implementing policies and procedures to determine whether and when material, nonpublic information has been disclosed. In such an event, these procedures would cover how public disclosure would be made, particularly since coordination with investor relations/public relations personnel and outside counsel may be desirable.
2. Advice of counsel may be particularly appropriate if the issuer chooses to “file” the information pursuant to Item 5 of Form 8-K. In some circumstances, the issuer may wish to avoid public disclosure by attempting to obtain an after-the-fact confidentiality agreement from the recipient of the information. The full range of options available to an issuer may be foreclosed if procedures are not in place to alert the appropriate persons of a disclosure-triggering event.

D. Evaluate the Alternative Means of Public Disclosure

1. Issuers should be sensitive to what constitutes “broad, non-exclusionary distribution” of information to the public. With increasing frequency, press conferences and conference calls are open to the public, either in person or by the internet or the telephone. Since Regulation FD does not require that public participants be able to ask questions, the conference or the call may be conducted on a listen-only basis for members of the public. The public must be given adequate notice of such events, either by press release or posting the notice on the issuer’s website or by furnishing the information on Form 8-K. Any notice should inform the public as to the time and place and the means for accessing the conference or the call.
2. Another means of dissemination is posting the information on the issuer’s website, which, standing alone, does not constitute adequate public disclosure except for posting notices. Each issuer must check to see whether or not its press releases are carried by major wire services. If not, then a press release, by itself, may not be adequate public disclosure.
3. Although Regulation FD provides issuers with the opportunity to disclose information on a Form 8-K filed with the Commission, issuers should be cautious in doing so, given that Form 8-K filings present other liability issues that are not present for press releases, conference calls or press conferences that are not filed.

E. Evaluate and Decide How to Deal with Analysts

1. Issuers should anticipate the scope of communications that will recur during private sessions with analysts or other market professionals or at investor conferences. Drilling down or amplifying on topics that are already covered in public disclosures will typically be acceptable because such details will not involve material, nonpublic information. Providing a higher level of “granularity” of information to analysts and inquisitive investors should be permissible if proper disclosures have already been made publicly at an appropriate level of materiality and generality. Venturing into topics and territories that are not covered at the “big picture” level in public disclosures can present issues under Regulation FD.
2. If it is an issuer’s practice to provide guidance to analysts as to expected future results and the issuer wishes to continue to do so, then the issuer will need to provide such guidance to all persons, including the public, at the same time either by a press release or by open conference calls and press conferences. Issuers will need to determine where they want to draw the line, particularly in unscripted communications between issuer representatives and analysts, which pose substantial risks under Regulation FD.

3. On-site visits by analysts to inspect premises and gather background information to complete their “mosaic” of information pose less of a risk under Regulation FD, particularly if senior officials are not involved.
4. Under Regulation FD, electronic media have a distinct advantage over print media since access to electronic media can provide the simultaneity required by an intentional disclosure whereas print media cannot. Electronic media would certainly include CNBC, MSNBC and CNNfn and could include Bloomberg and Reuters online services. Having electronic media attend an earnings conference call or a securities conference would also mean that the communication is exempt from Regulation FD since the media is not an enumerated person. The primary purpose of arranging for electronic media coverage is not to secure the exemption as much as to assure simultaneity. Inviting media, both print and electronic, is not without its downsides, however. Once given such access, it may be difficult to disinvite them and not having them in attendance after establishing a pattern or practice of doing so may be misconstrued or misinterpreted by market participants.

V. Rule 10b-5 Liability Issues

While cases based “solely” on a failure to comply with Regulation FD are not subject to a private right of action under Rule 10b-5, existing grounds for liability under Rule 10b-5 are not affected by Regulation FD and may be applied by private litigants to the same conduct or disclosure that could not be reached directly in private actions under the Regulation.¹⁷³

A. Duty to Update/Duty to Correct

Absent a duty to disclose, there is no general affirmative obligation by public companies to disclose information, even if it is material.¹⁷⁴ The First Circuit in Roeder v. Alpha Industries, Inc. identified three situations which trigger a duty to disclose: (1) when a statute or regulation requires disclosure; (2) when a

¹⁷³ Issuers and market participants should keep in mind that the Insider Trading Sanctions Act permits a court to increase monetary penalties, up to three times the amount of the profit obtained or loss avoided, for insider trading.

¹⁷⁴ See Roeder v. Alpha Industries, Inc., 814 F.2d 22, 27 (1st Cir. 1987), and the cases cited therein. The Commission acknowledges that “the federal securities laws do not generally require an issuer to make public disclosure of all important corporate developments when they occur. . . . [i]n the absence of a specific duty to disclose, the federal securities laws do not require an issuer to publicly disclose all material events as soon as they occur.” Proposing Release, 64 Fed. Reg. at 72591.

“corporate insider” trades on confidential information; and (3) when a corporation has made “inaccurate, incomplete or misleading prior disclosures.”¹⁷⁵

1. Release No. 33-6084 (1979) stated the Commission’s belief that “depending on the circumstances there is a duty to correct statements made in any filing...if the statements either have become inaccurate by virtue of subsequent events, or are later discovered to have been false and misleading from the outset and the issuer knows or should know that persons are continuing to rely on all or any material portion of the statements.”
2. The duty identified by the First Circuit in Roeder and by the Commission is commonly known as the duty to correct or to update, although as explained below, a distinction is typically drawn between the two. Courts generally find that no duty to update exists unless there was an original duty to disclose.¹⁷⁶ For example, in a Fourth Circuit case, Hillson Partners L.P. v. Adage, the court held that because the defendant had not violated a duty to disclose, there could be no subsequent duty to update.¹⁷⁷ The court found that “the statements at issue here were predictions, neither material under the federal securities laws nor pled with sufficient particularity to allege a claim for fraud. There is no duty to update such statements on the basis of subsequent events.”¹⁷⁸ In a Second Circuit case, In re Time Warner Securities Litigation, the court found no duty to update where the “attributed public statements lack the sort of definitive projections that might require later correction.”¹⁷⁹ Nonetheless, the court held that if a corporation is pursuing a specific business goal and announces that goal as well as an intended approach for reaching it, the corporation may come under an obligation to disclose other approaches to reaching the goal when

¹⁷⁵ Roeder, 814 F.2d at 27; see also Weiner v. Quaker Oats Co., 129 F.3d, 316, 318 (3d Cir. 1997) (citing cases imposing a duty to correct/update).

¹⁷⁶ By creating a duty to speak, for either intentional or unintentional statements of material, nonpublic information, Regulation FD provides a fertile field for more lawsuits under the duty to update and eliminates the ability of courts to decide that there was no duty to update because there was no duty to speak to begin with. While the Staff continues to believe in the duty to update forward-looking statements, the Private Securities Litigation Reform Act of 1995 (the “Reform Act”) contained a provision on the duty to update, *viz.* “[N]othing in this section shall impose upon any person a duty to update a forward-looking statement.” Given the pressure Regulation FD puts on the duty to update, it won’t be long before a court must interpret just what that provision of the Reform Act means.

¹⁷⁷ Hillson Partners L.P. v. Adage, 42 F.3d 204 (4th Cir. 1994).

¹⁷⁸ Id.

¹⁷⁹ In re Time Warner Inc. Securities Litigation, 9 F.3d 259, 267 (2d Cir. 1993), cert. denied, 511 U.S. 1017 (1994).

those approaches are under active and serious consideration.¹⁸⁰

The First Circuit has affirmed this line of argument. In Shaw v. Digital Equipment Corp., citing In re Time Warner, the court held that “cautiously optimistic comments” expressing, at most, a hope for a positive future do not create a duty to update.¹⁸¹ In Gross v. Summa Four, Inc., the court discussed the company’s failure to disclose various difficulties which it was experiencing with its customer orders after it had made statements about the number of significant orders it had received.¹⁸² The court held that to the extent such statements might carry a forward-looking, positive implication of future revenue from those orders, it “falls in the category of vague and loosely optimistic statements that this court has held non-actionable as a matter of law.”¹⁸³

Similarly, the Second Circuit in San Leandro Emergency Med. Plan v. Philip Morris Cos., found that general statements about expected income growth were not definite enough to create a duty to correct.¹⁸⁴

3. The duty to update commonly arises in two situations: (1) “a disclosure is in fact misleading when made, and the speaker thereafter learns of this,”¹⁸⁵ commonly known as the duty to correct; and (2) a statement which was accurate when made becomes misleading due to subsequent events, commonly known as the duty to update, in the narrower sense. The duty to update in that sense exists only so long as the fact is “alive” in the marketplace.¹⁸⁶
 - a. The concept of the fact being “alive in the marketplace” is essential to determining whether there is a duty to update. Yet, the case law provides no clear, bright-line rule as to its meaning. Instead, a facts and circumstances analysis is applied. A fact with a “short life” may not have to be updated when subsequent events occur, whereas a fact with a “long life” may need to be updated over an extended period of time.

¹⁸⁰ Id. at 268.

¹⁸¹ Shaw v. Digital Equipment Corp., 82 F.3d 1194, 1219 n.33 (1st Cir. 1996).

¹⁸² Gross v. Summa Four, Inc., 93 F.3d 987 (1st Cir. 1996).

¹⁸³ Id. at 995.

¹⁸⁴ San Leandro Emergency Med. Plan v. Philip Morris Cos., 75 F.3d 801 (2d Cir. 1996).

