



409 What Can You Say & When-Guidance to Give to Your CEO & CFO

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Faculty Biographies

Douglas K. Chia

Douglas K. Chia is senior counsel and assistant corporate secretary at Johnson & Johnson, the world's most broadly based health care company, headquartered in New Brunswick, New Jersey. His responsibilities include providing legal counsel to the corporation on matters of corporate governance, securities regulation, public company disclosure, and Sarbanes-Oxley act compliance.

Prior to joining Johnson & Johnson, Mr. Chia was assistant general counsel, corporate at Tyco International. In private practice, Mr. Chia was an associate at the law firms of Simpson Thacher & Bartlett and Clifford Chance, practicing in the New York and Hong Kong offices of each firm. While in private practice, Mr. Chia provided legal counsel to issuers and underwriters on securities offerings and cross-border transactions.

Mr. Chia is a member of ACC and the Society of Corporate Secretaries & Governance professionals.

Mr. Chia received his A.B. from Dartmouth College and his J.D. from the Georgetown University Law Center.

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Session 409: What Can You Say & When — Guidance to Give to Your CEO & CFO

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ACC's 2005 Annual Meeting: Legal Underdog to Corporate
Superhero—Using Compliance for a Competitive Advantage

October 17-19, Marriott
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Public company communications are complex and fraught with risk. Recent Regulation FD and similar legislation in Canada and the EU preclude selective disclosure of material information. What guidance should you give your CEO and CFO in their dealings with the press, analysts, rating agencies, and investors while protecting your corporate officers and directors? Experienced general counsel will share how to ethically, legally, and proactively manage public company communications by identifying and resolving disclosure issues before they cost the company time and money.



Communicating With:

External Party	Responsible Department	Regulatory Regime
Analysts/Investors	Investor Relations	Reg. FD
Media	Communications/ Public Relations	Stock Exchange Rules
Ratings Agencies	Treasury	Contractual
Regulators	Legal	Attorney-Client Privilege



External Communications



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Communicating With: Analysts & Investors

Primary Spokespersons:	<ul style="list-style-type: none"> ● CEO ● CFO ● VP for Investor Relations
Regulatory Regime:	<ul style="list-style-type: none"> ● Reg. FD ● Other securities regulations (e.g., Rule 10b-5, Reg. G)
Forums:	<ul style="list-style-type: none"> ● Earnings calls ● Analyst conferences ● One-on-one investor meetings ● Phone inquiries

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Communicating With: Media

Primary Spokespersons:	<ul style="list-style-type: none"> ● CEO ● VP for Media Relations
Regulatory Regime:	<ul style="list-style-type: none"> ● Stock exchange rules ● Securities laws (e.g., <u>Basic v. Levinson</u>)
Forums:	<ul style="list-style-type: none"> ● Press conferences ● Interviews (print & TV) ● Phone inquiries



Communicating With: Rating Agencies

Primary Spokespersons:	<ul style="list-style-type: none"> ● CFO ● Treasurer
Regulatory Regime:	<ul style="list-style-type: none"> ● None (contractual)
Forums:	<ul style="list-style-type: none"> ● Rating agency presentations ● Responses to written requests and surveys ● Phone inquiries



Dangers & Pitfalls

- Selective disclosure
- Wearing different-colored glasses
- Timing
- Tone and body language
- No benefit of hindsight

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Compliance and Role of In-House Counsel

- Importance of:
 - Internal Policies
 - Advance Preparation
 - Post-Event Review
 - Training

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Importance of Internal Policies

- Reg. FD Policy
- Crisis Management Policy
- Designated Spokespersons
- Disclosure Controls and Procedures
- Disclosure Committee

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Importance of Advance Preparation

- Write scripts
- Write Q&A
- Rehearse scripts and Q&A
- Set ground rules
- Have standby press release

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Importance of Post-Event Review

- Conduct debriefing
- Review and keep transcript
- Review and keep press clippings
- Review analyst reports



Importance of Training

- Train new officers
- Conduct periodic refresher training
- Teach self-policing
 - Lawyers won't always be in the room (nor should they be)
 - Even if lawyers are there, that's not always a defense



Supplementary Materials

- Text of Reg. FD
- SEC Adopting Release for Reg. FD
- SEC Q&A on Reg. FD
- Johnson & Johnson Reg. FD Guidelines

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Regulation FD

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Regulation FD--Fair Disclosure

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Reg. § 243.100 -- General Rule Regarding Selective Disclosure

- a. Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in [Rule 101\(e\)](#):
1. Simultaneously, in the case of an intentional disclosure; and
 2. Promptly, in the case of a non-intentional disclosure.
 1. Except as provided in paragraph (b)(2) of this section, paragraph (a) of this section shall apply to a disclosure made to any person outside the issuer:
 - i. Who is a broker or dealer, or a person associated with a broker or dealer, as those terms are defined in [Section 3\(a\)](#) of the Securities Exchange Act of 1934;
 - ii. Who is an investment adviser, as that term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); an institutional investment manager, as that term is defined in Section 13(f)(5) of the Securities Exchange Act of 1934, that filed a report on Form 13F with the Commission for the most recent quarter ended prior to the date of the disclosure; or a person associated with either of the foregoing. For purposes of this paragraph, a "person associated with an investment adviser or institutional investment manager" has the meaning set forth in Section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)), assuming for these purposes that an institutional investment manager is an investment adviser;
 - iii. Who is an investment company, as defined in Section 3 of the Investment Company Act of 1940, or who would be an investment company but for Section 3(c)(1) or Section 3(c)(7) thereof, or an affiliated person of either of the foregoing. For purposes of this paragraph, "affiliated person" means only those persons described in Section 2(a)(3)(C), (D), (E), and (F) of the Investment Company Act

- of 1940, assuming for these purposes that a person who would be an investment company but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 is an investment company; or
- iv. Who is a holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information.
2. Paragraph (a) of this section shall not apply to a disclosure made:
- i. To a person who owes a duty of trust or confidence to the issuer (such as an attorney, investment banker, or accountant);
 - ii. To a person who expressly agrees to maintain the disclosed information in confidence;
 - iii. To an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available; or
 - iv. In connection with a securities offering registered under the Securities Act, other than an offering of the type described in any of [Rule 415\(a\)\(1\)\(i\)-\(vi\)](#).

Definitions**Reg. § 243.101 This section defines certain terms as used in Regulation FD (Rule 100 through Rule 103).**

- a. *Intentional.* A selective disclosure of material nonpublic information is "intentional" when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic.
- b. *Issuer.* An "issuer" subject to this regulation is one that has a class of securities registered under [Section 12](#) of the Securities Exchange Act of 1934, or is required to file reports under [Section 15\(d\)](#) of the Securities Exchange Act of 1934, including any closed-end investment company (as defined in Section 5(a)(2) of the Investment Company Act of 1940), but not including any other investment company or any foreign government or foreign private issuer, as those terms are defined in [Rule 405](#) under the Securities Act.
- c. *Person acting on behalf of an issuer.* "Person acting on behalf of an issuer" means any senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser), or any other officer, employee, or agent of an issuer who regularly communicates with any person described in [Rule 100\(b\)\(1\)\(i\)](#), (ii), or (iii), or with holders of the issuer's securities. An officer, director, employee, or agent of an issuer who discloses material

Regulation FD

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.

- d. *Promptly*. "Promptly" means as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange) after a senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser) learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.
- e. *Public disclosure*.
 1. Except as provided in paragraph (e)(2) of this section, an issuer shall make the "public disclosure" of information required by [Rule 100\(a\)](#) by furnishing to or filing with the Commission a [Form 8-K](#) disclosing that information.
 2. An issuer shall be exempt from the requirement to furnish or file a Form 8-K 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.
- f. *Senior official*. "Senior official" means any director, executive officer (as defined in Rule 3b-7 of this chapter), investor relations or public relations officer, or other person with similar functions.
- g. *Securities offering*. For purposes of [Rule 100\(b\)\(2\)\(iv\)](#):
 1. *Underwritten offerings*. A securities offering that is underwritten commences when the issuer reaches an understanding with the broker-dealer that is to act as managing underwriter and continues until the later of the end of the period during which a dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated);
 2. *Non-underwritten offerings*. A securities offering that is not underwritten:
 - i. If covered by [Rule 415\(a\)\(1\)\(x\)](#), commences when the issuer makes its first bona fide offer in a takedown of securities and continues until the later of the end of the period during which each dealer must deliver a prospectus or the sale of the securities in that takedown (unless the takedown is sooner terminated);
 - ii. If a business combination as defined in Rule 165(f)(1), commences when the first public announcement of the transaction is made and continues until the completion of the vote or the expiration of the tender offer, as applicable (unless the transaction is sooner terminated);
 - iii. If an offering other than those specified in paragraphs (a) and (b) of this section, commences when the issuer files a registration statement and continues until the later of the end of the period during which each dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated).

Reg. § 243.102 No Effect on Antifraud Liability

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Regulation FD

No failure to make a public disclosure required solely by 243.100 shall be deemed to be a violation of Rule 10b-5 under the Securities Exchange Act.

Reg. § 243.103 No Effect on Exchange Act Reporting Status

A failure to make a public disclosure required solely by 243.100 shall not affect whether:

- a. For purposes of Forms [S-2](#), [S-3](#), [S-8](#) under the Securities Act, an issuer is deemed to have filed all the material required to be filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) or, where applicable, has made those filings in a timely manner; or
- b. There is adequate current public information about the issuer for purposes of 230.144(c) of this chapter (Rule 144(c)).

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U.S. Securities and Exchange Commission

Final Rule: Selective Disclosure and Insider Trading

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 243, and 249

Release Nos. 33-7881, 34-43154, IC-24599, File No. S7-31-99

RIN 3235-AH82

Selective Disclosure and Insider Trading

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting new rules to address three issues: the selective disclosure by issuers of material nonpublic information; when insider trading liability arises in connection with a trader's "use" or "knowing possession" of material nonpublic information; and when the breach of a family or other non-business relationship may give rise to liability under the misappropriation theory of insider trading. The rules are designed to promote the full and fair disclosure of information by issuers, and to clarify and enhance existing prohibitions against insider trading.

EFFECTIVE DATE: The new rules and amendments will take effect October 23, 2000.

FOR FURTHER INFORMATION CONTACT: Richard A. Levine, Sharon Zamore, or Jacob Lesser, Office of the General Counsel at (202) 942-0890; Amy Starr, Office of Chief Counsel, Division of Corporation Finance at (202) 942-2900.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today is adopting new rules: Regulation FD,¹ Rule 10b5-1,² and Rule 10b5-2.³ Additionally, the Commission is adopting amendments to Form 8-K.⁴

I. Executive Summary

We are adopting new rules and amendments to address the selective disclosure of material nonpublic information by issuers and to clarify two issues under the law of insider trading. In response to the comments we received on the proposal, we have made several modifications, as discussed below, in the final rules.

Regulation FD (Fair Disclosure) is a new issuer disclosure rule that addresses selective disclosure. The regulation provides that when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information. The timing of the required public disclosure depends on whether the selective disclosure was intentional or non-intentional; for an intentional selective disclosure, the issuer must make public disclosure simultaneously; for a non-intentional disclosure, the issuer must make public disclosure promptly. Under the regulation, the required public disclosure may be made by filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public.

Rule 10b5-1 addresses the issue of when insider trading liability arises in connection with a trader's "use" or "knowing possession" of material nonpublic information. This rule provides that a person trades "on the basis of" material nonpublic information when the person purchases or sells securities while aware of the information. However, the rule also sets forth several affirmative defenses, which we have modified in response to comments, to permit persons to trade in certain circumstances where it is clear that the information was not a factor in the decision to trade.

Rule 10b5-2 addresses the issue of when a breach of a family or other non-business relationship may give rise to liability under the misappropriation theory of insider trading. The rule sets forth three non-exclusive bases for determining that a duty of trust or confidence was owed by a person receiving information, and will provide greater certainty and clarity on this unsettled issue.

II. Selective Disclosure: Regulation FD

A. Background

As discussed in the Proposing Release,⁵ we have become increasingly concerned about the selective disclosure of material information by issuers. As reflected in recent publicized reports, many issuers are disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public. Where this has happened, those who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of

Selective Disclosure and Insider Trading

those kept in the dark.

We believe that the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets. Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.

Issuer selective disclosure bears a close resemblance in this regard to ordinary "tipping" and insider trading. In both cases, a privileged few gain an informational edge -- and the ability to use that edge to profit -- from their superior access to corporate insiders, rather than from their skill, acumen, or diligence. Likewise, selective disclosure has an adverse impact on market integrity that is similar to the adverse impact from illegal insider trading: investors lose confidence in the fairness of the markets when they know that other participants may exploit "unerodable informational advantages" derived not from hard work or insights, but from their access to corporate insiders.⁶ The economic effects of the two practices are essentially the same. Yet, as a result of judicial interpretations, tipping and insider trading can be severely punished under the antifraud provisions of the federal securities laws, whereas the status of issuer selective disclosure has been considerably less clear.⁷

Regulation FD is also designed to address another threat to the integrity of our markets: the potential for corporate management to treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors. As noted in the Proposing Release, in the absence of a prohibition on selective disclosure, analysts may feel pressured to report favorably about a company or otherwise slant their analysis in order to have continued access to selectively disclosed information. We are concerned, in this regard, with reports that analysts who publish negative views of an issuer are sometimes excluded by that issuer from calls and meetings to which other analysts are invited.⁸

Finally, as we also observed in the Proposing Release, technological developments have made it much easier for issuers to disseminate information broadly. Whereas issuers once may have had to rely on analysts to serve as information intermediaries, issuers now can use a variety of methods to communicate directly with the market. In addition to press releases, these methods include, among others, Internet webcasting and teleconferencing. Accordingly, technological limitations no longer provide an excuse for abiding the threats to market integrity that selective disclosure represents.

To address the problem of selective disclosure, we proposed Regulation FD. It targets the practice by establishing new requirements for full and fair disclosure by public companies.

1. Breadth of Comment on the Proposal

Selective Disclosure and Insider Trading

The Proposing Release prompted an outpouring of public comment -- nearly 6,000 comment letters.⁹ The vast majority of these commenters consisted of individual investors, who urged -- almost uniformly -- that we adopt Regulation FD. Individual investors expressed frustration with the practice of selective disclosure, believing that it places them at a severe disadvantage in the market. Several cited personal experiences in which they believed they had been disadvantaged by the practice.¹⁰ Many felt that selective disclosure was indistinguishable from insider trading in its effect on the market and investors, and expressed surprise that existing law did not already prohibit this practice.

Other comments suggested that today's self-directed, online investors do not expect to rely exclusively on research and analysis performed by professionals, as was more common in the past. With advances in information technology, most notably the Internet, information can be communicated to shareholders directly and in real time, without the intervention of an intermediary. This online revolution has created a greater demand, expectation, and need for direct delivery of market information. As many individual commenters noted, under this paradigm, analysts still provide value for investors by using their education, judgment, and expertise to analyze information. On the other hand, investors are rightly concerned with the use of information gatekeepers who merely repeat information that has been selectively disclosed to them.

Noting that analysts predominantly issue "buy" recommendations on covered issuers, investors also made the point that current selective disclosure practices may create conflicts of interest; analysts have an incentive not to make negative statements about an issuer if they fear losing their access to selectively disclosed information. Thus, these commenters suggested that a rule against selective disclosure could lead to more objective and accurate analysis and recommendations from securities analysts.

We also received numerous comments from securities industry participants, issuers, lawyers, media representatives, and professional and trade associations. Almost all of these commenters agreed that selective disclosure of material nonpublic information was inappropriate and supported our goals of promoting broader and fairer disclosure by issuers. Some of these commenters believed the proposal was a generally appropriate way to address the problem of selective disclosure. Many others, however, expressed concerns about the approach of Regulation FD and suggested alternate methods for achieving our goals or recommended various changes to the proposal.

2. Need for Regulation

One fundamental issue raised by these commenters was whether Regulation FD is necessary. Some commenters stated that there is limited anecdotal evidence of selective disclosure. Others suggested that it appears that issuer disclosure practices are generally improving, so that we should refrain from

rulemaking at this time, and instead permit practices to evolve and encourage voluntary adherence to "best practices" of disclosure. We do not agree with these views.

It is, of course, difficult to quantify precisely the amount of selective disclosure -- just as it is difficult to quantify precisely the amount of ordinary insider trading. Incidents of selective disclosure, like insider trading, by definition are not conducted openly and in public view. Nevertheless, we have noted numerous media reports in the past two years alleging selective, exclusionary disclosure practices.¹¹ More generally, surveys of practices of issuer personnel indicate significant acknowledgement of the use of selective disclosure of material information.¹² Based on these public reports, as well as our staff's experience, it is clear to us that the problem of selective disclosure is not limited, as some commenters have suggested, to just a few isolated incidents.

Some commenters cited a February 2000 NIRI survey suggesting an improvement in issuer disclosure practices, in that most issuers responding to the survey now are opening certain of their conference calls to individual investors.¹³ To the extent this demonstrates voluntary improvement in response to our efforts to focus attention on the problem,¹⁴ we believe this is a positive development. However, these voluntary steps, while laudable, have been far from fully effective. We note, for example, that all of the public reports of selective disclosure cited above occurred after the Commission had begun to focus public attention on issuer selective disclosure. Some occurred even after we proposed Regulation FD. This suggests that the problematic practices targeted by Regulation FD are continuing to occur. Finally, the overwhelming support from investors for Regulation FD demonstrates a strong perception among the investing public that selective disclosure is a significant problem, and shows a corresponding need to prohibit this practice in order to bolster investor confidence in the fairness of the disclosure process.

Some commenters contended that rulemaking on this topic was an inappropriately broad response to the issue.¹⁵ They suggested instead that we use existing tools (namely, the law of insider trading) to bring individual enforcement actions in those cases that appear to involve significant selective disclosures. While we have considered this approach -- and of course we remain free to bring such cases where a selective disclosure does violate insider trading laws -- we do not agree that this is the appropriate response to the legal uncertainties posed by current insider trading law. In other contexts, we have been criticized for attempting to "make new law" in an uncertain area by means of enforcement action and urged instead to seek to change the law through notice-and-comment rulemaking. We believe that this rulemaking is the more careful and considered response to the problem presented by selective disclosure.¹⁶

3. Effect of Regulation FD on Issuer Communications

One frequently expressed concern was that Regulation FD would not lead to broader dissemination of information, but would in fact have a "chilling effect" on the disclosure of information by issuers.¹⁷ In the view of these commenters, issuers would find it so difficult to determine when a disclosure of information would be "material" (and therefore subject to the regulation) that, rather than face potential liability and other consequences of violating Regulation FD, they would cease informal communications with the outside world altogether.¹⁸ Some of these commenters therefore recommended that the Commission not adopt any mandatory rule prohibiting selective disclosure, like Regulation FD, but instead pursue voluntary means of addressing the problem, such as interpretive guidance, or the promotion of a "blue ribbon" panel to develop best practices for issuer disclosure. Other commenters recommended various ways that Regulation FD could be made narrower or more well-defined, in order to ameliorate some of the concerns about chilling. Other commenters, however, took issue with the supposition that issuer disclosures would be chilled. As some commenters stated, the marketplace simply would not allow issuers to cease communications with analysts and security holders.¹⁹

We have considered these views carefully. As discussed in the Proposing Release, we are mindful of the concerns about chilling issuer disclosure; we agree that the market is best served by more, not less, disclosure of information by issuers. Because any potential "chill" is most likely to arise -- if at all -- from the fear of legal liability, we included in proposed Regulation FD significant safeguards against inappropriate liability. Most notably, we stated that the regulation would not provide a basis for private liability, and provided that in Commission enforcement actions under Regulation FD we would need to prove knowing or reckless conduct.

