# DELIVERING STRATEGIC SOLUTIONS ACCA'S 2000 ANNUAL MEETING

May 8, 2000

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

**Re:** ***Selective Disclosure (File No. S7-31-99)***

Dear Mr. Katz:

The Committee on Federal Regulation of Securities of the Business Law Section of the American Bar Association appreciates the opportunity to comment on the Securities and Exchange Commission's proposed rules regarding selective disclosure (Regulation FD). These comments have been prepared by members of the Committee and of the Section's Ad Hoc Committee on Public Company Information Practices, and a draft of this letter was circulated for comment among members of these Committees and the chairs and vice-chairs of the subcommittees and task forces of the Committee on Federal Regulation of Securities, the officers of that Committee, the members of the Advisory Committee of that Committee and the officers of the Section. This letter generally represents the views of those members of the Committees who have reviewed the letter in draft form. However, this letter does not represent the official position of the American Bar Association, the Section or the Committees, nor does it necessarily reflect the views of all of those who have reviewed it.

While we understand the Commission's objective of curtailing the selective dissemination of material information to the disadvantage of retail investors and support efforts to broaden access to information, we are concerned that the rulemaking approach proposed by the Commission, even though appearing to be purposefully measured, could have a pervasive impact on corporate information practices and runs a significant risk of chilling the accelerating pace of information flow to the markets. This would be an unfortunate outcome because the Commission's informal efforts to draw attention to the problems of selective disclosure have prompted a trend toward broader dissemination of information to investors.

The Commission must address and balance two core issues in its assessment of proposed Regulation FD. First, the securities markets benefit greatly from a constant flow of informal communications between issuers and analysts or investors. The revolution in information technology has broadened dramatically the rapid access of all investors to these communications. Broad dissemination of information to analysts and other market participants who are in a position to digest and evaluate the information increases market transparency and efficient pricing. We are concerned that there is significant risk that imposition of a new regulatory disclosure regime will impair, not enhance, the flow of valuable information.

On the other hand, the Commission is correct that the integrity of the securities markets is impaired when issuers disclose unquestionably material information selectively to market participants who then use it to take advantage of other market participants. We note that the Commission has initiated few enforcement actions arising from the improper selective disclosure of material, nonpublic information in issuer/analyst situations. At present, the Commission feels that it is constrained from initiating such cases and that the requirements for tipper/tippee liability developed by the Supreme Court fit poorly in the context of informal issuer communications. The question for the Commission is whether by rulemaking it can craft a targeted, workable remedy for improper selective disclosures without causing disruption to the dissemination of beneficial information (or whether other measures can achieve the Commission's objectives).

We appreciate the importance of both of these core issues and understand the Commission's concerns. However, we believe that (a) the case has not been made that Regulation FD is needed and (b) in its proposed form, there are significant shortcomings in Regulation FD. While we are not persuaded that any new rule is appropriate, we make suggestions to address these shortcomings should the Commission nevertheless proceed with the rulemaking. We include, as Appendix A, several illustrative situations which we believe demonstrate the difficulties of proposed Regulation FD, its far-reaching impact and its potential disrupting effect on corporate information flow. As a preliminary matter, we urge the Commission to consider that its concerns may be better addressed through SEC interpretative releases and private initiatives.

## I. Proposed Regulation FD

Proposed Regulation FD would mandate that whenever an issuer discloses material, nonpublic information, that issuer must make public disclosure of that information. If the disclosure is "intentional," the public disclosure must be made at least "simultaneously"; if the disclosure is inadvertent, public disclosure must be made promptly and in any case within 24 hours of a senior official becoming aware of the inadvertent disclosure. For purposes of the rule, an issuer would "make disclosure" through a press release "containing that information through a widely circulated news or wire service, a Form 8-K filing with the Commission or other means likely to disseminate such information broadly to the marketplace." Proposed Regulation FD does not, by its terms, create an affirmative duty for public companies to release all material information to the marketplace. It is only invoked when an issuer provides material, nonpublic information outside the context of normal periodic reports filed with the Commission.

In proposing Regulation FD, the Commission stated that it was "troubled by the many reports of selective disclosure and the potential impact of this practice on market integrity." We do not countenance selective disclosure that seeks to provide an informational advantage to selected market participants, and we regularly counsel our clients to refrain from engaging in selective disclosure and to publicly disseminate material information that may have been selectively disclosed. But we question whether the abuses are so extensive as to justify a new regulatory regime, as proposed by the Commission, that would intrude on the information practices of all public companies.

The Commission's assertion of the existence of a problem is based primarily upon anecdotal evidence. There is a noticeable absence of any relevant economic or similar study evaluating either the breadth and market impact of selective disclosure activity or the consequences of proposed Regulation FD on corporate information practices and market transparency. We believe a new regulatory regime with the far-reaching impact of proposed Regulation FD, and that departs so dramatically from past regulatory policy, should be undertaken, if at all, only upon a more solid foundation.

The Commission's decision to propose rulemaking stems, in large measure, from some of the difficulties it has experienced in the past in prosecuting selective disclosure as illegal "tipping" under the antifraud

provisions of the securities laws. Under the law that was established in the Supreme Court's *Dirks* decision, a tipping violation of the antifraud provisions of the federal securities laws can only be proven if the Commission demonstrates that (1) the speaker breached a fiduciary duty in communicating material, nonpublic information, (2) the person receiving the information knew of the breach and (3) the speaker received some improper personal benefit from imparting the information. The proposing release concedes that the Commission has initiated enforcement actions involving selective disclosure rarely and expresses the concern that "many have viewed *Dirks* as affording considerable protection to insiders who make selective disclosures to analysts, and to the analysts (and their clients) who receive selectively disclosed information."