¹⁸⁵ Backman v. Polaroid Corp., 910 F.2d 10, 16-17 (1st Cir. 1990).

¹⁸⁶ Ross v. A.H. Robins Co., 465 F. Supp. 904, 908 (S.D.N.Y. 1979), rev'd on other grounds, 607 F.2d 545 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980).

- (1) The court in Ross v. A.H. Robins Co. addressed this issue as follows:

“Both section 10(b) and Rule 10b-5 are silent as to the effect of time on the duty to correct, but logic compels the conclusion that time may render statements immaterial and end any duty to correct or revise them. In measuring the effect of time in a particular instance, the type of later information and the importance of earlier information contained in a prior statement must be considered. Thus, general financial information in a two-year old annual report may be stale and immaterial... . However, no general rule of time can be applied to all circumstances. Rather, a ‘particular duty to correct a specific prior statement exists as long as traders in the market could reasonably rely on the statement.’”¹⁸⁷

Thus, as summarized by a First Circuit judge in Backman v. Polaroid Corp., there is “no duty to update statements of past historical fact that were accurate when made but have simply become stale with the passage of time.”¹⁸⁸

- (2) The First Circuit in Backman stated that “in special circumstances, a statement, correct at the time, may have a forward intent and connotation upon which parties may be expected to rely. If this is a clear meaning and there is a change, correction, more exactly further disclosure, may be called for.”¹⁸⁹ While one commentator has suggested that the duty to update “applies only to statements that are ‘forward-looking’ – statements that by their terms purport to continue to be valid beyond the date they are made,”¹⁹⁰ the test in A.H. Robins does not appear to be so limited.

¹⁸⁷ Id.

¹⁸⁸ Backman, 910 F.2d at 21 (Bounes, J., dissenting).

¹⁸⁹ Backman, 910 F.2d at 17.

¹⁹⁰ Rosenblum, An Issuer’s Duty under Rule 10b-5 to Correct and Update Materially Misleading Statements, 40 Cath. U.L. Rev. 289, 291 (1991).

- b. Once the duty arises to update or to correct prior material statements that have become inaccurate, it attaches whether or not the company or its insiders are trading.¹⁹¹
- c. In In re IBM Corporate Securities Litigation,¹⁹² the Second Circuit addressed the distinction between the duty to correct and the duty to update in a shareholder litigation suit involving IBM's dividend.

In 1992, shareholders filed suit against IBM alleging, among other things, that the company violated its duty to correct statements made by management regarding IBM's ability to pay its dividend of \$1.21 per share. IBM's dividend, the court found, was "important to investors, many of whom purchased IBM securities because of its strong dividend." Throughout the first half of 1992, IBM officers made statements that IBM would be able to cover its dividend, even though, in 1991, IBM had suffered major losses, and the company's financial situation was continuing to deteriorate in 1992. On September 30, 1992, IBM's CFO said "I see no need to cut the dividend," and on October 15, 1992, IBM's Director of Investor Relations was asked if IBM would be "able to cover the dividend next year," to which he stated, "yes." On November 25, 1992, the CFO revealed to a pension fund that IBM's dividend was "vulnerable and likely to be cut." On December 15, 1992, IBM announced that it was "unsure of its ability to maintain the dividend at current levels." Shareholder suit immediately followed. On January 26, 1993, IBM's Board voted to cut the dividend.¹⁹³

The shareholders claimed that IBM violated its duty to correct its statements that the dividend was "safe," and that "I see no short term problems at all," when, by November 25, IBM's position on its dividend had changed. The Second Circuit rejected the claim on the following grounds: first, it characterized plaintiff's theory as a duty to update, not the duty to correct. "[I]f and when a speaker learns that a prior statement was misleading when made, a duty to correct arises."¹⁹⁴ Whereas, "a duty to update may exist when a statement, reasonable at the time it is made, becomes misleading because of a subsequent event. However, there is no duty to update vague statements of optimism or expressions of opinion. There is

¹⁹¹ See In re Warner Communications Sec. Litig., 618 F. Supp. 735 (S.D.N.Y. 1985), aff'd, 798 F.2d 35 (2d Cir. 1986).

¹⁹² In re IBM Corporate Securities Litigation, 163 F.3d 102 (2d Cir. 1998).

¹⁹³ Id. at 105-106.

¹⁹⁴ Id. at 109.

also no need to update when the original statement was not forward looking and does not contain some factual representation that remains ‘alive’ in the minds of investors as a continuing representation, or if the original statements are not material.”¹⁹⁵

Here, the Second Circuit found that IBM’s September and October statements were not misleading when made, and hence, there was no duty to correct the statements: on September 30 and on October 15, IBM did not have a plan or need to alter the dividend. As for the duty to update, the Second Circuit viewed IBM’s statements as “vague expressions of opinion which are not sufficiently concrete, specific or material to impose a duty to update.”¹⁹⁶

- d. The Third Circuit drew the distinction between the duty to correct and the duty to update in In re Burlington Coat Factory Securities Litigation.¹⁹⁷ As an example of the duty to correct, the court gave the scenario of a forward-looking statement made on the basis of a reasonably misread, blurred number on a fax containing vital information. The information upon which the statement was based would have been wrong at the time the statement was made, and a duty to correct might attach. The court found that the plaintiffs pled a failure to comply with a duty to correct, but did not allege any facts that would show that the forecast when made was unreasonable and thus, the duty in question was more properly characterized as the duty to update. The court then discussed the policy of encouraging disclosure of soft information because of the information’s value to investors and the “well-settled” principles that there is no general duty for an issuer to disclose all material information and that there is no representation in an accurate report of past successes that the success will continue. The court concluded that ordinary earnings projections did not need to be updated, contrasting this type of forecast with statements about expected takeovers or mergers and updates about “extreme changes” in those plans, in which such a duty may exist.¹⁹⁸

On the other hand, the Seventh Circuit, in Stransky v. Cummins Engine Co., defined the duty to correct as involving an accidental misstatement of historical facts. As for correction of forward-looking statements found to be untrue once new information has

¹⁹⁵ Id. at 110 (omitting internal citations).

¹⁹⁶ Id.

¹⁹⁷ In re Burlington Coat Factory Securities Litigation, 114 F.3d 1410 (3d Cir. 1997).

¹⁹⁸ Id. at 1430-34.

been received, the court stated, “[t]his court has never embraced such a theory, and we decline to do so now.”¹⁹⁹

B. Dealing with Analysts under the Entanglement and Adoption Theories.

Outside and apart from Regulation FD, companies and their officers face a host of pitfalls when communicating with analysts. Companies are often asked to review an analyst’s report prior to its release, which may give the company an opportunity to correct factual errors prior to publication and enhance the relationship with the analyst. In so doing, however, the company may, perhaps even inadvertently, engage in conduct that will cause a court to attribute statements concerning soft information to the company itself, rather than the analyst, which in turn can create potential liability for the company for securities fraud. While there is typically not a duty to update or correct statements by a third party, a company may assume such a duty by adopting or entangling itself with the statements of a third party, such as an analyst. The “entanglement” theory holds that a company that puts its imprimatur on an analyst’s report prior to its publication is responsible for its accuracy and any duty to update in connection therewith. The “adoption” theory holds that a company may be liable for misstatements in an analyst’s report by “adopting” the contents of the report after publication.

The legal boundary as to the words and conduct that cause “adoption” by the company of an analyst’s report or “entanglement” with the analyst’s report is unclear. The Supreme Court has not spoken on the matter and only a few courts of appeal have addressed the issue. Officers of public companies therefore must carefully regulate their actions with regard to analysts, even though they are constantly experiencing market pressure to engage in conversations with analysts.

1. Appellate Court Decisions

The Second Circuit introduced the concept of “entanglement” with an analyst’s statements in Elkind v. Liggett & Myers, Inc.²⁰⁰ In Elkind, plaintiffs alleged fraud because earnings forecasts in analysts’ reports had been incongruent with Liggett’s internal forecasts. Liggett had made it a practice to review and correct draft reports by analysts on the company. The court found that this was not sufficient to find that Liggett had placed its “imprimatur” on the reports. One apparently crucial fact for the court’s analysis was that Liggett had specifically adopted a policy of not commenting on earnings forecasts. The court did note, however, that “a company may so involve itself in the preparations of reports and projections by outsiders as to assume a duty to correct material errors in

¹⁹⁹ Stransky v. Cummins Engine Co., 51 F.3d 1329, 1332 (7th Cir. 1995).

²⁰⁰ Elkind v. Liggett & Myers, Inc., 635 F.2d 156 (2d Cir. 1980).

those projections.”²⁰¹ The court also pointed out the perils of reviewing an analyst’s draft reports: a company in so doing has to refrain from misleading investors by implying approval of the report on the one hand and tipping material inside information in the course of correcting errors on the other.²⁰² Elkind does not say what constitutes sufficient entanglement with analysts’ reports. From the weight given Liggett’s policy of not commenting on earnings forecasts, one could argue that detailed review and correction without such a policy may be enough.

The Fourth Circuit’s analysis in Raab v. General Physics Corporation,²⁰³ does not deviate from Elkind’s basic principle. In Raab, the court found that “*without control* over [the analysts’] report, any statement made by [General Physics] personnel could be taken out of context, incorrectly quoted, or stripped of important qualities” (emphasis added). The court also noted that plaintiffs did not plead with specificity who allegedly supplied the information to the analyst or how it was supplied, and that the analyst’s report did not directly quote General Physics.

