Lurking in the Shadows: The Hidden Issues of the Securities and Exchange Commission's Regulation FD

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Lurking in the Shadows: The Hidden Issues of the Securities and Exchange Commission’s Regulation FD

Marc I. Steinberg* & Jason B. Myers**

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In the not-so-distant past, issuers of publicly held securities often would selectively disclose material nonpublic information to analysts and other securities market insiders in advance of any broad public announcement. Perceiving that such practices impeded a fair marketplace to all investors, the Securities and Exchange Commission (Commission or SEC) promulgated Regulation FD (Regulation), standing for “Fair Disclosure,” which now proscribes these practices.¹ Today, issuers of publicly held securities can no longer

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selectively disclose material nonpublic information to analysts, broker-dealers, other market professionals, or favored shareholders without a corresponding announcement to the general public.

A. Identifying the Problem

The practice of selective disclosure, as well as its effects, is illustrated in an October 1999 Washington Post article regarding Hewlett-Packard (H-P).\(^2\) The episode in question started October 1, 1999, when H-P’s CEO held a conference call with analysts at which the executive disclosed, among other bits of information, that an earthquake in Taiwan may disrupt the production of a component that the company used in producing personal computers. This conference call was open to the media and H-P posted the transcript of the call on its Internet Web site. A few weeks later, analysts called H-P to obtain more information from the company before it went into a regular, self-imposed silence period prior to issuing its quarterly report. H-P officials told analysts who called the company that it was in fact experiencing a disruption. As a result, several analysts downgraded their earnings estimates for H-P, leading to a large sell-off of stock. By the time H-P issued a press release two days later and a formal announcement the day after that, the company’s stock price fell twelve percent. Those investors affiliated with the analysts to whom H-P conveyed the information were able to sell off stock before the price fell, thus protecting the value of their investment. Others, however, stood by watching their investment decline without any public statement from H-P.\(^3\)

This incident, highlighting the practice and effects of selective disclosure, is not the most egregious example; indeed, H-P can point to a number of practices in its defense. First, the company had publicly disclosed the potential disruption of its flow of PC components in its October 1 conference call. In addition, H-P did not consider the distinction between may have problems and in fact having problems to be significant.\(^4\) But for those investors outside the informational loop, the effect of the selected disclosure was the same: the “chosen few” analysts . . . guard[ed] the information carefully to

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3. See Barbash, supra note 2, at H1 (reporting that after the sell-off started on Tuesday afternoon, H-P did not issue a press release regarding the earthquake-related problems until Thursday and a formal statement until Friday morning).

4. See id. (“The analysts were informed. [H-P manager of media and financial relations Marlene] Somsak told me, that ‘we do see some disruption in component supply.’ They were, in her words, ‘now experiencing’ some difficulty, not just ‘worrying about it.’ Now, as far as the company was concerned, this was not a major problem. Nor did the company consider it terribly important news or even new news. ‘We considered it to be a reiteration of predislosed business conditions and risks,’ she said.”).
maximize the advantage of their pre-knowledge” while the general public “frustrating[ly] [sat] by in ignorance.”

According to former SEC Chair Arthur Levitt, selective disclosure practices benefit market professionals at the expense of small investors and “simply . . . defy the principles of integrity and fairness.” Before Regulation FD, however, even though selective disclosure of material nonpublic information may have been perceived as unfair, it normally was not illegal. The practice of selectively disclosing such information generally does not fall within the antifraud provisions of Section 10(b) of the 1934 Securities Exchange Act and its regulatory counterpart, Rule 10b-5. Thus, no liability normally attaches to issuers, their executives, or market professionals for trading by the professionals’ clients in the subject companies’ securities based on material nonpublic information.

How did the securities laws develop in such a way that permitted selective disclosure? For many years, selective disclosure had been seen as generally falling under early insider trading case law, thus leading to liability exposure for issuers and their insiders who selectively tipped material nonpublic information as well as their tippees who themselves tipped or traded on the information. The distinction between a tipper, the person in the issuer company who conveyed information, and a tippee, the one who received the information, was seen as “untenable”; the tippee was under the same disclose-or-abstain obligation as an insider. In Dirks v. SEC, the Commission sought to receive Supreme Court approbation of the SEC’s approach to the tipper-tippee insider trading prohibitions unto Section 10(b) and Rule 10b-5. To the SEC’s dismay, however, the Supreme Court found that tippee liability was premised on a breach of fiduciary duty by the tipper. Thus, tippee liability

5. Id. (quoting a comment posted on the online chat room http://www.ragingbull.com).
8. See Proposed Rule Release, supra note 2, at 72,593 (citing SEC v. Bausch & Lomb, Inc., 565 F.2d 8 (2d Cir. 1977)).
11. Raymond Dirks was a broker-dealer who received information regarding Equity Funding of America (Equity Funding) from a former officer of the company, Ronald Secrist. Secrist alleged that Equity Funding engaged in fraudulent practices that resulted in overstating the company’s assets and asked Dirks to investigate this claim. Dirks did so, but in the process also disclosed Secrist’s allegations to others in the investment community. After Equity Funding’s stock price fell and a Wall Street Journal article, based on information that Dirks uncovered in his investigation, revealed the company’s fraudulent practices, Equity Funding was put into receivership. The SEC investigated Dirks and claimed that he violated the federal securities laws’ antifraud provisions because he improperly tipped the subject information. See id. at 648-51.
12. See id. at 660 (“[T]ippee responsibility must be related back to insider responsibility by a necessary finding that the tippee knew the information was given to him in breach of a duty by a person having a special relationship to the issuer not to disclose the information. . . . Tipping thus properly is viewed only as a means of indirectly violating the Cady, Roberts disclose-or-abstain rule.”) (quoting In re Investors Mgmt. Co., 44
is derivative; if the tipper would not be liable for a breach of fiduciary duty in disclosing the subject information, then the tippee legally may trade. The Court’s test for determining whether the tipper breached a duty was “whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.” Thus, tipper-tippee liability under the insider trading law generally extends only to tippers who receive the required personal benefit and to tippees who knew or should have known of the breach.

Another significant case is United States v. O’Hagan in which the Supreme Court embraced the misappropriation theory. This theory “holds that a person ... violates ... Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.” Importantly, application of the misappropriation theory is conditioned on the recipient of the information having a duty to the source and undertaking to preserve the confidentiality of the subject information.

Dirks and O’Hagan created a gap in the securities laws that, before Regulation FD, permitted selective disclosure. Selective disclosure of information usually stemmed from a high-ranking official in a company or an employee whose responsibilities entailed regularly communicating with analysts. Generally, these disclosures were made on behalf of and for the benefit of the company; they were designed to enable analysts to make more accurate assessments of the company's performance, and even perhaps with the objective of inducing analysts to make more favorable ones. At a minimum, selective...
disclosure was a way for issuers to curry favor with analysts.\textsuperscript{20} Nonetheless, given the absence of any personal benefit, the Supreme Court’s holding in \textit{Dirks} foreclosed any tipper liability to the insider who selectively disclosed material nonpublic information as well as any tippee liability to the analyst who recommended trading in the company’s stock to clients.\textsuperscript{21} In addition, the analyst ordinarily did not incur liability under \textit{O'Hagan}’s misappropriation theory because no obligation was owed by the analyst to the issuer to keep the information confidential.\textsuperscript{22}

As a result, analysts and their clients benefited from the system of selective disclosure that developed by being able to act on material information in advance of others. This left unaffiliated investors in the position of only being able to react to the changes in stock prices created by the first wave of trading. In response to this situation, the SEC sought to provide an equal playing field for all investors by promulgating Regulation FD. The Commission attempted to structure the Regulation to balance all investors’ access to information with a narrowly crafted regulatory scheme that would not deter issuer public disclosure of material information.\textsuperscript{23} In doing so, the basic premise is fairly straightforward. But, the Regulation leaves open many unresolved issues that undoubtedly will need to be answered as the Commission implements the Regulation.

This Article explores key issues likely to arise under Regulation FD, including some that the Commission may not have envisioned in promulgating the Regulation. The next Section begins by reviewing the scope of the Regulation in the ensuing discussion. In Part II, the Article addresses how well the Regulation fits with the policies underlying the federal securities laws. Focusing on issues related to an issuer’s duty to disclose, the efficiency of capital markets, and the Commission’s predominant emphasis on fairness in promulgating the Regulation, the authors note that in many ways Regulation FD provides an awkward fit with the general securities law framework. In Parts III and IV, the Article examines more closely how this awkward fit will play out in practice as the Commission implements the Regulation. Here, the authors highlight such issues as materiality determinations, distinguishing between intentional and non-intentional disclosures, and Regulation FD’s interplay with Rule 10b-5. Finally, in Part IV, the authors offer some concluding thoughts on the Regulation’s future.

\textbf{B. The Scope of Regulation FD}

The SEC adopted Regulation FD in response to the perceived unfairness when companies selectively disclose material nonpublic information to analysts, institutional investors, other securities market insiders, and favored shareholders. The Regulation’s basic premise provides that an issuer, or person acting on its behalf, cannot disclose material nonpublic information to these groups without making a corresponding public disclosure.\textsuperscript{24} As summarized by the SEC:

\begin{quote}
\textsuperscript{20} See Proposed Rule Release, \textit{supra} note 2, at 72,592.
\textsuperscript{21} See \textit{Dirks}, 463 U.S. at 663.
\textsuperscript{22} See \textit{O'Hagan}, 521 U.S. at 652.
\textsuperscript{23} See Regulation FD Release, \textit{supra} note 1, at 51,718 ("Because any potential 'chill' is most likely to arise—if at all—from the fear of legal liability, we included in proposed Regulation FD significant safeguards against inappropriate liability.").
\textsuperscript{24} \textit{Id.} at 51,716. The discussion in this Article setting forth Regulation FD’s general parameters is derived from the Regulation FD Release as well as MARC. I. STEINBERG, \textit{UNDERSTANDING SECURITIES LAW} §
Regulation FD (Fair Disclosure) is a new issuer disclosure rule that addresses selective disclosure. The regulation provides that when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer’s securities who may well trade on the basis of the information), it must make public disclosure of that information. The timing of the required public disclosure depends on whether the selective disclosure was intentional or non-intentional; for an intentional selective disclosure, the issuer must make public disclosure simultaneously; for a non-intentional disclosure, the issuer must make public disclosure promptly. Under the regulation, the required public disclosure may be made by filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public.25

Regulation FD’s scope focuses on those who are prohibited from selectively disclosing material nonpublic information and those to whom the selective disclosure is directed. The Regulation prohibits a company, or persons acting on the company’s behalf, from selectively disclosing material inside information regarding that company or its securities.26 For the purpose of the Regulation, an issuer includes a company that has a class of securities registered under Section 12 of the Securities Exchange Act or is required to file reports under Section 15 of that Act.27

Regulation FD defines a “person acting on behalf of the issuer” as “any senior official of the issuer . . . or any other officer, employee, or agent of an issuer who regularly communicates with any [enumerated recipient of information discussed below] . . . , or with holders of the issuer’s securities.”28 This definition focuses on those persons whose job functions regularly entail the disclosure of company-related information to the enumerated recipients. Selective disclosure by personnel who may occasionally interact with analysts or investors, for example, would not give rise to liability under Regulation FD.29 Thus, material nonpublic information disclosed in the due course of business to customers and suppliers would be outside the scope of the Regulation.30 The Commission, however, has noted that, as prohibited by Section 20(b) of the Securities Exchange Act,31 a senior official cannot escape liability by directing non-covered personnel to make a selective disclosure of information to someone within the classes of enumerated recipients. In such a case, the senior officer would be held responsible for making the selective disclosure.32 Finally, the definition of a “person

10.08 (3d ed. 2001).
25. Regulation FD Release, supra note 1, at 51,716.
27. See id. § 243.101(b). Among other entities, the Regulation expressly excludes from the definition of “issuer” any foreign government or foreign private issuer.
28. Id. § 243.101(c). The Regulation defines “senior official” as “any director, executive officer, investor relations or public relations officer, or other person with similar functions.” Id. § 243.101(f).
29. See Regulation FD Release, supra note 1, at 51,720 n.36.
30. See id.
31. 15 U.S.C. § 78t(b) (2000) (“It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person.”).
32. See Regulation FD Release, supra note 1, at 51,720 (“[T]o the extent that another employee had been
acting on behalf of the issuer” specifically excludes an “officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to an issuer.” 33 In this situation, the issuer would not be held responsible under Regulation FD for its employee’s actions. 34

Regulation FD applies when material nonpublic information is selectively disclosed to one of four enumerated classes of recipients outside the issuer: (1) a broker or dealer, or a person associated with a broker or dealer; (2) an investment advisor, an institutional investment manager, or a person associated with either; (3) an investment company or affiliated person thereof; or (4) a holder of the issuer’s securities, where it is reasonably foreseeable that the holder will purchase or sell the issuer’s securities based on the information. 35

The Regulation expressly excludes, and thus does not apply to, the following: a “person who owes a duty of trust or confidence to the issuer” 36 (e.g., temporary insiders); a “person who expressly agrees to maintain the disclosed information in confidence”; 37 a credit rating agency, “provided the information is disclosed solely for the purpose of developing a credit rating and the entity’s ratings are publicly available”; 38 and, with certain exceptions, “in connection with a securities offering registered under the Securities Act.” 39 Furthermore, although not specifically referenced, disclosure to the media or communications to government agencies are outside the Regulation’s scope. 40

II. REGULATION FD’S POLICY IMPLICATIONS

On its face, Regulation FD seems to provide a clear proscription: thou shall not selectively disclose. With this directive, the Commission sought to plug at least a portion of the gap—that Dirks and O’Hagan created—permitting selective disclosure. But this rule does not cleanly fit into the federal securities laws’ existing disclosure framework. The reason for this awkward fit is this: the Commission, without expressly stating,
challenged a number of key principles that have shaped the disclosure framework—principles that have permitted, facilitated, and perhaps even encouraged an unequal distribution of information. In doing so, the SEC promulgated a rule that rejects or modifies core assumptions underlying the federal securities laws.