## II. Concerns Over Proposed Regulation FD

### A. The Current State of Informal Corporate Communication Practices

To place our concerns about Regulation FD in context, it is important to outline the informal channels of information flow that now permeate the marketplace. We have had two parallel information regimes that have worked well to make the U.S. securities markets the most efficient and best informed markets in the world. These regimes are the Commission's regulated system, based primarily on the Exchange Act periodic reporting requirements, and the informal information system in which issuers communicate directly to investors and the marketplace through such means as press releases, analyst conference calls, investor conferences, one-on-one calls, individual investor meetings and, with the advent of the information technology revolution, company websites. This informal system is highly complex and multi-faceted, and has been regulated primarily through the general antifraud and insider trading provisions. To comply with these provisions and maintain credibility with investors, most issuers are intensely aware of the need to avoid selective disclosure. However, in order to facilitate the free flow of information under this informal system for the benefit of investors and the marketplace as a whole, difficult judgments are made on a real time basis on what information is material and whether it should be withheld or disseminated broadly.

The informal information system has developed and works because it has not been overregulated, but has been permitted to evolve against the backdrop of general antifraud and insider trading regulation applied on a case by case basis, taking into account changing circumstances. The importance of this evolution has never been greater given the rapid changes taking place in communication methods.

Quarterly analyst conference calls, investor conferences and "one-on-one" meetings and conversations with senior management are an integral part of the manner in which issuers communicate with the market and in which analysts, both buy-side and sell-side, and investors obtain information for evaluation and the exercise of investment judgment. The National Investor Relations Institute ("NIRI") conducted a 1998 survey of 227 public companies which indicated that 82 percent conducted analyst conference calls, a significant increase from 61 percent in a comparable 1995 survey. The same survey also found that 82 percent of these companies disseminated their quarterly financial results on their Internet websites.

Issuers are now taking advantage of technological advances to provide greater access to these forums. A February 2000 NIRI survey of 225 public companies found that nearly half of the respondents that were conducting analyst conference calls were broadcasting them live over the Internet on a real time basis. In total, of those companies that conduct conference calls, 82 percent allow investors real time access, a *51 percent increase* from just two years ago. Additionally, this survey found that 74 percent permitted the media access to these calls, a *60 percent increase* from two years ago. NIRI projects that these figures will increase this year to 90 percent of public companies allowing individual investors real time access to conference calls and 86 percent allowing the media such access. These figures are a powerful demonstration that public companies, on their own initiative, are eliminating many of the

problems of selective disclosure that apparently motivated the Commission to propose Regulation FD and are broadly disseminating information at an accelerating pace.

Analysts and institutional investors play a key role in the informal information system, and understanding that role is critical to evaluating regulatory policy in this area. "Sell-side" analysts typically are affiliated with broker-dealer firms and use their expertise and industry knowledge to provide proprietary investment information to customers and potential customers of the firm. The field is highly competitive and a heavy premium is placed on the validity of that information. Accordingly, sell-side analysts (i) ferret out information about companies, both from company officials and other sources, (ii) digest and analyze the information, along with information about other companies, the industry and the general economy, and (iii) disseminate that information to customers and others. Although this information is targeted to customers of the firm, as a result of electronic financial news services and the Internet, sell-side analysts' reports quickly become widely available to the marketplace. Obviously, there is no perfect equality in access to this information, but no system (even the Commission's regulated system) can produce total equality, and the disparity in access to the information provided by sell-side analysts has been rapidly shrinking.

"Buy-side" analysts typically work for institutional investors, such as mutual fund complexes. They engage in the same activities as sell-side analysts, but do so on behalf of a particular investor. Accordingly, their information does not get the same wide dissemination as that of sell-side analysts. However, it is important to bear in mind the role of the institutional investors in the investment system. They are the vehicle through which millions of retail investors invest. These retail investors entrust their funds to the institutions because of their ability to obtain and evaluate information and therefore apply their expertise and knowledge for the benefit of the retail investor. It is through these institutions that the retail investors benefit from the corporate information flow. The market as a whole benefits from the more efficient pricing that takes place through the investment decisions of these institutional investors.

To date, the absence of intrusive regulation has allowed this informal channel to evolve into an important source of information to the marketplace. Rather than taking action that will discourage the flow of information to analysts and institutional investors, the Commission should be encouraging issuers to provide such information, as long as it is done sufficiently broadly and on a basis that does not discriminate in favor of only certain of these investors.

### B. Uncertainty of the Materiality Standard

A significant concern regarding Regulation FD centers on its reliance on materiality. This is one of the most amorphous concepts in the securities laws. As a general principle, information is "material" if "there is a substantial likelihood that a reasonable person would consider it important." This is a difficult, subjective analysis; it is even more difficult when made on a real time basis. Indeed, in Staff Accounting Bulletin ("SAB") No. 99, issued last August, the Commission's Staff cautioned that, while traditional quantitative measures may form part of the analysis, qualitative considerations must be weighed carefully as well. SAB No. 99 notes, for example, that "the demonstrated volatility of the price of a registrant's securities in response to certain types of disclosures may provide guidance as to whether investors regard quantitatively small misstatements as material." The breadth of this standard, in our view, will make materiality judgments required by Regulation FD more difficult and will expose companies to after-the-fact assessments of their materiality judgments. The combined impact of these effects will be to discourage communication.