The issue of quotation or a lack of it was significant as well in the case of In re Time Warner Inc. Securities Litigation.²⁰⁴ The court stated that allegations by plaintiffs in their complaint that certain unidentified personnel at Time Warner made statements to analysts that were then repeated by the analysts were insufficient to survive a motion to dismiss. Discounting concerns that anonymous disclosure to analysts of misleading information creates a liability barrier for “scheming corporations,” the court stated that for a company to be held liable for analysts’ statements supposedly derived from the company, a specific individual must be cited as the source of the information. The court distinguished lower court cases in which the statements were alleged to have been made by “spokespersons” because of the existence of other factors, such as the fact that a press release was involved, or the fact that other actions entangling the company with the analysts’ statement had taken place.²⁰⁵

²⁰¹ Id. at 163.

²⁰² Id.

²⁰³ Raab v. General Physics Corporation, 4 F.3d 286 (4th Cir. 1993).

²⁰⁴ In re Time Warner Inc. Securities Litigation, 9 F.3d 259 (2d Cir. 1993).

²⁰⁵ Compare Simon v. American Power Conversion Corp., 945 F. Supp. 416, (D. R.I. 1996), in which the court held that pleadings alleging simply that “management” caused the allegedly misleading statements in the analysts’ reports was sufficient to survive a motion to dismiss and holding that this was consistent with Time Warner.

The Ninth Circuit’s decision in In re Syntex Corporation Securities Litigation²⁰⁶ echoes Elkind’s emphasis on “imprimatur.” Shareholder-plaintiffs claimed that Syntex was liable for misleading statements made by analysts concerning Syntex’s drug products. The Ninth Circuit held that “in order to be liable for unreasonably disclosed third-party forecasts, defendants must have put their imprimatur, express or implied, on the projections.”²⁰⁷ The court found that there was only a “one-way” flow of information existed -- from Syntex to the analysts, and from the analysts to the public. And when Syntex’s chief executive officer was asked about analysts’ predictions relating to future earnings per share, the chief executive officer replied, “We don’t forecast earnings,” and emphasized that such estimates should not be attributed to Syntex. Accordingly, the court found that there was no “imprimatur,” and hence, no adoption or entanglement with the analysts’ reports.

2. District Court Decisions

Decisions at the district court level provide more specific examples of what conduct or words may so entangle a company and an analyst as to create liability for a company.

a. Distributing the Analyst’s Report

Companies should avoid distributing analysts’ reports containing projections or listing them on their websites or providing a hyperlink to them. In In re Rasterops Corporation Securities Litigation, the court held that a complaint should survive a motion to dismiss only because of the “crucial fact” that the company had circulated copies of the report to prospective investors.²⁰⁸ In Stack v. Lobo, the court held that an allegation that the defendant company incorporated an analyst’s report in its investor relations package was sufficient to state a claim for adoption by the company of the statements in the report.²⁰⁹ In In re Cypress Semiconductor Securities Litigation, however, the court held that a company’s sending a report to only two investors was not sufficient to constitute adoption.²¹⁰

²⁰⁶ In re Syntex Corp. Securities Litigation, 95 F.3d 922 (9th Cir. 1996).

²⁰⁷ Id. at 934 (quoting In re Stac Electronics Sec. Litig., 82 F.3d 1480, 1492 (9th Cir. 1996)).

²⁰⁸ In re Rasterops Corp. Securities Litigation, 1994 WL 618970 (N.D. Cal. 1994).

²⁰⁹ Stack v. Lobo, 903 F. Supp. 1361 (N.D., Cal. 1995).

²¹⁰ In re Cypress Semiconductor Securities Litigation, 891 F. Supp. 1369 (N.D. Cal. 1995).

The Commission seems to have picked up on this theme. In a 1997 settled enforcement action against Presstek, Inc., the Commission indicated that an issuer that disseminates third party reports may be deemed to have adopted the contents of those reports even if it had no role in their preparation. The Commission charged that “Presstek adopted those unrealistic projections by distributing the Cabot Letter [a financial newsletter] without disclaimer, and during a time when Presstek elected not to make public its own projections because management did not view them as reliable.”²¹¹

b. Reviewing the Analyst’s Report

Lower courts have given further meaning to the Elkind scenario of “entanglement” with a research report through a prior review of a draft of the report. In Stack, allegations that individuals of the defendant company reviewed certain analysts’ reports were held to be sufficient to state a claim on the basis of entanglement. In In re Rasterops Corporation Securities Litigation, the court held that entanglement was sufficiently pled in order to survive a motion to dismiss where plaintiffs alleged that the defendants “provided information for, saw, reviewed and/or approved” draft analysts’ reports, while consistently, throughout the relevant time period, maintaining contact with securities analysts and feeding them information suggesting that the defendant’s business was strong.²¹² The court in In re Caere Corporate Securities Litigation advocated a strict standard to find entanglement.²¹³ It set out three requirements for a pleading to be sufficient on this matter. Pleadings should be required to: “(1) identify specific forecasts and name the insider who adopted them; (2) point to specific interactions between the insider and analysts which gave rise to the entanglement; and (3) state the dates on which the acts which allegedly gave rise to the entanglement occurred.” In this case, where plaintiffs allegedly met with analysts regularly, defendants were given an opportunity to comment on forecasts, but confirmation of information by defendants, which was limited to statements that the company would “continue to experience strong growth in revenues and earnings,” was held to be insufficient.²¹⁴

²¹¹ In re Presstek, Inc., Release No. 34-39472 (Dec. 22, 1997) (cited in case reports as SEC v. Howard, 1997 WL 284554).

²¹² In re Rasterops Corp. Securities Litigation, 1993 WL 476661 (N.D. Cal. 1993).

²¹³ In re Caere Corporate Securities Litigation, 837 F. Supp. 1054 (N.D. Cal. 1993).

²¹⁴ Id. at 1059.

In SEC v. Wellshire Securities, Inc., the court found no entanglement where defendants reviewed a draft report, corrected it, and the draft was inserted into the final report.²¹⁵ While noting the Elkind court's reliance on the policy regarding earnings forecasts, the court stated that the level of involvement in Elkind, where actual meetings between analysts and defendants took place, was much higher than in this case. This case is significant in that the Commission position -- that entanglement should be found where significant contact exists without the critical no-comment policy of Liggett -- was rebuffed by the court through a comparison of the quality of the contact, not the substance of the review itself.

The court in Greenberg v. Compuware Corp. surveyed Elkind and other cases, but dismissed plaintiff's claim mainly because the court did not find that the statements cited by plaintiffs were actionable misrepresentations.²¹⁶ However, the court did go on to say that "even if the allegation is taken as meaning that the Defendants signed drafts of the analysts' reports, this does not rise to the level of having control over what was published, and a review of the analysts' reports . . . establishes that they do not contain the signature of any defendant and do not credit Defendants with having provided any specific information."²¹⁷ The court found that Elkind's standard of "entanglement" and Raab's standard of "control" were reconcilable, in that they both address the issue of whether control over the final content of the report was exercised.²¹⁸ The allegations in this case were found not to meet that standard.

Illustrating the importance of control over the analyst's ultimate product, the district court in In re Syntex Corporation Securities Litigation, citing the three pleading factors of Caere, dismissed a claim because it found only a "one-way flow of information," where the defendants supplied information to the analysts and the analysts supplied information to the customers.²¹⁹ There were no allegations that there was any entanglement with the reports prior to or after the publications of the report. However, in In re Cirrus Logic Securities Litigation, the court held that the absence of

²¹⁵ SEC v. Wellshire Securities, Inc., 773 F.Supp 569 (S.D.N.Y. 1991).

²¹⁶ Greenberg v. Compuware Corp., 889 F. Supp. 1012 (E.D. Mich. 1995).

²¹⁷ Id. at 1021.

²¹⁸ Id. at 1020.

²¹⁹ In re Syntex Corporation Securities Litigation, 855 F. Supp. 1086 (N.D. Cal. 1994).

entanglement or adoption does not mean that a company may not be liable for analysts' statements.²²⁰ The In re Cirrus Logic court distinguished In re Syntex on the ground that the court in that case presupposed that information provided by the company to the analysts was accurate, and the analysts' projections alone were inaccurate. Here, the court found that, through the analysts, the defendants had made statements to the market that were themselves misleading, an activity for which they should be held just as liable as if the statement had gone straight from the company to the investors.²²¹

c. Words of Adoption

Companies may become liable for analysts' estimates when they comment either on an analysts' spoken estimate, as in a conference call with analysts, or on an already issued analyst report. In Schaffer v. Timberland Co., the court held that allegations of defendant management's statements that analysts' "estimates for our performance are reasonable," among other statements, were sufficient to state a claim.²²² The court noted that allegations of "specific analyst statements... , sometimes directly quoted, upon which [the plaintiffs] alleged the statements were based," and allegations of "the nature, substance and date of the communications between the analysts and the defendants," and "statements of approval of erroneous projections of outside analysts" constituted sufficient allegations of entanglement to survive a motion to dismiss.²²³ The court in In re Gupta Corporation Securities Litigation held that an allegation that the company endorsed analysts' estimates with the word that it was "comfortable" with these estimates had stated a claim, but that use of the words "within reason" to describe estimates would not constitute adoption.²²⁴

In In re Ann Taylor Stores Securities Litigation, the court held that a statement by a company spokesperson that the company was "comfortable" with an analysts' projection was sufficient to state a claim.²²⁵ A similar result was reached for the statement that the

²²⁰ In re Cirrus Logic Securities Litigation, 946 F. Supp. 1446 (N.D. Cal. 1996).

