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Texas Gulf Sulphur and Information Disclosure Policy

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TEXAS GULF SULPHUR AND INFORMATION DISCLOSURE POLICY

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ABSTRACT

Texas Gulf Sulphur*'s bold ultimatum—"disclose or abstain"— enjoys an enduring place of prominence in discussions of insider trading law because of the intuitive simplicity with which it asserts the expectations of investors in securities markets. As the law of information dissemination has developed into a distinct subset of federal securities law over the past fifty years, however, it is equally important to reflect on how the* Texas Gulf Sulphur *opinion has shaped the views of courts and regulators in crafting rules and guidelines for information disclosure. Indeed,* Texas Gulf Sulphur *anticipated—and continues to inform—contemporary debates relating to the dissemination of real-time material information, including questions such as how and how much material, nonpublic information should be disclosed to the public, who is in a position to make effective "disclosures" that satisfy the "disclose or abstain" rule, and the standard for determining when new information may be acted upon by insiders. Even as its influence over insider trading doctrine has waned,* Texas Gulf Sulphur*'s aspirational standard of "equal access to material information" continues to fuel the imagination of investors and policy makers in regulating twenty-first century securities markets.*

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FEW formulas in corporate law offer the reductive grace of the "disclose or abstain" rule,[1] as popularized by *Texas Gulf Sulphur*.[2] The Second Circuit's opinion sets forth the premises of its test with intuitive simplicity: investors have a "justifiable expectation" that "all investors trading on impersonal exchanges have relatively equal access to material information."[3] Accordingly,

> anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.[4]

Despite half a century of guidance from the U.S. Supreme Court on the scope of insider trading liability since then,[5] *Texas Gulf Sulphur* continues to dominate business associations and securities casebooks because of its bold ultimatum concerning the integrity of markets and the expectations of investors.[6] The part of the case that calls to me when I teach it is the framing of the choice to "disclose" material nonpublic information: it is easy enough to understand what it means to "abstain," but how does one "disclose"—or more precisely, under what circumstances is dissemination of non-public information sufficient to cure otherwise privileged trading?

On the one hand, the answer is straightforward: "[b]efore insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public."[7] The *Texas Gulf Sulphur* opinion nevertheless anticipates many of the questions of the dissemination of real-time material information that regulators and academics grapple with as part of the emerging study of information dissemination as a distinct subset of securities law.[8]

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1. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).
2. *See* Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 236 (2d Cir. 1974) (referring to "our 'disclose or abstain' rule" as articulated in *Texas Gulf Sulphur*); Fridrich v. Bradford, 542 F.2d 307, 318 (6th Cir. 1976) (referring to "the 'abstain or disclose' rule in" *SEC v. Texas Gulf Sulphur*).
3. *Texas Gulf Sulphur*, 401 F.2d at 848.
4. *Id.*
5. *See* Salman v. United States, 137 S. Ct. 420, 427–28 (2016) (holding that "a tipper breaches a fiduciary duty by making a gift of confidential information to 'a trading relative,'" regardless of whether the tipper receives "something of a 'pecuniary or similarly valuable nature' in exchange"); United States v. O'Hagan, 521 U.S. 642, 665 (1997) (upholding criminal liability under the "misappropriation theory" of insider trading); Dirks v. SEC, 463 U.S. 646, 664 (1983) (holding "that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain").
6. *See, e.g.*, Wendy Gerwick Couture, *Professor Alan R. Bromberg and the Scholarly Role of the Treatise*, 68 SMU L. REV. 703, 705–06 (2015) (noting the influence of the *Texas Gulf Sulphur* case on Professor Bromberg's vision for a securities law treatise).
7. *Texas Gulf Sulphur*, 401 F.2d at 854.
8. *See* ONNIG H. DOMBALAGIAN, CHASING THE TAPE: INFORMATION LAW AND POLICY IN CAPITAL MARKETS 163 (2015); Kevin S. Haeberle & M. Todd Henderson, *Informa-*

These include issues such as how material, nonpublic information should be disclosed to the public, the extent to which disclosure is an option for insiders or derivative insiders without executive authority, and the standard for determining when new information may be acted upon by insiders.

Our understanding of some of these questions has evolved over the past fifty years, while others remain the topic of significant uncertainty. Nevertheless, both the SEC's regulatory policy and ensuing federal jurisprudence on disclosure mechanisms, selective disclosures, and outsider trading each owe a great deal to the aspirational "equal footing" for insiders and outsiders that the SEC fought for (and which the Second Circuit endorsed) in *Texas Gulf Sulphur*.[9]

I. HOW IS MATERIAL, NONPUBLIC INFORMATION DISCLOSED TO THE PUBLIC?

The process of disclosure undertaken by the defendants in *Texas Gulf Sulphur* seems hopelessly primitive by today's standards. Put aside for a moment the "gloomy" April 12 statement made by Texas Gulf Sulphur's executive vice president, Charles Fogarty, relating to the K-55-1 drill core[10]—and the cacophony of opinions it elicited from the en banc court—as to materiality, accuracy, and completeness.[11] The very mechanics of the "ultimate disclosure of the discovery" of the 25 million ton ore strike to the press, the financial community, and the public are a stark contrast to the protocols that publicly traded companies follow today when disseminating material information.