While it is true that issuers always have to make materiality assessments, the context relevant to proposed Regulation FD is different. When an issuer makes materiality judgments in preparing a registration statement or periodic report, or even a press release, the assessment is made in a controlled

setting with active assistance of advisors. When public company spokespersons engage in rapid "real time" communications with analysts and institutional investors on an almost continuous basis, however, they must make snap materiality judgments under often probing, difficult circumstances. Even when a materiality judgment by a company is made after careful consideration (*e.g.* when an analyst call is scripted ahead of time), market reaction may reflect an unanticipated assessment of the materiality of the information once it is received by analysts and the marketplace. For example, an analyst might simply be so impressed with a technical demonstration of a new product during a site visit or an investor conference that she issues a strong buy recommendation thereby moving the price of the company's shares (*See* hypothetical 1 in the attached Appendix A). In itself, the demonstration would not likely be considered material new information by management, but the import of SAB 99 may facilitate after the fact allegations due to the market's positive reaction to the information.

It is also true that issuers currently must make materiality judgments in their contacts with analysts. Regulation FD, however, would change the environment by imposing an affirmative regulatory obligation on issuers and creating an express remedy for the Commission's Staff to revisit these judgments. For public companies engaged in continuous contacts with analysts and the financial press, the risk of an SEC enforcement action in the rapidly moving information environment may have the effect of chilling communications with analysts and the marketplace. Given the proven volatility that issuers face when they fail to adequately communicate information to the marketplace, such a chilling of the flow of "real time" information, for fear of making incorrect materiality judgments or inadvertently stumbling into a required public disclosure, could have unfortunate economic consequences for issuers, as well as depriving the markets of valuable, timely information.

**C. Difficulties of Compliance**

In proposing Regulation FD, the Commission expressly acknowledges that in complying with the regulation, corporate officials "may feel compelled to consult with counsel more frequently about their ability to respond to questions from analysts and investors." In particular, the Proposing Release suggests that such consultations would assist corporate officials in making difficult materiality judgments. However, this suggestion is a difficult one to implement due to the nature of corporate communications with analysts and institutional investors. In the current marketplace, information flow to these persons often occurs on a rapid, real-time basis. Corporate investor relations officials must often "think on their feet" and make snap materiality judgments. For example, a question and answer session during a conference call may give a corporate official only seconds to make a materiality judgment. In this environment, it is highly impractical to consult with counsel regarding whether the information being revealed is material. Counsel would essentially have to be constantly available to ensure that investor relations officials do not inadvertently reveal material, nonpublic information, a highly impractical and prohibitively expensive solution.

Even if it is practical to have legal counsel in every analyst meeting, or on the line whenever an investment relations person answers an analyst call, it is impossible to expect the lawyer to make an informed, nuanced materiality judgment "on the fly," with no time to ask relevant questions or consult precedent, and it would be a very unsatisfactory disclosure environment if analyst calls and meetings were subjected to interruption or adjournment in order to make an informed materiality judgment. Furthermore, it would be difficult for a corporate official to seek the advice of counsel on each question posed during an analyst conference call or at an investor conference. Such a consultation might itself attach undue significance to the answer, causing listeners to draw misleading conclusions, resulting in greater instability and misinformation in the marketplace.

We are unpersuaded by arguments in defense of the proposal that enforcement action is only likely in egregious cases. First, initiation of enforcement actions is unpredictable. The assumption that future enforcement officials will exercise conservative prosecutorial judgment is not a sound basis on which to

launch new regulations. As important, our members who counsel clients as to compliance with federal securities laws do so on a basis that promotes careful compliance and without reference to an enforcement "lottery." Regulation premised on less than careful compliance is not sound policy because it runs the risk of (i) eroding the self-policing aspect of our securities regulatory system which is an important foundation of our market's integrity or (ii) resulting in uneven and inconsistent compliance. Finally, as detailed further in Section II(H) infra, any restraint exercised by the Commission in enforcement of Regulation FD will not be matched by the plaintiffs' bar in parlaying filings or other public disclosures under Regulation FD into private claims alleging securities fraud.

**D. Problem of Interference with Ordinary Business Communications**

Public companies, in the course of conducting their day-to-day operations, must often share material, nonpublic information with third parties. Examples of such communications include negotiations with lenders, labor unions, government agencies, credit rating agencies and counter-parties in transactions. It is not common practice, or in many such cases even feasible, to obtain explicit confidentiality agreements. (*See* hypotheticals [2, 3, 4] in the attached Appendix A). Many counter-parties, and most governmental bodies, rating agencies and the financial press simply will not enter into express confidentiality agreements. Under proposed Regulation FD, an issuer would be required to publicly disseminate "material" information furnished in such circumstances, and its failure to do so could make it the target of an enforcement action for selectively revealing material, nonpublic information. As a result, issuers will face an unacceptable burden in conducting their ordinary business communications while they attempt to comply with proposed Regulation FD. This result probably was not intended by the Commission, but the rule as proposed provides no exclusion for such business communications.

**E. Problem of Unintended Disclosures**

Under proposed Regulation FD, public companies that make unintentional disclosures of material, nonpublic information must promptly (within 24 hours of a senior official becoming aware of the unintentional disclosure) make a public disclosure in a Form 8-K filing with the SEC or widely disseminate such information. This situation can arise in a number of contexts. For example, a CFO might accidentally reveal unreleased segment earnings information while fielding a question during an analyst conference call. The market significance of this information may not be immediately apparent.

Given the short time in which they would have to remedy the inadvertent release of nonpublic information, companies would be required to make difficult materiality judgments under unreasonable time pressure. In order to avoid being second-guessed by the SEC later, issuers may feel compelled to disclose information before the issuer is prepared to make that disclosure. For example, if some aspect of the company's previously unreleased quarterly earnings is released during a conference call, the company may be forced under Regulation FD either to release that one aspect out of context or to prematurely disclose the entire earnings report of the company in a Form 8-K filing or press release, even though the Company's internal review, and the auditor's SAS No. 71 review, are not completed. This is particularly troublesome if a company has not yet completed its own analysis of its earnings, forcing possible future restatements of earnings by the company if the numbers later prove to be incorrect. Similarly, a response to an analyst's, stockholder's or reporter's question at a meeting that is not open to all could trigger a public disclosure to comply with Regulation FD. The result is likely to be that companies will be reluctant to schedule individual or small group meetings with analysts, financial reporters or even stockholders. This would seriously impair the flow of information and damage corporate investor relations programs. If a company goes ahead with such contacts, and an inadvertent "material" disclosure is made, the resulting general disclosure by Form 8-K filing or press release may cause the information's apparent importance to be blown out of proportion to its real significance and induce unjustified market volatility. We fear that these risks will cause companies to significantly cut back on existing informal communications, a step backward in getting information to the marketplace.