²²¹ Id. at 1467.

²²² Schaffer v. Timberland Co., 924 F. Supp. 1298, 1314 (D. N.H. 1996).

²²³ Id. at 1312.

²²⁴ In re Gupta Corp. Securities Litigation, 900 F. Supp. 1217 (N.D. Cal. 1994).

²²⁵ In re Ann Taylor Stores Securities Litigation, 807 F. Supp. 990 (S.D.N.Y. 1992).

company “remained comfortable” with estimates, in In re Employee Benefit Plans Securities Litigation.²²⁶

In re Adobe Systems, Inc. Securities Litigation involved a conference call situation as described in the introduction to this section.²²⁷ An analyst asked about possible earnings of \$2.25 per share. The company stated that “most of those estimates are clustering around \$2.10 or so, and obviously we’d feel more comfortable with that, and I’m not saying \$2.25 is not doable, but I think we just need to wait and see a little longer, it’s kind of early in the year yet.” The court held that this statement constituted a prediction by the company.

The court in Oppenheimer vs. Novell, Inc. was more reserved.²²⁸ The court held that a statement that the company was “comfortable” with analysts’ estimates “could be viewed simply as an expression of optimism; their statement seems to mean simply that Novell is pleased with the way the analysts have estimated their third quarter performance. However, viewing this statement most favorably to plaintiff’s position, it could be read as an affirmation that, in fact, the analysts estimates are correct... . However strained this interpretation seems, the court will on a motion to dismiss accept this interpretation.”²²⁹

As these cases make clear, use of the word “comfortable” in relation to analysts’ forecasts can result in an adoption of those forecasts. The apparent skepticism of the court in Oppenheimer is outweighed by the number of decisions that interpret this word as a clear expression of adoption. According to one journalist, analysts believe that use of the word “comfortable” in effect “put[s] holy water” on and confirms an estimate.²³⁰

d. Prepublication and Postpublication Adoption

An interesting analysis to come out of the lower court decisions is the distinction between adoption before and after publication of analysts’ reports. Entanglement of the Elkind or Raab variety

²²⁶ In re Employee Benefit Plans Securities Litigation, 1992 U.S. Dist. LEXIS 21823.

²²⁷ In re Adobe Systems, Inc. Securities Litigation, 787 F. Supp. 912 (N.D. Cal. 1992).

²²⁸ Oppenheimer v. Novell, Inc., 851 F. Supp. 412 (D. Utah 1994).

²²⁹ Id. at 416.

²³⁰ Leslie Scism, Firms Increasingly Make End Runs Around Analysts, Wall St. J., Aug. 30, 1993, at C1, cited by James J. Junewicz, Handling Wall Street Analysts, Insights, January 1995, at 11.

would constitute prepublication adoption. Postpublication adoption would be found when an indication that published or otherwise suggested forecasts are accurate is given, either by words or, as explained above, by distribution of the report in question. In postpublication adoption, liability does not rest on “imputing the analysts’ statement to the company. Rather, the corporation’s implied representation that the analysts’ forecasts are accurate is itself actionable.”²³¹

C. Tipping and Insider Trading

The Commission proposed and adopted Regulation FD, in part, as a response to the difficulty in prosecuting tips to analysts under an insider trading theory after the Supreme Court’s decision in SEC v. Dirks.²³² As the Commission explained in the Proposing Release, “many have viewed Dirks as affording considerable protection to insiders who make selective disclosures to analysts, and to the analysts (and their clients) who receive selectively disclosed information.”²³³ Nonetheless, in the Release, the Commission has advised that “liability for ‘tipping’ and insider trading under Rule 10b-5 may still exist if a selective disclosure is made in circumstances that meet the *Dirks* ‘personal benefit’ test.”²³⁴

“Tipper” liability for a corporate insider arises when an individual who has received material, nonpublic information from that insider trades on that information. Tipper liability is a danger for officers discussing the company with analysts because the very essence of the conversation is for the analysts to hear important information that others have not yet incorporated into their trading

²³¹ In re Cypress Semiconductor, 891 F. Supp. at 1377; see also Schaffer, 924 F. Supp. at 1314.

²³² While the Commission continues to pursue enforcement actions for selective disclosure, the number of insider-trading cases brought against analysts remains limited. For example, only two of the 48 insider-trading cases the Commission brought in 1997 were against analysts. See Paul Beckett & Rebecca Buckman, SEC’s Levitt Warns Analysts on Certain Trades, Wall St. J., Mar. 9, 1998. The personal benefit requirement appears to be the chief obstacle in bringing enforcement actions. There is no liability unless the recipient of the information knows or has reason to know that the information was passed on to him for the insider’s personal benefit. See Donald C. Langevoort, Insider Trading: Regulation, Enforcement & Prevention § 4.03 (1999). In an unpublished opinion, a federal judge dismissed a lawsuit against Rational Software, whose chairman allegedly privately advised an analyst to lower his estimates before the public announcement of third-quarter and year-end earnings, because of insufficient evidence of his personal benefit. Text of the opinion is available at: <http://securities.stanford.edu/decisions/ratl/97cv21001/068.html>. Enforcement is also difficult because the antifraud standards vary from court to court.

²³³ Proposing Release, 64 Fed. Reg. at 72593.

²³⁴ Release, 65 Fed. Reg. at 51726.

decisions. In view of this difficulty, the court in Bausch & Lomb described the encounter as follows:

Many a corporate executive, conscious of the antifraud provisions of the Securities Acts, may analogize an encounter with a financial analyst to a fencing match conducted on a tightrope; he is compelled to parry often incisive questioning while teetering on the fine line between data properly conveyed and material inside information that may not be revealed without simultaneously disclosing it to the public. Exhorted by the Securities and Exchange Commission and the various stock exchanges to divulge tidbits of nonpublic ‘non-material’ information, which may assume heightened significance when woven by the skilled analyst into the matrix of knowledge obtained elsewhere, the corporate representative will incur severe consequences if he discusses areas which are later deemed material.²³⁵

1. Case Law Development

- a. Selective disclosure has been viewed by the Commission as a form of insider trading under Rule 10b-5.²³⁶ The rationale for insider trading liability has shifted from a policy of equal access to material information for all traders, as shown by SEC v. Texas Gulf Sulphur Co.,²³⁷ to a rationale that relies more on the fiduciary principle relating to insiders’ use of material information, as shown by Chiarella v. United States.²³⁸ With this shift, the danger of tipper liability for communications with analysts apparently waned.
- b. SEC v. Bausch & Lomb, Inc. was an early application of the insider trading doctrine to pursue a selective disclosure claim.²³⁹

²³⁵ SEC v. Bausch & Lomb, 565 F.2d 8, 9 (2d Cir. 1977).

²³⁶ See Bruce A. Hiler, The SEC and the Insider/Tipper, N.Y.L.J., Aug. 29, 1991, at 5. References to “insider trading” include two types of activities. “Classical insider trading” occurs when a corporate insider trades her company’s securities using material, nonpublic information. “Misappropriation” results when a trader exploits material, nonpublic information when trading securities in breach of a duty owed to the source of the information. See Saikrishna Prakash, Our Dysfunctional Insider Trading Regime, 99 Colum. L. Rev. 1491, 1492 n.4 (1999). The “misappropriation” theory was accepted by the Supreme Court in United States v. O’Hagan, 521 U.S. 642, 652 (1997).

²³⁷ SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

²³⁸ Chiarella v. U.S., 445 U.S. 222 (1980).

²³⁹ SEC v. Bausch & Lomb, Inc., 565 F.2d 8 (2d Cir. 1977).

The Commission brought an enforcement action under Rule 10b-5 against the Bausch & Lomb and its chief executive officer for disclosing information regarding the company's first quarter earnings at an analyst meeting prior to public disclosure. The Commission prosecuted the chief executive officer for negligently revealing to groups of analysts the negative impact that problems with a product would have on the company's earnings. The court noted that for weeks the company had been hounded by analysts requesting information and in a moment of weakness the chief executive officer disclosed information which resulted in purchases by the analysts' and their clients.

The court observed that selective disclosure liability turns on materiality. "Corporate management may reveal to securities analysts or other inquirers nonpublic information that merely fills "interstices in 'analysis' or tests the 'the meaning of public information.'" A duty to disclose only arises when the information "leaked" is material.²⁴⁰

After extensive fact finding, the district court found that the information disclosed was not material. The Second Circuit upheld this finding, indicating that "materiality has become one of the most unpredictable and elusive concepts of the federal securities laws."²⁴¹

While finding no liability since the information disclosed was immaterial, the Second Circuit grappled with the concept of differential disclosure, but did not find it to be *per se* illegal. The securities laws have long rested on the assumption that a fully effective disclosure policy does not require the reporting of complicated business facts to the individual investor and that some disclosures only reach average investors after they have undergone a filtration process through intermediaries.