A. Duty to Disclose Versus Parity of Information

Regulation FD highlights a key tension underlying much of the implementation of the federal securities laws. On one hand, the underlying premise of the Securities Act of 1933 and the Securities Exchange Act of 1934 is full disclosure of material information. On the other hand, one need not disclose material information unless under a duty to do so. The federal securities law framework reflects a “bottom-up” approach where various individual rules developed over time are aggregated into one system. Regulation FD adds another duty, under certain conditions when the issuer elects to speak, to the list of issuer disclosure obligations where one did not exist before.

Regulation FD promotes a system of equal access to information for all investors. Moreover, it reflects the Commission’s determination that, given the impact of modern technology (e.g., the Internet, 24-hour trading, etc.) on the rapidity of movement in stock prices, equal access to information can be obtained only by ensuring that all participants in the market are able to learn of new material information at the same time.

The concepts of parity of information and equal access to information can be found elsewhere in the securities markets both domestically and internationally. For example, SEC Rule 14e-3 establishes that a person possessing nonpublic material information derived, directly or indirectly, from the bidder or the target in connection with a tender offer must either disclose that information or abstain from trading on it. In addition, the listing agreements for the national stock exchanges and National Association of Securities Dealers Automatic Quotation (NASDAQ) System require companies to adhere to a much greater level of continuous disclosure of material events than what issuers must follow under the federal securities laws.

41. See Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972) ("The Court has said that the 1934 Act and its companion legislative enactments embrace a fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.") (internal quotations omitted).

42. See Chiarella v. United States, 445 U.S. 222, 235 (1980) ("We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.").

43. See Dale Arthur Oesterle, The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Corporations: "Are We There Yet?", 20 CARDOZO L. REV. 135, 138 (1998) (contrasting the bottom-up approach with a top-down disclosure system where a general disclosure rule is established from which specific exceptions are carved out).

44. See infra notes 128-129 and accompanying text.

45. See 17 C.F.R. § 240.14e-3 (2000) (providing in part: "it shall be unlawful for any person described in paragraph (d)(2) of this rule to communicate material nonpublic information relating to a tender offer to any other person under circumstances in which it is reasonably foreseeable that such communication is likely to result in a violation of this section"); see also STEINBERG, supra note 24, § 11.06 ("As adopted, with certain exceptions, Rule 14e-3 applies this disclose-or-abstain provision to the possession of material information relating to a tender offer where the persons knows or has reason to know that the information is nonpublic and was received directly or indirectly from the offeror, the subject corporation, any of their affiliated persons, or any person acting on behalf of either company.").

46. See, e.g., NEW YORK STOCK EXCHANGE LISTED COMPANIES MANUAL § 202.05 (2002), available at
Furthermore, many other countries have adopted securities frameworks based on either an access-to-information or parity-of-information approach. In conjunction with these approaches, many nations with developed securities markets have established by statute rigorous rules limiting insiders from tipping material nonpublic information. For example, German law prohibits primary insiders either from trading on or tipping material nonpublic information; in addition, the initial recipients of such information cannot tip it to others. In the United Kingdom, one who knowingly receives material nonpublic information from an insider, either directly or indirectly, is subject to a broad prohibition against trading and tipping. Furthermore, Australian law subjects any tippee (regardless of how remote) who knowingly possesses material nonpublic information from trading on or tipping such information. In this comparative view, a specific provision comparable to Regulation FD would not be necessary. The selective disclosure of material nonpublic information already would constitute unlawful tipping in developed securities markets abroad and thus would be prohibited. Such is the logical extension of the equal-access and parity-of-information approaches found abroad.

Despite the prevalence of the equal-access approach internationally, the United States' duty-based federal securities law framework is generally not premised on parity of

http://domino.nyse.com/lcm.nsf ("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."). The exchanges, however, do not necessarily strictly enforce this disclosure requirement. See Oesterle, supra note 43, at 138.

47. See MARC I. STEINBERG, INTERNATIONAL SECURITIES LAW: A CONTEMPORARY AND COMPARATIVE ANALYSIS 114-44 (1999). Foreign jurisdictions adopting the “access” doctrine include the United Kingdom; France; Germany; Italy; Ontario, Canada; and Mexico. Australia, for example, uses the parity-of-information approach. See id.

48. In addition to the specific countries discussed infra notes 49–51 and accompanying text, the European Union promulgated the European Economic Community Directive Coordinating Regulation on Insider Trading. See Council Directive 89/592, 1989 O.J. (L 344) 30. This Directive includes a provision defining a “secondary insider” as “any person [other than a primary insider] who with full knowledge of the facts possesses insider information, the direct or indirect source of which could not be other than a [primary insider].” Id. art. 4. Similarly, the International Organization of Securities Commissions (IOSCO) set forth the goal that securities regulation should ensure that all investors have fair access to market facilities and market or price information. Moreover, markets should not allow some investors to hold an unfair advantage over others. See International Organization of Securities Commission [IOSCO], Objectives and Principles of Securities Regulation (Sept. 1998), at http://www.IOSCO.org/docs-public/1998-objectives.html (last visited Jan. 17, 2002) [hereinafter IOSCO Objectives]. But cf., e.g., “Ley del Mercado de Valores” [Securities Market Law], D.O., 2 de febrero de 1975, art. 16-Bis. 1 (Mex.) (declining to impose liability on either tippers or tippees).


50. See Criminal Justice Act, 1993, §§ 52, 57 (Eng.); see also Tim Herrington & Jason Glover, The United Kingdom, in INSIDER TRADING IN WESTERN EUROPE: CURRENT STATUS 33, 43 (Gerhard Wegen & Heinz-Dieter Assmann eds., 1994).

or equal access to information.\textsuperscript{52} In \textit{Chiarella v. United States},\textsuperscript{53} the Supreme Court specifically rejected the notion "that the federal securities laws have created a system providing equal access to information necessary for reasoned and intelligent investment decisions."\textsuperscript{54} Sellers, purchasers, and market intermediaries are under no duty to disclose material inside information unless they are specifically obliged to do so; absent such a requirement, participants in the securities markets have no general affirmative duty to disclose material information.\textsuperscript{55}

Regulation FD seeks to mesh an equal-access/parity-of-information rule into the duty-based disclosure framework.\textsuperscript{56} To comport with the rest of the underlying disclosure framework, the Regulation establishes a specific duty for an issuer—to speak publicly if and when its representatives speak at all. This specific duty, however, is a broad-based one owed to all actual and potential participants in the market for that company’s securities. Few rules in the securities regulatory system provide such a wide range of beneficiaries to a duty to disclose. Because it creates a specific duty with a broad scope, Regulation FD fits awkwardly within the securities law framework.

\textbf{B. The Relationship Between Disclosure and Market Efficiency}

A well-established principle of securities regulation is that a capital market should be efficient.\textsuperscript{57} The efficient market theory holds that a market is efficient when it "rapidly reflects new information in price."\textsuperscript{58} An appropriate question, therefore, is to what extent does Regulation FD promote and/or hinder market efficiency. To help answer this question, we turn to a previously developed theory by Professors Ronald J. Gilson and Reinier H. Kraakman regarding market efficiency.\textsuperscript{59}

\begin{itemize}
\item \textsuperscript{52} Exceptions to this general rule do exist. See, e.g., United States v. O’Hagan, 521 U.S. 642, 666-77 (1997) (determining that in promulgating Rule 14e-3 the Commission properly exercised its rulemaking authority); United States v. Chestman, 947 F.2d 551, 556-64 (2d Cir. 1991) (portion of opinion affirming Chestman’s conviction based on Rule 14e-3); supra note 45 and accompanying text (regarding Rule 14e-3).
\item \textsuperscript{53} Id. at 232 (internal quotations of appellate court decision omitted).
\item \textsuperscript{54} Id. at 232 (internal quotations of appellate court decision omitted).
\item \textsuperscript{55} See, e.g., Staffin v. Greenberg, 672 F.2d 1196, 1202 (3d Cir. 1982) (“[O]ne who purchases stock on the open market who is neither an insider nor a fiduciary . . . need not disclose the reasons for his purchase, even if the purchase is based on the knowledge of material facts.”).
\item \textsuperscript{57} See, e.g., Basic, Inc. v. Levinson, 485 U.S. 224, 243-47 (adopting the fraud-on-the-market theory, in part, "[b]ecause most publicly available information is reflected in [a stock’s] market price"); Preliminary Response of the Commission to the Recommendation of the Advisory Committee on Corporate Disclosure, Securities Act Release No. 5,906, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,505, at 80,048 (Feb. 15, 1978) (“The basic objective of the disclosure requirements is to increase investor confidence and to make the securities markets more efficient and as fair and honest as possible.”) (emphasis added) [hereinafter Release No. 5,096]; IOSCO Objectives, supra note 48 (stating as an objective “to ensure that markets are fair, efficient and transparent”); Lynn A. Stout, \textit{The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation}, 87 MICH. L. REV. 613, 615 n.3 (1988) (citing examples of congressional statements in favor of promoting market efficiency).
\item \textsuperscript{58} 4 ALAN BROMBERG & LEWIS D. LOWENFELS, SECURITIES FRAUD AND COMMODITIES FRAUD § 8.6 (1994 & Supp. 1999).
\end{itemize}
Gilson and Kraakman note that even in an efficient market where stock prices rapidly reflect new information, the speed at which the prices absorb the information will vary based on the mechanisms by which the information is disclosed. Thus, various forms of disclosure will have different "relative efficiencies"; some forms of disclosure will result in new equilibrium pricing more efficiently than others. Gilson and Kraakman set forth a continuum of disclosure mechanisms, ranging from the most efficient to the least:

- **Universally Informed Trading**: where all participants in the securities market receive the information at the same time and without significant costs.
- **Professionally Informed Trading**: where "a minority of knowledgeable traders who control a critical volume of trading" develop or receive information and whose trading signals to the marketplace the existence of new information.
- **Derivatively Informed Trading**: where nonpublic information is leaked through such mechanisms as insider trading, misappropriation, or inadvertent disclosure.
- **Uninformed Trading**: where no trader of a company’s stock possesses nonpublic information, but where that stock’s price reflects traders’ aggregate forecasts based on available information.

Regulation FD’s goal is to achieve the first tier of disclosure—universally informed trading. The selective disclosure practices that the Regulation proscribes fall within the second category—professionally informed trading.

One can make an argument that selective disclosure provides a relatively efficient means of improving the overall quality of information in the marketplace and that the Regulation eliminates this benefit. Regulation FD’s critics contend that it will chill disclosure. Assume for the moment that these critics are correct, or that, at a minimum,

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60. See id. at 559 ("[D]ifferent market mechanisms may be responsible for the reflection in price of differentially available categories of information.").