4. Revisions to Narrow the Scope of Regulation FD

Nevertheless, to provide even greater protection against the possibility of inappropriate liability, and to guard further against the likelihood of any chilling effect resulting from the regulation, we have modified Regulation FD in several respects.

First, we have narrowed the scope of the regulation so that it does not apply to all communications with persons outside the issuer. The regulation will apply only to communications to securities market professionals and to any holder of the issuer's securities under circumstances in which it is reasonably foreseeable that the security holder will trade on the basis of the information.

Second, we have narrowed the types of issuer personnel covered by the regulation to senior officials and those persons who regularly communicate with securities market professionals or with security holders. The effect of these first two changes is that Regulation FD will not apply to a variety of legitimate, ordinary-course business communications or to disclosures to the media.

Third, to remove any doubt that private liability will not result from a Regulation FD violation, we have revised Regulation FD to make absolutely clear that it does not establish a duty for purposes of Rule 10b-5 under the Securities Exchange Act of 1934 ("Exchange Act"). The regulation now includes an express provision in the text stating that a failure to make a disclosure required solely by Regulation FD will not result in a violation of Rule 10b-5.

Fourth, we have made clear that where the regulation speaks of "knowing or reckless" conduct, liability will arise only when an issuer's personnel knows or is reckless in not knowing that the information selectively disclosed is both material and nonpublic. This will provide additional assurance that issuers will not be second-guessed on close materiality judgments. Neither will we, nor could we, bring enforcement actions under Regulation FD for mistaken materiality determinations that were not reckless.

Fifth, we have expressly provided that a violation of Regulation FD will not lead to an issuer's loss of eligibility to use short-form registration for a securities offering or affect security holders' ability to resell under Rule 144 under the Securities Act of 1933 ("Securities Act"). This change eliminates additional consequences of a Regulation FD violation that issuers and other commenters considered too onerous.

We have made two other significant changes to the scope of Regulation FD, which, while not specifically addressed to concerns about chilling disclosure, narrow its scope. In response to concerns about the interplay of Regulation FD with the Securities Act disclosure regime, we have expressly excluded from the scope of the regulation communications made in connection with most securities offerings registered under the Securities Act. We believe that the Securities Act already accomplishes most of the policy goals of Regulation FD for purposes of registered offerings, and we will consider this topic in the context of a broader Securities Act rulemaking. Also, we have eliminated foreign governments and foreign private issuers from the coverage of the regulation.

With these changes, we believe Regulation FD strikes an appropriate balance. It establishes a clear rule prohibiting unfair selective disclosure and encourages broad public disclosure. Yet it should not impede ordinary-course business communications or expose issuers to liability for non-intentional selective disclosure unless the issuer fails to make public disclosure after it learns of it. Regulation FD, therefore, should promote full and fair disclosure of information by issuers and enhance the fairness and efficiency of our markets.

B. Discussion of Regulation FD

Rule 100 of Regulation FD sets forth the basic rule regarding selective disclosure. Under this rule, whenever:

- (1) an issuer, or person acting on its behalf,

- (2) discloses material nonpublic information,

- (3) to certain enumerated persons (in general, securities market professionals or holders of the issuer's securities who may well trade on the basis of the information),

- (4) the issuer must make public disclosure of that same information:

- (a) simultaneously (for intentional disclosures), or

- (b) promptly (for non-intentional disclosures).

As a whole, the regulation requires that when an issuer makes an intentional disclosure of material nonpublic information to a person covered by the regulation, it must do so in a manner that provides general public disclosure, rather than through a selective disclosure. For a selective disclosure that is non-intentional, the issuer must publicly disclose the information promptly after it knows (or is reckless in not knowing) that the information selectively disclosed was both material and nonpublic.

We have modified several of the key terms in the regulation that serve to define its precise scope and effect. We discuss the key provisions of the regulation below.

1. Scope of Communications and Issuer Personnel Covered by the Regulation

As proposed, Regulation FD would have applied to any disclosure of material nonpublic information made by an issuer, or person acting on its behalf, to "any person or persons outside the issuer." A number of commenters stated that, as proposed, Regulation FD was too broad in its coverage of disclosures to "any person or persons outside the issuer," and in its definition of "person acting on behalf of an issuer." We are persuaded that these comments have merit, and thus we have modified the scope of the regulation in several respects.

a. Disclosures to Enumerated Persons

Commenters stated that if Regulation FD applied to disclosures made to "any person" outside the issuer, it would inappropriately interfere with ordinary-course business communications with parties such as customers, suppliers, strategic partners, and government regulators.²⁰ In addition, several media organizations and rating agencies commented that the regulation should not apply to disclosures made to the press, or to rating agencies for purposes of securities ratings.²¹ Overall, commenters suggested various ways to narrow the scope of the regulation, including providing specific exclusions for various types of recipients of information,²² or expressly limiting the regulation's coverage to persons such as securities analysts, market

professionals, institutional investors, or others who regularly make or would reasonably be expected to make investment decisions involving the issuer's securities.²³

In response to these comments, we have narrowed the coverage of the final regulation. The regulation is designed to address the core problem of selective disclosure made to those who would reasonably be expected to trade securities on the basis of the information or provide others with advice about securities trading. Accordingly, Rule 100(a) of Regulation FD, as adopted, makes clear that the general rule against selective disclosure applies only to disclosures made to the categories of persons enumerated in Rule 100(b)(1).

Rule 100(b)(1) enumerates four categories of persons to whom selective disclosure may not be made absent a specified exclusion. The first three are securities market professionals -- (1) broker-dealers and their associated persons, (2) investment advisers, certain institutional investment managers²⁴ and their associated persons, and (3) investment companies, hedge funds,²⁵ and affiliated persons.²⁶ These categories will include sell-side analysts, many buy-side analysts, large institutional investment managers, and other market professionals who may be likely to trade on the basis of selectively disclosed information. The fourth category of person included in Rule 100(b)(1) is any holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that such person would purchase or sell securities on the basis of the information. Thus, as a whole, Rule 100(b)(1) will cover the types of persons most likely to be the recipients of improper selective disclosure, but should not cover persons who are engaged in ordinary-course business communications with the issuer, or interfere with disclosures to the media or communications to government agencies.²⁷

Rule 100(b)(2) sets out four exclusions from coverage. The first, as proposed, is for communications made to a person who owes the issuer a duty of trust or confidence -- i.e., a "temporary insider" -- such as an attorney, investment banker, or accountant. The second exclusion is for communications made to any person who expressly agrees to maintain the information in confidence.²⁸ Any misuse of the information for trading by the persons in these two exclusions would thus be covered under either the "temporary insider" or the misappropriation theory of insider trading. This approach recognizes that issuers and their officials may properly share material nonpublic information with outsiders, for legitimate business purposes, when the outsiders are subject to duties of confidentiality.²⁹

The third exclusion from coverage in Rule 100(b)(2) is for disclosures to an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available. As discussed by commenters,³⁰ ratings organizations often obtain nonpublic information in the course of their ratings work. We are not aware, however, of any

incidents of selective disclosure involving ratings organizations. Ratings organizations, like the media, have a mission of public disclosure; the objective and result of the ratings process is a widely available publication of the rating when it is completed. And under this provision, for the exclusion to apply, the ratings organization must make its credit ratings publicly available. For these reasons, we believe it is appropriate to provide this exclusion from the coverage of Regulation FD.

The fourth exclusion from coverage is for communications made in connection with most offerings of securities registered under the Securities Act. We discuss this exclusion in greater detail in Part II.B.6 below.

b. Disclosures by a Person Acting on an Issuer's Behalf

As proposed, Regulation FD defined any "person acting on behalf of an issuer" as "any officer, director, employee, or agent of an issuer, who discloses material nonpublic information while acting within the scope of his or her authority." A number of commenters stated that this definition was too broad and should be limited to "senior officials," to designated or authorized spokespersons, or in some other manner.³¹ One commenter said that the definition should be broader to prevent evasion.³² One commenter stated that if the scope of Regulation FD were limited to disclosures to analysts and institutional investors, then the definition of "person acting on behalf of an issuer" would be appropriate.³³

We have modified slightly the definition of "person acting on behalf of an issuer" to make it more precise. We define the term to mean: (1) any senior official of the issuer;³⁴ or (2) any other officer, employee, or agent of an issuer who regularly communicates with any of the persons described in Rule 100(b)(1)(i), (ii), or (iii), or with the issuer's security holders.³⁵ By revising the definition in this manner, we provide that the regulation will cover senior management, investor relations professionals, and others who regularly interact with securities market professionals or security holders.³⁶ Of course, neither an issuer nor such a covered person could avoid the reach of the regulation merely by having a non-covered person make a selective disclosure. Thus, to the extent that another employee had been directed to make a selective disclosure by a member of senior management, that member of senior management would be responsible for having made the selective disclosure. See Section 20(b) of the Exchange Act. In addition, as was proposed, the definition expressly states that a person who communicates material nonpublic information in breach of a duty to the issuer would not be considered to be acting on behalf of the issuer. Thus, an issuer is not responsible under Regulation FD when one of its employees improperly trades or tips.³⁷

2. Disclosures of Material Nonpublic Information

The final regulation, like the proposal, applies to disclosures of "material

nonpublic" information about the issuer or its securities. The regulation does not define the terms "material" and "nonpublic," but relies on existing definitions of these terms established in the case law. Information is material if "there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision.³⁸ To fulfill the materiality requirement, there must be a substantial likelihood that a fact "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."³⁹ Information is nonpublic if it has not been disseminated in a manner making it available to investors generally.⁴⁰

The use of the materiality standard in Regulation FD was the subject of many comments. Some commenters supported the use of the existing definition of materiality, noting that attempts to define materiality for purposes of Regulation FD could have implications beyond this regulation.⁴¹ Other commenters, however, including securities industry representatives, securities lawyers, and some issuers or issuer groups, stated that using a general materiality standard in the regulation would cause difficulties for issuer compliance.⁴² These commenters claimed that materiality was too unclear and complex a standard for issuer personnel to use in making "real time" judgments about disclosures,⁴³ and that this vagueness would lead to litigation and a chilling effect on corporate disclosure practices.⁴⁴ These commenters offered a variety of recommendations to address this issue.

Some commenters suggested that the regulation include a bright-line standard or other limitation on what was material for purposes of Regulation FD, or identify in the regulation an exclusive list of types of information covered.⁴⁵ While we acknowledged in the Proposing Release that materiality judgments can be difficult, we do not believe an appropriate answer to this difficulty is to set forth a bright-line test, or an exclusive list of "material" items for purposes of Regulation FD. The problem addressed by this regulation is the selective disclosure of corporate information of various types; the general materiality standard has always been understood to encompass the necessary flexibility to fit the circumstances of each case. As the Supreme Court stated in responding to a very similar argument: "A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the securities acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over- or underinclusive."⁴⁶

Other suggestions from commenters included providing more interpretive guidance about types of information or events that are more likely to be considered material. While it is not possible to create an exhaustive list, the following items are some types of information or events that should be reviewed carefully to determine whether they are material: (1) earnings information; (2) mergers, acquisitions, tender offers, joint ventures, or

changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract); (4) changes in control or in management; (5) change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report; (6) events regarding the issuer's securities -- e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and (7) bankruptcies or receiverships.⁴⁷

By including this list, we do not mean to imply that each of these items is per se material. The information and events on this list still require determinations as to their materiality (although some determinations will be reached more easily than others). For example, some new products or contracts may clearly be material to an issuer; yet that does not mean that all product developments or contracts will be material. This demonstrates, in our view, why no "bright-line" standard or list of items can adequately address the range of situations that may arise. Furthermore, we do not and cannot create an exclusive list of events and information that have a higher probability of being considered material.

One common situation that raises special concerns about selective disclosure has been the practice of securities analysts seeking "guidance" from issuers regarding earnings forecasts. When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD. This is true whether the information about earnings is communicated expressly or through indirect "guidance," the meaning of which is apparent though implied. Similarly, an issuer cannot render material information immaterial simply by breaking it into ostensibly non-material pieces.

At the same time, an issuer is not prohibited from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a "mosaic" of information that, taken together, is material. Similarly, since materiality is an objective test keyed to the reasonable investor, Regulation FD will not be implicated where an issuer discloses immaterial information whose significance is discerned by the analyst. Analysts can provide a valuable service in sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions. We do not intend, by Regulation FD, to discourage this sort of activity. The focus of Regulation FD is on whether the issuer discloses material nonpublic information, not on whether an analyst, through some combination of persistence, knowledge, and insight, regards as material information whose significance is not apparent to the reasonable investor.

Finally, some commenters stated that greater protection would be afforded to issuers if we made clear that the regulation's requirement for "intentional" (knowing or reckless) conduct also extended to the judgment of whether the information disclosed was material.⁴⁸ We agree that this clarification is appropriate. As adopted, Rule 101(a) states that a person acts "intentionally" only if the person knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic.⁴⁹ As commenters suggested, this aspect of the regulation provides additional protection that issuers need not fear being second-guessed by the Commission in enforcement actions for mistaken judgments about materiality in close cases.

3. Intentional and Non-intentional Selective Disclosures: Timing of Required Public Disclosures

A key provision of Regulation FD is that the timing of required public disclosure differs depending on whether the issuer has made an "intentional" selective disclosure or a selective disclosure that was not intentional. For an "intentional" selective disclosure, the issuer is required to publicly disclose the same information simultaneously.⁵⁰

a. Standard of "Intentional" Selective Disclosure

Under the regulation, a selective disclosure is "intentional" when the issuer or person acting on behalf of the issuer making the disclosure either knows, or is reckless in not knowing, prior to making the disclosure, that the information he or she is communicating is both material and nonpublic.⁵¹ A number of commenters thought that the distinction between intentional and non-intentional disclosures was appropriate.⁵² Others, however, stated that the "intentional" standard should not include reckless conduct, because of the risk that this standard, in hindsight, could be interpreted as close to a negligence standard.⁵³ Some commenters suggested that there be a safe harbor for good-faith efforts to comply with Regulation FD or for good-faith determinations that information was not material.⁵⁴

After considering these comments, we have determined to adopt the "intentional"/non-intentional distinction essentially as proposed. By creating this distinction, Regulation FD already provides greater flexibility as to the timing of required disclosure in the event of erroneous judgments than do other issuer disclosure provisions under the federal securities laws; it essentially incorporates the knowing or reckless mental state required for fraud into this disclosure provision. Since recklessness suffices to meet the mental state requirement even for purposes of the antifraud provisions,⁵⁵ we believe it is appropriate to retain recklessness in Regulation FD's definition of "intentional" as well. Further, in view of the definition of recklessness that is prevalent in the federal courts,⁵⁶ it is unlikely that issuers engaged in good-faith efforts to comply with the regulation will be considered to have acted recklessly.

As requested by several commenters, moreover, we emphasize that the definition of "intentional" in Rule 101(a) requires that the individual making the disclosure must know (or be reckless in not knowing) that he or she would be communicating information that was both material and nonpublic. Thus, in the case of a selective disclosure attributable to a mistaken determination of materiality, liability will arise only if no reasonable person under the circumstances would have made the same determination.⁵⁷ As a result, the circumstances in which a selective disclosure is made may be important. We recognize, for example, that a materiality judgment that might be reckless in the context of a prepared written statement would not necessarily be reckless in the context of an impromptu answer to an unanticipated question.

b. "Prompt" Public Disclosure After Non-intentional Selective Disclosures

Under Rule 100(a)(2), when an issuer makes a covered non-intentional disclosure of material nonpublic information, it is required to make public disclosure promptly. As proposed, Rule 101(d) defined "promptly" to mean "as soon as reasonably practicable" (but no later than 24 hours) after a senior official of the issuer learns of the disclosure and knows (or is reckless in not knowing) that the information disclosed was both material and nonpublic. "Senior official" was defined in the proposal as any executive officer of the issuer, any director of the issuer, any investor relations officer or public relations officer, or any employee possessing equivalent functions.

Commenters expressed varying views on the definition of "promptly" provided in the rule. Some said that the time period provided for disclosure was appropriate;⁵⁸ others said it was too short;⁵⁹ and still others said that it was too specific, and should require disclosure only as soon as reasonably possible or practicable.⁶⁰ We believe that it is preferable for issuers and the investing public that there be a clear delineation of when "prompt" disclosure is required. We also believe that the 24-hour requirement strikes the appropriate balance between achieving broad, non-exclusionary disclosure and permitting issuers time to determine how to respond after learning of the non-intentional selective disclosure. However, recognizing that sometimes non-intentional selective disclosures will arise close to or over a weekend or holiday, we have slightly modified the final rule to state that the outer boundary for prompt disclosure is the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange, after a senior official learns of the disclosure and knows (or is reckless in not knowing) that the information disclosed was material and nonpublic. Thus, if a non-intentional selective disclosure of material, nonpublic information is discovered after the close of trading on Friday, for example, the outer boundary for making public disclosure is the beginning of trading on the New York Stock Exchange on Monday.

Commenters also expressed differing views on the definition of "senior official" contained in the regulation. We are adopting this definition as

proposed.⁶¹ However, in response to comments, we have provided greater clarity as to when the duty to make "prompt" disclosure begins. The requirement to make prompt disclosure is triggered when a senior official of the issuer learns that there has been a non-intentional disclosure of information by the issuer or a person acting on behalf of the issuer that the senior official knows, or is reckless in not knowing, is both material and non-public.⁶² Similar to the language contained in the definition of "intentional," discussed above, this language is designed to make clear that the requirements of the regulation are only triggered when a responsible issuer official (1) learns that certain information has been disclosed, (2) knows (or is reckless in not knowing) that the information disclosed is material, and (3) knows (or is reckless in not knowing) that the information disclosed is nonpublic.

4. "Public Disclosure" Required by Regulation FD

Rule 101(e) defines the type of "public disclosure" that will satisfy the requirements of Regulation FD. As proposed, Rule 101(e) gave issuers considerable flexibility in determining how to make required public disclosure. The proposal stated that issuers could meet Regulation FD's "public disclosure" requirement by filing a Form 8-K, by distributing a press release through a widely disseminated news or wire service, or by any other non-exclusionary method of disclosure that is reasonably designed to provide broad public access -- such as announcement at a conference of which the public had notice and to which the public was granted access, either by personal attendance, or telephonic or electronic access. This definition was designed to permit issuers to make use of current technologies, such as webcasting of conference calls, that provide broad public access to issuer disclosure events.