## F. Adverse Consequences of Non-Compliance

The above discussion indicates the difficult compliance problems we believe Regulation FD presents. Compounding our concerns are the draconian consequences that could result from even an inadvertent failure to file a required Form 8-K or Form 6-K if a general public disclosure has not been made in compliance with Regulation FD. Several of the Commission's other rules and forms, such as Rule 144 and Forms S-2, S-3, S-8 and F-3, condition their use on the issuer being timely and current in filing its Exchange Act reports. Accordingly, as described in footnote 56 of the Proposing Release, a failure to file or make alternative public disclosure, or a late filing or disclosure, pursuant to the requirements of Rule 100 of Regulation FD would result in an issuer being unable to file a Form S-3 or F-3 for an offering of its securities.

A failure to file or publicly disclose also could preclude an issuer from using Form S-8 for an offering of securities under an employee benefit plan and officers and directors and other holders of restricted securities from selling their securities under Rule 144. Given the imprecise nature of the required determinations under Regulation FD, we believe such consequences are inappropriate. Additional difficulty is created by the permissible use of alternative means of public dissemination, other than a Form 8-K or 6-K, to satisfy Rule 100. For example, if an issuer takes advantage of one of these other means of dissemination and it is later determined that the dissemination did not satisfy the requirements of proposed Rule 101(e), it is not clear whether the issuer was timely in its filing requirements. This raises the question of whether Section 5 violations occurred in connection with registration statements that were filed relying on incorporation by reference or affiliate or restricted securities resales were incorrectly made in reliance on Rule 144.

The "file or otherwise publicly disclose" requirement is highly problematic for an "intentional" selective disclosure, as well as for one that is "unintentional." In the intentional situation, a failure to file or otherwise publicly disseminate, *at the same time as the selective disclosure*, arguably can *never* be cured. Thus, the violation could be viewed as having been immediately and irrevocably established and the loss of access to Forms S-3 and S-8, and Rule 144, may occur with no opportunity for cure. This is an unacceptable result, particularly when the SEC will be making judgments as to possible violations long after they have occurred and long after companies have proceeded with short form prospectuses, or affiliates have made Rule 144 sales, believing that the company was in compliance with its reporting obligations under Section 13(a). The situation is hardly ameliorated for "unintentional" disclosures, where the company and its officers have only 24 hours to assess the situation, seek legal advice and make the filing or other disclosure.

## G. Problems under the Securities Act of 1933

The Proposing Release acknowledges that Regulation FD implicates the Securities Act of 1933 ("Securities Act"), and the Commission has proposed a new Rule 181 to deal with these concerns. The concerns arise because a disclosure made to satisfy the requirements of Regulation FD may be deemed to be an "offer" of the issuer's securities for purposes of Section 5 of the Securities Act and the required dissemination may be a "prospectus." While proposed Rule 181 addresses this concern once an issuer files a registration statement, it does not address the period during which a reporting company is planning an offering, nor does it address the problems created if an issuer is conducting a private or Regulation S offering.

The interplay of the Commission's policies on roadshows for registered offerings, which circumscribes the permitted audience, and the requirements of Regulation FD place public issuers in a difficult position. On the one hand, if they are to market their offering through traditional means, they must limit the audience; on the other hand, if they limit the audience, under Regulation FD they must limit the information they provide or be prepared to give it broad dissemination.

Another Securities Act problem derives from the automatic incorporation by reference of Form 8-K filings into an issuer's Form S-2, S-3 or F-3 filing, and the consequent Securities Act liabilities associated with such filings. A Form 8-K filed to comply with Regulation FD will be prepared under intense time pressure and may have to contain disclosures the issuer did not plan to make. The incorporation by reference of this filing into the issuer's registration statement will increase the issuer's exposure to liability.

**H. Private Rights of Action**

The Commission states that it has based proposed Regulation FD on the reporting rather than the antifraud provisions of the federal securities laws (and has stated that it does not intend to create a new private right of action). The reality, however, is that the proposed rule contemplates Commission enforcement actions alleging that there has been (a) an intentional or knowing (b) failure to disclose (c) material information that (d) should have been disclosed pursuant to an SEC rule. In practical terms, this provides a roadmap for a prima facie case for a private action claiming violation of the antifraud provisions of the federal securities laws because all of the elements of a violation of Section 10(b) and Rule 10b-5 under the Exchange Act will have been established, except for the elements of a purchase or sale and of reliance, which the courts may presume under the fraud on the market theory. Additionally, the rule may cause courts to revisit, and expand, the duty to update as a predicate for issuer antifraud liability. This expansion in liability would come in the wake of, and be at cross purposes with, Congressional actions to circumscribe private antifraud actions.

**III. Alternatives to Rulemaking**

Instead of promulgating rules that could chill the flow of information to the marketplace, impose additional compliance costs on all public issuers and potentially increase liability, the Commission should focus attention on how public companies can institute best practices to avoid the selective disclosure of material, nonpublic information. Technological advances, as outlined above, can facilitate the elimination of this problem. As an alternative to rulemaking, we urge the Commission to consider an approach that leaves Regulation FD pending while private sector organizations — including issuer organizations, investor relations and analyst groups, investors, bar groups such as the ABA and other market participants — use this opportunity to develop "best practices" guidelines for issuer communications and promote their adoption. This private initiative approach instigated by the Commission has worked well before. It is also evident that the Commission's efforts to date have produced tangible improvement in issuer conduct. There is no reason why this success cannot be expanded.