How did Texas Gulf Sulphur bring the news of the ore strike to market? According to the court, a reporter for the Canadian mining industry journal, *The Northern Miner*, was granted permission to visit the drillsite, interview Texas Gulf Sulphur principals, and prepare an article on April 13. The reporter's take, "after having been submitted to Mollison [a vice president at Texas Gulf Sulphur] and returned to the reporter unamended on April 15," was eventually published in the journal on April 16.[12] Meanwhile, "[a] statement relative to the extent of the discovery . . . was given to the Ontario Minister of Mines for release to the Canadian media."[13] The ministry was expected to release the announcement drafted by Texas Gulf Sulphur "over the airways" at 11 P.M. on April 15,[14] but the ministry did not act until 9:40 A.M. on April 16, and even

tion-Dissemination Law: The Regulation of How Market-Moving Information Is Revealed, 101 CORNELL L. REV. 1373, 1376–84 (2016).

9. *See Texas Gulf Sulphur*, 401 F.2d at 852.

10. *Id.* at 845–46.

11. *See id.* at 864 (Friendly, J., concurring); *id.* at 869 (Kaufman, J., concurring); *id.* (Anderson, J., concurring); *id.* (Hays, J., concurring); *id.* at 870 (Moore, J., dissenting).

12. *Id.* at 846.

13. *Id.*

14. *Id.*

then only issued an "abbreviated announcement."[15]

Management's "official detailed statement" was read to "representatives of [the] American financial media from 10:00 A.M. to 10:10 or 10:15 A.M. on April 16."[16] The statements thereafter "appeared over Merrill Lynch's private wire at 10:29 A.M. and, somewhat later than expected, over the Dow Jones ticker tape at 10:54 A.M."[17] Meanwhile, parts of the *Northern Miner* article and the ministry's report "had sporadically reached New York on the morning of the 16th through reports from Canadian affiliates to a few New York investment firms."[18]

We have since grown accustomed to thinking of the release of new information to market as a highly regulated process that prevents exactly this kind of haphazard dissemination of information. Today, an issuer proposing to disseminate material information during trading hours would be expected to alert the primary exchange where its securities trade to determine whether a regulatory halt should be instituted across the national marketplace.[19] The information itself would be included in an SEC current report furnished to or filed with the Commission and broadly disseminated to the media.[20] This protocol gives market participants "time to assess the impact of the news" and recalibrate buying and selling interest once any trading halt is lifted.[21]

The coordinated dissemination of new information and the free, instantaneous public disclosure system we expect today is itself the product of decades of innovation.[22] The SEC had uncertain authority to coordinate trading activity across exchanges prior to the authorization of the national market system in the 1975 Amendments to the Securities Exchange Act.[23] Until the Internet gained widespread use and the SEC's EDGAR system replaced paper disclosures with electronic filings, major brokerage

15. *Id.* at 853–54.

16. *Id.* at 846.

17. *Id.* at 846–47.

18. *Id.* at 853–54.

19. *See, e.g.*, NYSE Listed Co. Manual § 202.06(B) (Dec. 4, 2017), 1991 WL 11236725, at *2 (requiring listed issuers to "notify the Exchange by telephone at least ten minutes prior to release of the announcement" of material news so that the Exchange can locate the information and make a determination whether to halt trading); *see also* Sec. & Exch. Comm'n, Trading Halts and Delays, https://www.sec.gov/fast-answers/answers tradinghalthtm.html (last visited Mar. 28, 2018).

20. Form 8-K, 17 C.F.R. § 249.308 (2017), is used for the current reports required by 17 C.F.R. § 240.13a-11 or § 240.15d-11 and for reports of nonpublic information required to be disclosed by Regulation FD, 17 C.F.R. §§ 243.100 and 243.101.

21. Trading Halts and Delays, *supra* note 19.

22. *See, e.g.*, Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,593 (proposed Dec. 28, 1999) [hereinafter Regulation FD Proposing Release] ("A generation ago, issuers may have relied on conferences attended by a handful of interested parties, or news releases that led to delayed, indirect retransmission of information to the public.").

23. Securities Acts Amendments of 1975, Pub. L. No. 94–29, § 6, 89 Stat. 97 (1975) (codified as amended at 15 U.S.C. § 78k–1 *et seq.*). *See* Joel Seligman, *The Future of the National Market System*, 10 J. Corp. L. 79, 81 (1984) (noting the "difficult technical problems and policy decisions," as well as "political" obstacles, "involved in converting a system of unaffiliated securities exchanges and over-the-counter markets into a national market system").

firms—or wirehouses[24]—served as a necessary intermediary for transmitting real-time information to investment professionals, while management shared fundamental information with analysts at private conferences for filtration to the public.[25] Retail investors, of course, relied on print media—i.e., articles and stock quotes in newspapers—to make investment decisions.