61. Gilson and Kraakman write:

   The operational definition of market efficiency tightly restricts the speed of the market’s response to new information by requiring prices to reflect such information "always"—i.e., very promptly. It is a short step from this emphasis on the rapidity of price response to a definition of "relative efficiency." The market, and the mechanisms that operate to reflect new information in price, are more or less efficient depending on how quickly they yield efficient equilibrium prices; relative efficiency is a measure of the speed with which new information is reflected in price.

   *Id.* at 560 (footnotes omitted).

62. *Id.* at 568.

63. *Id.* at 569-70 (noting that the rapidity by which a stock price responds to the professionally informed trading depends on the volume of such trading).

64. See Gilson & Kraakman, *supra* note 59, at 572-73.

65. *Id.* at 579-81.


67. Press Release, Securities Industry Association, SEC Attempt to Cast More Light on Corporate
Regulation FD will significantly delay an issuer's public release of material information (particularly if it is bad news). Under this scenario, Regulation FD would (at least temporarily) force all investors into the lowest tier of disclosure—uninformed trading, where no trader would possess the applicable material nonpublic information. If selective disclosure were allowed, however, issuers would be more receptive to leak information into the marketplace. As recipients of the information commence trading on the selectively disclosed information, that would signal to others in the marketplace that the current stock price does not reflect all material information. Moreover, according to the critics, the gradual movement toward an equilibrium price accurately reflecting all material information is preferable to the spasmodic shocks that accompany the public disclosure required under Regulation FD.  

Under the efficient market theory, the information available in the marketplace and a company's stock price are connected. With selective disclosure placing information into the marketplace at a time when it might otherwise not be, that information will become absorbed into the stock price. The question is the pace at which the information becomes absorbed. The argument above presumably envisions a fairly quick rate of absorption—that selective disclosure is in fact a relatively efficient mechanism of disclosure.

By promulgating Regulation FD, the Commission seems to have called this assumption into question or viewed it as secondary to facilitating investor fairness. Although the assumption of rapid absorption is useful for economic-theory based arguments, it may not comport with the realities of securities trading. For selectively disclosed information to be absorbed into the marketplace, recipients first must act on it. Such recipients will be ahead of the curve in terms of the gradual movement in the stock price toward equilibrium. As Gilson and Kraakman note, "the relative efficiency of market mechanisms determines the magnitude of arbitrage opportunities that new information creates for the fortunate traders who 'know' it first." Regulation FD posits that the relative inefficiency of selective disclosure and the arbitrage opportunities that result from such practices are significant enough to threaten the integrity of the securities markets.

If the Commission is correct in this regard, then Regulation FD is an effective way to minimize the adverse impact of selective disclosure practices. But, if the Commission has underestimated the rapidity of information flows and overestimated the extent of

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68. Cf. Gerri Willis, *Stocks You've Always Wanted at Prices You Won't Believe*, SMART MONEY, Dec. 1, 2000, at 150, 152 ("In the past, most companies would manage investor expectations by quietly letting a few analysts in on the change instead of blaring the news through the foghorn of a public release. [Regulation FD] makes nasty public warnings the only way out.").

69. See Gilson & Kraakman, supra note 59, at 572 (contending that professionally informed trading results in a rapid assimilation of the information into the stock price).

70. See Proposed Rule Release, supra note 2, at 72,592 n.15 (citing an empirical study of trading in companies' stock after conference calls with analysts in which the authors conclude that certain investors are given the opportunity to trade on material information disclosed during the calls before that information is disseminated fully to the public); cf. John C. Coffee Jr., *Is Selective Disclosure Now Lawful?*, N.Y. L.J., July 31, 1997, at 5 (evaluating the similarities and differences of insider trading's and selective disclosure's respective effects on market efficiency).

71. Gilson & Kraakman, supra note 59, at 560.
arbitrage opportunities, then the Regulation may serve as an unwarranted burden on the infusion of quality information into the marketplace. The issue of Regulation FD’s effect on the relative efficiency of disclosure—that is, how fast information flows into the marketplace and is absorbed into a company’s stock price under the Regulation’s framework—is one that the Commission will need to continually assess.

With Regulation FD, the Commission has expressed its clear preference for the top-tier disclosure of material information; selective disclosure of material information is too inefficient and unfair to allow this mechanism to be used in the securities markets. But selective disclosure is not the only form of second-tier disclosure. Indeed, the basic job of an analyst is to sift through a wealth of public information to identify arbitrage opportunities for their clients. Such information becomes meaningful to most investors only when analysts, employing what is called the mosaic approach, piece together relevant disparate public information into a comprehensive analysis. This refining approach, in addition to the raw information disclosed by issuers, drives a significant portion of trading in the capital markets.

Examining Regulation FD solely from a market efficiency standpoint sends an inconsistent message. Selective disclosure practices and an analyst’s ferreting-of-information function may be fairly equivalent efficient mechanisms of disclosure. Moreover, selective disclosure normally should be a more efficient means in that analysts procure new information in a less costly manner. Nevertheless, Regulation FD prohibits these practices, while permitting and even encouraging a theoretically equally efficient means of disseminating information pursuant to the mosaic approach. Clearly, as discussed next, the Commission took into account other factors than just market efficiency in promulgating Regulation FD. Considered from this specific perspective, however, the Commission has left open the question of the Regulation’s own efficiency by challenging the assumptions underlying the efficiency of selective disclosure.

C. Balancing Notions of Fairness and Investor Confidence With Other Goals

The federal securities regulatory framework incorporates a number of goals and principles, including those discussed in the two preceding Sections. It also strives to promote fairness and investor confidence in the system. These goals and principles

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72. See id. at 571-72 (contending that even though market professionals will be able to trade at an informational advantage over other investors before the stock price reaches an equilibrium, their long-term returns will not be significantly greater than the market average).

73. See Dirks v. SEC, 463 U.S. 646, 658-59 (1983) (“It is commonplace for analysts to ferret out and analyze information, and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation’s securities.” (internal quotations and citations omitted)).

74. See Regulation FD Release, supra note 1, at 51,721.

75. Cf. Dirks, 463 U.S. at 658-59 (discussing the importance of analysts in preserving a healthy market); Information Blackout, supra note 67 (discussing the Regulation’s potential effect on “the ability of securities firms to guide their client’s investment decisions”).

76. See Proposed Rule Release, supra note 2, at 72,592 (indicating that the SEC recognizes the benefits that accrue to the securities markets from analysts who ferret out information).

77. See Release No. 5,096, supra note 57, at 80,047 (parenthetical quotation); cf. IOSCO Objectives, supra note 48 (identifying the three core objects of securities regulation as: to protect investors; to ensure that markets are fair, efficient and transparent; and to reduce systemic risk).
sometimes coalesce but other times conflict. Perhaps surprisingly, rules promoting the
efficiency of the marketplace at times do so at the expense of other goals.\textsuperscript{78} As noted
above, the Commission sought to promote more than just market efficiency by
promulgating Regulation FD; it expressly sought to enhance fairness and investor
confidence in the integrity of the nation's capital markets.\textsuperscript{79}

In the abstract, one may assert that selective disclosure in and of itself is not
necessarily a bad thing. If information were selectively disclosed among all participants
in the marketplace on a random basis, that theoretically could offer some efficiency and
benefits to the securities markets. A fundamental problem with selective disclosure
practices in the past has been that it imposed structural biases into the marketplace.\textsuperscript{80}

The first bias separated market professionals from non-professional investors and
clearly favored the former. One class of investors—those affiliated with analysts and
other market intermediaries who received nonpublic information—consistently were able
to take advantage of the arbitrage opportunities arising from selective disclosure, while
other investors were not permitted to share in these benefits.\textsuperscript{81}

The second bias stemmed from the fact, or at least the perception, that issuers doled
out information like a commodity to those analysts who had or would report favorably on
the company.\textsuperscript{82} Such a narrowed mechanism of dissemination presumably reduced the
relative efficiency of selective disclosure as a means by which stock prices would absorb
material information. For selective disclosure to be an efficient mechanism of
dissemination, the few parties who receive the information must control, either directly or
indirectly, a sufficient volume of trading in order for the stock price to reflect rapidly any
selectively disclosed information. If only a relatively small number of analysts are privy
to selectively disclosed information, as would be the case when selectively disclosed
information is treated like a precious commodity, then a fundamental component of
selective disclosure is lacking for it to be considered an efficient mechanism.\textsuperscript{83}

These biases affected the competitiveness of the marketplace. Market insiders with
access to selectively disclosed information and individual investors who did not hold
such a privileged position were facing different market structures, with insiders ahead of
the information curve and individuals behind it. Moreover, the biases became
systematized, thereby restructuring the rules of the investing game to downplay skill in

\textsuperscript{78} See Stout, supra note 57, at 616 ("In each case, legal rules that favor efficient stock markets do so by
sacrificing other regulatory goals."); id. at n.10 ("Allowing insiders to trade on the basis of information
unavailable to public investors violates notions of fairness.... Program trading erodes investor
confidence ....").

\textsuperscript{79} See Regulation FD Release, supra note 1, at 51,716 ("Where [selective disclosure] happened, those
who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of those
kept in the dark. We believe that the practice of selective disclosure leads to a loss of investor confidence in the
integrity of our capital markets.").

\textsuperscript{80} See Proposed Rule Release, supra note 2, at 72,591 ("In practice, issuers also retain control over the
audience and forum for some important disclosures.").

\textsuperscript{81} See Regulation FD Release, supra note 1, at 51,716.

\textsuperscript{82} See id. at n.7. ("Regulation FD is also 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.").

\textsuperscript{83} See Gilson & Kraakman, supra note 59, at 569 (noting that efficient professionally informed trading
requires a sufficient amount of traders who "control a critical volume of trading").
The Hidden Issues of the SEC's Regulation FD

analyzing information, or even blind luck, in favor of having the right connection with any given issuer. The Supreme Court previously has noted that "it is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?" Selective disclosure practices, as they developed, resulted in the equivalent of a crooked crap game.

The Commission thus sought to eliminate this perceived "stacked deck" by prohibiting selective disclosure practices. That in itself is an admirable goal, but it does come with consequences. By placing emphasis predominantly on fairness and investor confidence, the Commission uprooted the balance between these objectives and others, such as market efficiency and disclosing information only when under a duty to do so. In doing this, the Commission wedged Regulation FD awkwardly into the existing disclosure framework.

III. ISSUES STEMMING FROM REGULATION FD'S FOCUS ON THE INTENTIONAL AND NON-INTENTIONAL DISCLOSURE OF MATERIAL NONPUBLIC INFORMATION

It is important to note that this Article makes no qualitative judgments regarding Regulation FD. It is far too early to do so, at least until more empirical information is available regarding its implementation and effect. But, it is not too early to identify what likely will become problem areas stemming from the Regulation's awkward fit into the existing disclosure framework. With this in mind, this Article next explores the problems that the Commission will face in implementing Regulation FD.

A. Materiality and the Intentional/Non-Intentional Distinction

Although one could explore the hidden issues of Regulation FD along several lines, this Article focuses on the most important ones. In this regard, issues that will emerge as fundamental, or at least become more prevalent as the SEC implements Regulation FD, are those relating to the Regulation's focus on materiality and the distinction between intentional and non-intentional disclosures. Because these terms are somewhat imprecise by their nature, the primary issues to arise will likely be associated with determining what standards are used to measure the materiality of selectively disclosed information and whether a subject disclosure was intentional.