**IV. Specific Comments on Regulation FD**

If, despite the significant issues raised above, the Commission proceeds to adopt some form of Regulation FD, then we urge the Commission to consider changes to the rule. While, for the reasons discussed above, we do not believe new rulemaking is necessary or desirable, some of the rule's unintended effects could be ameliorated if the following changes were made.

**First, the Commission should narrow Regulation FD's focus to communications addressed directly to analysts and market participants by senior management.** As outlined above, the proposed rule reaches many routine business communications that are entirely proper and have not been areas of major concern with respect to selective disclosure. For these routine contacts, traditional insider trading principles (including the misappropriation theory) can address any improper use of information. To eliminate any uncertainty about the scope of Regulation FD, the rule should be limited to market participants, *i.e.*, analysts and institutional investors. Further, the rule should apply only to equity analysts since bond analysts have not been the source of problems and this limitation would

avoid having to address materiality distinctions for purposes of bonds compared to stock (for example, merely because a company discloses a new product development to a bond analyst which may be material to the equity markets, that should not trigger a disclosure obligation when the information is unlikely to be material in the bond market).

The proposed rule also should be limited to communications made by senior management and those employees authorized to speak on behalf of the company to analysts and market participants. Unauthorized communications of material, nonpublic information by lower-level employees typically should not bring the company within the ambit of Regulation FD.

**Second, Regulation FD's definitions should identify the types of information that should be disseminated broadly.** Materiality remains one of the most amorphous concepts in the federal securities laws. The discussion above and the examples in Appendix A underscore that simply stating that a materiality analysis applies opens many good faith disclosures to difficult real time decision-making and probing after-the-fact reviews. While SAB No. 99 professes to articulate no new standard, it provides ample basis for uncertainty in the application of Regulation FD. This is particularly true when materiality assessments can be driven, after-the-fact, by marketplace volatility that coincides with, and may — or may not — be related to, a purported selective disclosure of information.

We believe that Regulation FD's definitions should include a section (f) that identifies the type of information that typically should be disseminated broadly. This includes, for example, (a) earnings information after a fiscal quarter has closed; (b) warnings of an anticipated earnings shortfall expected to impact the market; (c) significant changes in the issuer's relationship with a customer that accounts for more than ten percent of issuer's gross revenue; (d) the resignation of the issuer's chief executive officer or other key management personnel; (e) significant regulatory or legal proceedings that could impair at least ten percent of the issuer's assets; (f) resignation or termination of the issuer's independent auditors; and (g) defaults of significant loan covenants and events of a similar magnitude.

Much of the uncertainty under Regulation FD would be ameliorated if this list were exclusive and set the scope of the disclosure requirement. If the Commission is not prepared to provide an exclusive list, the rule should not be based on a general "materiality" standard. Rather, recognizing that Regulation FD is a reporting rule, the Commission should adopt a different concept with a more appropriate threshold, qualifying that standard with a list of the types of information typically covered in this context. Even if the rule and the adopting release simply made clear that the enumerated items represent the type of information the Commission would expect to be broadly disseminated, some of the concern — and potential chilling effect of Regulation FD — from the inherent uncertainty of the materiality concept might be lessened.

Simply put, the Commission needs to better address the inherent uncertainty of the materiality concept before adopting a rule that expressly requires materiality judgments with hair trigger timing.

**Third, an adopting release should provide a clear and precise picture of the type of conduct Regulation FD is intended to curtail.** Typically, when the Commission develops a new rule (or refines an existing rule) to redress a specific form of misconduct, it offers a fairly detailed picture of the conduct involved. By contrast, Regulation FD's Proposing Release makes only general observations about the selective disclosure of material, nonpublic information.

Based on our discussions with the SEC's staff, we believe that there are certain practices at which Regulation FD is aimed. These practices typically involve both disclosures of information in circumstances in which there can be no question about the materiality of the information involved and disclosures in settings specifically prone to selective disclosure — such as closed analyst conference calls and investment bank investor conferences. By providing a clearer picture of the type of conduct

Regulation FD is intended to curtail, the Commission can provide guidance and help circumscribe the expansive reach of the proposal.

The Commission should make it clear that it is *not* seeking to regulate routine business disclosures or day to day interactions with analysts and the financial press.

**Fourth, transmission of an analyst conference call over the Internet should be deemed adequate simultaneous disclosure for purposes of Regulation FD.** Increasing numbers of issuers are making their quarterly analyst conference calls available through simultaneous "webcasts." These transmissions allow all investors to access the meeting at the same time on a more effective and cost efficient basis than telephone conference calls, which have limitations on the number of callers that can be accommodated and can be costly. Formally incorporating this concept into the rule would serve to accelerate the pace at which information technology serves to level the playing field among investors in the capital markets. In order to facilitate that process, Regulation FD should mandate that notice be provided generally of the conference call (and notice should be sufficient if placed on the issuer's website at the same time it is provided to selected participants).

**Fifth, the requirement of public dissemination should be qualified by a recognition of the circumstances of individual issuers.** As currently drafted, Regulation FD provides that information can be broadly disseminated (a) through a press release carried through a "widely circulated news or wire service," (b) a filing on Form 8-K (or Form 6-K) or (c) disseminated "through any other method of disclosure that is reasonably designed to provide broad public access to the information." The rule must take into account that smaller issuers often have difficulty attracting attention in the marketplace. As is the case in other aspects of the securities laws, the assessment of the adequacy of disclosure practices must be company-specific. This could be achieved by qualifying the dissemination requirement to efforts that are "reasonable under the circumstances of the issuer involved and the market for its securities."