Commenters generally favored the flexible approach provided by Rule 101(e). The American Society of Corporate Secretaries and the Financial Executives Institute, among others, agreed that the definition should not stipulate particular means of technology used for public disclosure. Individual investors supported the idea that issuers should open their conference calls to the public through means such as webcasting over the Internet. Some commenters, however, raised the concern that conference calls or webcasts should not be permitted to supplant the use of press releases as means of disclosing material information.⁶³ Others suggested that we provide that an issuer's posting of information on its website should also be considered sufficient Regulation FD disclosure.⁶⁴

After considering the range of comments on this issue, we have determined to adopt a slightly modified definition of "public disclosure" that would provide even greater flexibility to issuers in determining the most appropriate means of disclosure. As adopted, Rule 101(e) states that issuers can make public disclosure for purposes of Regulation FD by filing or furnishing a Form 8-K, or by disseminating 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."

a. Form 8-K Disclosure

Commenters generally opposed the proposed new Item 10 of Form 8-K based, in large part, on a concern that people would construe a separate Item 10 filing as an admission that the disclosed information is material.⁶⁵ In light of the timing requirements for making materiality judgments under Regulation FD, commenters wanted to be able to err on the side of filing information that may or may not be material, without precluding a later conclusion that the information was not material. Commenters recommended amending Item 5 of Form 8-K to include required Regulation FD disclosures.⁶⁶ Some commenters also suggested that Regulation FD submissions on Form 8-K should not be treated as "filed" for purposes of the Exchange Act.

In light of these comments, we provide that either filing or furnishing information on Form 8-K solely to satisfy Regulation FD will not, by itself, be deemed an admission as to the materiality of the information. In addition, while we retain a separate Item, we also are modifying Item 5 of Form 8-K to address commenters' concerns. As revised, issuers may choose either to "file" a report under Item 5 of Form 8-K or to "furnish" a report under Item 9 of Form 8-K that will not be deemed "filed." If an issuer chooses to file the information on Form 8-K,⁶⁷ the information will be subject to liability under Section 18 of the Exchange Act. The information also will be subject to automatic incorporation by reference into the issuer's Securities Act registration statements, which are subject to liability under Sections 11 and 12(a)(2) of the Securities Act. If an issuer chooses instead to furnish the information,⁶⁸ it will not be subject to liability under Section 11 of the Securities Act or Section 18 of the Exchange Act for the disclosure, unless it takes steps to include that disclosure in a filed report, proxy statement, or registration statement. All disclosures on Form 8-K, whether filed or furnished, will remain subject to the antifraud provisions of the federal securities laws.

b. Alternative Methods of Public Disclosure

We are recognizing alternative methods of public disclosure to give issuers the flexibility to choose another method (or a combination of methods) of disclosure that will achieve the goal of effecting broad, non-exclusionary distribution of information to the public.⁶⁹

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

given adequate notice of the conference or call and the means for accessing it. The regulation does not require use of a particular method, or establish a "one size fits all" standard for disclosure; rather, it leaves the decision to the issuer to choose methods that are reasonably calculated to make effective, broad, and non-exclusionary public disclosure, given the particular circumstances of that issuer. Indeed, we have modified the language of the regulation to note that the issuer may use a method "or combination of methods" of disclosure, in recognition of the fact that it may not always be possible or desirable for an issuer to rely on a single method of disclosure as reasonably designed to effect broad public disclosure.

We believe that issuers could use the following model, which employs a combination of methods of disclosure, for making a planned disclosure of material information, such as a scheduled earnings release:

- First, issue a press release, distributed through regular channels, containing the information;⁷⁰
- Second, provide adequate notice, by a press release and/or website posting, of a scheduled conference call to discuss the announced results, giving investors both the time and date of the conference call, and instructions on how to access the call; and
- Third, hold the conference call in an open manner, permitting investors to listen in either by telephonic means or through Internet webcasting.⁷¹

By following these steps, an issuer can use the press release to provide the initial broad distribution of the information, and then discuss its release with analysts in the subsequent conference call, without fear that if it should disclose additional material details related to the original disclosure it will be engaging in a selective disclosure of material information. We note that several issuer commenters indicated that many companies already follow this or a similar model for making planned disclosures.⁷²

In the Proposing Release, we stated that an issuer's posting of new information on its own website would not by itself be considered a sufficient method of public disclosure. As technology evolves and as more investors have access to and use the Internet, however, we believe that some issuers, whose websites are widely followed by the investment community, could use such a method. Moreover, while the posting of information on an issuer's website may not now, by itself, be a sufficient means of public disclosure, we agree with commenters that issuer websites can be an important component of an effective disclosure process. Thus, in some circumstances an issuer may be able to demonstrate that disclosure made on its website could be part of a combination of methods, "reasonably designed to provide broad, non-exclusionary distribution" of information to the public.⁷³

We emphasize, however, that while Rule 101(e) gives an issuer considerable

flexibility in choosing appropriate methods of public disclosure, it also places a responsibility on the issuer to choose methods that are, in fact, "reasonably designed" to effect a broad and non-exclusionary distribution of information to the public. In determining whether an issuer's method of making a particular disclosure was reasonable, we will consider all the relevant facts and circumstances, recognizing that methods of disclosure that may be effective for some issuers may not be effective for others. If, for example, an issuer knows that its press releases are routinely not carried by major business wire services, it may not be sufficient for that issuer to make public disclosure solely by submitting its press release to one of these wire services; the issuer in these circumstances should use other or additional methods of dissemination, such as distribution of the information to local media, furnishing or filing a Form 8-K with the Commission, posting the information on its website, or using a service that distributes the press release to a variety of media outlets and/or retains the press release.

We also caution issuers that a deviation from their usual practices for making public disclosure may affect our judgment as to whether the method they have chosen in a particular case was reasonable. For example, if an issuer typically discloses its quarterly earnings results in regularly disseminated press releases, we might view skeptically an issuer's claim that a last minute webcast of quarterly results, made at the same time as an otherwise selective disclosure of that information, provided effective broad, non-exclusionary public disclosure of the information.⁷⁴ In short, an issuer's methods of making disclosure in a particular case should be judged with respect to what is "reasonably designed" to effect broad, non-exclusionary distribution in light of all the relevant facts and circumstances.

5. Issuers Subject to Regulation FD

Regulation FD will apply to all issuers with securities registered under Section 12 of the Exchange Act, and all issuers required to file reports under Section 15(d) of the Exchange Act, including closed-end investment companies, but not including other investment companies, foreign governments, or foreign private issuers.

As written, proposed Regulation FD would have applied to foreign sovereign debt issuers required to file reports under the Exchange Act. Today's Regulation FD excludes these issuers from coverage. Proposed Regulation FD also would have applied to foreign private issuers. However, the Commission has determined to exempt foreign private issuers at this time as it has in the past exempted them from certain U.S. reporting requirements such as Forms 10-Q and 8-K. Today's global markets pose new regulatory issues. In recognition of this fact, the Commission will be undertaking a comprehensive review of the reporting requirements of foreign private issuers.⁷⁵ In the interim, we remind foreign private issuers of their obligations to make timely disclosure of material information pursuant to applicable SRO rules and policies,⁷⁶ and our expectation that the markets will enforce these obligations. Also, while Regulation FD will not apply, foreign issuers in their disclosure practices remain subject to liability for conduct that violates, and

meets the jurisdictional requirements of, the antifraud provisions of the federal securities laws.⁷⁷

6. Securities Act Issues

a. The Operation of Regulation FD During Securities Offerings

As proposed, Regulation FD would have applied to disclosures made by a reporting company in connection with an offering under the Securities Act. Commenters expressed a number of concerns about tensions they perceived in the interplay of the disclosure requirements of Regulation FD and those of the Securities Act.⁷⁸

With respect to public offerings, commenters worried that a public disclosure mandated by Regulation FD could violate Section 5 of the Securities Act. Section 5 places limitations on the type of disclosures that may be made at various intervals during a registered offering.⁷⁹ Commenters were concerned that public disclosures mandated by Regulation FD would exceed those limitations. Commenters similarly raised concerns about proposed Regulation FD's interrelationship with unregistered offerings of securities. Here, the principal concern was that public disclosure mandated by Regulation FD could conflict with the conditions of the exemption from registration on which the issuer was relying.

i. Registered Offerings Exemption

In light of the comments we have received and our own further consideration, we have determined that our concerns about selective disclosure in connection with registered offerings under the Securities Act should not be addressed by overlaying Regulation FD onto the system of regulation provided by that Act. The mandated disclosure regime and the civil liability provisions of the Securities Act reduce substantially any meaningful opportunity for an issuer to make selective disclosure of material information in connection with a registered offering. We are satisfied that the Securities Act already accomplishes at least some of the policy imperative of Regulation FD within the context of a registered offering. Thus, with limited exceptions, Regulation FD as adopted does not apply to disclosures made in connection with a securities offering registered under the Securities Act.⁸⁰

In reaching this conclusion, we also note that our Division of Corporation Finance is currently involved in a systematic review of the Securities Act disclosure system as it relates to communications during the offering process. To the extent selective disclosure concerns arise in connection with registered offerings of securities, we believe it would be more appropriate to consider that impact in the context of a broader Securities Act rulemaking.

In creating the exclusion for registered offerings, we have defined for purposes of Regulation FD when those offerings are considered to begin and

end.⁸¹ Communications that take place outside the periods clearly specified would not be considered a part of the registered securities offering to which the exemption from Regulation FD applies. Communications that are not made in connection with a registered offering also are not exempt.⁸²

ii. Unregistered Offerings

Unregistered offerings are not subject to the full public disclosure and liability protections that the Securities Act applies to registered offerings. An issuer engaged in an unregistered securities offering does not have the same discipline imposed under the Securities Act to merge material information into its public disclosure. While we have carefully considered the concerns expressed by commenters, we believe that Regulation FD should not provide an exception for communications made in connection with an unregistered offering. We believe that reporting companies making unregistered offerings should either publicly disclose the material information they disclose nonpublicly or protect against misuse of that information by having those who receive it agree to maintain it in confidence.

If a reporting issuer releases material information nonpublicly during an unregistered offering with no such understanding about confidentiality, we believe that disclosure under Regulation FD is appropriate. We believe this even if, as a result of such disclosure, the availability of the Securities Act registration exemption may be in question. Public companies undertaking unregistered offerings will need to consider the impact their selective disclosure could have on any exemption they use. Before an exempt offering begins, issuer's counsel should advise the client of the potential complications that selective disclosure of material nonpublic information could raise.

Issuers who undertake private unregistered offerings generally disclose the information to the investors on a confidential basis. Under Regulation FD, public companies will still have the ability to avoid premature public disclosure in those cases. A public company need not make public disclosure if anyone who receives the material, nonpublic information agrees to maintain that information in confidence.

b. Eligibility for Short-Form Registration and Rule 144

Commenters observed that a failure to file a Form 8-K under Regulation FD when no alternative qualifying public disclosure is made, would result in the loss of availability of short-form Securities Act registration on Forms S-2 and S-3.⁸³ They pointed out that because the proposal did not contain any means to alter that ineligibility, the issuer would be disqualified from using Form S-2 or S-3 for at least a year from the date of the non-compliance with Regulation FD. Commenters also noted that a failure to file a required Form 8-K would render Rule 144 temporarily unavailable for resale of restricted and control securities, and Form S-8 temporarily unavailable for employee benefit plan offerings.⁸⁴ They pointed out that the loss of Rule 144 would

primarily penalize shareholders reselling or attempting to resell securities. They also noted that the loss of Form S-8 could have a detrimental effect on employees.

The reporting status requirements in Forms S-2, S-3 and S-8 and Rule 144, the commenters argued, were not intended to be linked to a system for dissemination of discrete information outside of the traditional periodic reporting obligations of companies. The commenters were concerned that these consequences for the issuer and investors may be unduly harsh and not in line with the purposes of Regulation FD.

We find merit in these concerns and are modifying this aspect of the regulation. The purpose of Regulation FD is to discourage selective disclosure of material nonpublic information by imposing a requirement to make the information available to the markets generally when it has been made available to a select few. We agree that the purpose is not well served by negatively affecting a company's ability to access the capital markets. Nor is it well served by penalizing the shareholders or employees of the company. As discussed below, we have other adequate enforcement remedies that will provide a proportionate response for a violation and will have the desired effect on compliance. To implement our approach, Rule 103 of the regulation as adopted states that an issuer's failure to comply with the regulation will not affect whether the issuer is considered current or, where applicable, timely in its Exchange Act reports for purposes of Form S-8, short-form registration on Form S-2 or S-3 and Rule 144.

7. Liability Issues

We recognize that the prospect of private liability for violations of Regulation FD could contribute to a "chilling effect" on issuer communications. Issuers might refrain from some informal communications with outsiders if they feared that engaging in such communications, even when appropriate, would lead to their being charged in private lawsuits with violations of Regulation FD. Accordingly, we emphasized in the Proposing Release that Regulation FD is an issuer disclosure rule that is designed to create duties only under Sections 13(a) and 15(d) of the Exchange Act and Section 30 of the Investment Company Act. It is not an antifraud rule, and it is not designed to create new duties under the antifraud provisions of the federal securities laws or in private rights of action.⁸⁵

Most commenters who addressed this point believed that our decision not to create private liability for Regulation FD violations was appropriate. Several suggested, however, that the language in the Proposing Release offered insufficient protection from private lawsuits. In response to these comments, we have added to Regulation FD a new Rule 102, which expressly provides that no failure to make a public disclosure required solely by Regulation FD shall be deemed to be a violation of Rule 10b-5.⁸⁶ This provision makes clear that Regulation FD does not create a new duty for purposes of Rule 10b-5 liability. Accordingly, private plaintiffs cannot rely on an issuer's violation of Regulation FD as a basis for a private action alleging Rule 10b-5 violations.

Rule 102 is designed to exclude Rule 10b-5 liability for cases that would be based "solely" on a failure to make a public disclosure required by Regulation FD. As such, it does not affect any existing grounds for liability under Rule 10b-5. Thus, for example, liability for "tipping" and insider trading under Rule 10b-5 may still exist if a selective disclosure is made in circumstances that meet the *Dirks* "personal benefit" test.⁸⁷ In addition, an issuer's failure to make a public disclosure still may give rise to liability under a "duty to correct" or "duty to update" theory in certain circumstances.⁸⁸ And an issuer's contacts with analysts may lead to liability under the "entanglement" or "adoption" theories.⁸⁹ In addition, if an issuer's report or public disclosure made under Regulation FD contained false or misleading information, or omitted material information, Rule 102 would not provide protection from Rule 10b-5 liability.

Finally, if an issuer failed to comply with Regulation FD, it would be subject to an SEC enforcement action alleging violations of Section 13(a) or 15(d) of the Exchange Act (or, in the case of a closed-end investment company, Section 30 of the Investment Company Act) and Regulation FD. We could bring an administrative action seeking a cease-and-desist order, or a civil action seeking an injunction and/or civil money penalties.⁹⁰ In appropriate cases, we could also bring an enforcement action against an individual at the issuer responsible for the violation, either as "a cause of" the violation in a cease-and-desist proceeding,⁹¹ or as an aider and abetter of the violation in an injunctive action.⁹²

III. Insider Trading Rules

As discussed in the Proposing Release, the prohibitions against insider trading in our securities laws play an essential role in maintaining the fairness, health, and integrity of our markets. We have long recognized that the fundamental unfairness of insider trading harms not only individual investors but also the very foundations of our markets, by undermining investor confidence in the integrity of the markets. Congress, by enacting two separate laws providing enhanced penalties for insider trading, has expressed its strong support for our insider trading enforcement program.⁹³ And the Supreme Court in *United States v. O'Hagan* has recently endorsed a key component of insider trading law, the "misappropriation" theory, as consistent with the "animating purpose" of the federal securities laws: "to insure honest securities markets and thereby promote investor confidence."⁹⁴

As discussed more fully in the Proposing Release, insider trading law has developed on a case-by-case basis under the antifraud provisions of the federal securities laws, primarily Section 10(b) of the Exchange Act and Rule 10b-5. As a result, from time to time there have been issues on which various courts disagreed. Rules 10b5-1 and 10b5-2 resolve two such issues.

A. Rule 10b5-1: Trading "On the Basis Of" Material Nonpublic Information

1. Background

As discussed in the Proposing Release, one unsettled issue in insider trading law has been what, if any, causal connection must be shown between the trader's possession of inside information and his or her trading. In enforcement cases, we have argued that a trader may be liable for trading while in "knowing possession" of the information. The contrary view is that a trader is not liable unless it is shown that he or she "used" the information for trading. Until recent years, there has been little case law discussing this issue. Although the Supreme Court has variously described an insider's violations as trading "on"⁹⁵ or "on the basis of"⁹⁶ material nonpublic information, it has not addressed the use/possession issue. Three recent courts of appeals cases addressed the issue but reached different results.⁹⁷

As discussed more fully in the Proposing Release, in our view, the goals of insider trading prohibitions -- protecting investors and the integrity of securities markets -- are best accomplished by a standard closer to the "knowing possession" standard than to the "use" standard.⁹⁸ At the same time, we recognize that an absolute standard based on knowing possession, or awareness, could be overbroad in some respects. The new rule attempts to balance these considerations by means of a general rule based on "awareness" of the material nonpublic information, with several carefully enumerated affirmative defenses. This approach will better enable insiders and issuers to conduct themselves in accordance with the law.

While many of the commenters on Rule 10b5-1 supported our goals of providing greater clarity in the area of insider trading law, some suggested alternative approaches to achieving these goals. In that regard, a common comment was that the rule should not rely on exclusive affirmative defenses. Commenters suggested that we should either redesignate the affirmative defenses as non-exclusive safe harbors or add a catch-all defense to allow a defendant to show that he or she did not use the information.⁹⁹

We believe the approach we proposed is appropriate. In our view, adding a catch-all defense or redesignating the affirmative defenses as non-exclusive safe harbors would effectively negate the clarity and certainty that the rule attempts to provide. Because we believe that an awareness standard better serves the goals of insider trading law, the rule as adopted employs an awareness standard with carefully enumerated affirmative defenses. As discussed below, however, we have somewhat modified these defenses in response to comments that they were too narrow or rigid, and that additional ones were necessary.

Some commenters stated that an awareness standard might eliminate the element of scienter from insider trading cases, contrary to the requirements of Section 10(b) of the Exchange Act,¹⁰⁰ and that we therefore lack the

authority to promulgate the rule.¹⁰¹ These comments misconstrue the intent and effect of the rule. As discussed in the Proposing Release and expressly stated in the Preliminary Note, Rule 10b5-1 is designed to address only the use/possession issue in insider trading cases under Rule 10b-5. The rule does not modify or address any other aspect of insider trading law, which has been established by case law. Scienter remains a necessary element for liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Rule 10b5-1 does not change this.

2. Provisions of Rule 10b5-1

We are adopting, as proposed, the general rule set forth in Rule 10b5-1(a), and the definition of "on the basis of" material nonpublic information in Rule 10b5-1(b). A trade is on the basis of material nonpublic information if the trader was aware of the material, nonpublic information when the person made the purchase or sale.

Some commenters stated that a use standard would be preferable,¹⁰² or suggested that the rule instead state that awareness of the information should give rise to a presumption of use.¹⁰³ As noted above, we believe that awareness, rather than use, most effectively serves the fundamental goal of insider trading law -- protecting investor confidence in market integrity. The awareness standard reflects the common sense notion that a trader who is aware of inside information when making a trading decision inevitably makes use of the information.¹⁰⁴ Additionally, a clear awareness standard will provide greater clarity and certainty than a presumption or "strong inference" approach.¹⁰⁵ Accordingly, we have determined to adopt the awareness standard as proposed.