1. Meaning of "Material" and "Nonpublic"

Although the Regulation refers to "material" and "nonpublic" information, it does not define those terms. Instead, the SEC relies on case law to provide definitions. Thus, "[i]nformation is material if 'there is a substantial likelihood that a reasonable

84. See Proposed Rule Release, supra note 2, at 72,592.
86. See Proposed Rule Release, supra note 2, at 72,592 (discussing the Commission's concern regarding the effect that selective disclosure has on market integrity).
87. See Regulation FD Release, supra note 1, at 51,716 ("Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.")
shareholder would consider it important in making an investment decision . . . [and it is] a fact [that] 'would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.' Information is nonpublic "if it has not been disseminated in a manner making [such information] available to investors generally."89

The Supreme Court has long rejected any bright-line test for assessing materiality.90 As a result, the law surrounding the definition of materiality is an ever-changing one, often changing in subtle ways that make materiality determinations difficult. One recent development is the pronounced rejection of a quantitative threshold as the sole means for assessing materiality.91 Issuers and their auditors often would use such a threshold, such as five percent, for making materiality determinations; for example, if a misstatement in a financial statement resulted in a four percent overstatement of net income, issuers would not consider the misstatement to be material.92 The SEC staff, in Staff Accounting Bulletin 99 (SAB 99), contends that such a "rule of thumb," while useful as an initial step, is not dispositive of the misstatement's materiality.93

Despite the fact that the staff did not intend SAB 99 to "provide definitive guidance for assessing 'materiality' in other contexts,"94 courts are likely to use it as persuasive authority. One such example is the Second Circuit's decision in Ganino v. Citizens Utils. Co.95 The court, drawing from SAB 99,96 declined to find a misstatement amounting to 1.7% of total revenue to be immaterial as a matter of law simply because it involved such a small percentage.97 Based on these recent expositions on materiality, if a piece of financial data varies only a small percentage from original estimates but has a significant impact, the conclusion that the change is immaterial likely will be strongly contested.98

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89. Regulation FD Release, supra note 1, at 51,721 (citing SEC v. Texas Gulf Sulphur, 401 F.2d 833, 854 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969)).

90. See Basic, 485 U.S. at 236 ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.").

91. See, e.g., Ganino v. Citizens Utils. Co., 228 F.3d 154, 162 (2d Cir. 2000) ("[W]e have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation."); SAB 99, supra note 88, at 45,151 ("The staff reminds registrants and the auditors of their financial statements that exclusive reliance on . . . any percentage or numerical threshold [for making materiality determinations] has no basis in the accounting literature or the law.").

92. See SAB 99, supra note 88, at 45,151.

93. Id.

94. Id. at n.1.

95. 228 F.3d 154 (2d Cir. 2000).

96. Id. at 163 ("SAB No. 99 is 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.").

97. Id. at 161-64.

98. Examples of small percentage changes that have significant impact are addressed infra notes 115-116 and accompanying text. The Ganino court lists several cases where courts rejected a formulaic approach: Press v. Chem. Inv. Serv. Corp., 166 F.3d 529, 534-37 (2d Cir. 1999) (declining to establish a specific range beyond which a markup would be "excessive"); Glazer v. Formica Corp., 964 F.2d 149, 156 (2d Cir. 1992) (materiality in the context of merger negotiations depends on specific facts); In re Home Health Corp. of Am., Inc. Sec.
Given the difficulty in making materiality determinations, the Commission offered in the Regulation FD Release several examples of information that likely would require issuers to make a materiality determination: “(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; (4) changes in control or in management; (5) change in auditors; (6) events regarding the issuer’s securities; and (7) bankruptcies or receiverships.”99

In addition, SAB 99 offers a non-exhaustive list of qualitative “considerations that may well render material a quantitatively small misstatement.”100 Among these considerations are: “whether the misstatement masks a change in earnings or other trends”; “whether the misstatement hides a failure to meet analysts’ consensus expectations for the enterprise”; “whether the misstatement changes a loss into income or vice versa”; and “whether the misstatement concerns a segment or other portion of the registrant’s business that has been identified as playing a significant role in the registrant’s operations or profitability.”101 The Regulation FD Release and SAB 99 thus provide issuers with some guidance with respect to making materiality determinations in order to comply with Regulation FD. But with any piece of information, the key for a materiality determination is on what significance a reasonable investor would place on the information. Thus, materiality determinations remain elusive and subject to scrutiny with the gloss of hindsight.

2. Intentional and Non-Intentional Selective Disclosure

Another important issue under Regulation FD involves whether the issuer selectively disclosed the information intentionally or non-intentionally. This assessment determines when the issuer must make the information publicly available. If the issuer intentionally and selectively discloses material nonpublic information, then it must disclose the same information simultaneously to the public.102 If the selective disclosure is non-intentional, the issuer must disclose the information promptly, which is defined:

as soon as reasonably practicable (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 of the issuer . . . 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 reckless103 in not knowing, is both material and non-public.104

Litig., No. Civ. A. 98-834, 1999 U.S. Dist. LEXIS 1230, at *6-*7 (E.D. Pa. Jan. 29, 1999) (holding that a de minimis loss was not immaterial where a qualitative factor caused the loss to be significant); In re Kidder Peabody Sec. Litig., 10 F. Supp. 2d 398, 410 (S.D.N.Y. 1998) (declining to find that misstatements affecting profits by 2.54% were immaterial). But see SEC v. Hoover, 903 F. Supp. 1135, 1146 (S.D. Tex. 1995) (finding that withholding information regarding a zero to two percent decrease in year-end estimated earnings was not material as a matter of law).

99. Regulation FD Release, supra note 1, at 51,721. The SEC, however, chose not to establish bright-line tests for such information in part because it is not material per se.
100. SAB 99, supra note 88, at 45,152.
101. Id.
103. By “reckless” the Commission means:
The standard for determining whether a selective disclosure is "intentional" meshes with the Regulation's definitions of materiality and nonpublic. The Regulation defines "intentional" to be that "the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic." Thus, if an issuer were merely negligent in erroneously judging whether a certain piece of selectively disclosed information is either material or nonpublic, Regulation FD would not impose liability. By using this standard, the Commission seeks to provide "additional protection that issuers need not fear being second-guessed by the Commission in enforcement actions for mistaken judgments about materiality in close cases." Nonetheless, the SEC warned that the determination of materiality should take into account all facts and circumstances. Thus, for example, a materiality judgment that might not be reckless in the context of an impromptu answer to an unexpected question at a press conference may be reckless in the context of a prepared written statement where the issuer has more time to evaluate the information it is about to disclose. Furthermore, if an issuer displays a pattern of "mistaken" judgments regarding materiality, that company's credibility would be harmed when it comes to future claims that any particular disclosure was not intentional.

B. Issues To Be Resolved

1. Materiality Determinations

An issuer can selectively disclose information in various manners. For example, it can prepare a formal statement that is released in advance to selected analysts; an officer can leak information to gauge how the marketplace may respond, much like the way a politician floats a trial balloon; or a spokesperson can let information slip in response to an unexpected question. In each context, the issuer or person speaking on its behalf is required under Regulation FD to make a materiality judgment about the information. But the level of information at that person's immediate disposal and the time in which that determination must be made varies widely. In the first two examples, the issuer likely will have sufficient time to consider its decision and consult with counsel in advance. In the third context, in response to a question, the spokesperson does not necessarily have that benefit.

105. Id. § 243.101(a) (emphasis added).
106. Regulation FD Release, supra note 1, at 51,722 (stating that "in the case of a 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").
107. See id.
108. See id. at n.57.
The Commission recognizes that, under Regulation FD, people speaking on behalf of the company often will be required to make fast judgments as to the materiality of information. SEC General Counsel David Becker reflected that such materiality determinations will be easy to second-guess in hindsight, but that "[t]he SEC understands that people sometimes must make a real-time decision as to whether information is material."\(^{109}\) Stephen Cutler, Deputy Director of the SEC's Division of Enforcement, perhaps seeking to provide some comfort to issuers and their executives, remarked that the Commission is "not looking for hides to tack up on the shed door."\(^{110}\) Similarly, SEC Enforcement Division Director Richard H. Walker opined that a mistaken materiality judgment "must represent an extreme departure from standards of reasonable care in order for the [enforcement] division to allege a violation of Regulation FD."\(^{111}\)

Despite this rhetoric of assurance, the language of Regulation FD itself does not provide much flexibility specifically in regard to making materiality determinations. Even though issuers will be required to make predictions on whether any piece of information is material, the real test will be in hindsight when the SEC initiates an enforcement action against an issuer for a Regulation FD violation. In that regard, a piece of information ultimately will be deemed to be material or immaterial regardless of the manner in which it was selectively disclosed. The materiality standard will be applied in the same way regardless of whether an alleged violator has had several weeks to decide whether to selectively disclose certain information or is one who attempts to make a good faith spur-of-the-moment materiality determination but does so erroneously.

The primary protection that the Regulation offers to issuers for mistaken materiality judgments lies in the distinction between intentional and non-intentional disclosures (this distinction will be examined more fully in the ensuing discussion; for now we will focus on the implications that it has for assessing materiality determinations). For a disclosure to be deemed intentional, the issuer must know, or be reckless in not knowing, that the information was material; mistaken good-faith materiality determinations likely will not be considered "intentional."\(^{112}\) The Commission has assured that it will take into account all the facts and circumstances regarding the materiality determination, thus allowing for relaxing the Regulation's application to an issuer who makes an erroneous spur-of-the-moment materiality determination. The distinction of being found to have made a non-intentional disclosure buys the issuer time to make a corresponding public disclosure without incurring liability under Regulation FD. If the issuer believes, however, that the information is not material, then additional time would not be necessary. Under such circumstances, the issuer would not feel compelled to disclose the information publicly because it already had made its materiality determination. Nonetheless, if the information in hindsight were deemed material and the issuer recklessly made this determination, then the issuer would violate the Regulation because it failed to make a prompt public

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110. Id.
112. See Regulation FD Release, supra note 1, at 51,722 ("[I]t is unlikely that issuers engaged in good-faith efforts to comply with the regulation will be considered to have acted recklessly."),
announcement following a senior official learning of the inadvertent selective disclosure.\textsuperscript{113}

The issue, therefore, is at what point an issuer responding to an unanticipated question, for example, must make a materiality determination. The answer apparently is that, even though the language of the Regulation does not expressly provide, the issuer must make not one, but two, such determinations. The issuer must make the first determination at the time the question is posed and the spokesperson decides to answer;\textsuperscript{114} the second must come shortly afterward so that if the issuer concludes that the information is material, it can publicly and timely disseminate the information in order to satisfy Regulation FD.

Let us next examine how these interpretive issues may play out. Consider, for example, the situation regarding Hewlett-Packard discussed at the beginning of this Article. There, the company apparently did not consider the distinction between a possible disruption in its component supply, which it previously publicly disclosed, and the actual disruption that in fact transpired to be material. Let us add some facts to create a new scenario involving a hypothetical issuer, Acme Co. Suppose that the actual disruption in Acme's supply of components occurs late in the fiscal quarter and causes revenue to be 0.9\% less than originally projected. Further suppose that at the end of a conference call unrelated to the component supply, Anna List, an analyst for a Wall Street investment firm, asks Ima Mouthpiece, the company’s manager of media and financial relations, about the effect a potential disruption in supply might have on the company’s revenues. Mouthpiece thinks for a moment and responds, “Well, we are actually experiencing a disruption in supply, but its impact on revenues is small—less than 1\% for the quarter.’’

This is the type of spur-of-the-moment response that likely would be considered to be a non-intentional selective disclosure. Mouthpiece made a good faith, but hurried, materiality determination regarding both pieces of information (the actual disruption and the impact on revenues) and concluded that neither was material. If company officials abide by or concur with this determination, they will not feel compelled to issue a public announcement; in their view, Regulation FD would not apply because the information was immaterial. But the Commission may, after the fact, conclude that this information was material. If this happens, the company may be deemed to have violated the Regulation.

\textsuperscript{113} See 17 C.F.R. \S\ 243.100(a)(2) (2000). One question to consider is whether the issuer must be at least reckless in making its materiality determination in order to violate Regulation FD. In the Regulation FD release, the SEC opined: “Neither will we, nor could we, bring enforcement actions under Regulation FD for mistaken materiality determinations that were not reckless.” Regulation FD Release, supra note 1, at 51,718. Moreover, SEC Enforcement Director Walker contends that an issuer must undertake an extreme departure of reasonable care in making an incorrect materiality determination in order to have violated Regulation FD. See supra note 111 and accompanying text. Interestingly, the language of the Regulation itself, however, does not necessarily support this proposition. As noted in the text, the mens rea associated with materiality determinations is used to distinguish between intentional and non-intentional disclosure. Thus, under a strict reading of the Regulation, if an issuer negligently and erroneously determined that information was not material, it could still violate Regulation FD for failing to conform to the Regulation’s disclosure requirements for non-intentional disclosures. See generally infra Part III.B.2.