Given the prevalent use of company websites to provide information to investors and the investor population's broad and expanding access to the Internet, the rule should recognize posting on a company website as sufficient dissemination for purposes of Regulation FD. This would help address the problem of smaller issuers. It would also ameliorate some of the difficulties of Regulation FD because issuers would find it easier to post information on their websites and will be more comfortable doing so. Access to information on the Internet, whether on a company's website or other readily accessible websites, has become more effective dissemination than traditional hard copy and print media publication.

A flexible standard of public dissemination will achieve the Commission's objective of fostering broad-based disclosure without imposing another burdensome filing requirement on issuers. We do not believe a Form 8-K filing should be mandated for all cases to which Regulation FD would apply. Historically, issuance of a press release has been considered adequate public dissemination, with filing of a Form 8-K required only for specified types of significant information. A Form 8-K filing requirement would add an even greater compliance burden on issuers and prompt them to take a narrower view of the applicability of Regulation FD than if they were able to select the method of public dissemination. Furthermore, it would convert Regulation FD from a rule targeted at discouraging selective disclosure to an equal-access rule. The trend of informal information practices has been toward open analyst calls, and this trend can be expected to accelerate if open calls are deemed to constitute adequate dissemination. Conversely, if a filing requirement is imposed regardless of whether the call is open, there would be little incentive to open the call. Furthermore, a requirement to file a transcript of the call would discourage these calls because such a filing would convert a spontaneous oral conversation into a permanent written record, with expanded liability exposure and more onerous standards for obtaining a liability safe harbor.

**Sixth, Regulation FD should regulate only intentional selective disclosure.** The conduct the Commission has focused on is when persons deliberately provide an informational advantage to one part of the marketplace. The rule should be targeted at that conduct, with "intentional" defined to mean "pre-planned." Attempting to regulate inadvertent disclosures only adds complexity and additional burdens to the rule while inviting after-the-fact assessments of good-faith judgments. The Commission could address issues surrounding inadvertent disclosures interpretively in the adopting release, and influence issuer conduct that way.

If the Commission determines, nonetheless, to attempt to cover inadvertent disclosures, a requirement that the Company make a public disclosure within 24 hours after becoming aware of the inadvertent disclosure will be impractical. We suggest, instead, that issuers be required to disseminate the information "promptly" and the adopting release should note that, typically, a prompt release will be made within two business days. For Section 13(d) filings, the Commission has required "prompt" amendments to filings. A fixed time deadline does not provide sufficient flexibility to address different situations and issuers. The Commission also should make clear, as we believe is intended, that "promptly" is measured from the time a senior official becomes aware not only of the disclosure but that it was material and nonpublic.

It also would assuage some concerns over the problems of compliance with Regulation FD if the Commission included a specific good faith defense. In other words, there would be no violation of the rule if an issuer's representatives did not in good faith believe that selectively disclosed information was material. A specific good faith defense would be analogous to the safe harbor for forward-looking statements in Section 27E(c) of the Exchange Act which provides expressly that a person shall not be liable for false or misleading forward-looking statements unless such statements are made with "actual knowledge" that they were false or misleading. The adoption of the safe harbor language is particularly appropriate because many of the sensitive issues involved in informal issuer communications involve predictive statements by an issuer's senior management.

**Seventh, a provision should be added to Regulation FD providing that a failure, in the absence of the specified public dissemination, to file a Form 8-K or 6-K will not make an issuer untimely in filing its required Exchange Act reports.** The purpose of the timely filing requirements is to ensure that an issuer has completed mandated periodic reports. This is a fixed requirement that can be monitored efficiently by the company and its advisors. Practical difficulties will arise at a number of levels if an issuer and its advisors, not to mention underwriters and their counsel, must assess whether any disclosures were required and not made under Regulation FD in the year preceding the short-form registration or the Rule 144 sale. This uncertainty would impair the efficiency of the capital raising process without advancing the objectives of Regulation FD.

Additionally, Form 8-K filings under Regulation FD should be permitted under item 5 (Other Events) rather than as a separate item in order to avoid an issuer having to identify the disclosure as a "material" disclosure under Regulation FD. Also, as discussed above, to eliminate Securities Act liability concerns, the submission should not be treated as "filed" and incorporated by reference into the issuer's registration statements unless the issuer elects to treat it as "filed."

**Eighth, proposed Rule 181 should be expanded to apply to pre-filing disclosures and to private and offshore offerings (*i.e.* such disclosures shall not be "general solicitation" or "directed selling efforts").** The Proposing Release specifically solicits comment on whether the Commission "should also adopt an exemption from liability under Section 5(c) of the Securities Act for communications made before the filing of a registration statement." We believe that without such an exemption, Regulation FD is unworkable. An issuer should not have to delay a necessary financing simply because Regulation FD has forced it to make a disclosure relating to anticipated earnings or a new product. Because Regulation FD would apply only to public companies, the concerns about extending the

exemption to communications prior to filing a registration statement should not be as great as in an IPO. These issuers would be filing periodic reports and so required information would be available. The rule can address abusive situations by including a preliminary note that it does not apply to devices to avoid the registration requirements.

As discussed above, there are difficult issues created by the interplay of Regulation FD and the Securities Act when an issuer is conducting a securities offering. These difficulties focus some of the problems we have with the Regulation FD proposal. However, should the Commission decide nevertheless to proceed with its adoption, we believe that, with the expansion of Rule 181, the proposal correctly addresses the interplay with the Securities Act. As noted above, we believe the exclusion of pre-IPO communications is an appropriate practical approach. These companies are not yet public, a greater level of interaction with analysts and investors is necessary in the IPO context to arrive at appropriate pricing judgments and the immediate after-market has the benefit of the intensive prospectus preparation and review process. To the extent there are issues regarding the scope of information provided in IPO roadshows outside the prospectus, these should be dealt with as part of the general review of public offering roadshow practices.