If the informational advantages that insiders and professionals enjoyed over the common investor were a palpable reality then, today's informational asymmetries are relatively subtle, yet equally compelling. Automated information technology has not eliminated—so much as rescoped—the problem of informational asymmetries in markets.[26] High-end traders—such as investment banks and hedge funds—have heavily invested in algorithmic technology that can instantaneously pull, parse and act on electronic disclosures from the SEC and other public sources of information without human intervention.[27] Exchanges, moreover, have wrestled with the problem of balancing commercial incentives to provide privileged access to their members against their quasi-public mandate to promote fair and honest markets.[28]

The SEC's long-term strategy in the face of these new technologies, informed by *Texas Gulf Sulphur* and its progeny, is to "promote fair treatment of large and small investors by, among other things, giving all investors timely access to the material information an issuer chooses to disclose."[29] But making information available to all investors simultane-

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24. *See Definition of Wirehouse*, FIN. TIMES, http://lexicon.ft.com/term?term=Wire house [https://perma.cc/99HX-QPU3] (last visited Apr. 5, 2018) ("A wirehouse is a large integrated broker with a national, as opposed to regional, business. Wirehouses once collected trade orders from branch offices in distant cities using dedicated telegraph lines").

25. *See, e.g.*, Regulation FD Proposing Release, *supra* note 22, at 72,593 ("[R]evolutions in communications and information technologies have made it much easier for issuers today to disseminate important information broadly and swiftly. A generation ago, issuers may have relied on conferences attended by a handful of interested parties, or news releases that led to delayed, indirect retransmission of information to the public.").

26. *See* DOMBALAGIAN, *supra* note 8, at 163–78 (2015); Yesha Yadav, *How Algorithmic Trading Undermines Efficiency in Capital Markets*, 68 VAND. L. REV. 1607, 1611, 1664 (2015) (arguing that while "algorithms help markets make gains on several measures of informational efficiency, they also create costs for their ability to allocate capital productively").

27. *See, e.g.*, Chris Brummer, *Disruptive Technology and Securities Regulation*, 84 FORDHAM L. REV. 977, 1001 (2015) (observing "the increasing dependence on, and deployment of, computers and computer processing to not only execute trades and collect market data but to also *make independent trading decisions*"); Yadav, *supra* note 26, at 1625–31 (describing various algorithmic trading strategies).

28. Brummer, *supra* note 27, at 1028–31 (describing how "individually and collectively, maker-taker fees, colocation services, and private data feeds reflect the disintermediation of exchanges . . . and, by extension, regulatory gatekeepers"); Yesha Yadav, *Insider Trading and Market Structure*, 63 UCLA L. REV. 968, 968 (2016) (analogizing the informational harms from such "structural insider trading" to those "regulated under conventional theories of corporate insider trading").

29. Regulation FD Proposing Release, *supra* note 22, at 72,593–94 (adding that "early insider trading case law [citing *Texas Gulf Sulphur*] . . . appeared to require that traders have equal access to corporate information," though later cases determined that "the antifraud provisions of the securities laws do not require that all traders possess equal information when they trade").

ously is a deceptively difficult mandate.[30] The SEC's principal regulatory instrument for doing so is Regulation Fair Disclosure (FD).[31] But "fair disclosure" is not synonymous with simultaneity; even putting aside the problem of "promptly" correcting inadvertent disclosures, it is not clear how "broad, non-exclusionary distribution"[32] of material information can realistically be achieved in today's informational landscape without creating informational winners and losers.[33]

The problem of course is that issuers have too many dissemination tools at their disposal—EDGAR, websites, social media, and other "push" technologies—all of which have their unique protocols and strategic corporate uses. While disclosure policy might favor the use of the SEC's EDGAR system for dissemination of new information,[34] it cannot chill the use of alternative information channels in a robust informational marketplace. Indeed, an issuer ought to be obligated to release news "through the fastest possible means," whatever it is.[35] As such, the SEC has cautioned issuers that public investors must be aware of, and have access to, websites that are to be used as tools of information dissemination.[36] Further, issuers must avoid alternative disclosure tools—such as social media—that have more limited distribution or may not be generally recognized as dissemination tools.[37]

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30. *See* 15 U.S.C. § 78m(*l*) (2012) (authorizing the SEC to adopt rules requiring reporting issuers to "disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer").

31. Regulation FD, 17 C.F.R. § 243.100 *et seq.* (2017).

32. 17 C.F.R. § 243.101(e)(2) (2017).

33. Haeberle & Henderson, *supra* note 8, at 1417–18 (observing that Regulation FD "results in asymmetries throughout prolonged periods that are slightly lower than they otherwise would be in the period leading up to full releases of new information . . . , yet markedly higher ones in the period that takes place just after those full releases (because the information comes out with a burst of trading when it must be made available to all at once when first released)").

34. Regulation FD requires an issuer to make public disclosure by furnishing or filing Form 8-K, subject to an exemption "if it instead disseminates the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public." 17 C.F.R. §§ 243.101(e)(1)–(2).

35. *See, e.g.*, NYSE Listed Co. Manual § 202.06(C) (Dec. 4, 2017), 1991 WL 11236725, at *3 ("News which ought to be the subject of immediate publicity must be released by the fastest available means. The fastest available means may vary in individual cases and according to the time of day. Typically, this requires that issuers either (i) include the news in a Form 8-K or other SEC filing, or (ii) issue the news in a press release to the major news wire services, including, at a minimum, Dow Jones & Company, Inc., Reuters Economic Services and Bloomberg Business News.").