\textsuperscript{114} Of course, the spokesperson could respond “no comment” as a way to avoid making a selective disclosure, but doing so in itself may raise other issues, as discussed infra Part IV.A.
This scenario highlights the difficulty in making materiality determinations, particularly at the spur of the moment. The distinction between a highly possible disruption and an actual disruption coming to fruition is a narrow one that the typical investor may or may not find material. But the active sell-off of stock in the real-life Hewlett-Packard situation following the disclosure of the actual disruption would seem to indicate that analysts and their firms’ clients considered the new information to be material.\textsuperscript{115} In hindsight, H-P’s assessment of the importance of this information appears incorrect.

The disclosure regarding the impact on revenue presents a further problem for spokespersons fielding on-the-spot questions. The only information that Ima Mouthpiece may have had readily available likely was quantitative—e.g., the less than one percent impact. She may not have readily possessed or been told of certain qualitative factors that might affect the materiality determination regarding this information. For example, Mouthpiece may not have known what impact the disruption in supply would have if extrapolated over a full quarter, as opposed to occurring only late in the fiscal period. The Commission likely will look to such qualitative factors when making its materiality determination regardless of what information the spokesperson had at the time of the non-intentional disclosure. This scenario thus highlights the point made above—that cautious issuers should undertake a second materiality determination following any spur-of-the-moment discussion between personnel and market professionals covered by Regulation FD.

Another related issue is how strictly the SEC will enforce the Regulation when it comes to materiality determinations. The above discussion has shown the tough issues that companies face with respect to materiality determinations, particularly as the law of materiality evolves.\textsuperscript{116} The Commission is well within its authority to treat issuers who make good-faith, but erroneous, materiality determinations with some leniency. But, as noted above, the Commission’s current rhetoric of flexibility is not derived specifically from the Regulation itself; it reflects more of the current interpretation that the Commission has decided to give the Regulation. Thus, the Commission could decide to enforce the Regulation more stringently in the future. In the Regulation FD Release, the

\textsuperscript{115} Cf. Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 166 (2d Cir. 1980) (noting that the fact that institutional investors did not sell stock after learning a piece of information serves as evidence of that information’s immateriality); SEC v. Hoover, 903 F. Supp. 1135, 1146-47 (S.D. Tex. 1995) (discussing “market reaction as a measure of materiality”). Market reaction to information, however, at best merely represents evidence of materiality; the standard remains focused on the importance that a reasonable investor would place on the information in making an investment decision. See Basic, Inc. v. Levinson, 485 U.S. 224, 232 (1988).

\textsuperscript{116} By comparison, internationally the concepts of materiality and market price are tied together by statute. See, e.g., Securities Act, R.S.O., § 1(1) (1990) (Ont., Can.) (defining a material fact as a “fact that significantly affects or would reasonably be expected to have a significant effect on the market price or value of securities”); “Ley del Mercado de Valores” [Securities Market Law], D.O., 2 de febrero de 1975, art. 16-Bis. (Mex.); Criminal Justice Act, 1993, § 60(4) (Eng.); Commission des Opérations de Bourse Regulation 90-08, J.O., July 20, 1998, p. 8602, D.S.L. 345, art. 1 (Fr.) (privileged information is “any precise non-public information . . . which, if made public, might affect the price of the security”); Wertpapierhandelsgesetz [Securities Trading Law], v. 26.7.1994 (BGBl. I S. 1749), § 13 (F.R.G.); Law No. 58 of Feb. 24, 1998, Gazz. Uff. No. 71, March 26, 1998, art. 180, para. 3 (Italy); Corporations Law, 1970, § 1002(G)(1) (Austl.) (regarding information that, if it were generally available, “might have a material effect on the price or value of securities”).

\textsuperscript{116} See supra notes 91-101 and accompanying text.
SEC laid the groundwork for more stringent enforcement against issuers who make repeated erroneous materiality determinations.\(^{117}\) In addition, Enforcement Director Walker has noted that the staff will target two types of violations: "intentional or reckless disclosure of information that is unquestionably material . . . [and] those who deliberately attempt to 'game the system.'"\(^ {118}\) Certainly, the Commission could decide to view materiality determinations with an even more critical eye if it believes that it needs to do so to make the Regulation more meaningful.

2. Distinguishing Between Intentional and Non-Intentional Disclosure

As noted above, Regulation FD's distinction between intentional and non-intentional disclosures serves a formal function of determining when an issuer must make a public disclosure following a selective disclosure of material nonpublic information.\(^ {119}\) It also serves an informal function of providing the Commission some flexibility in implementing the Regulation. Although the Regulation attempts to demarcate the line between the two, that line likely will be quite blurry as the SEC begins to enforce the Regulation. The question to consider, therefore, is how the Regulation's differentiation between intentional and non-intentional disclosure will play out in practice, or more specifically, what standards will the Commission use in distinguishing intentional from non-intentional disclosures.

In theory, almost any selective disclosure of information could be deemed intentional. Even the spur-of-the-moment type of disclosure discussed above envisions the spokesperson making a calculated assessment of whether the information is material and nonpublic and whether to answer the question posed. Furthermore, because the Regulation's definition of "intentional" includes a standard of recklessness,\(^ {120}\) the spokesperson may be assumed to have certain knowledge that he or she does not actually have at the time of disclosure. Thus, the Commission conceivably could argue in every case that the selective disclosure was intentional and required simultaneous public disclosure.\(^ {121}\)

Although the merits of this argument may vary from case to case, it provides the Commission with a strong negotiating tool to induce a settlement from an alleged violator. Specifically, the SEC staff could propose a settlement in which the issuer would consent to Commission findings of a non-intentional disclosure violation, but threaten to pursue an intentional disclosure breach if the issuer does not accept the offer. Issuers might be willing to accept such a settlement as a means to limit the sanctions they receive, such as a reduced monetary penalty, and to control the adverse publicity and

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117. See Regulation FD Release, supra note 1, at 51,722 n.57.
118. Walker Comments, supra note 111, at 4. One "games the system" 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." Id.
119. See supra Part III.A.2.
121. Cf. Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 167 (2d Cir. 1980) (stating, in a Rule 10b-5 case, that "[i]n a case where deliberately tips information which he knows to be material and nonpublic to an outsider who may reasonably be expected to use it to his advantage" is considered to have satisfied the "knowing" standard for scienter).
legal costs associated with defending against the claim.122 The *in terrorem* benefit that the SEC will receive by the blurry line between intentional and non-intentional emphasizes the policy decision that the Commission will make in enforcing the Regulation. Although the Commission’s current position appears to be more lenient to issuers who truly make a non-intentional disclosure, just how the SEC enforcement staff implements the Regulation remains to be seen.

One situation that may arise occurs when an issuer makes a good-faith attempt to disclose information publicly, perhaps in connection with an intentional disclosure in a closed meeting with analysts, but does not do so in a way that satisfies the Regulation’s requirement of being “reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”123 For example, suppose an issuer that trades on the NASDAQ Small Cap Market submits a press release to major business wire services believing that the services will carry the release, but the issuer has been reckless in not knowing that the services will not do so.124 The Regulation FD Release notes that if an issuer knows that its press releases are not carried by the major wire services, the release may not be sufficient to satisfy the public disclosure requirement;125 and the SEC equates recklessness with knowing misconduct. Therefore, the SEC could assert that the press release in this hypothetical example failed to satisfy Regulation FD’s definition of public disclosure. As a result, the disclosure to the analysts that prompted the press release effectively will remain “selective” and thus violate the Regulation. Thus, what started as a good-faith attempt to satisfy Regulation FD would be deemed violative.

Given the Commission’s rhetoric exhibited in the Regulation FD Release, the SEC would not necessarily pursue enforcement in this seemingly anomalous situation. The Regulation FD Release ostensibly provides issuers with a good deal of discretion in making public disclosures, stating that the Regulation does not establish a “‘one size fits all’ standard for disclosure . . . [and] leaves the decision to the issuer to choose methods that are reasonably calculated” to result in an effective public disclosure.126 The Release cautions, however, that the Commission will examine “all the relevant facts and circumstances,”127 thus leaving the SEC and its staff latitude in how stringently the Regulation’s language will be enforced.

Another implementation issue that will arise stemming from the intentional/non-intentional distinction is how rigorously the Commission will enforce the timing of public disclosure. The Commission already seems to have established a very hard-line interpretation of the Regulation’s requirement for a “simultaneous” public disclosure to be made in conjunction with an intentional selective disclosure. This issue arose during a conference call in which SEC staff discussed issues related to the Regulation:

If an impermissible disclosure is made late in the day, and the disclosure seemed intentional, a press release that is issued well before the market opens

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124. This could happen if, for example, the major business wire services have reported on one or more press releases issued by the company, but those were the exceptions as opposed to the norm.
126. *Id.*
127. *Id.*
the following day would not be considered "simultaneous," said [Deputy
Director Stephen] Cutler. With after-hours trading and 24-hour trading
becoming more prevalent, he stated that "simultaneous means
simultaneous." 128

The Commission’s concern about after-hours and 24-hour trading is warranted as news
stories often report incidences in which stock prices rose or fell dramatically in such
trading following an announcement released after normal business hours. 129

The question thus arises whether the Commission will take a similar approach in
determining whether a public release following a non-intentional disclosure is sufficiently
“prompt” to satisfy the Regulation. The Regulation’s definition of “promptly” has
significant room for interpretation. For example, the definition begins by stating that
"[p]romptly’ means as soon as reasonably practicable.” 130 If “simultaneous means
simultaneous,” then presumably “as soon as” means “as soon as.” Cautious issuers should
not be misled by the parenthetical conditional language in the Regulation’s definition of
“promptly”—specifically, “[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.” 131 This
language may represent the absolute latest time at which an issuer must make a public
announcement after learning of a non-intentional disclosure. Given the Commission’s
concern regarding after-hours trading, the Regulation’s 24-hour language presumably
does not provide a regulatory safe harbor. Because parties with information could be
trading on that information at any time, issuers would be well advised to act with the
utmost urgency in releasing information or else risk liability under Regulation FD.

In this regard, a dispute over whether an issuer made a public disclosure promptly
could come down to a matter of hours (theoretically, even minutes). Consider the
impromptu-question scenario discussed in the previous section involving Acme Co.
where Ima Mouthpiece selectively disclosed the existence of an actual delay in supply
and its impact on revenues. Suppose that, this time, immediately after making a non-
intentional disclosure of material nonpublic information in response to Anna List’s

128. See Staff Explains, supra note 109, at 4.
129. See, e.g., Lee Gomes & Don Clark, Oracle Issues Profit Warning As Sales Slow, WALL ST. J., Mar. 2,
2001, at A3 (stock price fell over 21% in heavy volume of after-hours trading following an announcement made
after 4 p.m.); 3Com Lowers Targets for Latest Quarter, Cites Industry Turmoil, WALL ST. J., Mar. 1, 2001, at
B10 (stock price fell 13% in after-hours trading following an announcement made after regular trading hours);
fell 9.3% in after-hours trading following a warning of lower-than-expected profits); VA Linux’s Net Loss
Widened in 2nd Period, WALL ST. J., Feb. 21, 2001, at B8 (stock price fell 22.4% in after-hours trading
following a disclosure made after the markets closed at 4 p.m.); Mark Heinzl, Nortel Is Hit By Downturn in
Telecom, WALL ST. J., Feb. 16, 2001, at A3 (stock price fell 23% in after-hours trading, reducing Nortel’s
capitalization by more than $20 billion and representing a new 52-week low price).
131. See Regulation FD Release, supra note 1, at 51,723. As with other interpretive issues, Regulation FD
does not clearly indicate whether this parenthetical language is a stand-alone provision or works in conjunction
with the rest of the definition of “promptly.” In other words, when does this provision’s clock start running—
when the non-intentional disclosure is made, or when a senior official learns or was reckless in not learning
about it? The Regulation FD Release suggests the latter: “Thus, if a non-intentional selective disclosure of
material, nonpublic information is discovered after the close of trading on Friday, for example, the outer
boundary for making public disclosure is the beginning of trading on the New York Stock Exchange on
Monday.” Id. at 51,723 (emphasis added). See infra note 138.
question, Mouthpiece realizes that the information is material and that the company must publicly disclose the information. Senior officials at Acme draft an appropriate press release in the matter of an hour, but are unable to get the company president, who is traveling or otherwise unavailable, to sign off on the release. Even though the senior officials who drafted the release have the authority to issue it, they normally do not do so without the president’s approval. As a result, they wait another three hours to issue the press release until they are able to communicate with the president.