The proposed affirmative defenses generated a substantial number of comments. Some commenters suggested that the affirmative defenses in the Proposing Release were too restrictive,¹⁰⁶ or that additional defenses were needed to protect various common trading mechanisms, such as issuer repurchase programs and employee benefit plans.¹⁰⁷ Some of these commenters noted that the requirement that a trader specify prices, amounts, and dates of purchases or sales pursuant to binding contracts, instructions, or written plans left some common, legitimate trading mechanisms outside the protection of the proposed affirmative defenses. Additionally, some commenters questioned the Proposing Release's exclusion of a price limit from the definition of a specified "price."¹⁰⁸ In consideration of these comments, we are revising the affirmative defense that allows purchases and sales pursuant to contracts, instructions, and plans. The revised language responds to commenters' concerns by providing appropriate flexibility to persons who wish to structure securities trading plans and strategies when they are not aware of material nonpublic information, and do not exercise any influence over the transaction once they do become aware of such information.

As adopted, paragraph (c)(1)(i) sets forth an affirmative defense from the general rule, which applies both to individuals and entities that trade. To satisfy this provision, a person must establish several factors.

- First, the person must demonstrate that before becoming aware of the information, he or she had entered into a binding contract to purchase or sell the security, provided instructions to another person to execute the trade for the instructing person's account, or adopted a written plan for trading securities.¹⁰⁹
- Second, the person must demonstrate that, with respect to the purchase or sale, the contract, instructions, or plan either: (1) expressly specified the amount, price, and date; (2) provided a written formula or algorithm, or computer program, for determining amounts, prices, and dates; or (3) did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who did exercise such influence was not aware of the material nonpublic information when doing so.¹¹⁰
- Third, the person must demonstrate that the purchase or sale that occurred was pursuant to the prior contract, instruction, or plan. A purchase or sale is not pursuant to a contract, instruction, or plan if, among other things, the person who entered into the contract, instruction, or plan altered or deviated from the contract, instruction, or plan or entered into or altered a corresponding or hedging transaction or position with respect to those securities.¹¹¹

Under paragraph (c)(1)(ii), which we adopt as proposed, the exclusion provided in paragraph (c)(1)(i) will be available only if the contract, instruction, or plan was entered into in good faith and not as part of a scheme to evade the prohibitions of this section.

Paragraph (c)(1)(iii) defines several key terms in the exclusion. We are adopting, substantially as proposed, the definition of "amount",¹¹² which means either a specified number of shares or a specified dollar value of securities. We have revised the definition of "price" and added a definition of "date." As adopted, "price" means market price on a particular date or a limit price or a particular dollar price.¹¹³ "Date" means either the specific day of the year on which a market order is to be executed, or a day or days of the year on which a limit order is in force.¹¹⁴

Taken as a whole, the revised defense is designed to cover situations in which a person can demonstrate that the material nonpublic information was not a factor in the trading decision. We believe this provision will provide appropriate flexibility to those who would like to plan securities transactions in advance at a time when they are not aware of material nonpublic information, and then carry out those pre-planned transactions at a later

time, even if they later become aware of material nonpublic information.¹¹⁵

For example, an issuer operating a repurchase program will not need to specify with precision the amounts, prices, and dates on which it will repurchase its securities. Rather, an issuer could adopt a written plan, when it is not aware of material nonpublic information, that uses a written formula to derive amounts, prices, and dates. Or the plan could simply delegate all the discretion to determine amounts, prices, and dates to another person who is not aware of the information -- provided that the plan did not permit the issuer to (and in fact the issuer did not) exercise any subsequent influence over the purchases or sales.¹¹⁶

Similarly, an employee wishing to adopt a plan for exercising stock options and selling the underlying shares could, while not aware of material nonpublic information, adopt a written plan that contained a formula for determining the specified percentage of the employee's vested options to be exercised and/or sold at or above a specific price. The formula could provide, for example, that the employee will exercise options and sell the shares one month before each date on which her son's college tuition is due, and link the amount of the trade to the cost of the tuition.

An employee also could acquire company stock through payroll deductions under an employee stock purchase plan or a Section 401(k) plan. The employee could provide oral instructions as to his or her plan participation,¹¹⁷ or proceed by means of a written plan.¹¹⁸ The transaction price could be computed as a percentage of market price, and the transaction amount could be based on a percentage of salary to be deducted under the plan.¹¹⁹ The date of a plan transaction could be determined pursuant to a formula set forth in the plan.¹²⁰ Alternatively, the date of a plan transaction could be controlled by the plan's administrator or investment manager, assuming that he or she is not aware of the material, nonpublic information at the time of executing the transaction, and the employee does not exercise influence over the timing of the transaction.¹²¹

One commenter noted that the proposed Rule 10b5-1 defenses were not co-extensive with exemptions from liability and reporting under Section 16 of the Exchange Act.¹²² The Section 16 exemptive rules do not provide any exemption from liability under Section 10(b) and Rule 10b-5. The adoption of Rule 10b5-1 does not change this principle. However, we have drafted the Rule 10b5-1 defenses so that their conditions should not conflict with the conditions of the Section 16 exemptive rules.¹²³

The proposal included an additional affirmative defense available only to trading parties that are entities. In response to comments, the rule as adopted clarifies that this defense is available to entities as an alternative to the other enumerated defenses described above.

Under this provision, an entity will not be liable if it demonstrates that the

individual making the investment decision on behalf of the entity was not aware of the information, and that the entity had implemented reasonable policies and procedures to prevent insider trading.¹²⁴ The American Bar Association commented that the use in this rule of the term "reasonable policies and procedures . . . to ensure" against insider trading differed from the standard provided in Section 15(f) of the Exchange Act, which requires a registered broker or dealer to establish, maintain, and enforce written policies and procedures "reasonably designed" to prevent insider trading. As we noted in the Proposing Release, we derived this provision from the defense against liability codified in Exchange Act Rule 14e-3, regarding insider trading in a tender offer situation. Rule 14e-3, which pre-dates Exchange Act Section 15(f), also used the "to ensure" language. We are not aware, however, nor did commenters suggest, that use of that language has created any problems of compliance with Rule 14e-3. We believe, in any event, that the standards should be interpreted as essentially the same.¹²⁵

B. Rule 10b5-2: Duties of Trust or Confidence in Misappropriation Insider Trading Cases

1. Background

As discussed more fully in the Proposing Release, an unsettled issue in insider trading law has been under what circumstances certain non-business relationships, such as family and personal relationships, may provide the duty of trust or confidence required under the misappropriation theory.¹²⁶ Case law has produced the following anomalous result. A family member who receives a "tip" (within the meaning of *Dirks*) and then trades violates Rule 10b-5. A family member who trades in breach of an express promise of confidentiality also violates Rule 10b-5. A family member who trades in breach of a reasonable expectation of confidentiality, however, does not necessarily violate

Rule 10b-5.

As discussed more fully in the Proposing Release, we think that this anomalous result harms investor confidence in the integrity and fairness of the nation's securities markets. The family member's trading has the same impact on the market and investor confidence in the third example as it does in the first two examples. In all three examples, the trader's informational advantage stems from "contrivance, not luck," and the informational disadvantage to other investors "cannot be overcome with research or skill."¹²⁷ Additionally, the need to distinguish among the three types of cases may require an unduly intrusive examination of the details of particular family relationships. Accordingly, we believe there is good reason for the broader approach we adopt today for determining when family or personal relationships create "duties of trust or confidence" under the misappropriation theory.

Some of the commenters who submitted comment letters on Rule 10b5-2

supported the proposal.¹²⁸ Some offered suggestions or alternative approaches.¹²⁹ Others expressed concern that the rule would erode standards of personal and family privacy.¹³⁰ As discussed in the Proposing Release, the rule is not designed to interfere with particular family or personal relationships; rather, its goal is to protect investors and the fairness and integrity of the nation's securities markets against improper trading on the basis of inside information. Moreover, we do not believe that the rule will require a more intrusive examination of family relationships than would be required under existing case law without the rule. Current case law, such as *United States v. Chestman*,¹³¹ and *United States v. Reed*,¹³² already establishes a regime under which questions of liability turn on the nature of the details of the relationships between family members, such as their prior history and patterns of sharing confidences.¹³³ By providing more of a bright-line test for certain enumerated close family relationships, we believe the rule will mitigate, to some degree, the need to examine the details of particular relationships in the course of investigating suspected insider trading.

2. Provisions of Rule 10b5-2

We are adopting Rule 10b5-2 substantially as proposed. The rule sets forth a non-exclusive list of three situations in which a person has a duty of trust or confidence for purposes of the "misappropriation" theory of the Exchange Act and Rule 10b-5 thereunder.¹³⁴

First, as proposed, we provide that a duty of trust or confidence exists whenever a person agrees to maintain information in confidence.¹³⁵

Second, we provide that a duty of trust or confidence exists when two people have a history, pattern, or practice of sharing confidences such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality.¹³⁶ This is a "facts and circumstances" test based on the expectation of the parties in light of the overall relationship. Some commenters were concerned that, as proposed, this provision examined the reasonable expectation of confidentiality of the person communicating the material nonpublic information rather than examining the expectations of the recipient of the information and/or both parties to the communication.¹³⁷ We believe that mutuality was implicit in the proposed rule because an inquiry into the reasonableness of the recipient's expectation necessarily involves considering the relationship as a whole, including the other party's expectations. Nevertheless, we have revised the provision to make this mutuality explicit.

Two commenters suggested that this part of the rule be limited to a history, pattern, or practice of sharing business confidences.¹³⁸ Although we have determined not to adopt such a limitation, we note that evidence about the type of confidences shared in the past might be relevant to determining the

reasonableness of the expectation of confidence.

Third, we are adopting as proposed a bright-line rule that states that a duty of trust or confidence exists when a person receives or obtains material nonpublic information from certain enumerated close family members: spouses, parents, children, and siblings. An affirmative defense permits the person receiving or obtaining the information to demonstrate that under the facts and circumstances of that family relationship, no duty of trust or confidence existed. Some commenters noted that the enumerated relationships do not include domestic partners, step-parents, or step-children. We have determined not to include these relationships in this paragraph, although paragraphs (b)(1) and (b)(2) could reach them. Our experience in this area indicates that most instances of insider trading between or among family members involve spouses, parents and children, or siblings; therefore, we have enumerated these relationships and not others.

IV. Paperwork Reduction Act

Certain provisions of Regulation FD contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.¹³⁹ We published notice soliciting comments on the collection of information requirements in the Proposing Release, and submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The titles for the collections are (1) Form 8-K, and (2) Reg FD-Other Disclosure Materials.

We received two comments concerning our estimate that an issuer would make five disclosures under Regulation FD per year. The Bond Market Association stated that we provided no basis for our estimate.¹⁴⁰ The Securities Industry Association indicated that the basis for the estimate is unclear and suggested that the estimate is too low.¹⁴¹ In the Proposing Release, we stated that we believe that issuers will make one disclosure per quarter plus, on average, one additional disclosure per year under Regulation FD. While we recognize that some issuers may make more than five annual FD disclosures, we also believe that a substantial number of issuers will make fewer than five FD disclosures annually.¹⁴² As discussed in the Proposing Release, in many cases, information disclosed under Regulation FD would be information that an issuer ultimately was going to disclose to the public. Under Regulation FD, that issuer likely will not make any more public disclosure than it otherwise would, but it may make the disclosure sooner and now would be required to file or disseminate that information in a manner reasonably designed to provide broad, non-exclusionary distribution of the information to the public. We therefore believe that our estimate that issuers will make five disclosures per year under Regulation FD is appropriate.

The Bond Market Association also stated that the time required to accomplish disclosure will be longer than our estimate of five hours, but did not quantify how much longer.¹⁴³ As discussed in the Proposing Release, we

estimated the average number of hours an entity spends completing Form 8-K by contacting a number of law firms and other persons regularly involved in completing the form. We therefore believe that our estimate is appropriate. We additionally believe it is reasonable to estimate that other forms of disclosure, such as a press release, will require no more (and probably less) than the preparation time of Form 8-K.

OMB approved the regulation's information collection requirements. Form 8-K (OMB Control No. 3235-0060) was adopted pursuant to Sections 13, 15, and 23 of the Exchange Act, and Regulation FD-Other Disclosure Materials (OMB Control No. 3235-0536) was adopted pursuant to Sections 13, 15, 23, and 36 of the Exchange Act. We are not collecting information pursuant to Regulation FD on Form 6-K (OMB Control No. 3235-0116), as initially proposed, because, as discussed in this Release, we have modified Regulation FD to exclude foreign private issuers from coverage. We have adopted Regulation FD with some additional modifications to the regulation as proposed. None of these modifications (other than the exclusion of foreign private issuers from coverage), however, has an impact on our burden hour estimate.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. Compliance with the disclosure requirements is mandatory. There is no mandatory retention period for the information disclosed, and responses to the disclosure requirements will not be kept confidential.

V. Cost-Benefit Analysis

A. Regulation FD: Selective Disclosure

Regulation FD requires that when an issuer intentionally discloses material nonpublic information to securities market professionals or holders of the issuer's securities who are reasonably likely to trade on the basis of the information, it must simultaneously make public disclosure. When the issuer's selective disclosure of material nonpublic information is not intentional, the issuer must make public disclosure promptly.

1. Benefits

Regulation FD will provide several important benefits to investors and the securities markets as a whole. First, current practices of selective disclosure damage investor confidence in the fairness and integrity of the markets. When selective disclosure leads to trading by the recipients of the disclosure or trading by those whom these recipients advise, the practice bears a close resemblance to ordinary "tipping" and insider trading. The economic effects of the two practices are essentially the same; in both cases, a few persons gain an informational edge -- and use that edge to profit at the expense of the uninformed -- from superior access to corporate insiders, not through skill or diligence.¹⁴⁴ Thus, investors in many instances equate the practice of

selective disclosure with insider trading.¹⁴⁵

The Chicago Board Options Exchange also commented that selective disclosure is extremely detrimental to the markets, in that the unusual trading and increased volatility that result from selective disclosure can cause market makers substantial losses and potentially lead to wider and less liquid options markets.¹⁴⁶ This argument can be extended to the primary markets for the securities as well. Economic theory and empirical studies have shown that stock market transaction costs increase when certain traders may be aware of material, undisclosed information.¹⁴⁷ A reduction in these costs should make investors more willing to commit their capital.

The inevitable effect of selective disclosure, as indicated by numerous comment letters we received, is that individual investors lose confidence in the integrity of the markets because they perceive that certain market participants have an unfair advantage.¹⁴⁸ Although one commenter questioned this investor confidence argument,¹⁴⁹ we agree with the common sense view -- expressed by both the Supreme Court and the Congress -- that investors will lose confidence in a market that they believe is unfairly rigged against them.¹⁵⁰ Similarly, economic studies have provided support for the view that insider trading reduces liquidity, increases volatility, and may increase the cost of capital.¹⁵¹

Given the similarity of selective disclosure practices to ordinary tipping and insider trading, we believe that a regulation addressing selective disclosure of material information will promote benefits similar to insider trading regulation. Regulation FD will foster fairer disclosure of information to all investors, and increase investor confidence in market integrity. By enhancing investor confidence in the markets, therefore, the regulation will encourage continued widespread investor participation in our markets, enhancing market efficiency and liquidity, and more effective capital raising.

Second, the regulation likely also will provide benefits to those seeking unbiased analysis. This regulation will place all analysts on equal footing with respect to competition for access to material information. Thus, it will allow analysts to express their honest opinions without fear of being denied access to valuable corporate information being provided to their competitors. Analysts will continue to be able to use and benefit from superior diligence or acumen, without facing the prospect that other analysts will have a competitive edge solely because they say more favorable things about issuers.¹⁵²

2. Costs

The regulation will impose some costs on issuers. First, issuers will incur some additional costs in making the public disclosures of material nonpublic information required by the regulation. Regulation FD gives issuers two

options for making public disclosure. The issuer can: (1) file or furnish a Form 8-K,¹⁵³ or (2) disseminate 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 (press release, teleconference, or web-conference).

Because the regulation does not require issuers to disclose material information (just to make any disclosure on a non-selective basis), we cannot predict with certainty how many issuers will actually make disclosures under this regulation. For purposes of the Paperwork Reduction Act, however, we base our estimate of the paperwork burden of the regulation on our belief that issuers will make on average five¹⁵⁴ public disclosures under Regulation FD per year.¹⁵⁵ Since there are approximately 13,000 issuers affected by this regulation, we estimate that the total number of disclosures under Regulation FD per year will be 65,000.

If an issuer files a Form 8-K, we estimate that the issuer would incur, on average, five burden hours per filing. This estimate is based on current burden hour estimates under the Paperwork Reduction Act for filing a Form 8-K and the staff's experience with such filings. For the purposes of the Paperwork Reduction Act, we estimate that in preparing Form 8-Ks approximately 25% of the burden hours are expended by the company's internal professional staff, and the remaining 75% by outside counsel. Assuming a cost of \$85/hour for in-house professional staff and \$175/hour¹⁵⁶ for outside counsel, the total cost would be \$762.50 per filing. These assumptions reflect the greater reliance on outside lawyers in preparing documents to be filed with the Commission.

We have no direct data on which to base estimates of the costs of the other disclosure options. However, we anticipate that other methods of disclosure, such as press releases, may require less preparation time than a Form 8-K and will be prepared primarily, if not exclusively, by the company's internal staff.¹⁵⁷ Moreover, if the costs of another method of disclosure are less than the costs of filing the Form 8-K, we presume issuers will choose another method of public disclosure. Issuers may, however, choose to use methods of dissemination with higher out-of-pocket costs, presumably because they believe these methods provide additional benefits to the issuer or investor for which they are willing to pay. Given that we estimate that there will be 65,000 disclosures under Regulation FD per year at an approximate cost ranging from \$537.50 to \$762.50 per disclosure, we estimate that the total paperwork burden of preparing the information for disclosure per year will be approximately \$34,937,500 to \$49,562,500.¹⁵⁸

We received several comments concerning the costs of the disclosure options provided by Regulation FD. Two commenters suggested that the benefits of the regulation outweigh the costs of making disclosure.¹⁵⁹ One commenter suggested that the direct costs to issuers of complying with the regulation will exceed the \$33 million that we estimated in the Proposing Release.¹⁶⁰

This commenter suggested that there is no basis for our estimate that issuers will make on average five disclosures per year, and that our estimate that it will take five hours to make disclosure under the regulation is too low, due to legal involvement with each corporate communication. This commenter additionally stated that the cost estimates for in-house and outside legal advice do not reflect the current or future marketplace and that the estimates do not consider all of the people involved in the disclosure process or the costs of a decision not to make disclosure.¹⁶¹ Another commenter stated that our estimate of, on average, five disclosures per issuer per year is too low. This commenter also said that it could not quantify the costs of Regulation FD.¹⁶²

Our estimate of five disclosures per issuer is based on several factors. First, we believe that for a large group of issuers, five disclosures reflects the need to make one FD disclosure per quarter, and allows for one additional miscellaneous FD disclosure. At the same time, however, we recognize that there will be a wide variation among disclosure practices at different issuers. Some issuers may average more annual FD disclosures. A substantial number of other issuers, however, depending on their industry, shareholder composition, or level of analyst coverage,¹⁶³ may make fewer if any FD disclosures annually. Thus, we believe the estimate adequately allows for a wide variety of situations. We, therefore, believe that five is a reasonable estimate of the average number of disclosures each issuer will make annually under Regulation FD. We also believe it is reasonable to assume that the costs of making disclosure via some other method, such as a press release, will not be greater than the costs of filing a Form 8-K.