36. *See* Commission Guidance on the Use of Company Web Sites, Release No. 58288, 73 Fed. Reg. 45,862 (Aug. 7, 2008) (codified at 17 C.F.R. pts. 241 & 271). For example, in determining whether information posted on a website satisfies the "public disclosure" requirements of Rule 101(e), "companies must consider whether and when: (1) [a] company [w]eb site is a recognized channel of distribution, (2) posting of information on a company [w]eb site disseminates the information in a manner making it available to the securities marketplace in general, and (3) there has been a reasonable waiting period for investors and the market to react to the posted information." *Id.* at 45,867.

37. *See* Report of Investigation Pursuant to § 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Release No. 69279 (Apr. 2, 2013), 2013 WL 5138514, at *3–7.

Even the SEC's proprietary information dissemination tools can result in informational asymmetries. For example, a recent study demonstrates that the SEC's file transfer protocol and public dissemination services themselves, until recently, gave professional investors lead time sufficient to earn trading profits.[38] Moreover, some scholars have questioned the premise that investors are better off with assurances of exacting informational symmetry, given the volatility that surrounds the release of new information, the effort required to digest it, and the technological resources needed to exploit instantaneity.[39]

Efforts making information more readily actionable in order to improve the speed with which information is impounded into market prices may have the same effect. The SEC's Office of Structured Disclosure, for example, "supports the Commission's efforts to make required disclosures accessible and usable by structuring disclosures using a variety of standardized languages and frameworks."[40] These include the establishment of an XBRL filing program for corporate financial statements.[41] The effect of these initiatives on trading markets is unclear: while they ostensibly promote market efficiency, they may also have the effect of scaring retail investors out of markets in the wake of new disclosures.[42]

II. HOW MUCH "DISCLOSURE" IS ENOUGH?

Texas Gulf Sulphur itself is a puzzlement insofar as it is not clear what ought to have been disclosed to satisfy the "disclose or abstain" rule. The majority suggested that the objective "that access to material information be enjoyed equally" could have been satisfied by "nothing more than the disclosure of basic facts," permitting outsiders to draw upon their evaluative expertise.[43] In dissent, Judges Moore and Lumbard questioned the "full disclosure theory" advocated by Judge Waterman and the majority, by asking the following question: Would disclosure of the facts developed

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38. *See* Robert J. Jackson & Joshua R. Mitts, *How the SEC Helps Speedy Traders* 8–12, (Columbia Univ. Sch. of Law, Center for Law & Econ. Studies, Working Paper No. 501, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2520105 [https://perma.cc/8NCA-SFRP].

39. *See* Haeberle & Henderson, *supra* note 8, at 1379–80.

40. SEC. AND EXCH. COMM'N, STRUCTURED DISCLOSURE AT THE SEC: HISTORY AND RULEMAKING, https://www.sec.gov/page/osdhistoryandrulemaking [https://perma.cc/6YSP-YQE3] (last visited Mar. 28, 2018).

41. *See* Interactive Data To Improve Financial Reporting, Release No. 9002, 74 Fed. Reg. 6776 (Feb. 10, 2009) (codified at 17 C.F.R. pts. 228, 230, 232, 239, 240, 249).

42. One study found "an increase in information efficiency, a decrease in event return volatility, and a reduction of change in stock returns volatility" in the post-XBRL disclosure of sampled firms. Joung W. Kim et al., *The Effect of First Wave Mandatory XBRL Reporting across the Financial Information Environment*, 26 J. INFO. SYS. 127, 127 (2012). Another attributed wider abnormal bid–ask spreads, a reduction in abnormal liquidity, and a decrease in abnormal trading volume, particularly for small trades, in the market immediately following the introduction of XBRL tagging to retail investors' heightened fears of adverse selection. *See* Elizabeth Blankespoor et al., *Initial evidence on the market impact of the XBRL mandate*, 19 REV. ACCT. STUD. 1468, 1468 (2014).

43. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

as of the time the alleged insider trading began "have given the buying or selling public the so-called advantages possessed by the insiders?"[44]

Judge Moore seemed to deride the idea that factual disclosure of the circumstances surrounding the K-55-1 discovery in late 1963 would have satisfied the majority: indeed, he argued that a detailed factual exposition of the technical findings "would, of course, have been of no value to anyone except possibility a few graduates of Institutes of Technology," while observing that "any announcement of the discovery of a remarkable mine would have been both false and misleading" at the time.[45] Indeed, the dissent turned the SEC's own disclosure guidance against it, noting that "under the Commission's own standards, [Texas Gulf Sulphur], if it revealed any information during the November 1963-April 1964 period," would have had to temper the reporting of any finds with the caution that "'no body of commercial ore is known to exist on the property.'"[46]

The dissenters further questioned whether the majority fairly drew the line between the "superior financial or other expert analysis" of an insider expert's "educated guesses or predictions" from the "basic facts" of the discovery.[47] They recounted a "myriad of reasons" in the public domain that insiders might have given in addition to the K-55-1 find to motivate their purchases, including "the development of a phosphate project and potash mine," an anticipated "turnabout in the price of sulphur stocks," "the new high level of free world sulphur use and output," and "the launching of the world's largest liquid sulphur tanker" to name a few.[48] The dissent cautioned that the majority "confuse[d] the inducing motive of the individual purchaser with knowledge of material facts which ought to be revealed to the public at large."[49]