In this scenario, a strict interpretation of Regulation FD would require Acme to issue the release when it was first drafted and reviewed by authorized personnel, one hour after the non-intentional selective disclosure. The fact that the company followed its normal procedures for issuing a press release (i.e., obtaining the president’s approval) may not be relevant to a determination of when Acme should have released the information “as soon as reasonably practicable.” Furthermore, the fact that the company issued the release well within twenty-four hours of learning of the disclosure may be irrelevant because it still did not issue the release “as soon as reasonably practicable.” This scenario is just but one possibility used to highlight the differing interpretations of “reasonably practicable.” The conclusion that one can draw is that issuers may not be able to delay for any reason, even legitimate business ones, in making a public disclosure following a non-intentional selective disclosure.

Another aspect of the Regulation’s definition of “promptly” that merits attention is that the clock for measuring if a disclosure was made “as soon as reasonably practicable” starts to run “after a senior official of the issuer... learns that there has been a non-intentional disclosure . . ., or is reckless in not knowing.” The term “learns”—both by its own meaning and in contrast to the phrase “reckless in not knowing”—means actual knowledge. In many cases a senior official likely will have actual knowledge of a non-intentional disclosure within a fairly short time of it being made because either a senior official will have made the disclosure or the covered person acting on behalf of the issuer will have reported the disclosure to a senior official soon afterwards.

Let us consider this latter scenario more closely: Suppose a non-senior official acting on behalf of the issuer who is covered under the Regulation makes a non-intentional disclosure. The issuer incurs the risk that the non-senior official might not inform a senior official of the disclosure in a timely manner. For example, the person might not believe the information was material and thus not feel compelled to inform her supervisor of the disclosure. Or, if the covered person does recognize the materiality of the disclosed information, he may seek to avoid being reprimanded for making the disclosure and thus hide or lie about the disclosure in hopes that the issue will go away. Finally, busy work schedules may prevent the spokesperson from being able to debrief a senior official.

Regardless of the reason, an indeterminate period of time—a few hours, a few days, a few weeks—may pass before a senior official actually learns of the disclosure. Assuming that the issuer’s securities are traded in an efficient market (where selective disclosure represents a relatively efficient mechanism of dissemination) and that the recipients of the disclosed information trade on it, the market will have absorbed the

133. See supra Part II.B.
disclosed information before the issuer arguably would be required to make the public disclosure under Regulation FD. During that time, industry insiders and professionals likely will be able to respond to changing circumstances faster than individual investors and, as a result, take better advantage of arbitrage opportunities associated with the information.

Under this scenario, even if the issuer eventually makes a public disclosure promptly following a senior official’s actual knowledge of the non-intentional disclosure, the Commission may seek to attach Regulation FD liability presumably based on the issuer being reckless in not knowing of the non-intentional disclosure. Effectively the Commission would be saying to the subject issuer, “Your failure to learn of the disclosure represented an extreme departure from the standards of ordinary care. You should have instituted reasonably effective compliance procedures that would have enabled you to act sooner, thereby providing the small investor the same opportunity to respond that the institutional investors had.” Several issues arise, however, if liability is to attach based on a senior official’s recklessness in not knowing.

First, because the Regulation creates liability exposure to the issuer based on a senior official’s recklessness, how will the Commission determine the time at which a senior official should have had knowledge? This issue may be particularly important in circumstances where the time frame between the non-intentional disclosure and the eventual public disclosure is relatively lengthy. Neither Regulation FD nor Commission releases provide any specific guidance. Absent such guidance, the determination seemingly would be within the discretion of the Commission and its staff.

A second related issue stems from the Commission’s position that “in view of the definition of recklessness that is prevalent in the federal courts, it is unlikely that issuers engaged in good-faith efforts to comply with the regulation will be considered to have acted recklessly.” This language may effectively require issuers to establish a formal reporting system to ensure that non-senior officials covered by the Regulation inform a senior official of any statements made to the specific recipients of information listed in Regulation FD. Adhering to such a reporting system presumably would satisfy the need to make a good-faith effort to comply with the Regulation. But it also crystallizes two instances in which liability under the reckless standard could be met: situations where the reporting system is not followed and instances where a company does not maintain such a formal system. In both cases, the Commission’s argument that the issuer’s actions

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134. See infra notes 135-138 and accompanying text. Cf. Basic, Inc. v. Levinson, 485 U.S. 224, 244 (1988) (“With the presence of a market, the market is interposed between seller and buyer and, ideally, transmits information to the investor in the processed form of a market price. . . . The market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price.”) (emphasis added).

135. With respect to the adoption and implementation of a reasonably effective reporting system, see infra notes 137, 140 and accompanying text.

136. Regulation FD Release, supra note 1, at 51,722. For the definition of “reckless,” see supra note 103.

137. As an analogy for an issuer’s duty to ensure proper report systems, consider a broker-dealer’s duty to supervise its employees. Cf. e.g., 15 U.S.C. § 78o(b)(4)(E) (2000) (Exchange Act § 15(b)(4)(E)) (establishing both a duty to supervise persons under a broker-dealer’s supervision to prevent them from violating the securities laws and a safe harbor when procedures are designed and followed to prevent such a violation); In re Prudential-Bache Secs., Inc., Exchange Act Release No. 22,755, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) § 83,948 (1986) (“The responsibility of broker-dealers to supervise their employees by means of
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represented an "extreme departure from the standards of ordinary care"138 would have a greater likelihood of success.

C. Implementing Regulation FD

As noted above, the Commission and its staff enjoy significant discretion in implementing Regulation FD. The language of the Regulation itself and the Commission's formal releases are sufficiently vague to allow either relatively relaxed enforcement or more stringent implementation. Even SEC Commissioner Laura S. Unger has advanced the idea that the Commission and staff need to clarify the practices that would likely receive the Commission's attention.139

The problem with such vagueness is that commercial certainty reigns for issuers that seek to comply with the Regulation. To preserve the integrity of Regulation FD, the SEC should heed Commissioner Unger's call for more definitive guidance on key ambiguous issues such as those highlighted above. Law-observant issuers and their executives should not have to rely only on informal assurances from SEC officials that they are "not looking for hides to tack up"; they should receive better guideposts from the Commission in advance.

Until such guidance becomes available, however, issuers will be faced with the prospect of how best to comply with Regulation FD. Cautious issuers probably should pay little regard to the assurances offered by SEC representatives. Instead, they may wish to assume that the Commission and its staff will implement the Regulation more effective, established procedures is a critical component in the federal investor protection scheme regulating the securities markets."]. Present applications of compliance programs in the corporation securities law context include those directed against illegal insider trading. See WANG & STEINBERG, supra note 13, § 13.6.

138. Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569 (9th Cir. 1990); Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1045 (7th Cir. 1977), cert. denied, 434 U.S. 875 (1977). Note, moreover, that the SEC in the Regulation FD release may have implied that issuers who make the requisite disclosure within the confines of the "24-hour requirement" will not be subject to liability. The Commission stated:

We believe that it is preferable for issuers and the investing public that there be a clear delineation of when "prompt" disclosure is required. We also believe that the 24-hour requirement strikes the appropriate balance between achieving broad, non-exclusionary disclosure and permitting issuers time to determine how to respond after learning of the non-intentional selective disclosure. However, recognizing that sometimes non-intentional selective disclosures will arise close to or over a weekend or holiday, we have slightly modified the final rule to state that the outer boundary for prompt disclosure is 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 of the disclosure and knows (or is reckless in not knowing) that the information disclosed was material and nonpublic. Thus, if a non-intentional selective disclosure of material, nonpublic information is discovered after the close of trading on Friday, for example, the outer boundary for making public disclosure is the beginning of trading on the New York Stock Exchange on Monday.

Regulation FD Release, supra note 1, at 51,722-23.

139. Unger Explains Reg FD Vote, Vows to Monitor Rule Effects, Fed. Sec. L. Rep. (CCH) No. 1950, at 4-5 (Nov. 15, 2000) (calling for the Commission and staff to "provide more guidance regarding the practices that are of concern to the Commission and those that are not") [hereinafter Unger Explains]. Unger "voted against the adoption of Regulation FD and pledged to monitor the regulation for its effectiveness." Id. at 4; cf. Smith, supra note 111, at 61 (questioning what effect the eventual appointment of the successor to former Commission Chair Levitt will have on Regulation FD).
stringently, either now or in the future. Thus, they should implement sufficient processes to protect against Regulation FD liability. Such processes, as noted above, would include reviewing after-the-fact any information disclosed following an on-the-spot decision that the information was immaterial and implementing a formal reporting system between non-senior officials covered by the Regulation and an appropriate senior official.140

IV. THE INTERPLAY BETWEEN REGULATION FD AND RULE 10b-5

The Commission structured Regulation FD to impose a distinct duty, the failure of which is not supposed to give rise to liability under the federal securities laws’ antifraud provisions. The Regulation states "No failure to make a public disclosure [under the Regulation] . . . shall be deemed to be a violation of Rule 10b-5."141 Even though a Regulation FD violation does not constitute fraud per se, the Regulation may not be as independent of Rule 10b-5 as the Regulation’s language implies.142

A. Relationship Between Regulation FD and Rule 10b-5

In certain circumstances, an issuer may have certain affirmative disclosure obligations,143 such as a duty to respond to rumors144 or a duty to update previous

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140. Compare this process with a broker-dealer’s duty to supervise, discussed supra note 137. See 15 U.S.C. § 78u-1(b)(1)(A)-(B) (Exchange Act § 21A) (establishing liability for a controlling person who knows or is reckless in not knowing that a controlled person engaged in illegal insider trading or tipping, or failed to establish, maintain, or enforce procedures designed to prevent such activity).


142. The discussion in the text focuses on potential liability that issuers may face in regard to Regulation FD and/or Rule 10b-5. The Regulation, however, also interacts with new Rule 10b5-2 and the misappropriation theory to expose recipients of information selectively disclosed under a confidentiality agreement to potential Rule 10b-5 liability. See 17 C.F.R. § 240.10b5-2 (2000). With Regulation FD, the Commission seeks to stem the unfairness associated with selective disclosure in two ways: by preventing issuers from selectively disclosing material nonpublic information in the first place and by burdening the recipients of any such information that is selectively disclosed with an obligation that such recipients hold the information in confidence. For this latter approach to be meaningful, the Commission will need to prosecute any recipients who trade on such information under the securities laws’ antifraud provisions, basing liability on the misappropriation theory and the recipient’s breach of a duty owed to the issuer. See generally United States v. O’Hagan, 521 U.S. 642, 649-59 (1997); see also supra notes 15-17 and accompanying text.

Prior to Regulation FD, the issue of whether a confidentiality agreement gave rise to the duty necessary to pursue a misappropriation claim was not a given. Under certain state law contract principles, “merely reposing confidential information in and of itself will not create a fiduciary relationship.” Trumpet Vine Invs., N.V. v. Union Capital Partners I, Inc., 92 F.3d 1110, 1117 (11th Cir. 1996) (applying New York state law); see also United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991) (stating, in a case involving information shared between a husband and his wife, “[r]eposing confidential information in another, then, does not by itself create a fiduciary relationship” for Rule 10b-5 criminal liability); Walton v. Morgan Stanley & Co., 623 F.2d 796, 799 (2d Cir. 1980) (applying Delaware law to reject the claim that an investment banker “became a fiduciary . . . by virtue of the receipt of confidential information”). The Commission’s new Rule 10b5-2 closes this issue by basing antifraud liability on “material nonpublic information misappropriated in breach of a duty of trust or confidence”; it goes on to define “duty of trust or confidence” to include “whenever a person agrees to maintain information in confidence.” 17 C.F.R. § 240.10b5-2 (2000).

The Hidden Issues of the SEC's Regulation FD

As the illustration below shows, if an issuer finds itself in a situation where it has such a duty, simultaneous obligations arise under Regulation FD and Rule 10b-5.146

Perhaps this issue is best discussed in the context of earnings guidance, a topic that has received particular attention from the Commission, issuers, and the securities industry. The SEC has stated that "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." But, such information may be just the information needed to update disclosures previously made or to respond to a rumor attributable to the issuer.