While it is possible that issuers may incur some cost in connection with the implementation of corporate policy relating to disclosure, as well as decisions not to make disclosure under the regulation, we believe that any additional costs would not be substantial. Many issuers already consult with in-house and/or outside counsel regarding their disclosure obligations under the federal securities laws. Moreover, as we have narrowed the definition of "persons acting on behalf of the issuer" to cover only those who regularly interact with securities market professionals and security holders, the issuer personnel whose disclosures will be covered by the regulation are those who are most likely to be well-versed in disclosure issues and practiced in making judgments on these issues. Further, to the extent that issuers already have policies in place to cover the types of disclosures those personnel can make, we expect the additional costs associated with compliance to be small. Thus, after careful consideration of the comments, we have determined that our estimates of the costs of making disclosure are appropriate.

One commenter asserted that our cost-benefit analysis does not consider indirect costs on capital formation.¹⁶⁴ These costs, according to this commenter, include less liquidity, missed market opportunities, and the introduction of market inefficiencies. One such market inefficiency, according to the commenter, might result from confidentiality agreements becoming a regular practice, thereby excluding some institutions that cannot or will not agree to the restrictions in such agreements. This commenter also suggested

a cost resulting from issuers' involving their attorneys in each corporate communication. This commenter did not quantify these purported costs.

We believe that this comment does not adequately take into account the flexibility provided in Regulation FD for issuer compliance. The regulation gives issuers a variety of ways to comply, and we assume that an issuer will be able to determine the least costly methods of compliance for its particular circumstances. Moreover, as discussed in the Release, we have significantly narrowed the scope of the regulation in ways that should reduce both direct and indirect compliance costs; for example, we have narrowed the types of communications covered, and excluded communications made in connection with most registered securities offerings. Further, as discussed above, we believe that the regulation will encourage continued widespread investor participation in our markets, which will enhance market efficiency and liquidity, and foster more effective capital raising. Thus, we have carefully considered whether the regulation will increase the costs of capital formation, and we believe it may, in fact, reduce such costs.¹⁶⁵

The regulation may also lead to some increased costs for issuers resulting from new or enhanced systems and procedures for disclosure practices. As indicated by some commenters,¹⁶⁶ we believe that many, if not most, issuers already have internal procedures for communicating with the public; for many issuers, therefore, new procedures to prevent selective disclosures will not be needed. There might be a cost to these issuers, however, for enhancing and strengthening existing procedures to safeguard against selective disclosures that are not intentional to ensure prompt public release when such disclosures do occur.

Some commenters suggested that disclosure methods utilizing Internet technology impose minimal costs.¹⁶⁷ In particular, one commenter noted that there are several services that make the audio signal from conference calls available over the Internet at no cost.¹⁶⁸ Another commenter disagreed, and stated that some of the methods of making disclosure, such as webcasts, are costly.¹⁶⁹ This commenter suggested that additional costs might include those associated with new technologies, but provided no quantitative data associated with any such costs.¹⁷⁰ As stated above, we believe that making disclosure by a method other than a Form 8-K will likely be less costly than making disclosure by filing a Form 8-K. We believe that issuers will use new technology to the extent that it is cost-effective to do so; in any event, no issuer will be required to expend more on disclosures utilizing new technology than it would cost to make disclosure by filing a Form 8-K.

One potential cost of the regulation that we have identified is the risk that the regulation might "chill" corporate disclosures to analysts, investors, and the media. We recognized the concern that issuers may speak less often out of fear of liability based on a post hoc assessment that disclosed information was material, and that if such a chilling effect resulted from Regulation FD, there would be a cost to overall market efficiency and capital formation.

A number of commenters also raised the concern about a chilling effect as a significant potential cost of Regulation FD, and several of these suggested that we were underestimating this effect.¹⁷¹ A common theme among these commenters was that the regulation would result in the flow of less information to the marketplace, rather than more, and that the cost of this effect would be greater surprise and volatility.¹⁷² However, these commenters were unable to quantify these costs. Moreover, other commenters, including issuers who would be subject to the regulation, did not necessarily agree that their communications would be significantly chilled.¹⁷³

In response to the concerns about a diminished flow of information, as discussed elsewhere in this Release, we have made several significant modifications that we believe reduce the likelihood of a chilling effect. These modifications include narrowing the scope of the regulation so that it does not apply to all communications with persons outside the issuer, narrowing the types of issuer personnel covered by the regulation to senior officials and those who would normally be expected to communicate with securities market professionals or security holders, and clarifying that where the regulation requires "knowing or reckless" conduct, liability will attach only when an issuer's personnel know or are reckless in not knowing that the information selectively disclosed is both material and nonpublic. Additionally, as discussed below, we have added an express provision in the regulation's text designed to remove any doubt that private liability will not result from a Regulation FD violation.

In addition, there are numerous practices that issuers may employ to continue to communicate freely with analysts and investors, while becoming more careful in how they disclose information. Moreover, the regulation only covers the selective disclosure of material nonpublic information; the level of non-material information available to the market need not decrease. We believe issuers will have strong reasons to continue releasing information given the market demand for information and a company's desire to promote its products and services. One economic study has found that more public disclosure is associated with factors that have been shown to reduce the cost of capital.¹⁷⁴ Finally, commenters expressed concern that the regulation would increase the risk of private liability. Regulation FD is designed to create duties only under Sections 13(a) and 15(d) of the Exchange Act and Section 30 of the Investment Company Act, and does not create new duties under Section 10(b) of the Exchange Act. As discussed, we have added an express provision to the regulation stating that a failure to make a disclosure required solely by Regulation FD will not result in a violation of Rule 10b-5.

B. Rule 10b5-1: Trading "On The Basis Of" Material Nonpublic Information

Rule 10b5-1 would define when a sale or purchase of a security occurred "on the basis of" material nonpublic information. Under the rule, a person trades "on the basis of" material nonpublic information if the person making the

purchase or sale was aware of the material nonpublic information at the time of the purchase or sale. However, the rule provides exclusions for certain situations in which a trade resulted from a pre-existing plan, contract, or instruction that was made in good faith.

1. Benefits

We anticipate two significant benefits arising from Rule 10b5-1. First, the rule should increase investor confidence in the integrity and fairness of the market because it clarifies and strengthens existing insider trading law. Second, the rule will benefit corporate insiders by providing greater clarity and certainty on how they can plan and structure securities transactions. The rule provides specific guidance on how a person can plan future transactions at a time when he or she is not aware of material nonpublic information without fear of incurring liability. We believe that this guidance will make it easier for corporate insiders to conduct themselves in accordance with the laws against insider trading.

2. Costs

The rule does not require any particular documentation or recordkeeping by insiders, although it would, in some cases, require a person to document a particular plan, contract, or instruction for trading if he or she wished to demonstrate an exclusion from the rule. Some commenters suggested that the proposed affirmative defenses did not allow for certain commonly used mechanisms for trading securities, such as issuer repurchase plans. If the rule prohibited, for example, issuers from repurchasing their securities, a cost might have resulted. As discussed elsewhere in this Release, however, we have modified the rule to provide appropriate flexibility to persons who wish to structure securities trading plans and strategies when they are not aware of material nonpublic information. Any entity that sought to rely on the affirmative defense in paragraph (c)(2) for institutional traders would be required to comply with the specific provisions of that paragraph, including implementing reasonable policies and procedures to prevent insider trading. We believe that most entities to whom this affirmative defense would be relevant -- *i.e.*, broker-dealers and investment advisers -- already have procedures in place, because of existing statutory requirements.¹⁷⁵ Thus, as adopted, we do not believe that any costs that may be imposed by Rule 10b5-1 will be significant.¹⁷⁶

C. Rule 10b5-2: Duties of Trust or Confidence in Misappropriation Insider Trading Cases

1. Benefits

Rule 10b5-2 enumerates three non-exclusive bases for determining when a person receiving information is subject to a "duty of trust or confidence" for purposes of the misappropriation theory of insider trading. Two principal benefits are likely to result from this rule. First, the rule will provide greater

clarity and certainty to the law on the question of when a family relationship will create a duty of trust or confidence. Second, the rule will address an anomaly in current law under which a family member receiving material nonpublic information may exploit it without violating the prohibition against insider trading. By addressing this potential gap in the law, the rule will enhance investor confidence in the integrity of the market.

2. Costs

We do not attribute any costs to Rule 10b5-2 and no commenter suggested otherwise.

VI. Consideration of Impact on the Economy, Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Sections 2(b) of the Securities Act, 3(f) of the Exchange Act, and 2(c) of the Investment Company Act require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, also to consider whether the action will promote efficiency, competition, and capital formation. As discussed above, we believe that Regulation FD and Rules 10b5-1 and 10b5-2 will bolster investor confidence in the integrity of the markets and the fairness of the disclosure process. By enhancing investor confidence and participation in the markets, these rules should increase liquidity and help to reduce the costs of capital. Accordingly, the proposals should promote capital formation and market efficiency.¹⁷⁷

Section 23(a) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact on competition of any rule it adopts. Several commenters suggested that Regulation FD might have some effects on competition. One commenter suggested that the regulation would have a negative effect on competition because analysts operating independently of, and in competition with, each other can more effectively pursue an independent line of inquiry and ferret out negative information that management would rather not disclose. According to this commenter, "[l]eveling the playing field for analysts, as among themselves and vis-a-vis the general public, will undermine the great advantages of the current system."¹⁷⁸ We disagree. We believe, to the contrary, that the regulation will encourage competition because it places all analysts on equal competitive footing with respect to access to material information. Analysts will continue to be able to use and benefit from superior diligence or acumen, without facing the prospect that other analysts will have a competitive edge simply because they have been favored with selective disclosure. Additionally, analysts will be able to express their honest opinions without fear of being denied access to material corporate information.

Some commenters also suggested that it would be anti-competitive and unfair to exempt ratings agencies and/or the news media from the regulation's coverage.¹⁷⁹ According to these commenters, reporters are

competitors of analysts. We believe that there is a significant difference between analysts and news reporters, and therefore disagree with this comment. Reporters gather information for the purpose of reporting the news and informing the public; generally, their reports are widely disseminated. Similarly, ratings agencies make their ratings reports public when completed. Analysts, by contrast, gather and report information to be used for securities trading; their reports are typically available to a limited, usually paying, audience.

As discussed more fully above, we have decided to exclude foreign private issuers from the Regulation FD disclosure requirements in light of the fact that the Commission will be undertaking a comprehensive review of the reporting requirements of foreign private issuers. To the extent any anti-competitive effect may arise from exempting foreign private issuers from the regulation, we believe any such burden would be necessary and appropriate for the protection of investors. Overall, we do not believe that the regulation and rules will have any anti-competitive effects.

VII. Final Regulatory Flexibility Analysis

This Final Regulatory Flexibility Analysis ("FRFA") has been prepared in accordance with the Regulatory Flexibility Act ("RFA"). It relates to Regulation FD, Rule 10b5-1, and Rule 10b5-2 under the Exchange Act, as amended. The regulation and rules address the selective disclosure of material nonpublic information and clarify two unsettled issues under current insider trading law.

A. Need for the Regulation and Rules

The new regulation and rules address three separate issues. Regulation FD addresses the problem of issuers making selective disclosure of material nonpublic information to analysts or particular investors before making disclosure to the investing public. Rules 10b5-1 and 10b5-2 address two unsettled issues in insider trading case law: (1) when insider trading liability arises in connection with a person's "use" or "knowing possession" of material nonpublic information; and (2) when a family or other non-business relationship can give rise to liability under the misappropriation theory of insider trading. By addressing these issues, we believe the new regulation and rules will enhance investor confidence in the fairness and integrity of the securities markets.

Regulation FD requires that when an issuer intentionally discloses material nonpublic information it do so through public disclosure, not selective disclosure. When an issuer has made a non-intentional selective disclosure, Regulation FD requires the issuer to make prompt public disclosure thereafter. The regulation provides for several alternative methods by which an issuer can make the required public disclosure. We believe that this new regulation will provide for fairer and more effective disclosure of important information by issuers to the investing public.

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Rule 10b5-1 provides a general rule that liability arises when a person trades while "aware" of material nonpublic information. Rule 10b5-1 also provides affirmative defenses from the general rule to allow persons to structure securities trading plans and strategies when they are not aware of material nonpublic information, and follow through with the trades pursuant to those plans and strategies even after they become aware of material nonpublic information. We believe Rule 10b5-1 clarifies an important issue in insider trading law, and will enhance investor confidence in market integrity.

Rule 10b5-2 defines the scope of "duties of trust and confidence" for purposes of the misappropriation theory in a manner that more appropriately serves the purposes of insider trading law. Rule 10b5-2 will have no direct effect on small entities.

B. Significant Issues Raised by Public Comment

In the Proposing Release, we solicited comments on the Initial Regulatory Flexibility Analysis ("IRFA"). In particular, we requested comments regarding: (i) the number of small entity issuers that may be affected by the proposed regulation and rules; (ii) the existence or nature of the potential impact of the proposed regulation and/or rules on small entity issuers discussed in the analysis; and (iii) how to quantify the impact of the proposed regulation and rules. Commentators were asked to describe the nature of any impact and provide empirical data supporting the extent of the impact.

We did not receive any comments addressing the IRFA for proposed Regulation FD and Rules 10b5-1 and 10b5-2. We did receive several comments addressing the potential impact of proposed Regulation FD on small entity issuers and whether Regulation FD should treat them the same as other issuers.

One issue affecting small entities on which we received significant comment was the method of "public disclosure" required by Regulation FD. One commenter said that Regulation FD's public disclosure requirement should recognize the particular circumstances of the issuer; in this commenter's view, because smaller issuers often have more difficulty obtaining coverage, Regulation FD's public disclosure requirement could be qualified to require those efforts reasonable under the circumstances of the issuer and the market for its securities. This commenter noted that it would help address this issue if Regulation FD's public disclosure requirement could be satisfied by a website posting.¹⁸⁰ Another commenter said that Regulation FD's provision for public disclosure through a press release is not appropriate because this method does little, if anything, to provide investors with information regarding smaller companies.¹⁸¹

In response to these comments and others, we have modified the definition of "public disclosure" in the final regulation. The final regulation provides greater flexibility to an issuer to determine what is an appropriate means of making public disclosure in light of its particular circumstances. The final

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regulation permits issuers, including small entity issuers, to choose a method (or a combination of methods) of public disclosure reasonably designed to provide broad, non-exclusionary distribution of information to the public.

With respect to the regulation's application to disclosures of "material" nonpublic information, two commenters noted that what might be material to a small company might not be material to a large company.¹⁸² As noted elsewhere in the Release, the general materiality standard has always been understood to encompass the necessary flexibility to fit the circumstances of each case. Thus, we believe the use of a materiality standard in Regulation FD appropriately takes into account the differences between small and large issuers.

C. Small Entities Subject to the Regulation and Rules

Regulation FD will affect issuers and closed-end investment companies that are small entities.¹⁸³ We estimate there are between approximately 1,000 to 2,000 issuers subject to the reporting requirements of the Exchange Act that satisfy the definition of small entity.¹⁸⁴ We also estimate that there are approximately 62 closed-end investment companies that may be considered small entities subject to Regulation FD.¹⁸⁵

Rule 10b5-1 will apply to any small entities that engage in securities trading while aware of inside information and therefore are subject to existing insider trading prohibitions of Rule 10b-5. This could include issuers, broker-dealers,¹⁸⁶ investment advisers,¹⁸⁷ and investment companies. We estimate that there are approximately 913 broker-dealers that may be considered small entities.¹⁸⁸ We estimate that there are approximately 1,500 investment advisers that may be considered small entities.¹⁸⁹ We estimate that there are approximately 241 investment companies that may be considered small entities.¹⁹⁰ The Commission cannot estimate with certainty how many small entities engage in securities trading while aware of inside information and no comments were received on this point.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

1. Regulation FD

When an issuer, large or small, discloses material nonpublic information, Regulation FD requires it to file or furnish a Form 8-K, or to otherwise make public disclosure of 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.

The regulation's "public disclosure" requirement would give small entity issuers flexibility in how to disseminate information (such as via telephonic or Internet conference calls). This flexible performance element enables

small entity issuers the freedom to select the method (or combination of methods) of public disclosure that best suits their business operations while achieving broad dissemination of the information. Accordingly, we do not think the requirement will have a disproportionate affect on small entity issuers. In addition, by allowing an issuer to use a method "or combination of methods" of disclosure, Regulation FD recognizes that it may not always be possible for an issuer to rely on a single method of disclosure as reasonably designed to effect broad non-exclusionary public disclosure.

2. Rule 10b5-1

Rule 10b5-1 does not directly impose any recordkeeping or compliance requirements on small entities. To the extent that an entity engaged in securities trading wished to rely on an affirmative defense, it might document the existence of a pre-existing plan to trade. More generally, any entity, large or small, that sought to rely on the affirmative defense in paragraph (c)(2) for institutional traders would be required to comply with the specific provisions of that paragraph, including implementing reasonable policies and procedures to prevent insider trading. We believe that most entities to whom this affirmative defense would be relevant -- *i.e.*, broker-dealers and investment advisers -- already have procedures in place, because of existing statutory requirements.¹⁹¹

3. Rule 10b5-2

Rule 10b5-2 affects individuals and not entities. Accordingly, we believe that Rule 10b5-2 would not have a significant economic impact on a substantial number of small entities.

E. Agency Action to Minimize Effect on Small Entities

As required by Sections 603 and 604 of the RFA, the Commission has considered the following alternatives to minimize the economic impact of Regulation FD and Rule 10b5-1 on small entities: (a) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the regulation and the rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the regulation or rule, or any part thereof, for small entities.

With respect to Regulation FD, we continue to believe that different compliance or reporting requirements or timetables for small entities would interfere with achieving the primary goal of protecting investors. For the same reason, we believe that exempting small entities from coverage of Regulation FD, in whole or part, is not appropriate. In addition, we have concluded that it is not feasible to further clarify, consolidate, or simplify the regulation for small entities. We have, however, used performance elements in Regulation FD in two ways. Regulation FD does not require that an issuer satisfy its obligations in accordance with any specific design, but rather

allows each issuer, including small entities, flexibility to select the method (or combination of methods) of compliance that is most efficient and appropriate for its business operations. First, each issuer can select what method(s) to use to avoid selective disclosure (*e.g.*, by designating which authorized official(s) will speak with analysts). Second, each issuer can choose what method(s) to use for "public disclosure" (*e.g.*, filing or furnishing a Form 8-K, issuing a press release, holding a conference call transmitted telephonically or over the Internet, etc.). We do not believe different performance standards for small entities would be consistent with the purpose of Regulation FD.