The district court in Bausch & Lomb endorsed unequal access to information based on the practical realities of the corporations.²⁴²

- c. In the past, exceptions for analysts under the insider trading laws were advocated in light of the utility of analysts to the marketplace. Use of analysts to disseminate information was said to be efficient

²⁴⁰ Id. at 14-15.

²⁴¹ Id. at 9.

²⁴² See SEC v. Bausch & Lomb, Inc., 420 F. Supp. 1226, 1230 (S.D.N.Y. 1976).

for the company. Analysts provided credibility to the company in its disclosure, a way for the company to present information without the need for simplification for the public. Analysts were also a conduit to the marketplace for information, the gist of which the company wants to convey, but not the specifics.²⁴³

2. The Dirks Decision

In Dirks v. SEC, Ronald Secrist, a former officer of Equity Funding of America, informed an analyst named Ray Dirks that Equity Funding's assets had been falsely reported. Dirks tried unsuccessfully to convince a reporter and one of the Commission's regional offices of the fraud, but the information was never publicly disclosed. Prior to the fraud becoming public knowledge, Dirks informed his clients, who saved more than \$16 million by selling their stock. Dirks was censured by the Commission for disclosing the material nonpublic information to his clients.²⁴⁴ The Supreme Court reversed this decision, however, holding that Dirks could not be liable for tipper liability because the former company officer who disclosed the information did not breach a fiduciary duty to the company because he received no personal benefit from disclosing the information.

The Commission's position was that Dirks had aided and abetted his clients' insider trading. The Supreme Court's response was that a tippee could be liable only if the insider breached a fiduciary duty by disclosing the information, which means that the insider must experience some sort of personal gain, either pecuniary or reputational, from the disclosure.²⁴⁵

The Supreme Court suggested that a personal benefit could be found only when the relationship suggests that information was given for personal or monetary benefit or that information was given to a specific individual as a

²⁴³ See generally, Donald C. Langevoort, Investment Analysts and the Law of Insider Trading, 76 Va. L. Rev. 1023 (1990).

²⁴⁴ Raymond L. Dirks, Exchange Act Release No. 17,480 (Jan. 22, 1981). "Where 'tippees' – regardless of their motivation or occupation – come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (quoting Chiarella v. United States, 445 U.S. 222, 239 n.12 (1980)). Because Dirks had acted to bring a major fraud to light, he was only censured. The Court of Appeals for the D.C. Circuit upheld the Commission's enforcement action. Dirks v. SEC, 681 F.2d 824 (D.C. Cir. 1982), rev'd, 463 U.S. 646 (1983).

²⁴⁵ Dirks, 463 U.S. at 663.

gift.²⁴⁶ Furthermore, a tippee could not be liable unless the tippee knows or should have known that the insider has breached a fiduciary duty.²⁴⁷

In response, it was widely believed that this case opened up the channels of communications between officers and analysts, because the “personal gain” requirement was thought to be relatively narrow and focused on pecuniary gain.²⁴⁸

3. The Misappropriation Theory

- a. The misappropriation theory, as adopted by the Supreme Court in U.S. v. O’Hagan,²⁴⁹ holds that a person violates Section 10(b) and Rule 10b-5 when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Several writers have noted that the O’Hagan decision suggests that with the adoption of the misappropriation theory, selective disclosure is no longer a form of insider trading.²⁵⁰ Although the misappropriation theory avoids the pitfalls of requiring a personal benefit for an insider’s disclosure of information to an outsider, this theory of liability does not reach officials giving information to analysts because the information has not been stolen or misappropriated from the source.²⁵¹
- b. The Commission has settled a case, SEC v. Rosenberg, against an analyst for personally trading on material, nonpublic information received from a corporate insider on the grounds of misappropriation.²⁵² However, in Rosenberg, the Commission did

²⁴⁶ Id. In Burlington Industries, Inc. v. Edelman, a former officer of a takeover target was found to have breached his contractual and fiduciary duties to the target not to disclose inside information for personal gain. His insider status was retained even after his employment was terminated. The former officer (tipper) was found to have received a personal benefit as he was in the process of negotiating a contract with the tippee whereby the former officer would manage the company and receive an equity interest. Burlington Indust., Inc. v. Edelman, 666 F. Supp. 799 (M.D.N.C. 1987).

²⁴⁷ Dirks, 483 U.S. at 660.

²⁴⁸ “[T]he primary gainer of the Dirks case is the financial analyst. For the analyst category is very likely the prime example of the tip that is *not* given for either friendship or personal gain.” Loss, Fundamentals of Securities Regulations 768 (1988).

²⁴⁹ U.S. v. O’Hagan, 117 S. Ct. 2199, 2207 (1997).

²⁵⁰ See Norman Sobel, Comment: The Tangled Web of Issuer Liability for Analysts Statements: In re Cirrus Logic Sec. Litig., 22 Del. J. Corp. L. 1051, 1997, at 1067; John C. Coffee Jr., Is Selective Disclosure Now Lawful?, N.Y. L.J., July 31, 1997, at 5.

²⁵¹ The theory does not require showing of benefit to a tipper. See SEC v. Musella, 748 F.Supp. 1028, 1038 (S.D.N.Y. 1989).

²⁵² See SEC v. Rosenberg, No. 91-2403 (D.D.C. 1991) Litig. Release No. 12896 (Sept. 24, 1991).

not pursue the analyst for passing on material, nonpublic information to a client who subsequently traded on the information. It is doubtful that the misappropriation theory would support prosecution of an analyst for passing material, nonpublic information that had been voluntarily given by an authorized corporate officer. The misappropriation theory does not require showing of benefit to a tipper.²⁵³

4. The Commission's Response to Dirks

- a. Although the Commission has conceded in the Release that Dirks has posed a significant barrier to insider trading enforcement actions against insider tippees and their analyst tippees, the Commission has indicated in the Release that tipping liability "may still exist if a selective disclosure is made in circumstances that meet the Dirks 'personal benefit' test."²⁵⁴
- b. In addition, the Commission has signalled, in citing SEC v. Stevens²⁵⁵ in the Release, that it will continue to maintain that Dirks' "personal benefit" test includes any "reputational gain." In the 1991 Stevens case, the Commission brought an enforcement proceeding against Phillip J. Stevens, the former chief executive officer and chairman of a corporation, for tipping certain analysts through telephone calls. These calls were made prior to the public release of a decline in the corporation's first quarter revenues. The Commission determined that Stevens made these calls to protect and enhance his reputation as a corporate manager. The Commission based its finding on the fact that several years earlier, after an unexpected decline in earnings, an analyst dropped its coverage of the company. The Commission claimed that Stevens, perceiving the prior event as a threat to his professional reputation, was motivated to selectively disclose material information to analysts in order to protect and enhance his reputation. Stevens consented to an injunction and paid \$126,000 without admitting or denying the allegations.

On the one hand, to read the Dirks test so narrowly as to include only quantifiable gain to the defendant would shield from liability some individuals who disclose information with a definite personal quid pro quo in mind. Personal gain does not always come in the form of cash, and it is sometimes difficult to put an immediate

²⁵³ See SEC v. Musella, 748 F.Supp. 1028, 1038 (S.D.N.Y. 1989).

²⁵⁴ Release, 65 Fed. Reg. at 51726.

²⁵⁵ SEC v. Stevens, Litig. Release No. 12,813 (S.D.N.Y. Mar. 19, 1991), 1991 WL 296537 (S.E.C.).

value on an interaction involving information. In addition, the Dirks decision clearly spoke of “reputational” gain as well. On the other hand, the allegations of personal gain in Stevens boil down to the following: an executive gives a financial figure, which an analyst disputes, and the executive defends the figure. Any executive with the best interest of his/her company in mind would do this, since an analyst’s challenge to company figures could have a strong negative impact on his/her company. When an executive speaks for a company, personal credibility and corporate interests coincide. Since the reputation of a manager is always tied to the corporation’s performance, the Commission’s analysis demonstrated in this case would lead essentially to a rejection of the personal gain test of Dirks. This attitude was also apparent in a speech given by former SEC Commissioner Edward H. Fleischman, who stated that the Commission had intended to “electrify the tightrope” through the Stevens action. In this speech, then Commissioner Fleischman suggested that reputational benefits could be imputed regardless of whether the executive’s tenure had been long or short, or whether credibility problems had previously existed or not.²⁵⁶

- c. One writer has stated that the decision in U.S. v. O’Hagan, which suggests that selective disclosure authorized by the corporation will not lead to insider trading liability, evidences a climate in which the Commission would be unlikely to be able to sustain the Stevens position.²⁵⁷ However, it is probably still true that the protection afforded by Dirks on the issue of insider trading and analyst communications is less reliable than was once thought.²⁵⁸

²⁵⁶ Commissioner Edward H. Fleischman, Ferretting in the Interstices of S.E.C. Attitudes to Securities Analysts, Speech Presented to the 18th Annual Securities Regulation Institute, Univ. of California, San Diego, CA (Jan. 24, 1991) (as edited and annotated by Commissioner Fleischman), cited in Paul B. Brontas, Jr., Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts, 92 Colum. L. Rev. 1517 (1992).