Consider the following scenario building on the hypothetical involving Acme Co. Assume now that neither Ima Mouthpiece nor anyone else at Acme has yet disclosed that the company is in fact experiencing a component supply disruption (i.e., the most recent public disclosure was that the company “may” face a disruption). Anna List, trying to ferret out additional information about the company, calls Huck Ster, a mid-level sales manager at Acme with whom Anna has previously developed a relationship. Because Huck’s job duties do not normally include talking with analysts, he is not covered by Regulation FD. During the course of conversation, Huck implies that the company is having trouble filling orders because it is behind in its production. Based on this and

144. Issuers may have a related duty to disclose material information when rumors in the marketplace are attributable to them. See State Teachers Ret. Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981) (“A company has no duty to correct or verify rumors in the marketplace unless those rumors can be attributed to the company.”).

145. See In re Time Warner, Inc. Sec. Litig., 9 F.3d 259, 268 (2d Cir. 1993) (imposing “a duty to disclose arises whenever secret information renders prior public statements materially misleading”); Backman v. Polaroid Corp., 910 F.2d 10, 17 (1st Cir. 1990) (en banc) (“[I]n special circumstances, a statement, correct at the time, may have a forward intent and connotation upon which parties may be expected to rely. . . . [i]f there is a change, correction . . . further disclosure, may be called for.”). But cf. San Leandro Emergency Med. Plan v. Philip Morris Cos., 75 F.3d 801, 810 (2d Cir. 1996) (“We believe that Time Warner went nearly to the outer limit of the line that separates disclosable plans from plans that need not be disclosed.”).

146. See Regulation FD Release, supra note 1, at 51,726 (discussing possible connections between Regulation FD and bases for establishing Rule 10b-5 liability).

147. See id. at 51,721 (“One common situation that raises special concerns about selective disclosure has been the practice of securities analysts seeking ‘guidance’ from issuers regarding earnings forecasts.”).

148. See Walker Comments, supra note 111, at 4 (asserting that materiality of earnings guidance generates the greatest attention with respect to inquiries of companies regarding what they can say in this setting).

149. Regulation FD Release, supra note 1, at 51,721. But see Conner, supra note 56, at 265 n.177 (SEC General Counsel Harvey Goldschmidt contending that in most cases the selective disclosure to an analyst that estimated revenues would remain unchanged would “be okay as long as it is just a reaffirmation of public knowledge”).

150. Such a relationship usually will not arise in the normal course of business between the issuer and analysts. But such relationships could arise, for example, if the analyst and the mid-level manager have some form of significant social relationship outside of their professional lives. Or perhaps the issuer and analyst may have met at a professional conference, and the analyst keeps the manager’s contact information as a source to turn to for information about the company.

151. See Regulation FD Release, supra note 1, at 51,720 (“[T]he regulation will cover senior management, investor relations professionals, and others who regularly interact with securities market professionals or security holders.”).

152. Because Regulation FD does not cover the mid-level manager, if she discloses this information on her
other information that Anna has obtained, she concludes that Acme will not meet its earnings estimates for the quarter and advises her clients to sell the company’s stock. As this information quickly spreads around Wall Street, other analysts start putting calls into the issuer seeking guidance about its earnings estimates. In addition, a shareholder watching CNBC learns of the rumor and calls the investor relations manager at the issuer to ask if it is true. How should Acme respond?

In this scenario, Acme faces dilemmas between Rule 10b-5, Regulation FD, and its business interests. Assume that the company’s previous public statements regarding its earnings estimates continue to be “alive” in the marketplace and that subsequent events—namely, the disruption in component supply—have rendered those statements materially misleading. In this situation, Acme may have a duty to update the earnings estimates or potentially face Rule 10b-5 liability. Any selective disclosure of this information, however, will violate Regulation FD, so the company cannot simply respond to individual inquiries made by analysts and investors. On top of all this, Acme rightfully may be concerned that if and when the information becomes public, investors will overreact and sell off their stock in the company, thus leading to a rapid decline in the stock price. The best alternative to Acme’s problem may well be to announce revised earnings estimates to preclude any Rule 10b-5 liability and to do so with a public disclosure designed to satisfy Regulation FD. Although Acme faces adverse financial repercussions once the information becomes public, this consequence would have occurred in any event (but perhaps not as precipitously) regardless of the timing of disclosure. At least by making the disclosure up front, the company can foreclose any liability under the securities laws and frame the revised estimates in the best possible light (while still conveying them truthfully).

What if Acme decides, however, not to disclose updated earnings estimates? Given that the duty to update may arise only in special and limited circumstances, company

own accord (i.e., without direction from someone covered by the Regulation), such disclosure would not constitute a prohibited selective disclosure under the Regulation. See id. For example, “if an analyst sought to ferret out information about an issuer’s business by quizzing a store manager on how business was going, the store manager’s response ordinarily would not trigger any Regulation FD obligations.” Id. at n.56. Also assume for the sake of this analysis, the sales manager does not derive any personal benefit from this disclosure, thus foreclosing any Rule 10b-5 tipper/tippee liability under Dirks. See supra notes 10-14, 18-21 and accompanying text.

153. See Backman v. Polaroid Corp., 910 F.2d 10, 17 (1990). In addition to facing potential Rule 10b-5 liability if it fails to update earnings, under the scenario crafted, the issuer also might face such liability for failing to respond to a rumor ultimately attributable to such issuer. But the case for Rule 10b-5 liability probably would be harder to make based on the issuer failing to respond to a rumor. The only information that was attributable to the issuer was that orders were not being filled; no source within the issuer stated that the company would not meet earnings estimates. Because of this, the discussion in the text focuses on the issuer’s duty to update.

154. See Willis, supra note 68, at 152 (examining the relationship between companies that issued warnings and a fall in their stock price). Willis contends that in some cases investors overreacted to warnings by selling off their stock and that the resulting decline in some companies’ stock prices created opportunities for other investors to pick up “bargain stocks.” Id.

155. See Backman, 910 F.2d at 17 (quotation cited supra note 145). In construing the Backman decision, one commentator has argued:

For the first time, a court’s careful analysis in a specific factual context makes completely clear that the duty to update is not nearly as broad as some of the authorities seem to suggest. The duty
officials may believe that Acme would not face any Rule 10b-5 liability if it did not update earnings estimates. Under this scenario, the best approach may be simply to respond "no comment." Such a response is "generally [considered] the functional equivalent of silence"; a "no comment" response does not convey, at least in theory, any information about the earnings forecast and thus comports with Regulation FD. In addition, when properly used, a "no comment" statement likely would not be deemed to be an affirmative statement on which any Rule 10b-5 liability can be based.

The key, however, will be for issuers to know when using a "no comment" statement is appropriate. The Supreme Court has implied in dicta that under certain practices a "no comment" statement could be used to signal certain information. Given this, the issuer should not simply utter "no comment" conveniently to escape having to disclose bad news regarding earnings estimates even though it regularly provides updated information about positive changes in earnings estimates. The issuer should develop a "no comment" policy in regard to isolated inquiries on matters such as earnings forecasts regardless of what the revised earnings estimates would show and consistently adhere to that policy. If an issuer uses "no comment" merely as a means to signal bad news, doing so may be deemed to be the kind of "wink and nod" that Regulation FD proscribes.

is not triggered simply because a prior statement would no longer be true if repeated at a later date in the light of intervening facts. [The court] did not articulate in detail precisely when an updating duty would exist, but the brief discussion suggests that the duty would arise primarily in special circumstances.

Carl Schneider, The Uncertain Duty to Update—Polaroid II Brings a Welcome Limitation, 4 INSIGHTS, No. 10, 2, 10 (1992).

156. See In re Carnation Co., [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,801, at 87,596 n.6 (1985) ("[A]n issuer that wants to prevent premature disclosure of nonpublic preliminary merger negotiations can, in appropriate circumstances, give a 'no comment' response to press inquiries concerning rumors or unusual market activity."). Although the standards regarding "no comment" statements principally have been developed in the context of preliminary merger negotiations, presumably these standards also apply to issuers responding to rumors in the marketplace generally. See id.; Basic, Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988).


158. Cf, e.g., In re MCI Worldcom, Inc. Sec. Litig., 93 F. Supp. 2d 276, 280 (E.D.N.Y. 2000) ("Had MCI replied 'no comment' to questions about the merger, and said nothing more, the Complaint would not state a cause of action for securities fraud. However, MCI said more than 'no comment.'").

159. See Basic, 485 U.S. at 239 n.17 ("It has been suggested that given current market practices, a 'no comment' statement is tantamount to an admission that merger discussions are underway. . . . That may well hold true to the extent that issuers adopt a policy of truthfully denying merger rumors when no discussions are underway, and of issuing 'no comment' statements when they are in the midst of negotiations."). See generally Jason B. Myers, An Issuer's Duty to Disclose: Assessing the Liability Standards for Material Omissions, 30 SEC. REG. L.J. (forthcoming).
Regulation FD’s critics contend that it will chill the flow of information into the securities markets,\textsuperscript{161} while the Commission counters that the practicalities of the securities markets will induce issuers to continue to disclose material information.\textsuperscript{162} Based on the discussion above, both sides may be correct. In regard to isolated calls by favored analysts seeking to ferret out updated information or to confirm a rumor, whereas company spokespersons previously may have leaked such information, Regulation FD dissuades issuers from giving selective guidance to securities professionals. But when analysts start issuing their own warnings about the company’s earnings or unconfirmed information becomes widespread, the issuer likely will feel pressure to address these issues to stave off fears that might be building in the securities marketplace. Such disclosure also would foreclose any antifraud liability for failing to respond to the issuer’s duty to update or to respond to a rumor.

During the time commencing when the unconfirmed information first enters the marketplace (\textit{e.g.}, when the first analyst issues a warning) until the company publicly responds, Regulation FD’s effect is to shift the capital market for the company’s stock from professionally informed trading stemming from the selective disclosure of the material information that existed in the pre-Regulation FD era to uninformed trading that may prevail today. In other words, the Regulation moves the market toward a less efficient mechanism of disclosure.\textsuperscript{163} But once the issuer announces information publicly, the Regulation moves the market into the most efficient disclosure mechanism—universal trading.\textsuperscript{164} One key element in assessing Regulation FD’s effectiveness, therefore, will be determining what effect the pre-public disclosure period will have on the securities markets and issuers.

\textsuperscript{161} See, \textit{e.g.}, Information Blackout, supra note 67.

\textsuperscript{162} See Regulation FD Release, supra note 1, at 51,718 (referencing comments received in connection with the Proposed Rule Release, supra note 2). The Commission also contends that Regulation FD’s scope has been sufficiently narrowed to address the potential “chilling effect” on issuer disclosures. See \textit{id.}

\textsuperscript{163} See Gilson & Kraakman, supra note 59, at 579 (noting that uninformed trading represents the least efficient disclosure mechanism on the authors’ continuum).

\textsuperscript{164} See supra notes 60-72 and accompanying text.
B. Congruence Between Regulation FD and Rule 10b-5

The interplay between Regulation FD and Rule 10b-5 may converge and present greater liability risk for an issuer. As addressed above, violating the Regulation does not itself give rise to antifraud liability under Rule 10b-5. Nor does the violation of Regulation FD give rise to a private right of action. Nonetheless, an issuer’s failure to comply with Regulation FD may serve as evidence of an antifraud violation.

For example, consider one of the toughest elements of an antifraud claim based on a material omission: the duty to speak. In Chiarella v. United States, the Supreme Court noted “[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak.” One difficulty for plaintiffs in litigating such a claim is establishing the issuer’s duty to speak. In fact, outside the stock-offering context, courts often reflect the view that issuers have no general affirmative duty to disclose material information, unless, as noted above, the issuer is under a specific duty to do so. One specific duty with which an issuer must comply is to disclose information when the SEC’s rules and regulations require it to do so.

After the Commission first proposed Regulation FD, commentators expressed concern that the Regulation would constitute such a rule and, thus, provide a basis on which private plaintiffs could establish the required element of breach of duty to disclose. In response, the Commission added Rule 102, which “expressly provides that no failure to make a public disclosure required solely by Regulation FD shall be deemed to be a violation of Rule 10b-5.” Thus, an issuer’s violation of Regulation FD in itself will not give rise to a private lawsuit.