We have made a number of changes to proposed Regulation FD that we believe decrease its impact on all issuers, including small entity issuers.

First, we have narrowed the scope of communications covered by Regulation FD so it does not apply to all communications to persons outside the issuer. As revised, the regulation applies only to communications made to securities market professionals and to holders of the issuer's securities under circumstances in which it is reasonably foreseeable that the security holder will trade on the basis of the information.

Second, we have narrowed the definition of "person acting on behalf of the issuer" to senior officials and those persons who normally would be expected to communicate with securities market professionals or with holders of the issuer's securities.

Third, to remove any doubt that private liability will not result from a Regulation FD violation, we have added an express provision in the regulation text that a failure to make a disclosure required solely by Regulation FD will not result in a violation of Rule 10b-5.

Fourth, to clarify that a reasonable, but mistaken, determination that information was not material will not be second-guessed, the regulation text has been revised to provide that the materiality determination is subject to a recklessness standard.

Fifth, Regulation FD has been revised so that a failure to comply with its provisions will not disqualify an issuer from use of short-form registration for securities offerings or affect security holders' ability to resell under Securities Act Rule 144.

Sixth, Regulation FD has been revised to exclude communications made in connection with most securities offerings registered under the Securities Act.

With respect to Rule 10b5-1, we continue to believe that different compliance requirements for small entities would interfere with achieving the primary goal of protecting investors. For the same reason, we believe that exempting small entities from coverage of Rule 10b5-1, in whole or part, is not appropriate. In addition, we have concluded that it is not feasible to further clarify, consolidate, or simplify the rule for small entities. First, the

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aspects of Rule 10b5-1 that indirectly involve compliance requirements are for affirmative defenses to the general rule and therefore not required to comply with Rule 10b5-1. Second, we have used performance elements for the affirmative defense based on an institutional investor implementing proper informational barriers set forth in paragraph (c)(2) of Rule 10b5-1. If an entity decides to assert this affirmative defense, Rule 10b5-1 does not require that it satisfy its obligations under the affirmative defense in accordance with any specific design, but rather allows it flexibility to select which measure(s) it wants to put in place to satisfy the elements of the affirmative defense. We do not believe different performance standards for small entities would be consistent with the purpose of the rule.

We have made changes to Rule 10b5-1 that we believe will decrease its impact on small entities. First, a person may use limit orders in a pre-existing contract, plan, or instruction created while the person was not aware of any inside information. Second, Rule 10b5-1 as adopted provides that the price, amount, and date of a transaction do not have to be specified where the purchase or sale that occurred was the result of the pre-existing contract, plan, or instruction.

VIII. Statutory Bases and Text of Amendments

We are adopting Regulation FD, the amendments to Form 8-K, Rule 10b5-1, and Rule 10b5-2 under the authority set forth in Sections 10, 19(a), and 28 of the Securities Act, Sections 3, 9, 10, 13, 15, 23, and 36 of the Exchange Act, and Section 30 of the Investment Company Act.

List of subjects

17 CFR Part 240

Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 243 and 249

Securities, Reporting and recordkeeping requirements.

Text of Amendments

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 240 -- GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o,

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78p, 78q, 78s, 78u-5, 78w, 78x, 78ll(d), 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, and 80b-11, unless otherwise noted.

* * * * *

2. Section 240.10b5-1 is added after Section 240.10b-5 to read as follows:

§ 240.10b5-1 Trading "on the basis of" material nonpublic information in insider trading cases.

Preliminary Note to § 240.10b5-1: This provision defines when a purchase or sale constitutes trading "on the basis of" material nonpublic information in insider trading cases brought under Section 10(b) of the Act and Rule 10b-5 thereunder. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-1 does not modify the scope of insider trading law in any other respect.

(a) General. The "manipulative and deceptive devices" prohibited by Section 10(b) of the Act (15 U.S.C. 78j) and § 240.10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.

(b) Definition of "on the basis of." Subject to the affirmative defenses in paragraph (c) of this section, 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.

(c) Affirmative defenses.

(1)(i) Subject to paragraph (c)(1)(ii) of this section, a person's purchase or sale is not "on the basis of" material nonpublic information if the person making the purchase or sale demonstrates that:

(A) before becoming aware of the information, the person had:

(1) entered into a binding contract to purchase or sell the security,

(2) instructed another person to purchase or sell the security for the instructing person's account, or

(3) adopted a written plan for trading securities;

(B) the contract, instruction, or plan described in paragraph (c)(1)(i)(A) of this Section:

(1) specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold;

(2) included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or

(3) did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the contract, instruction, or plan, did exercise such influence must not have been aware of the material nonpublic information when doing so; and

(C) the purchase or sale that occurred was pursuant to the contract, instruction, or plan. A purchase or sale is not "pursuant to a contract, instruction, or plan" if, among other things, the person who entered into the contract, instruction, or plan altered or deviated from the contract, instruction, or plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale), or entered into or altered a corresponding or hedging transaction or position with respect to those securities.

(ii) Paragraph (c)(1)(i) of this section is applicable only when the contract, instruction, or plan to purchase or sell securities was given or entered into in good faith and not as part of a plan or scheme to evade the prohibitions of this section.

(iii) This paragraph (c)(1)(iii) defines certain terms as used in paragraph (c) of this Section.

(A) Amount. "Amount" means either a specified number of shares or other securities or a specified dollar value of securities.

(B) Price. "Price" means the market price on a particular date or a limit price, or a particular dollar price.

(C) Date. "Date" means, in the case of a market order, the specific day of the year on which the order is to be executed (or as soon thereafter as is practicable under ordinary principles of best execution). "Date" means, in the case of a limit order, a day of the year on which the limit order is in force.

(2) A person other than a natural person also may demonstrate that a purchase or sale of securities is not "on the basis of" material nonpublic information if the person demonstrates that:

(i) The individual making the investment decision on behalf of the person to purchase or sell the securities was not aware of the information; and

(ii) The person had implemented reasonable policies and procedures, taking into consideration the nature of the person's business, to ensure that individuals making investment decisions would not violate the laws prohibiting trading on the basis of material nonpublic information. These policies and procedures may include those that restrict any purchase, sale, and causing any purchase or sale of any security as to which the person has material nonpublic information, or those that prevent such individuals from becoming aware of such information.

3. Section 240.10b5-2 is added to read as follows:

§ 240.10b5-2 Duties of trust or confidence in misappropriation insider trading cases.

Preliminary Note to § 240.10b5-2: This section provides a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for purposes of the "misappropriation" theory of insider trading under Section 10(b) of the Act and Rule 10b-5. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-2 does not modify the scope of insider trading law in any other respect.

(a) Scope of Rule. This section shall apply to any violation of Section 10(b) of the Act (15 U.S.C. 78j(b)) and § 240.10b-5 thereunder that is based on the purchase or sale of securities on the basis of, or the communication of, material nonpublic information misappropriated in breach of a duty of trust or confidence.

(b) Enumerated "duties of trust or confidence." For purposes of this section, a "duty of trust or confidence" exists in the following circumstances, among others:

(1) Whenever a person agrees to maintain information in confidence;

(2) Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality; or

(3) Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of

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the information.

4. Part 243 is added to read as follows:

PART 243 -- REGULATION FD

Sec.

243.100 General rule regarding selective disclosure.

243.101 Definitions.

243.102 No effect on antifraud liability.

243.103 No effect on Exchange Act reporting status.

Authority: 15 U.S.C. 78c, 78i, 78j, 78m, 78o, 78w, 78mm, and 80a-29, unless otherwise noted.

§ 243.100 General rule regarding selective disclosure.

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

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

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

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

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

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

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that an institutional investment manager is an investment adviser;

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

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

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

(i) To a person who owes a duty of trust or confidence to the issuer (such as an attorney, investment banker, or accountant);

(ii) To a person who expressly agrees to maintain the disclosed information in confidence;

(iii) To an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available; or

(iv) In connection with a securities offering registered under the Securities Act, other than an offering of the type described in any of Rule 415(a)(1)(i) - (vi)

(§ 230.415(a)(1)(i) - (vi) of this chapter).

§ 243.101 Definitions.

This section defines certain terms as used in Regulation FD (§§ 243.100 - 243.103).

(a) Intentional. A selective disclosure of material nonpublic information is "intentional" when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic.

(b) Issuer. An "issuer" subject to this regulation is one that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934

(15 U.S.C. 78l), or is required to file reports under Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), including any closed-end investment company (as defined in Section 5(a)(2) of the Investment Company Act of 1940) (15 U.S.C. 80a-5(a)(2)), but not including any other investment company or any foreign government or foreign private issuer, as those terms are defined in Rule 405 under the Securities Act

(§ 230.405 of this chapter).

(c) Person acting on behalf of an issuer. "Person acting on behalf of an issuer" means any senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser), or any other officer, employee, or agent of an issuer who regularly communicates with any person described in § 243.100(b)(1)(i), (ii), or (iii), or with holders of the issuer's securities. An 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.

(d) Promptly. "Promptly" means as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange) after a senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser) learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.

(e) Public disclosure.

(1) Except as provided in paragraph (e)(2) of this section, an issuer shall make the "public disclosure" of information required by § 243.100(a) by furnishing to or filing with the Commission a Form 8-K (17 CFR 249.308) disclosing that information.

(2) An issuer shall be exempt from the requirement to furnish or file a Form 8-K 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.

(f) Senior official. "Senior official" means any director, executive officer (as defined in § 240.3b-7 of this chapter), investor relations or public relations officer, or other person with similar functions.

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

(1) Underwritten offerings. A securities offering that is underwritten commences when the issuer reaches an understanding with the broker-dealer that is to act as managing underwriter and continues until the later of

the end of the period during which a dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated);

(2) Non-underwritten offerings. A securities offering that is not underwritten:

(i) If covered by Rule 415(a)(1)(x) (§ 230.415(a)(1)(x) of this chapter), commences when the issuer makes its first bona fide offer in a takedown of securities and continues until the later of the end of the period during which each dealer must deliver a prospectus or the sale of the securities in that takedown (unless the takedown is sooner terminated);

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

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

§ 243.102 No effect on antifraud liability.

No failure to make a public disclosure required solely by § 243.100 shall be deemed to be a violation of Rule 10b-5 (17 CFR 240.10b-5) under the Securities Exchange Act.

§ 243.103 No effect on Exchange Act reporting status.

A failure to make a public disclosure required solely by § 243.100 shall not affect whether:

(a) For purposes of Forms S-2 (17 CFR 239.12), S-3 (17 CFR 239.13) and S-8 (17 CFR 239.16b) under the Securities Act, an issuer is deemed to have filed all the material required to be filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) or, where applicable, has made those filings in a timely manner; or

(b) There is adequate current public information about the issuer for purposes of § 230.144(c) of this chapter (Rule 144(c)).

PART 249 -- FORMS, SECURITIES EXCHANGE ACT OF 1934

5. The authority citation for Part 249 is amended by adding the following citations:

Authority: 15 U.S.C. 78a, et seq., unless otherwise noted;

Selective Disclosure and Insider Trading

Section 249.308 is also issued under 15 U.S.C. 80a-29.

* * * * *

6. Section 249.308 is amended by revising the phrase "Rule 13a-11 or Rule 15d-11 (§ 240.13a-11 or § 240.15d-11 of this chapter)" to read "Rule 13a-11 or Rule 15d-11 (§ 240.13a-11 or § 240.15d-11 of this chapter) and for reports of nonpublic information required to be disclosed by Regulation FD (§§ 243.100 and 243.101 of this chapter)".

7. Form 8-K (referenced in § 249.308) is amended:

a. in General Instruction A, by revising the phrase "Rule 13a-11 or Rule 15d-11" to read "Rule 13a-11 or Rule 15d-11, and for reports of nonpublic information required to be disclosed by Regulation FD (17 CFR 243.100 and 243.101)".

b. by adding one sentence to the end of paragraph 1 of General Instruction B;

c. in General Instruction B, by adding a new paragraph 2;

d. in General Instruction B.4., by revising the phrase "other events of material importance pursuant to Item 5," to read "other events of material importance pursuant to Item 5 and of information pursuant to Item 9,";

e. in General Instruction B. by adding a new paragraph 5;

f. in Item 5 of Information to be Included in the Report by adding a new sentence at the end of the paragraph;

g. by adding a new Item 9 under "Information to be Included in the Report", to read as follows:

Note: The text of Form 8-K does not, and these amendments will not, appear in the Code of Federal Regulations.

Form 8-K

* * * * *

GENERAL INSTRUCTIONS

* * * * *

B. Events to be Reported and Time for Filing of Reports

Selective Disclosure and Insider Trading

1. * * * A registrant either furnishing a report on this form under Item 9 or electing to file a report on this form under Item 5 solely to satisfy its obligations under Regulation FD (17 CFR 243.100 and 243.101) must furnish such report or make such filing in accordance with the requirements of Rule 100(a) of Regulation FD (17 CFR 243.100(a)).

2. The information in a report furnished pursuant to Item 9 shall not be deemed to be "filed" for the purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, except if the registrant specifically states that the information is to be considered "filed" under the Exchange Act or incorporates it by reference into a filing under the Securities Act or the Exchange Act.

* * * * *

5. A registrant's report under Item 5 or Item 9 will not be deemed an admission as to the materiality of any information in the report that is required to be disclosed solely by Regulation FD.

* * * * *

INFORMATION TO BE INCLUDED IN THE REPORT

* * * * *

Item 5. Other Events and Regulation FD Disclosure.

* * * The registrant may, at its option, file a report under this item disclosing the nonpublic information required to be disclosed by Regulation FD (17 CFR 243.100-243.103).

* * * * *

Item 9. Regulation FD Disclosure.

Unless filed under Item 5, report under this item only information the registrant elects to disclose through Form 8-K pursuant to Regulation FD (17 CFR 243.100-243.103).

* * * * *

By the Commission.

Jonathan G. Katz
Secretary

Dated: August 15, 2000

Footnotes

¹ 17 CFR 243.100-243.103.

² 17 CFR 240.10b5-1.

³ 17 CFR 240.10b5-2.

⁴ 17 CFR 249.308.

⁵ The new rules and amendments were proposed in Exchange Act Release No. 42259 (Dec. 20, 1999) [64 FR 72590].

⁶ United States v. O'Hagan, 521 U.S. 642, 658 (1997) (citing Victor Brudney, Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws, 93 Harv. L. Rev. 322, 356 (1979)). See also H.R. Rep. No. 100-910 (1988) ("The investing public has a legitimate expectation that the prices of actively traded securities reflect publicly available information about the issuer of such securities. . . . [T]he small investor will be - and has been - reluctant to invest in the market if he feels it is rigged against him.")

⁷ See Proposing Release, part II.A. As discussed in the Proposing Release, in light of the "personal benefit" test set forth in the Supreme Court's decision in Dirks v. SEC, 463 U.S. 646 (1983), many have viewed issuer selective disclosures to analysts as protected from insider trading liability, see, e.g., Paul P. Broutas Jr., Note: Rule 10b-5 and Voluntary Corporate Disclosures to Securities Analysts, 92 Colum. L. Rev. 1517, 1529 (1992). We have brought a settled enforcement action alleging a tipping violation by a corporate officer who was alleged to have acted with the motive to protect and enhance his reputation. SEC v. Phillip J. Stevens, Litigation Release No. 12813 (Mar. 19, 1991).

⁸ See e.g., Jeffrey M. Laderman, Who Can You Trust? Wall Street's Spin Game, Stock Analysts Often Have a Hidden Agenda, Bus. Wk., Oct. 5, 1998 and Amitabh Dugar, Siva Nathan, Analysts' Research Reports: Caveat Emptor, 5 J. Investing 13 (1996).

⁹ The public comments we received, and a summary of public comments prepared by our staff, can be reviewed in our Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549, in File No. S7-31-99. Public comments submitted by electronic mail are on our website, www.sec.gov.

¹⁰ See, e.g., Letters of Gary Aguirre, David Cambridge, Malcolm Kirby, and Doug Wilmsmeyer.

¹¹ See, e.g., EDS Call By Merrill Spurs Warning: Call of the Day, Bloomberg

News, June 9, 2000, available in Bloomberg, Hush List; Altera Steers Analysts' Revenue Forecasts: Call of the Day, Bloomberg News, June 6, 2000, available in Bloomberg, Hush List; Goldman Falls After Warning on 2nd-Quarter Profit, Bloomberg News, May 26, 2000, available in Bloomberg, Hush List; Pepsi Bottling Gives Select Group Early Look at Data, Bloomberg News, May 15, 2000, available in Bloomberg, Hush List; Investors Back SEC Rule to Ban Selective Disclosure, Bloomberg News, Apr. 27, 2000, available in Bloomberg Equity CN; Richard McCaffery, Papa John's Investors: The Last to Know, Motley Fool, Dec. 9, 1999 (<http://www.fool.com/news/1999/pzza991209.html>); Juniper Networks Doesn't Invite All Investors to Product Call, Bloomberg News, Dec. 7, 1999, available in Bloomberg, Hush List; Access Denied: Some Investors Lose When Kept Out, Bloomberg News, Dec. 6, 1999, available in Bloomberg, Hush List; Fred Barbash, Companies, Analysts a Little Too Cozy, Wash. Post, Oct. 31, 1999, at H1; SEC's Levitt Seeks to Open Company Conference Calls, Bloomberg News, Oct. 18, 1999, available in Bloomberg, Hush List; Susan Pulliam, Abercrombie & Fitch Ignites Controversy Over Possible Leak of Sluggish Sales Data, Wall St. J., Oct. 14, 1999, at C1; SEC May Propose Rule to Curb Selective Disclosure, Bloomberg News, Oct. 7, 1999, available in Bloomberg, Hush List; Idaho Conference of Moguls, Investors Boosts Stocks, Bloomberg News, July 8, 1999, available in Bloomberg, Hush List; ConAgra Excludes Investors From 3rd-Qtr Earnings Call, Bloomberg News, Mar. 25, 1999, available in Bloomberg, Hush List; Susan Pulliam and Gary McWilliams, Compaq is Criticized for How it Disclosed PC Troubles, Wall St. J., Mar. 2, 1999, at C1; Miriam Hill, Should Companies Play Favorites?, Philadelphia Inquirer, Feb. 2, 1999, at C1; Big Investors Get First Word With Market-Moving News, Bloomberg News, Dec. 14, 1998, available in Bloomberg, Hush List. We do not mean to suggest that all these reports necessarily involve selective disclosure of material nonpublic information.

¹² National Investor Relations Institute, A Study of Corporate Disclosure Practices, Second Measurement, 18 (May 1998); Stephen Barr, "Back to the Future: What the SEC Should Really Do About Earnings Management," CFO Magazine (Sept. 1999).

¹³ NIRI Executive Alert, Most Corporate Conference Calls Are Now Open to Individual Investors and the Media, Feb. 29, 2000.

¹⁴ See, e.g., Remarks of Chairman Arthur Levitt to the "SEC Speaks" Conference, "A Question of Integrity: Promoting Investor Confidence by Fighting Insider Trading" (Feb. 27, 1998); Remarks of Commissioner Isaac C. Hunt, Jr., "Navigating the Sea of Communications" (Feb. 26, 1999); Remarks of Commissioner Laura S. Unger, "Corporate Communications Without Violations: How Much Should Issuers Tell Their Analysts and When" (Apr. 23, 1999). Copies of these speeches are available on the SEC's website at www.sec.gov.