²⁵⁷ Norman Sobel, Comment: The Tangled Web of Issuer Liability for Analysts Statements: In re Cirrus Logic Securities Litigation, 22 Del. J. Corp. L. 1051, (1997) at 1067 (citing John C. Coffee, Jr., Is Selective Disclosure Now Lawful?, N.Y.L.J., July 31, 1997, at 5)).

²⁵⁸ Many commentators have criticized Stevens for trivializing the Supreme Court’s standard of personal benefit outlined in Dirks. See John C. Coffee, Jr. The SEC and the Securities Analyst, N.Y.L.J., May 30, 1991, at 5. “If the courts were to concur with the SEC as to the “reputational benefit” alleged in SEC v. Stevens, it is difficult to imagine any communication between a corporate official and the investment community where the SEC could not argue that the officer was using the communication to enhance his or her reputation or relationship with an analyst.” Steven E Bochner & Ignacio E. Salceda, Over the Wall: Handling Securities Analysts’ Conference Calls, Earnings Forecasts, and Reports Effectively, 1149 PLI/Corp 131 (1999). “The Stevens case illustrates that

- d. In In re Fox-Pitt Kelton, the Commission brought an action against a broker for failing to adequately ensure that an analyst employed by the company did not make use of material, nonpublic information.²⁵⁹ The Commission brought the action under Sections 15(b) and 21C of the Exchange Act. An analyst working for a broker participated in a conference call with other analysts where the issuer revealed material nonpublic information. The Commission wanted to impose liability on the analyst for using the information to trade securities on behalf of his clients and the brokerage firm's accounts. But, unable to find a breach of duty to the source of the information, the Commission brought an action against the securities firm for failing to maintain adequate procedures which reasonably prevented insider trading. This was a rather extreme case, as Fox-Pitt had no policy or procedures in place to prevent trading on material, nonpublic information. In addition to the analyst participating in the call, a sales person at the broker traded on behalf of the firm's clients and a senior employee traded for his personal account.

D. False or Misleading Statements

If an issuer's report or public disclosure made under Regulation FD – including press releases – contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made not misleading, and such statements were made “in connection with” the purchase and sale of a security, and the issuer acted with scienter, then such report or public disclosure may be subject to liability under Rule 10b-5.

Rule 10b-5's requirement of “in connection with” is satisfied so long as there is a connection between the statement made and transactions by and among members of the public, i.e., if the statement was “of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities.”²⁶⁰ Neither a corporation nor any other person involved in the issuance of a misleading statement can be held to have violated Rule 10b-5 unless they acted with scienter. The scienter requirement does not require that the person acted willfully, but may be met by

any executive whose responsibilities include [. . .] communication with analysts can be charged plausibly with deriving a ‘reputational benefit,’ which in turn would protect or enhance earning capacity, from the routine performance of duties.” Carl W. Schneider, Fencing on the Electrified Tightrope: Shocking Executives Who Value Reputation, Insights, July 1991, at 14.

²⁵⁹ In re Fox-Pitt, Kelton, Inc., Release No. 34-37940 (Admin. Proc. Nov. 12, 1996), 1996 WL 657769 (S.E.C.).

²⁶⁰ Texas Gulf Sulphur, 401 F.2d at 860.

showing that he acted recklessly. Moreover, the fraud-on-the-market line of cases could also be argued to apply to such situations.

VI. Recent Developments

According to recent media reports,²⁶¹ the Commission's Division of Enforcement is investigating whether Raytheon Co. and Motorola Inc. violated Regulation FD in their private discussions with Wall Street analysts.²⁶² While the mere existence of an enforcement inquiry does not mean that the Commission will bring an enforcement action and may not even mean that a violation has occurred, these two investigations can be helpful in analyzing the Division of Enforcement's current thinking concerning Regulation FD. Our description and analysis of the two fact patterns are based on the available facts.

A. Raytheon Co.

1. Facts

After Raytheon's annual investor conference in New York, which was Web cast, management, including the chief financial officer, provided more detail about Raytheon's earnings forecast to some Wall Street analysts. After the second meeting, the analysts' estimates of Raytheon's earnings for the first quarter of 2001 fell by a nickel, with several analysts stating in their written reports that the changes in their estimates resulted from private discussions with Raytheon management.²⁶³

2. Analysis

Based on the facts available, this fact pattern presents the issue of whether the Raytheon management provided material, nonpublic information to the analysts in the second meeting or whether the changes in their estimates for Raytheon's first quarter resulted from the analysts' putting together a mosaic of immaterial as well as fully disclosed material facts. The former is a violation of Regulation FD; the latter is not.

Selectively disclosing non-material information to an analyst is permissible under Regulation FD, even if the analyst is able to use the non-material information to complete a "mosaic" of information that, taken together, is material. This "mosaic" theory enables issuers to disclose information that is not important to the reasonable investor – and hence, not "material" – and yet can be important to

²⁶¹ See Michael Schroeder, SEC To Probe Whether Raytheon Violated Disclosure Regulations, Wall St. J., Mar. 15, 2001.

²⁶² See Outline at Section II.D, supra, for a description of liability under Regulation FD.

²⁶³ Schroeder, supra note 261.

the analyst, who recognizes its significance and uses it to reach a conclusion and make a recommendation. An issuer meeting with analysts without having a simultaneous Web cast runs the risk of making the correct ex ante judgment as to whether a reasonable investor would later find the information material.²⁶⁴

The Raytheon fact pattern is particularly poignant because the meeting with analysts occurred immediately after a Web cast investor conference. Given the definition of materiality under the case law and in SAB 99, public companies have been counseled that the risk of providing material, nonpublic information is lessened by temporal proximity to a Web cast investor conference. While we do not know the specifics of the discussion with the analysts, this fact pattern may also present a test of SAB 99.

B. Motorola Inc.

1. Facts

In a February 23, 2001 press release, Motorola announced that it did not expect to achieve “the first-quarter 2001 sales guidance of \$8.8 billion or the earnings guidance of 12 cents per share given on Jan. 11, 2001.”²⁶⁵ On March 9, 2001, at least five analysts reduced their first quarter Motorola earnings and revenue estimates after company representatives made a series of calls to analysts whose estimates were not in line with the company’s guidance on February 23. According to these analysts, Motorola only reiterated guidance, which “amounted to pointedly rereading last month’s warning, in the phone calls.”²⁶⁶

2. Analysis

This fact pattern may present the issue of whether reading already public guidance in a particular manner with varying degrees of emphasis to certain analysts who “have not gotten the previous message” represents a code that violates Regulation FD.²⁶⁷ It may also present a materiality issue.

Under Regulation FD, an issuer may selectively confirm a forecast it has previously made to the public without triggering Regulation FD’s public dissemination requirement so long as the confirmation is not material.²⁶⁸ In

²⁶⁴ See Outline at Section III.A.3, supra, for a description of the mosaic theory.

²⁶⁵ See Press Release, Motorola Inc., Motorola Does Not Expect To Achieve First Quarter Sales, Earnings Guidance (Feb. 23, 2001), available at <http://www.motorola.com/mediacenter>.

²⁶⁶ Schroeder, supra note 261.

²⁶⁷ See Outline at Section II.C.2(b), supra, for a description of code as a form of indirect guidance.

²⁶⁸ See Outline at Section III.A, supra, for a description of the Commission’s position on giving guidance to analysts.

deciding whether the confirmation is material, issuers need to address three questions: First, where is the issuer in the earnings cycle? Second, how much time has passed since the public guidance was given? And third, has anything important happened in the intervening period that would likely cause a reasonable investor to question the continued accuracy of the initial estimate? If so, a confirmation could be material.

It is unclear from the media report whether anything important happened between February 23 and March 9 that would cause confirmation of the public guidance to be material. Moreover, whether or not 17 days between the date of guidance and the date of confirmation is sufficiently brief to cause the confirmation to be immaterial depends on all the facts and circumstances, which are not yet available.

VII. Recommendations on FD Compliance from Various Firms

Regulation FD has spurred public relations firms and law firms, including Latham & Watkins, to propose advice to their issuer clients on how to comply with Regulation FD based on its text, on the Release and on statements made by various Commission officials. What follows is a table compiling various firms' recommendations to their clients. This table is not intended to be an exhaustive list of law firm recommendations. Rather, it is intended to show the diversity of current thinking about this controversial and complicated rule. This table shows a consensus on certain actions that issuers should adopt, and reveals, tellingly, other proposed actions that do not attract consensus. No doubt this table will change as ambiguities in Regulation FD and the Release are clarified and as companies gain experience and practices emerge under Regulation FD. The key to the firms listed in the table is as follows, with the date of each firm's recommendation:

LW is Latham & Watkins, dated Dec. 6, 2000

AB is The Abernathy MacGregor Group, Inc., dated Sept. 13, 2000

CG is Cleary, Gottlieb, Steen & Hamilton, dated Aug. 22, 2000

CO is Cooley Godward, dated Oct. 1, 2000

CW is Cadwalader, Wickersham & Taft, dated Sept. 7, 2000

DP is Davis, Polk & Wardwell, dated Aug. 18, 2000

FF is Fried, Frank, Harris, Shriver & Jacobsen, dated Sept. 15, 2000

GC is Gray Cary Ware & Freidenrich

GD is Gibson, Dunn & Crutcher, dated Sept. 7, 2000

HH is Hogan & Hartson

KL is Kirkpatrick & Lockhart, dated Aug. 2000

KM is Katten Muchin Zavis, dated Aug. 18, 2000

McC is McCutchen, Doyle, Brown & Enersen

McG is McGuireWoods, dated Sept. 2000

MF is Morrison & Foerster, dated Aug. 2000

ML is Morgan, Lewis & Bockius

PD is Palmer & Dodge, dated Aug. 2000

PR is Proskauer Rose, dated Sept. 2000

RG is Ropes & Gray, dated Aug. 30, 2000

SC is Sullivan & Cromwell, dated Sept. 7, 2000
SS is Shearman & Sterling, dated Sept. 2000
WC is Wilmer, Cutler & Pickering, dated Aug. 23, 2000