Much of this discussion naturally anticipates theories of materiality that prosecutors would articulate to assess the collective import of individually immaterial tidbits of non-public information slotted together to make trading decisions. Certainly, the majority in *Texas Gulf Sulphur* gave great weight to insiders' own estimation of the materiality of information based on their own trading activity.[50] From the perspective of non-insid-

44. *Id.* at 875 (Moore, J., dissenting).
45. *Id.*
46. *Id.* at 873.
47. *Id.* at 848–49.
48. *Id.* at 876.
49. *Id.* at 876–77.
50. *See id.* at 851 (noting that "a major factor in determining whether the K-55-1 discovery was a material fact is the importance attached to the drilling results by those who knew about it"). More recent cases addressing the materiality of information compiled by employees or other putative insiders include SEC. v. Steffes, 805 F. Supp. 2d 601, 613 (N.D. Ill. 2011) and SEC Charges Former Investment Banker with Insider Trading, SEC Litig. Release No. 22674 (Apr. 16, 2013), https://www.sec.gov/litigation/litreleases/2013/lr22674.htm [https://perma.cc/AG5D-6T82] (announcing settlement). One commentator has suggested that, at least with respect to cases of trading by insiders directly, such cases tend to ground their arguments in the "misappropriation" theory of insider trading liability. *See* Allan Horwich, *The Mosaic Theory of Materiality—Does the Illusion Have a Future?*, 43 Sec. Reg. L.J. 1, 7 (2015).

ers, however, building a mosaic of information through expert networks is part of analysts' mission to "ferret out and analyze information" to make trading decisions.[51] Despite the SEC's efforts to provide clarity through Regulation FD,[52] some commentators continue to analogize the task of corporate executives engaging with financial analysts "to a fencing match conducted on a tightrope."[53]

III. CAN ANYONE "DISCLOSE"?

In promulgating the "disclose or abstain" rule, the Second Circuit did not purport to "suggest that material facts must be disclosed immediately," but rather reaffirmed that "the timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC."[54] Invoking the "traditional fiduciary concepts" upon which the Supreme Court would later ground its insider trading jurisprudence, the court admitted that an insider who "is disabled from disclosing [information] in order to protect a corporate confidence, or who chooses not to do so, must abstain from trading" while the information remains undisclosed.[55]

For employees without the authority to speak for the firm, disclosure is probably not a realistic option without breaching their duties of loyalty and care as agents or fiduciaries of the issuer. The SEC's admonition that any spokespersons for public companies "need to be mindful of [their] obligations under the federal securities laws when making statements that can reasonably be expected to be made known to the market" essentially limits formal disclosures to a chosen few.[56] Even internal disclosures can be problematic: the court was split over the conduct of two officers—Stephens and Fogarty—who accepted stock option grants from the board of directors while in possession of information about the K-55-1 hole.[57] The dissenters suggest that the majority's decision "places insider recipi-

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

52. The SEC has acknowledged that absent an improper purpose, "an issuer is not prohibited from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a 'mosaic' of information that, taken together, is material." Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000) (final rule adopting Regulation FD, 17 C.F.R. § 243.100 *et seq.*).

53. SEC v. Bausch & Lomb Inc., 565 F.2d 8, 9 (2d Cir. 1977) (adding that executives are "compelled to parry often incisive questioning while teetering on the fine line between data properly conveyed and material inside information that may not be revealed without simultaneously disclosing it to the public"); *see also* JOHN J. HUBER & THOMAS J. KIM, THE SEC'S REGULATION FD – FAIR DISCLOSURE 7 (2001) ("As the fencing match between companies and analysts continues in the FD environment, new techniques, such as embargoes, may develop that comply with Regulation FD, yet nevertheless give analysts an advantage over the public.").

54. *Texas Gulf Sulphur*, 401 F.2d at 850–51 n.12.

55. *Id.* at 848.

56. Public Statements by Corporate Representatives, 49 Fed. Reg. 2468, 2469 (Jan. 20, 1984) (codified at 17 C.F.R. pts. 231, 241, 251, 271 (citing *Tex. Gulf Sulphur*, 401 F.2d at 858–60)).

57. *Texas Gulf Sulphur*, 401 F.2d at 864–65 (Friendly, J., concurring).

ents . . . in a difficult dilemma," insofar as they must decide whether to "perform the uncommon act of refusing such an option, promoting speculation as to the reasons therefor, or accept the option and face possible 10b-5 liability."[58]

Congress and the SEC have provided only limited and narrowly tailored guidance to corporate directors and executive officers since *Texas Gulf Sulphur*. In addition to requiring more timely and accessible publication of trades,[59] Congress and the SEC have adopted rules for directors and officers prohibiting the abuse of blackout periods.[60] More generally, the SEC has promulgated conditions for pre-clearance of trading plans to avoid allegations of improper trading.[61] Nevertheless, the broad net cast by *Texas Gulf Sulphur* may cause issuers to "adopt overbroad insider trading compliance programs, which comes at a heavy price in terms of corporate culture, cost of compensation, share liquidity, and cost of capital."[62]

The U.S. Supreme Court could have answered this question in *Dirks v. SEC*, where the SEC had censured the petitioner for openly discussing with a number of his clients and investors material non-public information he had obtained from corporate insiders, who were anxious to blow the whistle on an ongoing fraud at a publicly traded company.[63] The Supreme Court ultimately reversed Dirks's censure because insiders had not shared information with Dirks for an "improper purpose."[64] The *Dirks* Court, however, avoided a more interesting question: Whether a whistleblower or outsider in possession of inside information could effectively disclose under the "disclose or abstain" rule when she does not control the tools of information dissemination?[65]

58. *Id.* at 877 (Moore, J., dissenting).