However, in the case of public companies, we agree with the suggestion of Commissioner Hunt that communications in connection with securities offerings be excluded from Regulation FD because the issues involved in the interplay with the Securities Act need further consideration and, possibly, should be addressed in the broader context of permissible communications during securities offerings. Because public companies currently consider selective disclosure issues in public and private securities offerings, we would recommend that the Commission make clear that an exclusion for communications during securities offerings only applies to the dissemination requirements of Regulation FD and does not affect any other obligations that might exist regarding selective disclosure.

**Finally, the Commission should ameliorate the litigation concerns associated with Regulation FD.** In the Proposing Release, the Commission simply notes that because Regulation FD is promulgated pursuant to Section 13(a) of the Exchange Act, "no private liability will result from an issuer's failure to file or make public disclosures." As noted above, we believe the proposed rule could present significant new private litigation exposure. If Regulation FD is adopted, and the Commission really does not intend to subject those who violate Regulation FD to antifraud liability, the Commission should use its exemptive authority under the National Securities Markets Improvement Act of 1996 ("NSMIA") to provide that violations of Regulation FD will not provide a basis for liability under the antifraud provisions of the Exchange Act and the Securities Act and that a Form 8-K filing or other public dissemination under Regulation FD is not an admission of the failure to disclose material, nonpublic information.

NSMIA gave the Commission broad exemptive authority under both statutes. In particular, the authority granted to the Commission under Section 105 of NSMIA permits it to "exempt any persons, security, or transactions, or any class or classes of persons, securities, or transactions" from the various provisions of the securities laws provided "that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." The elimination of spurious and abusive litigation certainly falls within the public interest and, by using its exemptive authority, the Commission can achieve this goal.

## V. Conclusion

Selective disclosure is a familiar topic to securities practitioners and one on which we regularly counsel clients. There is considerable uncertainty in both the law and the regulatory climate and that uncertainty makes this a difficult area. We support the Commission's efforts to educate issuers and others about this issue and improve issuer public information practices. However, we believe that the

Commission's efforts to craft a regulatory regime in this highly complex and multi-faceted area will impede the healthy flow of information in the marketplace, increase market volatility, impair capital formation and increase liability risks. We urge the Commission to consider whether initiatives other than rulemaking could shape the practices that the Commission hopes to foster. If a rule must be adopted, this is a context in which we strongly believe that a much more narrowly-crafted rule would be critical. Any such rule should focus specifically on intentional selective disclosure of clearly material information by senior management to analysts and market professionals.

If the Commission should decide to proceed with rulemaking in this area, in view of the scope of the changes we believe necessary (as outlined in this letter), we recommend that the Commission should consider seeking additional comments before taking final action. The members of our Committees are available to discuss these comments at your convenience and to participate in ongoing efforts to foster best practices in information dissemination.

Respectfully submitted,

________________________________

Stanley Keller

Chair, Committee on Federal Regulation of Securities

________________________________

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cc: The Honorable Arthur Levitt, Chairman

The Honorable Paul R. Carey, Commissioner

The Honorable Isaac C. Hunt, Jr., Commissioner

The Honorable Norman S. Johnson, Commissioner

The Honorable Laura S. Unger, Commissioner

Harvey J. Goldschmid, Senior Special Counsel to the Chairman

David M. Becker, General Counsel

David B.H. Martin, Director, Division of Corporation Finance

## APPENDIX A — HYPOTHETICALS

The following hypothetical fact situations are derived from real-life counseling issues routinely faced by securities lawyers. In each instance, they demonstrate how Regulation FD, as presently drafted, will complicate further an already difficult area. The hypotheticals also demonstrate how regulatory uncertainty could chill information flow to the marketplace.

> 1. Company A has been a leader in its industry. It sees its industry stabilizing and has been developing a new technology-based, Internet-focused product that builds on, but goes beyond, its traditional product line. It has followed a policy of communications with the analyst and financial communities, holding quarterly earnings calls, presenting at investment banking seminars, holding one-on-one meetings with key institutions, hosting an annual, all-day analyst/institutional investor conferences and responding on an individual basis to inquiries. There are two key analysts in the industry and a number of other analysts who follow the Company.
>
> Company A has recently begun to make its quarterly earnings calls open to investors by transmitting them live on its website. It also permits investors to dial in to the call on a listen only basis but does not publish the call-in number because of the expense involved to accommodate a large number of call-ins. It has also posted on its website a replay of its most recent analyst conference presentation (without the Q&A period, which was somewhat disjointed). It has also followed a policy of issuing its earnings press release shortly before the quarterly call and it recently issued a press release contemporaneous with an analyst/investor meeting disclosing growth forecasts and revenue targets it planned to include as part of its larger presentation, which included technical demonstrations.
>
> Following a recent analysts conference (which was webcast) by Company A, there was the usual post-presentation milling around and questioning, with small groups of analysts (and possibly representatives of institutions and the media) questioning in separate clusters the CEO, COO, CFO and investor relations officer. Although they were each prepped on what they should say, they have different approaches to dialogues with outsiders and different senses of materiality. When debriefed, they all vigorously disclaimed providing any material information beyond what was covered in the presentation. The next day, a story ran in the Internet version of *The Wall Street Journal* that gave revenue forecasts beyond those given in the presentation.
>
> *Is this selective disclosure within the meaning of Regulation FD? Is it intentional? Does*

*the Internet "publication" obviate any selective disclosure concerns?*

2. Company A is seeking to negotiate a strategic acquisition, which has been kept confidential. Company A's investment banker on its own leaks to a media source word about the discussions as a way to bring pressure on the target.