With the word “solely,” however, the SEC recognized that Regulation FD’s language would not preclude private lawsuits related to a selective disclosure if they were based on other grounds, such as tipping and insider trading when the Dirks “personal benefit” test is met; the issuer’s failure to meet its duty to update or duty to correct, classified as a material omission.

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165. See Regulation FD Release, supra note 1, at 51,726 (stating that the Regulation “is not designed to create new duties under the antifraud provisions of the federal securities laws or in private rights of action”).

166. See Chiarella v. United States, 445 U.S. 222, 235 (1980); Roeder v. Alpha Indus., Inc., 814 F.2d 22, 27 (1st Cir. 1987) (stating that “the prevailing view . . . is that there is no such affirmative duty of disclosure” absent insider trading; a statute or regulation requiring disclosure; or an inaccurate, incomplete, or misleading prior disclosure); cf. Cooperman v. Individual, Inc., 171 F.3d 43, 49-50 (1st Cir. 1999) (examining when Section 11 of the Securities Act imposes a “specific obligation” to disclose material nonpublic information). But see Issen v. GSC Enters., 538 F. Supp. 745, 751-52 (N.D. Ill. 1982) (offering a widely rejected view that imposed civil liability on an issuer for omitting material facts from its annual report even though the issuer was under no other duty to disclose the information).


168. Id. at 235.

169. See supra note 55 and accompanying text.

170. Such specific duties include the duties to update and to respond to rumors, as discussed supra Part IV.A.


173. See Regulation FD Release, supra note 1, at 51,726 (commentators suggesting that proposed Regulation FD “offered insufficient protection from private lawsuits”).


175. Regulation FD Release, supra note 1, at 51,726.

when applicable;\textsuperscript{177} or entanglement or adoption theories related to an issuer’s interactions with analysts.\textsuperscript{178} As a result, a private litigant may be able to use a Regulation FD violation as evidence that one of the duties above did exist.

For example, assume an issuer provides material updated earnings estimates to an analyst without making a corresponding public disclosure. Not only would that violate Regulation FD, but a private litigant could argue that the selective disclosure represented the issuer’s tacit admission that the company’s earnings estimates still alive in the marketplace were incorrect and needed to be updated. Thus, this would be evidence that the issuer had a duty to update.

Similarly, although Regulation FD does not provide a private right of action,\textsuperscript{179} its application will assist in proving other elements necessary for establishing an antifraud claim in government and private suits. For example, both Rule 10b-5 and the Regulation require that the information involved be material.\textsuperscript{180} Because Regulation FD relies on the definition of materiality developed in Rule 10b-5 litigation,\textsuperscript{181} by establishing liability under Regulation FD, the Commission will have already provided evidence that the subject information in fact was material.\textsuperscript{182} In addition, if an issuer is found to have selectively disclosed material nonpublic information intentionally, that should ordinarily provide conclusive evidence of the company’s scienter required as part of a Rule 10b-5 claim.\textsuperscript{183}

Let us consider how these factors would come together, again returning to the hypothetical involving Acme Co. In this scenario, assume that Anna List calls Ima Mouthpiece after the market closed on a Tuesday afternoon to get updated information on the potential impact of the possible supply disruption. Mouthpiece replies, “We’ve been getting so many calls that we’re going to announce this anyway, but I will let you know. We are experiencing an actual disruption and our earnings will be down less than 1% for the quarter, but it may get worse since the disruption looks like it will continue into next

\textsuperscript{177} See Regulation FD Release, supra note 1, at 51,726 (citing Backman v. Polaroid Corp., 910 F.2d 10 (1st Cir. 1990) and In re Phillips Petroleum Sec. Litig., 881 F.2d 1236 (3d Cir. 1989).

\textsuperscript{178} See Regulation FD Release, supra note 1, at 51,726 (citing Elkind Liggett & Myers, Inc. 635 F.2d 156, 166 (2d Cir. 1980) and In re Presstek, Inc., Exchange Act Release No. 39,472 (Dec. 22, 1997))

\textsuperscript{179} See supra note 165 and accompanying text.

\textsuperscript{180} See supra note 144 and accompanying text.

\textsuperscript{181} A court's finding of materiality in a SEC enforcement action, as a matter of law, may preclude a company from raising the issue in a private Rule 10b-5 claim litigated in a different venue. See Parklane Hosiery Co. v. Shore, 439 U.S. 322, 337 (1979) (collateral estoppel prevented issuer from relitigating issues resolved against it in an SEC enforcement action).

\textsuperscript{182} A court's finding of materiality in a SEC enforcement action, as a matter of law, may preclude a company from raising the issue in a private Rule 10b-5 claim litigated in a different venue. See Parklane Hosiery Co. v. Shore, 439 U.S. 322, 337 (1979) (collateral estoppel prevented issuer from relitigating issues resolved against it in an SEC enforcement action).

\textsuperscript{183} See Aaron v. SEC, 446 U.S. 680, 701-02 (1980) (holding that scienter is required as an element of a Rule 10b-5 civil enforcement action); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976) (stating that the term scienter encompasses "a mental state embracing intent to deceive, manipulate, or defraud"). But see Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4 (2000) (stating that in private claims involving forward-looking statements, the plaintiff must prove that the statement was made with actual knowledge of its falsity; recklessness will not suffice); STEINBERG, supra note 24, § 10.05(b) (discussing "bespeaks caution" doctrine). Cf. Marc I. Steinberg, The Propriety and Scope of Cumulative Remedies Under the Federal Securities Laws, 67 CORNELL L. REV. 557 (1982) (discussing judicial approaches to the question of whether remedies under the federal securities laws are cumulative or exclusive).
Acme makes a public disclosure of the same information the following morning right before the stock market opens for normal trading.

Assume that the SEC brings an enforcement action against Acme for violating Regulation FD by failing to make a simultaneous public disclosure of the material nonpublic information that Mouthpiece told Anna. The selectively disclosed information involved may well be deemed material, particularly given the qualitative trend that Mouthpiece identified. By the same standards, this information will be construed identically for materiality purposes in a Rule 10b-5 action. Similarly, this selective disclosure may be deemed intentional, since Mouthpiece purposefully told Anna the information knowing it was not yet public. In an antifraud claim, a plaintiff would seek to use the Commission's case as conclusive evidence that the company intentionally deceived the market for the company's stock in favor of Anna and her clients. Finally, given that Mouthpiece told Anna that the company was planning on releasing the information anyway, that would provide evidence that Acme recognized it had a duty to update the information in the marketplace as of Tuesday afternoon. By not publicly disclosing that information at that time, Acme provided the breach of duty necessary for a private Rule 10b-5 antifraud claim.

To the extent antifraud claims such as this are litigated and reported, it will be interesting to see what impact any subsequent public disclosure by the issuer will have on Rule 10b-5 liability. Once the information becomes adequately and publicly disclosed, for example, by issuing a press release or by the company's periodic SEC filings, the window for an antifraud claim will close; the issuer cannot be said to be deceiving investors if accurate material information is publicly known. If the public disclosure comes at a fairly short time after the selective disclosure, for example a few hours or even a day, then plaintiffs presumably will have to prove that they in fact purchased or sold the company's stock during that timeframe between the selective and public disclosures. In the hypothetical above, the plaintiff would have to prove that she traded in Acme's stock between the selective disclosure to Anna on Tuesday afternoon and the public announcement on Wednesday morning. The lesson for issuers to be culled is that, even if covered personnel make an intentional selective disclosure in violation of Regulation FD, a subject issuer should make a subsequent public announcement as soon as practicable.

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184. Given the Commission's concern about 24-hour trading (see supra note 128 and accompanying text) it likely would be concerned about Anna's clients being able to trade on the information before the public announcement.

185. See supra notes 91-101 and accompanying text (regarding the importance of qualitative factors in assessing the materiality of quantitative statements).

186. For the purpose of this hypothetical, we assume that the private litigant files her lawsuit within the proper statute of limitations. See Lampf, Pleva, Lipkind, Prupis & Pettigrow v. Gilbertson, 501 U.S. 350, 364 (1991) (stating that a suit under Section 10(b) and Rule 10b-5 must be brought within one year of notice and within three years of the alleged violation).

187. See Parklane Hosiery, 439 U.S. at 332 (permitting offensive use of collateral estoppel for issues previously litigated in an SEC enforcement action).

188. See supra notes 143, 170 and accompanying text.

189. See Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 474-77 (1977) (observing that "nondisclosure is usually essential to the success of a manipulative scheme").
V. CONCLUDING THOUGHTS

Regulation FD represents a significant attempt by the Commission to restructure the balance of power among investors active in the securities marketplace. It may fit awkwardly in the existing securities framework, and that may lead to important interpretive issues down the line. But, the Regulation does fill a gap in an issuer's disclosure duties that had been left open by the federal securities laws and, at least in some small regard, brings the U.S. laws in line with other established markets abroad.\textsuperscript{190}

For all that Regulation FD does and does not do in attempting to fill this gap, it remains that the Regulation does not necessarily eliminate the informational disparity between insiders and individuals. It does not, for example, cover all material nonpublic information flowing out of an issuer, exempting information disclosed by non-senior officials, offered in the daily business of the issuer, or provided subject to a confidentiality agreement.\textsuperscript{191} Market insiders still retain an advantage in having access to this sort of information.\textsuperscript{192} Analysts still will be better able to uncover and piece together a mosaic of disparate bits of relevant information, and trade on it either for themselves or for their clients.\textsuperscript{193} In addition, even with information made publicly available in compliance with Regulation FD, insiders have a structural advantage over individual investors, advantages that stem from their position as professionals. Market professionals, practically speaking, will generally learn information sooner, analyze it faster and better, and act on it earlier than non-professionals.\textsuperscript{194}

Indeed, analysts incur much lower informational costs in obtaining news regarding a company. They are compensated and recognized for their skill in ferreting out information better and faster than anyone else. Furthermore, analysts play a crucial role in ensuring the efficiency of capital markets by turning raw data into a more widely accessible format.\textsuperscript{195} Thus, even in the absence of selective disclosure, analysts will tend to drive much of the trading in the marketplace, and many investors willingly follow their lead.\textsuperscript{196}

\textsuperscript{190} See supra notes 47-51 and accompanying text.
\textsuperscript{191} See Regulation FD Release, supra note 1, at 51,718-19 (stating that section 2(A)(4) of the Release discusses the Commission’s efforts to narrow Regulation FD’s scope).
\textsuperscript{192} See id. at 51,720 n.36 (discussing the analyst’s job of ferreting out information through contact with personnel that the Regulation does not cover).
\textsuperscript{193} See Dirks v. SEC, 463 U.S. 646, 658-59 n.17 (1983); see also Regulation FD Release, supra note 1, at 51,722 (“An issuer is not prohibited [by Regulation FD] 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 that, taken together, is material.”).
\textsuperscript{194} See Regulation FD Release, supra note 1, at 51,717 (stating that even with the advent of online trading, “analysts still provide value for investors by using their education, judgment, and expertise to analyze information”) (emphasis in original); Gilson & Kraakman, supra note 59, at 569 (noting that unsophisticated investors cannot make complete use of technical accounting data without analysts interpreting the information).
\textsuperscript{195} See, e.g., Serfaty v. Int’l Automated Sys., Inc., 180 F.R.D. 418, 422 (D. Utah 1998) (“Existence of such reports would suggest that investment professionals reviewed the reports and made trading recommendations to their investment clients based on the information in the reports.”); Cammer v. Bloom, 711 F. Supp. 1264, 1286 (D.N.J. 1989) (“The existence of such [securities] analysts [following and reporting on a company’s stock] would imply, for example, the PMM reports were closely reviewed by investment professionals, who would in turn make buy/sell recommendations to client investors.”).
\textsuperscript{196} Cf. Regulation FD Release, supra note 1, at 51,717 (“Noting that analysts predominantly issue ‘buy’
In this regard, Regulation FD in practical effect may be more symbolic than functional. The Commission promulgated the Regulation to address the perception that the markets' integrity was threatened.\textsuperscript{197} The Regulation may improve this perception without necessarily having an inordinately troublesome impact on issuer disclosure practices.\textsuperscript{198} But even if one assumes that the Regulation has a substantive impact in limiting selective disclosure, the inquiry that the Commission will need to continually address is whether the benefits of the new disclosure requirements outweigh their costs. With the many issues still to be resolved under Regulation FD, this analysis will remain subject to debate over the coming years.