59. *See* 15 U.S.C. § 78p(a) (2012); Mandated Electronic Filing and Web Site Posting for Forms 3, 4 and 5, 68 Fed. Reg. 25,788 (May 13, 2003) (mandating electronic filing via EDGAR of insider trading reports required under § 16 of the Exchange Act).

60. *See* Regulation BTR, 17 C.F.R. § 245.101 (2018) (prohibiting directors and executive officers of an issuer from trading in the issuer's equity securities during a pension plan "blackout period").

61. 17 C.F.R. § 240.10b5-1(c)(1)(i)(A), (B) (2017) (establishing an affirmative defense to insider trading if the accused, inter alia, "adopted a written plan for trading securities" prior to becoming aware of material non-public information that effectively eliminates the accused's discretion over the amount, price, or timing of trades).

62. John P. Anderson, *Solving the Paradox of Insider Trading Compliance*, 88 TEMP. L. REV. 273, 274–75 (2016).

63. *See* 463 U.S. 646, 648–52 (1983).

64. *Id.* at 659–77.

65. Certainly, the Supreme Court seemed to regard Secrist's role as a whistleblower as absolving him of any *deceptive* breach of fiduciary duty, without specifically considering whether his conduct would have been actionable under agency principles generally. *See id.* at 667 n.27 (finding "no evidence that Secrist's disclosure was intended to or did in fact 'deceive or defraud' anyone" as required to establish scienter). Even so, the groundrules for whistleblowing might well counsel against such attempts at public disclosure today: prospective whistleblowers have an incentive to disclose violative conduct privately through government or corporate channels in order to claim statutory protection from retaliation or to avoid personal liability for breach of non-disclosure agreements. *See* 18 U.S.C. § 1514A(a)(1) (2012) (protecting from retaliation whistleblowers who report information to a federal regulatory or law enforcement agency, Congress, or a supervisor); 15

For example, what efforts on Secrist's or Dirks's part would have been enough to allow trading thereafter? Certain "[p]erson[s] acting on behalf of an issuer"[66] are subject to the obligation to comply with specific disclosure protocols when communicating material information to investment professionals or shareholders.[67] The regulation provides no such guidance to non-officers, however, which leaves the "disclose or abstain" rule as a frustrating concept to apply: is Dirks prohibited from advising his clients to dump their Equity Funding shares because he has just enough inside information to know there is a fraud brewing, but not enough to persuade a reputable publisher to publish it? If so, can one be "tainted" by knowledge of information that cannot be effectively published?[68]

Obiter, the dueling opinions of the Supreme Court commented on Dirks' alacrity in communicating the fraud to the public. The majority observed that Dirks was "in touch regularly with William Blundell, the *Wall Street Journal*'s Los Angeles bureau chief," whom Dirks urged to write a story on the fraud allegations. "Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story," for fear that "publishing such damaging hearsay might be libelous."[69] The dissent was somewhat less impressed: they described Dirks's telephone-tag with the *Wall Street Journal* to be "feeble, at best," and observed that the trading halt at the New York Stock Exchange occurred "at about the same time Dirks was talking to Los Angeles SEC personnel."[70]

Even if an insider were to attempt disclosure, it is not clear whether subjective belief or the purity of intent is enough to absolve them of the duty to abstain if disclosure is not effective. For example, in *Texas Gulf Sulphur*, the court concluded that "the beliefs of Coates, Crawford and

U.S.C. § 78u-6(a)(6) (2012) (defining whistleblowers as "any individual who provides . . . information relating to a violation of the securities laws to the Commission"); *see also* Digital Realty Tr., Inc. v. Somers, 138 S.Ct. 767, 778 (2018) (holding that the Dodd-Frank Act's anti-retaliation provision, 15 U.S.C. § 78u-6(h), does not extend to an individual who has not reported a violation of the securities laws to the SEC); Kathryn Hastings, *Keeping Whistleblowers Quiet: Addressing Employer Agreements to Discourage Whistleblowing*, 90 TUL. L. REV. 495, 509–19 (2015) (discussing the difficulties of balancing corporate nondisclosure agreements with statutory whistleblower protections).

66. Regulation FD defines a "[p]erson acting on behalf of an issuer" to mean "any senior official of the issuer . . . , or any other officer, employee, or agent of an issuer who regularly communicates" with shareholders or certain investment professions described in Rule 100(b)(1). 17 C.F.R. § 243.101(c). Notably, "[a]n officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to the issuer shall not be considered to be acting on behalf of the issuer." 17 C.F.R. § 243.101(c)

67. Regulation FD requires that the issuer simultaneously or promptly disseminate information through a Form 8-K or other method "reasonably designed to provide broad, non-exclusionary distribution of the information to the public." 17 C.F.R. § 243.101(e).