*Is the Company responsible for this selective disclosure? If so, is it too late to comply with Regulation FD?*

3. Company A officials have a meeting to brief regulators who have to give key approvals for the new development. In the course of the briefing, material nonpublic information is disclosed to the regulators. When asked to sign a confidentiality agreement, the regulators point out the applicable Freedom of Information Act and state that they have no authority to enter into such an agreement.

*Has the Company violated Regulation FD if it cannot enter a confidentiality agreement?*

4. The CEO of Company A has preliminary discussions with his counterpart at another company regarding a possible merger of equals. Because of their relationship they share material nonpublic information prior to any confidentiality agreements being signed.

*Has the Company violated Regulation FD?*

5. Company A's investor relations officer fields a call from one of the key industry analysts who is seeking comfort on her new report on Company A. She asks the officer if she would be embarrassed by the report as currently drafted. The officer reminds her that it is Company A's policy not to give comfort on analyst's estimates but that she might want to consider whether she has taken into account sufficiently the potential delays in developing and implementing the new product line strategy. As a result, the analyst reduces her estimates.

*Has the Company made an intentional disclosure of material information? Must the Company disseminate this information broadly?*

6. Company B's investor relations manager receives a call from a brokerage firm analyst, who regularly follows Company B, about four weeks before the end of a fiscal quarter, just before Company B enters its quarter end "quiet period". The analyst asks: "have you changed your guidance on revenues, gross margins, tax burden or capital expectations since the general analyst conference after the last quarterly earnings release?" The investor relations manager says, "no . . . we have not." In his brokerage firm's morning call the next day, the analyst tells brokers in his firm, "Company B is still on target for a strong quarter. I am raising my recommendation from buy to strong buy". Company B's stock goes up 2 points, from $6 to $8 a share.

*Has the Company made an intentional or inadvertent selective disclosure? What is the Company required to do under Regulation FD?*

7. Company C receives a draft analyst report from a leading, highly influential industry analyst. Company C follows a policy — a very common policy according to NIRI — of reviewing analyst reports for factual accuracy but not commenting on analyst estimates. The report indicates that the analyst believes Company C has dramatically increased market share in its e-commerce business segment. This is a true statement so Company C does not correct or comment on it, but Company C knows the report is likely to send its

stock price up sharply.

*Must the Company make a public disclosure before the analyst report is issued?*

8. An analyst who follows Company E telephones the head of investor relations at Company E and asks if he can have a tour and briefing at a new Company E factory that is going to produce a new, high speed silicon chip. He also asks to meet with the product line manager to discuss the technical specifications for the chip and some possible applications. The chip, and its approximate speed, have been publicly announced, but this analyst has far more technical knowledge than most investors or investment managers, so will ask more thoughtful and more technical questions. His research report, when issued, will be very influential because of his reputation for making the right call on market potential for new semiconductor products. The head of investor relations has to decide whether it is permissible to grant the analyst's request or whether any interview of the product line manager must be conducted on a conference call open to all analysts, press and investors. (If this is required, Company E will simply not have any such briefings because its experience is that technical issues cannot be discussed in open calls without great risk of some of the listeners getting things wrong and making erroneous reports.)

*May Company E's head of investor relations grant the analyst's request without a significant risk of implicating Regulation FD?*

9. Company F officials met with the analysts and fund managers of a major fund complex and gave a presentation on its new product line and its prospects, which was generally consistent with Company F's public statements. Although Company F sought a confidentiality agreement from the fund, they were told it was against fund policy. Company F officials nevertheless decided to stay and proceed with the meeting. In response to probing questioning, they got into detail about regulatory issues, which the fund officials, because of their experience with the industry, were able to interpret as positive developments.

*Has Company F violated Regulation FD?*

10. The CEO of Company G met with an existing institutional investor to explore with it, on a preliminary basis, the investor's reaction to a possible management leveraged buyout at a premium. Before the subject of the meeting was discussed, the CEO requested a confidentiality agreement, which was declined. He then advised the investor that he was providing it with nonpublic information which might make it an insider. The investor indicated that it would reach its own conclusion on whether it was free to buy or sell Company G shares.

*Has Company G violated Regulatory FD or can it assume that there was a relationship of trust and confidence?*

11. Company H's CEO is named business leader of the year by a trade magazine that covers the company. She is interviewed for a cover story profiling her and her company. She makes very general, but also very positive statements about Company D's prospects in the interview that were not previously publicly disclosed. When Company H receives a courtesy advance copy of the story, it sees that the CEO's highly positive statements have been coupled with comments of analysts and others who know the company to support the story's thesis that the company is "going to knock the cover off the ball" in FY 2000.

*What if the publication was Time Magazine, The Wall Street Journal, CNN, Bloomberg News? Has Company H violated Regulation FD or has there been adequate public dissemination?*

12. Company I has followed the practice of holding analyst conference calls immediately following the release of its earnings report. The call is announced by a fax sent to Company I's investor relations list consisting of industry analysts, investment bankers, interested institutional investors and financial news media, totaling about 200 persons. A day or two after the call, Company I posts a transcript of the call (without the Q&A session) on its website. In the most recent call, the CEO gave specific guidance on Company I's expected growth for year 2000. In response to a question, he gave general guidance on Company F's expectations for 2001. Following the call, Company I's stock rose from 25 to 28.

*Has Company I violated Regulation FD in conducting this call which was open to a large number of market participants and media, but not simultaneously open to everyone? Once the transcript is on its website must Company I do anything further? Must the Q&A session be included to comply with Regulation FD?*

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