¹⁵ See, e.g., Letters of the Securities Industry Association, The Bond Market Association, and the American Bar Association.

¹⁶ We note, in addition, that if we were successful in enforcement actions charging selective disclosures as a form of fraudulent insider trading, the in terrorem effect of that success (and the consequent chilling effect on issuers) would certainly be far greater than the impact of the more measured approach we adopt today.

¹⁷ See, e.g., Letters of the Securities Industry Association, Sullivan and Cromwell, the Association for Investment Management and Research, Merrill Lynch, and the New York City Bar Association.

¹⁸ See, e.g., Letters of the Securities Industry Association, the Association for Investment Management and Research, and Merrill Lynch.

¹⁹ See, e.g., Letters of the United Kingdom Listing Authority, Chris Kallaher, and Joseph L. Toenjes.

²⁰ See, e.g., Letters of the American Bar Association, the American Corporate Counsel Association, the DC Bar, the American Society of Corporate Secretaries, and the Securities Industry Association.

²¹ Letters of Dow Jones, Moody's, and Standard and Poors.

²² See, e.g., Letters of Dow Jones (suggesting exclusion for "bona fide news organizations"); Standard and Poors (suggesting exclusion for disclosure to rating agencies when information provided in connection with rating process); and the Securities Industry Association (suggesting exclusion for disclosure to government recipients).

²³ See, e.g., Letters of the American Corporate Counsel Association, the American Society of Corporate Secretaries, the DC Bar, and Sullivan and Cromwell.

²⁴ Rule 100(b)(1)(ii) includes an "institutional investment manager" as defined in Section 13(f)(5) of the Exchange Act (15 U.S.C. 78m(f)(5)) that filed a Form 13F for the most recent quarter of the year. Generally, institutional investment managers are required to report on Form 13F if they exercise investment discretion with respect to accounts holding publicly traded equity securities having an aggregate market value of at least \$100 million. See Exchange Act Rule 13f-1, 17 C.F.R. 240.13f-1.

²⁵ Rule 100(b)(1)(iii) includes hedge funds by covering persons who would be categorized as investment companies but for the exclusions from the definition of investment company set forth in Sections 3(c)(1) or 3(c)(7) of the Investment Company Act (15 U.S.C. 80a-3(c)(1) or 80a-3(c)(7)).

²⁶ With one exception, we are using the definitions of these terms provided in the federal securities laws. With respect to investment companies and hedge funds, the definition of "affiliated person" that we provide for purposes of Regulation FD is somewhat narrower than the definition of that term provided in Section 2(a)(3) of the Investment Company Act (15 U.S.C. 80a-2(a)(3)). The Regulation FD definition does not include the persons included in Section 2(a)(3)(A) and (B) -- i.e., persons who own or control 5% of the voting securities of an investment company, or companies in which the investment company owns or controls 5% of the voting securities. We believe that these persons should not be included among those to whom selective disclosure is prohibited, because they are not ordinarily persons who will exercise influence or control over an investment company's investment decisions, or be used as conduits for transmission of selectively disclosed information.

²⁷ While it is conceivable that a representative of a customer, supplier, strategic partner, news organization, or government agency could be a security holder of the issuer, it ordinarily would not be foreseeable for the issuer engaged in an ordinary-course business-related communication with that person to expect the person to buy or sell the issuer's securities on the basis of the communication. Indeed, if such a person were to trade on the basis of material nonpublic information obtained in his or her representative capacity, the person likely would be liable under the misappropriation theory of insider trading.

²⁸ This agreement to maintain confidentiality must be express. However, this is not a requirement for a written agreement; an express oral agreement will suffice. In addition, it will not be necessary for the issuer to obtain a confidentiality agreement before making the disclosure. An agreement obtained after the disclosure is made, but before the recipient of the information discloses or trades on the basis of it, will be sufficient. In this manner, an issuer who has mistakenly made a selective disclosure of material information may try to avoid any harm resulting from the selective disclosure by obtaining from the recipient of that disclosure an agreement not to disclose or trade on the basis of the information.

²⁹ These first two exclusions recognize that an issuer may have a confidentiality agreement with, or be owed a duty of trust or confidence by, an individual or group within a larger organization. In that situation, the issuer can share material nonpublic information with the individual or group that owes it the duty of confidentiality, even though there may be other persons in the organization who do not owe the issuer such a duty (and disclosure to whom would be covered by Regulation FD). For example, if an issuer shares information with an investment banker subject to a duty of trust or confidence or an express confidentiality agreement, the issuer will not be deemed to be sharing the information with other parts of the investment banker's firm (e.g., sell-side analysts or sales force personnel). Conversely, the fact that a duty of trust or confidence or a confidentiality agreement specifically covers disclosure to the investment banker does not permit disclosure to others within the investment banker's firm.

³⁰ Letters of The Bond Market Association, Moody's, and Standard and Poors.

³¹ Letters of the American Bar Association, the American Corporate Counsel Association, and Cleary Gottlieb.

³² Letter of PricewaterhouseCoopers.

³³ Letter of the Business Roundtable.

³⁴ "Senior official" is defined in Rule 101(f) as any director, executive officer, investor relations or public relations officer, or other person with similar functions. See Section II.B.3.b below. In the case of a closed-end investment company, Regulation FD also defines the term "person acting on behalf of an issuer" to include a senior official of the issuer's investment adviser.

³⁵ See Rule 101(c). For a closed-end investment company subject to Regulation FD, an "agent" of the issuer would include a director, officer, or employee of the investment company's investment adviser or other service provider who is acting as an agent of the issuer.

³⁶ By including those who "regularly" communicate with securities market professionals and security holders, the rule focuses on those whose job responsibilities include dealing with securities market professionals and security holders, acting in those capacities. It does not cover every employee who may occasionally communicate with an analyst or security holder. Thus, if an analyst sought to ferret out information about an issuer's business by quizzing a store manager on how business was going, the store manager's response ordinarily would not trigger any Regulation FD obligations. Similarly, an employee who routinely dealt with customers or suppliers would not come within this definition merely because one of these customers or suppliers also happened to be a security holder of the issuer.

³⁷ As noted in the Proposing Release, in such a case the employee's potential liability will depend on existing insider trading law and relevant doctrines of controlling person liability. See, e.g., Sections 20A and 21A of the Exchange Act, 15 U.S.C. 78t-1 and 78u-1.

³⁸ TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); see Basic v. Levinson, 485 U.S. 224, 231 (1988) (materiality with respect to contingent or speculative events will depend on a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity); see also Securities Act Rule 405, 17 CFR 230.405; Exchange Act Rule 12b-2, 17 CFR 240.12b-2; Staff Accounting Bulletin No. 99 (Aug. 12, 1999) (64 FR 45150) (discussing materiality for purposes of financial statements).

³⁹ Id.

⁴⁰ See, e.g., Texas Gulf Sulphur, 401 F.2d 833, 854 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969); In re Investors Management Co., 44 S.E.C. 633, 643 (1971). For purposes of insider trading law, insiders must wait a "reasonable" time after disclosure before trading. What constitutes a reasonable time depends on the circumstances of the dissemination. Faberge, Inc., 45 S.E.C. 249, 255 (1973), citing Texas Gulf Sulphur, 401 F.2d at 854.

⁴¹ See, e.g., Letters of the Financial Executives Institute and the North American Securities Administrators Association.

⁴² See, e.g., Letters of the American Bar Association, the Association for Investment Management and Research, the Association of Publicly Traded Companies, Bank One, Cleary Gottlieb, Goldman Sachs, the Investment Company Institute, the New York City Bar Association, the Securities Industry Association, and Sullivan and Cromwell.

⁴³ See Letter of the American Bar Association.

⁴⁴ In the Proposing Release, we offered several suggestions for mitigating these concerns, including: (1) designating a limited number of persons who are authorized to make disclosures or field inquiries from investors, analysts, and the media; (2) keeping a record of communications with analysts; (3) declining to answer sensitive questions until issuer personnel could consult with counsel; or (4) seeking time-limited "embargo" agreements from analysts in appropriate circumstances. Several commenters believed that the first of these methods was a useful practice, which was already in place at many issuers, but did not believe the other suggestions would be practical. We did not intend to suggest that issuers were required to implement any of these practices, but only offered them as suggestions.

⁴⁵ See, e.g., Letters of the American Bar Association, the Association of Publicly Traded Companies, the Investment Company Institute, and the DC Bar.

⁴⁶ Basic Inc. v. Levinson, 485 U.S. 224, 236 (1988).

⁴⁷ Compare NASD Rule IM-4120-1. Some of these items are currently covered in Form 8-K reporting requirements.

⁴⁸ See, e.g., Letter of Charles Schwab.

⁴⁹ See also, Section II.B.3 below.

⁵⁰ Rule 100(a)(1).

⁵¹ Rule 101(a).

⁵² See, e.g., Letters of the American Corporate Counsel Association, Charles Schwab, and Dow Chemical.

⁵³ See, e.g., Letters of the American Society of Corporate Secretaries and Credit Suisse First Boston.

⁵⁴ See, e.g., Letters of the American Society of Corporate Secretaries, the American Corporate Counsel Association, and J.P. Morgan.

⁵⁵ See, e.g., Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38 (2d Cir.), cert. denied, 439 U.S. 1039 (1978); McLean v. Alexander, 599 F.2d 1190 (3d Cir. 1979); Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017 (6th Cir. 1979); SEC v. Carriba Air, Inc., 681 F.2d 1318 (11th Cir. 1982).

⁵⁶ See Hollinger v. Titan Capital Corp., 914 F.2d 1564 (9th Cir. 1990), cert. denied, 499 U.S. 976 (1991); Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033 (7th Cir.), cert. denied, 434 U.S. 875 (1977).

⁵⁷ Of course, a pattern of "mistaken" judgments about materiality would make less credible the claim that any particular disclosure was not intentional.

⁵⁸ See Letters of the Chicago Board Options Exchange and Gretchen Sprigg Wisheart.

⁵⁹ See, e.g., Letters of Cleary Gottlieb, Credit Suisse First Boston, Emerson Electric, and Morgan Stanley Dean Witter.

⁶⁰ See, e.g., Letters of the American Bar Association, the American Corporate Counsel Association, the National Investor Relations Institute, and PR Newswire.

⁶¹ Rule 101(f).

⁶² Rule 101(d).

⁶³ See, e.g., Letters of Business Wire, the Society of American Business Editors and Writers, PR Newswire, and the National Federation of Press Women.

⁶⁴ See, e.g., Letters of the American Corporate Counsel Association, the American Society of Corporate Secretaries, the Business Roundtable, Intel, and Dow Chemical.

⁶⁵ See, e.g., Letters of the American Corporate Counsel Association, the American Society of Corporate Secretaries, Cleary Gottlieb, and the National Investors Relations Institute.

⁶⁶ Item 5 is used for optional reporting of any information not required to be reported by a company.

⁶⁷ A company must designate in the Form 8-K that it is filing under Item 5 in this case.

⁶⁸ A company must designate in the Form 8-K that it is furnishing information under Item 9 in this case.

⁶⁹ Rule 101(e)(2).

⁷⁰ We do not share the concerns of some commenters that Regulation FD will lead to press releases being supplanted as a regular means of corporate disclosure. In many cases, a widely-disseminated press release will provide the best way for an issuer to provide broad, non-exclusionary disclosure of information to the public. Moreover, we note that self-regulatory organization ("SRO") rules typically require companies to issue press releases to announce material developments. We believe that these rules are appropriate, and do not intend Regulation FD to alter or supplant the SRO requirements.

⁷¹ Giving the public the opportunity to listen to the call does not also require that the issuer give all members of the public the opportunity to ask questions.

⁷² See Letters of Intel, Charles Schwab, and the Business Roundtable.

⁷³ We believe that if an issuer is using a webcast or conference call as part of its method of effecting public distribution, it should consider providing a means of making the webcast or call available for some reasonable period of time. This will enable persons who missed the original webcast or call to access the disclosures made therein at a later time.

⁷⁴ This is not to say, however, that an issuer may not change its usual practices on an ongoing basis rather than in isolated instances.

⁷⁵ The Commission has asked the Division of Corporation Finance to

undertake this review.

⁷⁶ See, e.g., NASDAQ Rules 4310(c)(16) and 4320(e)(14), and NYSE Listed Company Manual, § 2.

⁷⁷ See *Schoenbaum v. Firstbrook*, 405 F.2d 200, 208 (2d Cir.) rev'd on other grounds, 405 F.2d 215, 220 (2d Cir. 1968) (en banc). See also discussion in Section II.B.7. infra.

⁷⁸ See, e.g., Letters of the American Bar Association, the New York City Bar Association, The Bond Market Association, Cleary Gottlieb, Credit Suisse First Boston, and the Securities Industry Association.

⁷⁹ For example, Section 5(c) prohibits offers prior to the filing of a registration statement and Section 5(b)(1) prohibits the use of written or broadcast communications that fall within the "prospectus" definition (except the preliminary Section 10 prospectus) until the final Section 10(a) prospectus has been delivered.

⁸⁰ See Rule 100(b)(2). Registered shelf offerings under Rule 415(a)(1)(i), (ii), (iii), (iv), (v), or (vi) are not excluded from the operation of Regulation FD. Those offerings, which include secondary offerings, dividend or interest reinvestment plans, employee benefit plans, the exercise of outstanding options, warrants or rights, the conversion of outstanding securities, pledges of securities as collateral and issuances of American depositary shares, are generally of an ongoing and continuous nature. Because of the nature of those offerings, issuers would be exempt from the operation of Regulation FD for extended periods of time if the exclusion for registered offerings covered them. Public companies that engage in these offerings should be accustomed to resolving any Section 5 issues relating to their public disclosure of material information during these offerings.

In light of the revisions we have made to Regulation FD to exclude disclosures in connection with a registered offering, we are not adopting proposed Rule 181. That proposed rule was designed to address concerns that Regulation FD-required disclosures during a registered offering could be nonconforming prospectuses that violate Section 5(b)(1) of the Securities Act. Because Regulation FD will not apply to disclosure in connection with registered offerings (other than those of a continuous nature), we believe that Rule 181 is no longer necessary.

⁸¹ See Rule 101(g).

⁸² For example, communications that a public company makes about its future financial performance in one of its regularly scheduled conference calls with analysts would not be considered to be made in connection with an offering simply because the issuer was in the midst of a registered offering at that time.

⁸³ See, e.g., Letters of the American Bar Association; the American Corporate Counsel Association; the American Society of Corporate Secretaries; the New York State Bar Association; the Securities Industry Association; and Sullivan & Cromwell.

Form S-3 requires that the issuer be current and timely in filing its reports under Sections 13, 14 and 15(d) for a period of at least 12 calendar months prior to filing the registration statement. Form S-2 requires the same except that the issuer must be current in its reporting for the last 36 calendar months.

⁸⁴ Rule 144 requires that for such a resale to be valid the issuer of the securities must have made all filings required under the Exchange Act during the preceding 12 months. Form S-8 requires that the issuer be current in its reporting for the last 12 calendar months (or for such shorter period that the issuer was required to file such reports and materials). Rule 144 and Form S-8 eligibility would have been lost from the time of the failure to comply with Regulation FD until the company disclosed the information under the terms of the regulation.

⁸⁵ In addition, because a violation of Regulation FD is not an antifraud violation, it would not lead to loss of the safe harbor for forward looking statements provided by the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737. See Securities Act Section 27A(b), 15 U.S.C. 77z-2(b); and Exchange Act Section 21E(b), 15 U.S.C. 78u-5(b).

⁸⁶ This provision is limited to Regulation FD disclosure requirements and should be distinguished from other reporting requirements under Section 13(a) or 15(d) which do create a duty to disclose for purposes of Rule 10b-5.

⁸⁷ See *SEC v. Phillip J. Stevens*, supra note 7.

⁸⁸ See generally *Backman v. Polaroid Corp.*, 910 F.2d 10 (1st Cir. 1990) (en banc); *In re Phillips Petroleum Sec. Litig.*, 881 F.2d 1236 (3d Cir. 1989).

⁸⁹ See, e.g., *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156 (2d Cir. 1980); *In the Matter of Presstek, Inc.*, Exchange Act Release No. 39472 (Dec. 22, 1997).

⁹⁰ Regulation FD does not expressly require issuers to adopt policies and procedures to avoid violations, but we expect that most issuers will use appropriate disclosure policies as a safeguard against selective disclosure. We are aware that many, if not most, issuers already have policies and procedures regarding disclosure practices, the dissemination of material information, and the question of which issuer personnel are authorized to speak to analysts, the media, or investors. The existence of an appropriate

policy, and the issuer's general adherence to it, may often be relevant to determining the issuer's intent with regard to a selective disclosure.

⁹¹ Section 21C of the Exchange Act, 15 U.S.C. 78u-3. A failure to file or otherwise make required public disclosure under Regulation FD will be considered a violation for as long as the failure continues; in our enforcement actions, we likely will seek more severe sanctions for violations that continue for a longer period of time.

⁹² Section 20(e) of the Exchange Act, 15 U.S.C. 78t(e).

⁹³ Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264; Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677.

⁹⁴ United States v. O'Hagan, 521 U.S. 642, 658 (1997).

⁹⁵ See Dirks v. SEC, 463 U.S. 646, 654 (1983).

⁹⁶ See O'Hagan, 521 U.S. at 651-52.

⁹⁷ Compare United States v. Teicher, 987 F.2d 112, 120-21 (2d Cir.), cert. denied, 510 U.S. 976 (1993) (suggesting that "knowing possession" is sufficient) with SEC v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998) ("use" required, but proof of possession provides strong inference of use) and United States v. Smith, 155 F.3d 1051, 1069 & n.27 (9th Cir. 1998), cert. denied, 525 U.S. 1071 (1999) (requiring that "use" be proven in a criminal case).

⁹⁸ See Proposing Release at part III.A.1.

⁹⁹ See, e.g., Letters of the Securities Industry Association, the American Bar Association, Sullivan and Cromwell, and the DC Bar.

¹⁰⁰ Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Chiarella v. United States, 445 U.S. 222 (1980).

¹⁰¹ See Letters of the American Bar Association and Sullivan and Cromwell.

¹⁰² See, e.g., Letters of the American Bar Association, the New York City Bar Association, the Investment Company Institute, the DC Bar, and Sullivan and Cromwell.

¹⁰³ Letters of the American Society of Corporate Secretaries and Brobeck Phleger & Harrison.

¹⁰⁴ See Teicher, 987 F.2d at 120.

¹⁰⁵ Some commenters stated that "aware" was an unclear term that may be interpreted to mean something less than "knowing possession." We disagree. "Aware" is a commonly used and well-defined English word, meaning "having knowledge; conscious; cognizant." We believe that "awareness" has a much clearer meaning than "knowing possession," which has not been defined by case law.

¹⁰⁶ See, e.g., Letter of the Securities Industry Association.

¹⁰⁷ See Letters of LeBoeuf, Lamb, Greene, & MacRae (issuer repurchases); the American Society of Corporate Secretaries, Brobeck Phleger & Harrison (employee stock option plans); and L.B. Foster Company (employee stock purchase plans).