68. *See* Andrew Verstein, *Insider Tainting: Strategic Tipping of Material Nonpublic Information*, 112 NW. U. L. REV. 725, 748 (2018) (suggesting that management can trip up bidders in the market for corporate control through selective disclosure of non-public information).

69. *Dirks*, 463 U.S. at 649–50.

70. *Id.* at 670.

Clayton that the news of the ore strike was sufficiently public at the time of their purchase orders are to no avail if those beliefs were not reasonable under the circumstances."[71] Moreover, the court suggested that "whether the case before us is treated solely as an SEC enforcement proceeding or as a private action, proof of a specific intent to defraud is unnecessary" in insider trading cases.[72] Later cases would return to the issue whether intent to use inside information for purposes of reaping trading profits is necessary.[73] The SEC ultimately codified its position that trading while "aware" of material nonpublic information was sufficient to find liability,[74] while successfully defending the "knowing possession" standard in the context of tender offers.[75]

IV. WHEN IS "DISCLOSURE" EFFECTED?

Perhaps the only recourse is to wait until disclosure of the information, by whomever or whatever means, is complete. The defendants who traded on April 15th and 16th unsuccessfully argued that their purchases did not violate Rule 10b-6 because news of the strike "had already been effectively disclosed" prior to placing their orders.[76] "Crawford telephoned his orders to his Chicago broker about midnight on April 15 and again at 8:30 in the morning of the 16th, with instructions to buy at the opening of the Midwest Stock Exchange that morning."[77] Coates placed his telephone order with his son-in-law Haemisegger shortly after leaving the Texas Gulf Sulphur press conference around 10:20 A.M. on the 16th; Haemisegger and his customers also purchased 1,500 additional shares shortly before 10:20 A.M. on April 16.[78] A third insider, who was not a party to the appeal, acted after the news appeared over the Dow Jones

71. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 856 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

72. *Id.* at 854–55. Indeed, the Court aggressively suggested that "the common law standard of deceptive conduct has been modified in the interests of broader protection for the investing public so that negligent insider conduct has become unlawful." *Id.*

73. *See, e.g.*, United States v. Teicher, 987 F.2d 112, 120 (2d Cir. 1993) (suggesting that "knowing possession" is sufficient to trigger insider trading liability, without any proof of a "causal connection" to the trade); SEC v. Adler, 137 F.3d 1325, 1340 (11th Cir. 1998) (requiring the SEC to prove that material nonpublic information was "used in the trade," which could be inferred from an "insider's possession of material nonpublic information at the time of a trade"); United States v. Smith, 155 F.3d 1051, 1067 (9th Cir. 1998) (finding that "the weight of authority supports a 'use' requirement"); *see also* Regulation FD Proposing Release, *supra* note 22, at 72,600.

74. *See* 17 C.F.R. § 240.10b5-1(b) (providing that "a purchase or sale of a security of an issuer is 'on the basis of' material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale").

75. *See* 17 C.F.R. § 240.14e-3(a) (prohibiting trading in possession of material information relating to a tender offer if the trader "knows or has reason to know" the information is nonpublic and has been acquired from certain transaction participants); United States v. O'Hagan, 521 U.S. 642, 666–77 (1997).

76. *Texas Gulf Sulphur*, 401 F.2d at 853.

77. *Id.*

78. *Id.* at 847, 853–54.

broad tape.[79]

While Coates was "absolved" by the district court because the announcement had already been made,[80] the Second Circuit showed little sympathy. The court opined that even if "the contents of the official release could instantaneously be acted upon, at the minimum Coates should have waited until the news could reasonably have been expected to appear over the media of widest circulation."[81] More importantly, "where a formal announcement to the entire financial news media had been promised in a prior official release known to the media, all insider activity must await dissemination of the promised official announcement."[82]

Obliquely, the court recognized that merely completing the mechanics of disclosure might not be enough, and that a "reasonable waiting period"[83] might be necessary for markets to digest the information disclosed. Discussing the fate of the third insider, the court noted "in passing that, where the news is of a sort which is not readily translatable into investment action, insiders may not take advantage of their advance opportunity to evaluate the information by acting immediately upon dissemination."[84] This question, "the permissible timing of insider transactions after disclosures of various sorts," the court deferred to the expertise of the SEC, in the hope that it would utilize its rule-making power "in the future to provide some predictability of certainty for the business community."[85]

The SEC has never acted on the court's entreaty. Instead, citing *Texas Gulf Sulphur*, the SEC has maintained that "[i]nformation is nonpublic if it has not been disseminated in a manner making it available to investors generally,"[86] and that information is deemed published only once it is effectively "disseminated and absorbed" by the market.[87] Meanwhile, courts have taken the lead in enmeshing theories of market efficiency into Rule 10b-5 actions in deciding when information is "impounded" into the market price in an efficient market regardless of efforts at public

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79. *Id.* at 854 n.18.

80. *Id.* at 854 (citing SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 288–89 (S.D.N.Y. 1966), *aff'd in part, rev'd in part*, 401 F.2d 833 (2d Cir. 1968) ("Since TGS's announcement had been made when Coates telephoned Haemisegger, he did not violate Section 10(b) or Rule 10b-5.")).