Compilation of Regulation FD Recommendations from Various Firms

	LW	AB	CG	CO	CW	DP	FF	GC	GD	HH	KL	KM	McC	McG	MF	M
1. Determine/designate and limit who will be authorized spokespersons.	?	?	?	?	?		?	?	?	?	?	?	?	?	?	
2. Educate or inform spokespersons.	?				?	?			?		?	?	?	?	?	
3. Develop system for keeping track of publicly disclosed information.				?	?		?	?	?	?	?	?	?			
4. Prepare for unintentional disclosures./Create "disclosure" team.	?	?			?		?		?			?		?		
5. Review/reexamine written disclosure policies.	?			?	?	?			?		?	?				
6. Require earnings calls with analysts to be open to public on listen-only basis, etc.	?	?	?				?			?		?	?			
7. Hold debriefing sessions after an analyst conference.		?					?				?			?		
8. Require more than one company representative to be present during one -on-ones with analysts.	?										?	?		?		
9. Monitor what the market knows about your company.	?	?		?			?			?	?					
10. Request analysts to agree to limited embargoes on information, if appropriate.									?		?					
11. Script/prepare for analyst calls.	?	?	?	?	?		?	?			?		?			

	LW	AB	CG	CO	CW	DP	FF	GC	GD	HH	KL	KM	McC	McG	MF	M
12. Keep a written log of analyst conversations/all communications covered by FD.										?						
13. Adopt/review specific policy regarding reviewing drafts of analysts' reports.		?										?				
14. Use "safe harbor" language in making forward-looking statements.	?	?		?			?	?	?	?		?			?	
15. If you don't have a written disclosure policy, adopt one.	?			?							?	?				
16. Put clear limits/ground rules on communications during private sessions with analysts.	?	?			?							?				
17. Before any authorized representative discloses information that is in a gray area as to materiality, the representative should review the proposed disclosure with designated company officials, including internal legal counsel and, where appropriate, outside counsel.	?											?				
18. Don't review drafts of analysts' reports.		?														
19. Obtain confidentiality agreements from investors in private placements before giving them material, nonpublic information.										?						

	LW	AB	CG	CO	CW	DP	FF	GC	GD	HH	KL	KM	McC	McG	MF	M
20. If company decides to review analyst report, should limit review to correcting factual inaccuracies.	?	?		?										?		
21. Refer questions on earnings to existing disclosure.					?											
22. Don't make transcript of conference call available.		?														
23. Consider regular public dissemination of data that are typically provided to analysts, such as sales figures.												?				
24. Issuer should assume that Regulation FD will apply to all disclosures of material nonpublic information to a security holder, unless the holder agrees to maintain the information in confidence or is otherwise in a special relationship with the issuer.																
25. Do not record communications in one-on-ones or a small group discussion with analysts.	?															
26. Record conference calls and keep the tapes.								?								
27. Furnish, don't file, a Form 8-K, unless disclosure has been vetted by counsel.	?															
28. Establish form of confidentiality agreement to be used.																

	LW	AB	CG	CO	CW	DP	FF	GC	GD	HH	KL	KM	McC	McG	MF	M
29. Create a tailored, company-specific list of material information/topics.											?					
30. Issuers should discourage “follow-up” calls after conference calls.						?										
31. Confidentiality agreements should be obtained from investors in private placements (and also from lenders).						?										
32. Make file record of any oral confidentiality agreements.		?														
33. Establish policy for commenting on market rumors that appear to be affecting the price of the stock.		?														
34. Adopt formal policy on earnings guidance.		?														
35. Establish policy for dealing with “unreasonable” analyst earnings forecast.		?														
36. Don’t do one-on-ones during end of quarter blackout periods.	?	?						?								
37. Tell spokespersons to treat one-on-ones as if they’re being recorded.	?	?														
38. Treat disclosure of material, nonpublic information to the press the same way you treat such disclosure to investors.	?	?														

	LW	AB	CG	CO	CW	DP	FF	GC	GD	HH	KL	KM	McC	McG	MF	M
39. Treat disclosure of material nonpublic information to non-investor audiences (sales conventions, cocktail parties) the same way you treat such disclosure to investors.		?														
40. Post responses to common analyst/investor queries on corporate intranet so spokespersons can be consistent.							?									
41. Involve counsel in review of scripts prepared for conference calls.							?									
42. File “procedural” Form 8-K, which states that future disclosures shall be made on the issuer’s website.							?									
43. Create archive of disclosures on website solely for historical purposes.							?									
44. Establish a pattern of disclosure and don’t deviate from it.										?						
45. Ensure all planned announcements by covered persons that will not be disseminated broadly and might include material information are reviewed by counsel.																

	LW	AB	CG	CO	CW	DP	FF	GC	GD	HH	KL	KM	McC	McG	MF	M
46. Expand periodic public disclosures to include matters that you expect to talk about with analysts and investors.	?															
47. Ensure that people preparing road show and investor presentations are communicating with people preparing your periodic disclosure documents.	?															
48. Prohibit officers and employees from entering chat rooms to discuss the company's stock.								?								
49. Conduct one-on-ones with analysts only when the market is closed.								?								

APPENDIX A

HYPOTHETICALS

1. Each of Issuer A and Issuer B develops internal projections of revenues, expenses and earnings. Issuer A decides to release its projections to analysts and, concluding that the information is material, does so through means that satisfy the public dissemination requirements of Regulation FD. Issuer B, also of the view that its projections are material, decides not to share its projections with anyone outside the company. Each of Issuer A and Issuer B then files a registration statement on Form S-1. Does Issuer B have an obligation to include its projections in its Form S-1? Must Issuer A include its projections in its Form S-1? What if, instead of filing a Form S-1, Issuer A already has an effective shelf-registration statement at the time it discloses its projections and, a week later, decides to conduct a takedown offering? Must the projections be included (or incorporated by reference by Form 8-K) in the Form S-3? If projections must be included in either the Form S-1 or the Form S-3, must they be updated? Does it make a difference if Issuer A's registration statement is a resale shelf for selling securityholders?

2. Issuer C has announced that it is going to merge with another publicly-traded company in a registered stock-for-stock merger. Lobbyists for the issuer's competitors have complained to Congress that the merger is anticompetitive, and consumer advocates are calling for congressional hearings. In connection with Issuer C's Hart-Scott-Rodino filing, the Federal Trade Commission ("FTC") has made a second request for information, which is unusual and will require considerable time and attention to respond to, but does not, according to Issuer C's regulatory counsel, indicate any substantive opinion about the merger by the FTC and, by itself, is not expected to delay the merger's closing date. At an analysts-only conference call, Issuer C can anticipate being asked about the review status of the merger at the FTC. What can Issuer C say? What can Issuer C say to The Wall Street Journal reporter in a telephone interview following the conference call? What can Issuer C say at a private meeting with its three largest shareholders who are concerned about the merger's prospects? Are the answers different for a cash merger that is not registered under the Securities Act of 1933?

3. Issuer D has a policy designating which "senior officials" are authorized to speak with securities market professionals and lists the authorized senior officials on Issuer D's website. Issuer D's Assistant Comptroller is not so designated and therefore is not on the list, although Issuer D's CEO is a designated person. At a private meeting with large institutional shareholders, none of whom has entered into a confidentiality agreement, the CEO and the Assistant Comptroller field questions, and in the midst of the give-and-take, the Assistant Comptroller discloses material, nonpublic information. While the Assistant Comptroller did not intend to disclose the information, she knew that it was material and nonpublic when she said it. The CEO ignored the Assistant Comptroller's statement and went on to the next question. When must this information be publicly disseminated?

4. On Tuesday, an analyst asks Issuer E's investor relations officer whether their mutual friend, a software whiz who is a senior vice president at the issuer, is leaving Issuer E to join an Internet start-up, as he claimed he would at a cocktail party the night before. The investor relations officer answers yes. Three days later, the investor relations officer fields a call from a

journalist who is doing background on a story about Issuer E's CEO, which will appear in next month's issue of the magazine. During the call, the investor relations officer discloses that the software whiz will leave Issuer E by the end of the quarter. Two weeks later, Issuer E releases a press release announcing the software whiz's impending departure for greener pastures at an Internet start-up. Issuer E's stock price stays within its normal trading range. Upon the magazine's publication at the end of the month, Issuer E's stock price plummets on the news of the software whiz's departure, as he was considered by many analysts – as stated in their research reports – to be the key developer of Issuer E's main product offering. Did Issuer E violate Regulation FD? If so, when?