81. *Texas Gulf Sulphur*, 401 F.2d at 854.

82. *Id.*

83. *Id.* at 854 n.18.

84. *Id.*

85. *Id.*

86. Selective Disclosure and Insider Trading, 65 Fed. Reg. at 51,721 (citing *Texas Gulf Sulphur*, 401 F.2d at 854).

87. SEC Release Notice, *In re* Faberge, Inc., Release No. 10174 (May 25, 1973), 1973 WL 149283, at *6 (noting that "meaningful public disclosure" requires both that information is "disseminated in a manner calculated to reach the securities [marketplace] in general through recognized channels of distribution, and public investors must be afforded a reasonable waiting period to react to the information"); *see* Bradley J. Bondi & Steven D. Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J.L. & BUS. 151, 170 (2011) (describing the SEC's steadfast adherence to the "dissemination and absorption" theory).

disclosure.[88] As such, much like the "truth on the market" defense in securities fraud actions,[89] defendants may well have to make educated guesses about the effectiveness of "disclosure" when trading on the basis of material information.

Professor Bromberg counseled that "[f]or the cautious insider, waiting for the morning newspaper to carry the information is almost certainly safe" and that "waiting for fifteen minutes after the tape runs is probably sufficient."[90] Scholars have not been able to find much better guidance in the ensuing years; as Bondi and Loftchie note, "[o]ver the last two decades, courts have found that periods for information to become public range from [fifteen] minutes, to a day, or even several days after the information has been released."[91] Moreover, the SEC has suggested, citing *Texas Gulf Sulphur*, that the "nature and complexity of information" may require an even longer period.[92]

V. THE LEGACY OF *TEXAS GULF SULPHUR*

As a rule for guiding insider trading policy, *Texas Gulf Sulphur*'s influence has arguably waned considerably. U.S. Supreme Court jurisprudence has chosen to hinge insider trading liability on the deception of information producers, rather than expectations of information users,[93] and the SEC has followed suit in its own rulemaking.[94] As a principle of regulatory policy, however, *Texas Gulf Sulphur* remains just as relevant—and controversial—today as it did in 1968.

If the Securities Act articulated a vision of "full and fair disclosure," and the Exchange Act one of "fair and honest markets," *Texas Gulf Sulphur* has infused the SEC's corporate disclosure and market structure policy with an admittedly "utopian dream of information parity among

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88. *See, e.g.*, United States v. Libera, 989 F.2d 596, 601 (2d Cir. 1993) (noting that once "information is fully impounded in price, such information can no longer be misused by trading because no further profit can be made.").

89. *See* Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 516 (7th Cir. 1989) (noting that "[p]rompt incorporation of news into stock price is the foundation for the fraud-on-the-market doctrine and therefore supports a truth-on-the-market doctrine as well").

90. ALAN BROMBERG ET AL., BROMBERG & LOWENFELS ON SECURITIES FRAUD § 6:236 (2d ed. 2017) (quoted in Billard v. Rockwell Int'l Corp., 526 F. Supp. 218, 220 (S.D.N.Y. 1981), *aff'd*, 683 F.2d 51 (2d Cir. 1982)).

91. Bondi & Lofchie, *supra* note 87, at 172.

92. Commission Guidance on the Use of Company Web Sites, Release No. 58288, 73 Fed. Reg. 45,862, 45,867–68 (Aug. 7, 2008) (codified at 17 C.F.R. pts. 241 & 271) (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 854 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969)).

93. *See* United States v. Newman, 773 F.3d 438, 448–49 (2d Cir. 2014), *abrogated by* Salman v. United States, 137 S. Ct. 420 (2016) ("Although the Government might like the law to be different, nothing in the law requires a symmetry of information in the nation's securities markets"); *see also supra*, note 5.

94. *See* 17 C.F.R. § 240.10b5-1(a) (prohibiting trading on the basis of material nonpublic information "in breach of a duty of trust or confidence that is owed . . . to the issuer . . . or the shareholders of that issuer, or to any other person who is the source" of the information).

investors,"[95] but one that continues to capture the popular imagination as new and bedazzling asymmetries of information are cultivated and mined for profit.[96] The sparring opinions of the *Texas Gulf Sulphur* court were not blind to the implications of their bold statement, as well as the relative institutional competence of courts, legislators and regulators "to bring some semblance of order by means of workable rules and regulations" in the areas of disclosure policy and insider trading.[97] Perhaps one day, the SEC's information policy will outpace developments in information technology by developing principles for anticipating and addressing permissible and impermissible information asymmetry. Until then, *Texas Gulf Sulphur* will occupy a prominent place in law school casebooks and curricula and inspire new generations of securities lawyers and scholars to consider the implications of information dissemination for market integrity.

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95. James D. Cox, *Insider Trading and Contracting: A Critical Response to the 'Chicago School'*, 1986 DUKE L.J. 628, 631 (1986).
96. *See generally* MICHAEL LEWIS, FLASH BOYS: A WALL STREET REVOLT (2014).
97. *See Texas Gulf Sulphur*, 401 F.2d at 889 (Moore, J., dissenting).