5. Issuer F has engaged an investment bank to raise \$100 million in a Rule 144A offering. During the course of the offering, Issuer F disclosed material, nonpublic information to the investment bank. Four weeks before the end of a fiscal quarter, just before Issuer F enters its quarter-end blackout or quiet period, Issuer F's investor relations officer receives a call from an analyst who works at the investment bank and regularly follows Issuer F. The analyst asks, "Have you changed your guidance on earnings since the conference call after the last quarterly earnings release?" The investor relations officer says nothing and hangs up the phone. In the next morning's call to brokers at the investment bank, the analyst says, "Issuer F is still on target for a strong quarter. I am raising my recommendation from buy to strong buy." Issuer F's stock goes up 20%. What is Issuer F required to do under Regulation FD? Would the answer be different if Issuer F interviewed five banking firms and had confirmed that Issuer F was on track during the interviews?

6. Issuer G's investor relations officers and research scientists meet with a biotechnology fund that is well known for the scientific expertise of its portfolio managers, all of whom have doctorates from M.I.T. Consistent with its policy, the fund declines to enter into a confidentiality agreement with Issuer G. Issuer G gives a presentation on a new drug and its prospects, which are generally consistent with Issuer G's public statements. In response to questions, the research scientists engage the portfolio managers in a very informative, highly technical discussion about the drug, which the portfolio managers, because of their scientific background, are able to interpret as strongly positive developments. The next day, the fund makes a sizable investment in Issuer G. Has Issuer G violated Regulation FD? Would your answer be the same if Issuer G's research scientists had made the same statements at a university symposium consisting solely of professors and graduate students?

7. Issuer H receives a draft analyst report from a highly influential industry analyst. Issuer H's policy is to review analyst reports for factual accuracy but not to comment on earnings estimates. The report indicates that the analyst believes Issuer H has dramatically increased market share in one of its business segments. As this is a true statement, Issuer H neither corrects nor comments on it, although Issuer H knows the report is likely to send its stock price up sharply. When must Issuer H publicly disclose this information? Would your answer be different if the statement about the business segment is actually false and Issuer H points out the inaccuracy to avoid a mistake that would result in false expectations?

8. The CEO of Issuer I has preliminary discussions with her counterpart at Issuer J regarding a possible merger of equals. Because of their relationship, they share material,

nonpublic information prior to signing a confidentiality agreement. Has Issuer I violated Regulation FD? What if Issuer J is a securityholder of Issuer I?

8A. The negotiations between Issuer I and Issuer J are leaked to the press by a hedge fund manager, who is not connected to the negotiations. Issuer K then sends Issuer I a bear hug letter in which Issuer K states, “We know the price you’re negotiating with Issuer J. We understand Issuer J is offering \$100 per share. We are prepared to consider topping their offer by at least \$15 per share, subject to your discontinuing negotiations with Issuer J.” Thus far, Issuer I, consistent with its long-standing policy, has taken a no comment position on any press inquiries. What should Issuer I do now under Regulation FD?

8B. Would your answers be different if Issuer I and Issuer J are in the financial service industry and each has broker-dealer, investment advisor and mutual fund affiliates?

9. Issuer L very recently completed its IPO and is anxious to generate analyst attention. A leading industry analyst has started to call Issuer L’s investor relations officer on a daily basis to discuss the finer details of its MD&A. To make her happy, the investor relations officer discloses one piece of immaterial information each day. After two months, the analyst has enlarged her understanding of Issuer L and, consequently, has become very sensitive to the value of the daily piece of information she is given. For his part, the investor relations officer is pleased that he has been able to satisfy a leading industry analyst and is pleased, too, that the analyst understands Issuer L so well. The analyst’s questions are, by now, very refined and specific, as are his answers. Such is the analyst’s understanding of Issuer L that she does not give Issuer L a draft of her report for its review. Prior to issuing her report, which is extremely positive, the analyst advises her firm’s clients to buy Issuer L’s stock in very large amounts. Three days later, the report is publicly disseminated, and Issuer L’s stock shoots up 35%. A week later, Issuer L participates in a securities conference sponsored by the analyst’s investment banking firm in which Issuer L’s CFO discusses the company’s outlook and the analyst discusses her research report. Did Issuer L violate Regulation FD?

10. When Issuer M went public, the IPO prospectus included a key man risk factor about its CEO and other managers and disclosed that Issuer M had key man life insurance policies on each of its executive officers for very large amounts. While rumors about the CEO’s health circulated in the press for several weeks, Issuer M routinely stated that it would not comment on the CEO’s health because it was a private matter. On Monday, Issuer M published a press release announcing the CEO’s death on Friday morning “from a long and protracted illness.” Did Issuer M violate FD? If not, did it fail to update the IPO prospectus?

11. Issuer N is an employee-sensitive Internet company. Issuer N’s CEO believes in an open door policy with her employees in order to combat high employee turnover. Each week the CEO e-mails an employee newsletter that contains information about Issuer N’s products, revenues and prospects. For example, one newsletter congratulates the employees on their performance to date in the quarter and exhorts them to work harder to be able to beat the budgeted number. Each of the employees has agreed to buy or sell Issuer N’s common stock only during certain window periods. The weekly e-mails are typically not shared with family or friends by the employees. Has Issuer N violated FD if 98% of the employees are stockholders? What about

former employees or independent contractors or joint venture partners who have received the e-mails?

12. Issuer O has a universal shelf registration statement from which it sells debt securities from time to time as market conditions permit. Issuer O has used the same three investment banks as managers of its debt offerings for the past ten years. To comply with Regulation FD, Issuer O webcasts each of its earnings conference calls to the public and keeps the webcast available on its website for 72 hours after the call. If no material, nonpublic information is discussed on the analyst call and Issuer O starts a debt offering off the shelf the next day, must Issuer O file the webcast as a prospectus under Rule 424 of the Securities Act?

13. In response to Regulation FD, Issuer P decided to include full quarterly projections for each line item on its income statement (from revenue through net income) in its earnings press release and in its quarterly reports on Form 10-Q. The CEO routinely speaks at securities conferences sponsored by investment banking firms as well as one-on-ones in which he is asked about Issuer P's performance and prospects by analysts and shareholders. When, if at all, can the CEO affirm Issuer P's quarterly projection in these meetings without having to also make public disclosure? Is your answer different if 95% of Issuer P's revenue is earned in the last week of the quarter or if Issuer P's revenue is mostly earned in one quarter, such as the holiday season in December? Is your answer different if Issuer P publishes a press release every month stating whether it is on track or off track in realizing its quarterly projection?

14. Issuer Q and an unaffiliated private company have a joint venture pursuant to which the private company manufactures a product that Issuer Q sells. Since Issuer Q does not release projections, Harvey, the analyst, goes on plant tours of the private company's factory and talks to employees who work at the factory on a regular basis. Has Issuer Q violated Regulation FD? What if Harvey tells Issuer Q what he is doing? What actions, if any, is Issuer Q then required to take?

15. The CFO of Issuer R and Harvey, the analyst have been discussing Harvey's model of the company for years. The CFO never comments on anything in the model except historical facts. Whenever the CFO encounters something in Harvey's model that does not seem right, she asks Harvey what historical fact he is basing that piece of the model on. After years of meetings, Harvey knows he has to drill down to a historical fact before the CFO will address the issue. Hence, regardless of the piece of the model, the discussion between the CFO and Harvey relates only to historical facts. Does this practice comply with Regulation FD? If not, why?

16. Issuer S is a major producer of commodities ranging from energy, such as coal and natural gas, to metals, paper and plastics. Harvey, the analyst, asks the CFO about production volume for one of Issuer S's principal products. The CFO refers Harvey to publications that track industry trends for that product. Has the CFO violated Regulation FD?

17. In response to Regulation FD, Issuer T began to publish earnings projections and increase the duration of the blackout period at the end of each quarter. The day before the blackout or quiet period begins, Issuer T's CFO responds to an analyst question by referring the analyst to the fact that Issuer T published the earnings estimate at the beginning of the quarter. The CFO is

actually quite concerned about making those numbers, but has not yet concluded that the quarter is so bad that a pre-announcement is needed. Has the CFO violated FD? If not, has the CFO violated Rule 10b-5?

18. In making a Rule 144A offering, Issuer T plans to disclose material, nonpublic information to potential purchasers. The private placement memo for the offering states, “By opening this PPM you agree to keep this information confidential.” Does this language or any other confidentiality legend comply with Regulation FD? If not, would confidentiality agreements requiring each purchaser to keep the information confidential until Issuer T files its next Form 10-Q comply with Regulation FD?

19. Analyst calls the CEO of Issuer U regarding a market rumor that Issuer U is a takeover target. The market rumor is false. The CEO responds by stating, “You know that as part of Issuer U’s long-standing policy, we do not comment on unfounded market rumors.” Has Issuer U violated Regulation FD? What should Issuer U do next?

20. On Monday, Issuer V broadly disseminates a press release notice announcing that on Friday, 9:00 a.m., EST, Issuer V will post material, nonpublic information on its website. The press release also states that this information will not be disclosed in any medium or forum other than the website. On Friday, 9:00 a.m., EST, Issuer V announces on its website that it has agreed to acquire its main competitor for \$1 billion. No other public disclosure is made. Has Issuer V satisfied Regulation FD? What if Issuer V filed the press release notice on Form 8-K? If Issuer V decides to webcast its merger announcement – i.e., its CEO will broadcast the news live over the Internet – but uses no other medium or forum to disseminate the merger announcement, has Issuer V satisfied Regulation FD?