¹⁰⁸ See, e.g., Letter of the American Society of Corporate Secretaries.

¹⁰⁹ Rule 10b5-1(c)(1)(i)(A).

¹¹⁰ Rule 10b5-1(c)(1)(i)(B). We have removed the proposed affirmative defense for purchases or sales that result from a written plan for trading securities that is designed to track or correspond to a market index, market segment, or group of securities. We believe that the activity that was contemplated by that provision is permissible under the defense as adopted. Therefore, a separate defense is no longer necessary.

¹¹¹ Rule 10b5-1(c)(1)(i)(C). However, a person acting in good faith may modify a prior contract, instruction, or plan before becoming aware of material nonpublic information. In that case, a purchase or sale that complies with the modified contract, instruction, or plan will be considered pursuant to a new contract, instruction, or plan.

¹¹² Rule 10b5-1(c)(1)(iii)(A).

¹¹³ Rule 10b5-1(c)(1)(iii)(B).

¹¹⁴ Rule 10b5-1(c)(1)(iii)(C).

¹¹⁵ Some commenters raised questions about the treatment of standardized options trading under the proposed rule. These commenters suggested that the exercise of a standardized option should be allowed, regardless of what information the trader was aware of at the time of exercise, because the relevant investment decision was made when the person purchased the

standardized option. We do not agree that the decision to exercise a standardized option is not a separate investment decision. However, Rule 10b5-1, as adopted, does not affect the analysis of whether it is a separate investment decision. The rule could, however, affect options transactions in that it permits a person to pre-arrange, at a time when he or she is not aware of material nonpublic information, a plan for exercising options in the future.

¹¹⁶ A person would not satisfy this provision of the rule by establishing a delegation of authority under which the person retained some ability to influence the decision about how, when, or whether to purchase or sell securities.

¹¹⁷ Rule 10b5-1(c)(1)(i)(A)(2).

¹¹⁸ Rule 10b5-1(c)(1)(i)(A)(3).

¹¹⁹ Rule 10b5-1(c)(1)(i)(B)(2).

¹²⁰ *Id.*

¹²¹ Rule 10b5-1(c)(1)(i)(B)(3).

¹²² See Letter of L.B. Foster Company addressing Rule 16b-3(c), the exemption from Section 16(a) reporting and Section 16(b) short-swing profit liability for most transactions under tax-conditioned plans.

¹²³ For example, it will be possible to set up a trust so that the trust transactions will be eligible for both the Rule 16a-8(b)(3) exemption and the Rule 10b5-1(c)(1)(i)(B)(3) defense. The Rule 10b5-1(c)(1)(i)(B)(3) defense also will be available for portfolio securities transactions in which a Section 16 insider is not deemed to have a pecuniary interest by virtue of Rule 16a-1(a)(2)(iii).

¹²⁴ Rule 10b5-1(c)(2).

¹²⁵ The Securities Industry Association commented that paragraph (c)(2) would not allow institutions to engage in "dynamic hedging" in circumstances where the institution's trading desk, while managing its proprietary position through a hedge, also was aware of material nonpublic information. We do not believe paragraph (c)(2) should provide a defense in those circumstances, if the same trader who is aware of the material information is making the trading decisions for the firm. However, paragraph (c)(1), which would allow a broker-dealer to manage risk by devising a formula for hedging at a time when it is not aware of material nonpublic information, could provide a defense for that activity. Alternatively, the broker-dealer

could segregate its personnel and otherwise use information barriers so that the trader for the firm's proprietary account is not made aware of the material nonpublic information.

The Securities Industry Association also commented that the rule could unintentionally impede market liquidity when broker-dealers participate in shelf takedowns and other block transactions. The concern was that the rule would create uncertainty about whether a broker-dealer that held an order to execute a block transaction could continue to conduct regular market making in that same security. We believe that ordinary market making does not present insider trading concerns if a customer who places an order with a broker-dealer has an understanding that the broker-dealer may continue to engage in market making while working the order. Thus, a broker-dealer's ordinary market making would not be considered a "misappropriation" of the customer's information because it would not involve trading on the basis of the information in a manner inconsistent with the purpose for which it was given to the broker. If, however, a broker-dealer engaged in extraordinary trading for its own account when aware of unusually significant information regarding a customer order, it is possible, based on the facts and circumstances, that the broker-dealer would be held liable for insider trading or for front-running as defined by SRO rules.

¹²⁶ Proposing Release at part III.B.1.

¹²⁷ *O'Hagan*, 521 U.S. at 658-59.

¹²⁸ See, e.g., Letters of the American Society of Corporate Secretaries, the American Corporate Counsel Association, and the North American Securities Administrators' Association.

¹²⁹ See, e.g., Letter of the Association for Investment Management and Research.

¹³⁰ See, e.g., Letters of the American Bar Association and the New York City Bar Association.

¹³¹ 947 F.2d 551 (2d Cir. 1991) (en banc), *cert. denied*, 503 U.S. 1004 (1992).

¹³² 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 447 (2d Cir. 1985).

¹³³ *Reed*, for example, suggests that the types of confidences previously exchanged by family members (e.g., whether or not they were business confidences), may make a difference in determining whether or not a confidential relationship exists.

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¹³⁴ As stated in the Proposing Release and in the Preliminary Note to the rule, the law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5. This rule does not address or modify the scope of insider trading law in any other respect.

¹³⁵ Rule 10b5-2(b)(1).

¹³⁶ Rule 10b5-2(b)(2).

¹³⁷ Letters of the American Bar Association and the DC Bar.

¹³⁸ Letters of the American Bar Association and the New York City Bar Association.

¹³⁹ 44 U.S.C. 3501 *et seq.*

¹⁴⁰ *See* Letter of The Bond Market Association.

¹⁴¹ *See* Letter of the Securities Industry Association.

¹⁴² Many issuers, for example, do not have analyst coverage, *see* Harrison Hong et al., *Bad News Travels Slowly: Size, Analyst Coverage, and the Profitability of Momentum Strategies*, 55 J. Finance 265 (2000), or do not have institutional shareholders.

¹⁴³ *See* Letter of The Bond Market Association.

¹⁴⁴ A recent academic paper finds evidence that analyst conference calls are associated with increased return volatility, trading volume, and trade size. The authors interpret these results as evidence that material information may be revealed in analyst conference calls and that larger investors likely are taking advantage of this information. Richard Frankel et al., *An Empirical Examination of Conference Calls as a Voluntary Disclosure Medium*, 37 J. Acct. Res. 133 (1999). Two commenters questioned the reliability of the assumptions made in the study. We believe the assumptions are reasonable approximations, although not perfect. In any event, we view these results as corroborative evidence, not as the basis for our conclusions. *See* Letters of American Corporate Counsel Association and The Bond Market Association.

¹⁴⁵ *See, e.g.,* Letters of Pieter Bergshoeff and Barbara Black.

¹⁴⁶ Letter of the Chicago Board Options Exchange.

¹⁴⁷ *See* I. Krinsky and J. Lee, *Earnings Announcements and the Components of the Bid-Ask Spread*, 51 J. of Fin. 1523 (1996); C.M. Lee, B. Mucklow and

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M.J. Ready, *Spreads, Depth and the Impact of Earnings Information: An Intraday Analysis*, 6 Rev. of Fin. Stud. 345 (1993); A.S. Kyle, *Continuous Auctions and Insider Trading*, 53 Econometrica 1315 (1985); L.R. Glosten and P. Milgrom, *Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders*, 14 J. of Fin. Econ. 71 (1985).

¹⁴⁸ *See, e.g.,* Letters of IBM, A.T. Bigelow, and Thomas Brandon.

¹⁴⁹ Letter of Joseph McLaughlin.

¹⁵⁰ *See United States v. O'Hagan*, and H.R. Rep. No. 100-910, *supra*, note 6.

¹⁵¹ *See* M.J. Fishman and K.M. Hagerty, *Insider Trading and the Efficiency of Stock Prices*, 23 Rand J. of Econ. 106 (1992); M. Manove, *The Harm From Insider Trading and Informed Speculation*, 104 Q.J. of Econ. 823 (1989).

¹⁵² The Securities Industry Association disputed the significance of this benefit. Given the widespread reports, cited above and in the Proposing Release, of analysts' concerns about continuing access to corporate insiders, we continue to believe this is a significant issue.

¹⁵³ 17 CFR 249.308.

¹⁵⁴ We anticipate that many issuers will make one disclosure each quarter under Regulation FD. We also assume that issuers will, on average, make one additional disclosure per year.

¹⁵⁵ In many cases, information disclosed under Regulation FD would be information that an issuer was ultimately going to disclose to the public. Under Regulation FD, that issuer is not going to make any more public disclosure than it otherwise would, but it may make the disclosure sooner and now would be required to file or disseminate that information in a manner reasonably designed to provide broad, non-exclusionary distribution of the information to the public.

¹⁵⁶ In the Proposing Release, we assumed a cost of \$125 per hour for outside legal advice. We have revised that estimate and now assume that outside legal advice will cost \$175 per hour.

¹⁵⁷ Accordingly, in the Proposing Release, we assumed that 25% of the burden would be borne by outside counsel and 75% by in-house professional staff. This balance reflects our belief that many issuers will make disclosures by some disclosure option other than by a Form 8-K that will require less time from outside lawyers. Using these assumptions, the total approximate cost of a Regulation FD disclosure would be \$537.50.

¹⁵⁸ In the Proposing Release, we estimated the total paperwork burden to be approximately \$33,250,000. In addition to the changes noted above in notes 156 and 157, the revised figure also reflects a reduction in paperwork burden due to the exclusion from coverage of foreign private issuers under Regulation FD.

¹⁵⁹ Letters of Stephen Jones and Gretchen Sprigg Wisehart.

¹⁶⁰ Letter of The Bond Market Association.

¹⁶¹ Id.

¹⁶² Letter of the Securities Industry Association.

¹⁶³ See Harrison Hong et al., supra note 142.

¹⁶⁴ Letter of The Bond Market Association.

¹⁶⁵ See Fishman and Hagerty; Manove, supra note 151.

¹⁶⁶ See, e.g., Letters of Huntington Bancshares and Charles Schwab.

¹⁶⁷ See, e.g., Letters of Bradley Richardson and Scott Lawton.

¹⁶⁸ Letter of Net2000.

¹⁶⁹ Letter of the National Association of Real Estate Investment Trusts.

¹⁷⁰ Id.

¹⁷¹ See, e.g., Letters of the Securities Industry Association, The Bond Market Association, and the American Bar Association.

¹⁷² See, e.g., Letters of the Securities Industry Association and The Bond Market Association.

¹⁷³ See Letters of Charles Schwab and Net2000.

¹⁷⁴ R.J. Lundholm and M.H. Lang, Corporate Disclosure Policy and Analyst Behavior, 71 The Acct. Rev. 467 (1996).

¹⁷⁵ See Section 15(f) of the Exchange Act (15 U.S.C. 78o(f)) and Section 204A of the Investment Advisers Act (15 U.S.C. 80b-4a).

¹⁷⁶ In the Proposing Release, we asked whether we should require that contracts, instructions, or trading plans be approved by counsel. Commenters noted that such a requirement would impose costs. As adopted, the rule does not impose this requirement.

¹⁷⁷ We find that the exemption of issuers from the obligation to make public disclosure by furnishing or filing Forms 8-K on the condition that they disseminate the information through another method that is reasonably designed to provide broad, non-exclusionary distribution is necessary or appropriate in the public interest and is consistent with the protection of investors.

¹⁷⁸ Letter of the Securities Industry Association.

¹⁷⁹ Letters of the Securities Industry Association and Joseph McLaughlin.

¹⁸⁰ Letter of the American Bar Association.

¹⁸¹ Letter of VirtualFund.com.

¹⁸² Letters of the American Society of Corporate Secretaries and the Securities Industry Association.

¹⁸³ Exchange Act Rule 0-10(a) defines an issuer, other than an investment company, to be a "small business" or "small organization" if it had total assets of \$5 million or less on the last day of its most recent fiscal year. 17 CFR 240.0-10(a). Investment Company Act Rule 0-10(a) defines an investment company as a "small business" or "small organization" if it, "together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year." 17 CFR 270.0-10(a).

¹⁸⁴ In the IRFA, we estimated the number of issuers, other than investment companies, that may be considered small entities as approximately 830. The FRFA number represents the increased number of issuers filing Exchange Act reports pursuant to the NASD's new requirements implemented under Rule 6530 during the last 18 months.

¹⁸⁵ The Commission bases its estimate on information from Lipper Directors' Analytical Data, Lipper Closed-End Fund Performance Analysis Service, and reports investment companies file with the Commission on Form N-SAR.

¹⁸⁶ Exchange Act Rule 0-10(c) defines a broker-dealer as a small entity if it had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial

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statements were prepared and it is not affiliated with any person (other than a natural person) that is not a small entity. 17 CFR 240.0-10(c).

¹⁸⁷ Investment Advisers Act Rule 0-7 defines an investment adviser as a small entity if it: (i) manages less than \$25 million in assets, (ii) has total assets of less than \$5 million on the last day of its most recent fiscal year, and (iii) is not in a control relationship with another investment adviser that is not a small entity. 17 CFR 275.0-7.

¹⁸⁸ The Commission bases its estimate on information from FOCUS Reports.

¹⁸⁹ The Commission bases its estimate on information from the Commission's database of registration information.

¹⁹⁰ The Commission bases its estimate on information from Lipper Directors' Analytical Data and reports investment companies file with the Commission on Form N-SAR.

¹⁹¹ See Section 15(f) of the Exchange Act (15 U.S.C. 78o(f)) and Section 204A of the Investment Advisers Act (15 U.S.C. 80b-4a).

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U.S. Securities and Exchange Commission

Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations

Fourth Supplement (Includes Interpretations Issued May 2001, December 2000, and October 2000)

This is the fourth supplement (including interpretations issued May 2001, December 2000, and October 2000) to the Division of Corporation Finance's [telephone interpretation manual](#). [Additional supplements](#) are also available on the website. This supplement contains new interpretations issued by members of the staff in response to recent telephone inquiries. These interpretations relate to new Regulation FD and Rule 10b5-1 adopted in the [Selective Disclosure and Insider Trading](#) release (33-7881). Regulation FD and Rule 10b5-1 became effective October 23, 2000. Positions expressed may change without notice. Please also see the statement on the first page of the complete manual regarding the non-binding nature of telephone interpretations. The interpretations in this and the other supplements eventually will be integrated with the interpretations in the manual.

Interpretations Issued October 2000

Regulation FD

1. Can an issuer ever confirm selectively a forecast it has previously made to the public without triggering the rule's public reporting requirements?

Yes. In assessing the materiality of an issuer's confirmation of its own forecast, the issuer should consider whether the confirmation conveys any information above and beyond the original forecast and whether that additional information is itself material. That may depend on, among other things, the amount of time that has elapsed between the original forecast and the confirmation (or the amount of time elapsed since the last public confirmation, if applicable). For example, a confirmation of expected quarterly earnings made near the end of a quarter might convey information about how the issuer actually performed. In that respect, the inference a reasonable investor may draw from such a confirmation may differ significantly from the inference he or she may have drawn from the original forecast early in the quarter. The materiality of a confirmation also may depend on, among other things, intervening events. For example, if it is clear that the issuer's forecast is highly dependent on a particular customer and the customer subsequently announces that it is ceasing operations, a confirmation by the issuer of a prior forecast may be material.

We note that a statement by an issuer that it has "not changed," or that it is "still comfortable with," a prior forecast is no different than a confirmation of a prior forecast. Moreover, under certain circumstances, an issuer's reference to a prior forecast may imply that the issuer is

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confirming the forecast. If, when asked about a prior forecast, the issuer does not want to confirm it, the issuer may simply wish to say "no comment." If an issuer wishes to refer back to the prior estimate without implicitly confirming it, the issuer should make clear that the prior estimate was as of the date it was given and is not being updated as of the time of the subsequent statement.

2. Does Regulation FD create a duty to update?

No. Regulation FD does not change existing law with respect to any duty to update.

3. If an issuer wants to make public disclosure of material nonpublic information under Regulation FD by means of a conference call, what information must the issuer provide in the notice and how far in advance should notice be given?

An adequate advance notice under Regulation FD must include the date, time, and call-in information for the conference call.

Issuers also should consider the following non-exclusive factors in determining what constitutes adequate advance notice of a conference call:

- **Timing:** Public notice should be provided a reasonable period of time ahead of the conference call. For example, for a quarterly earnings announcement that the issuer makes on a regular basis, notice of several days would be reasonable. We recognize, however, that the period of notice may be shorter when unexpected events occur and the information is critical or time sensitive.
- **Availability:** If a transcript or re-play of the conference call will be available after it has occurred, for instance via the issuer's website, we encourage issuers to indicate in the notice how, and for how long, such a record will be available to the public.

4. Can an issuer satisfy Regulation FD's public disclosure requirement by disclosing material nonpublic information at a shareholder meeting that is open to all shareholders, but not to the public?

No. If a shareholder meeting is not accessible by the public, an issuer's selective disclosure of material nonpublic information at the meeting would not satisfy Regulation FD's public disclosure requirement.

5. Could an Exchange Act filing other than a Form 8-K, such as a Form 10-Q or proxy statement, constitute public disclosure?

Yes. In general, including information in a document publicly filed on EDGAR with the SEC within the time frames that Regulation FD requires would satisfy the rule. In considering whether that disclosure is sufficient, however, companies must take care to bring the disclosure to the attention of readers of the document, must not bury the information, and must not make the disclosure in a piecemeal fashion throughout the filing.

6. For purposes of Regulation FD, must an issuer wait some period of time after making a filing or furnishing a report on EDGAR that complies with the Exchange Act before making disclosure of the same information to a select audience?

Prior to making disclosure to a select audience, the issuer need only confirm that the filing or furnished report has received a filing date (as determined in accordance with Rules 12 and 13 of Regulation S-T) that is no later than the date of the selective disclosure.

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7. Can an issuer ever review and comment on an analyst's model privately without triggering Regulation FD's disclosure requirements?

Yes. It depends on whether, in so doing, the issuer communicates material nonpublic information. For example, an issuer ordinarily would not be conveying material nonpublic information if it corrected historical facts that were a matter of public record. An issuer also would not be conveying such information if it shared seemingly inconsequential data which, pieced together with public information by a skilled analyst with knowledge of the issuer and the industry, helps form a mosaic that reveals material nonpublic information. It would not violate Regulation FD to reveal this type of data even if, when added to the analyst's own fund of knowledge, it is used to construct his or her ultimate judgments about the issuer. An issuer may not, however, use the discussion of an analyst's model as a vehicle for selectively communicating – either expressly or in code – material nonpublic information.

8. During a nonpublic meeting with analysts, an issuer's CEO provides material nonpublic information on a subject she had not planned to cover. Although the CEO had not planned to disclose this information when she entered the meeting, after hearing the direction of the discussion, she decided to provide it, knowing that the information was material and nonpublic. Would this be considered an intentional disclosure that violated Regulation FD because no simultaneous public disclosure was made?

Yes. A disclosure is "intentional" under Regulation FD when the person making it either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic. In this example, the CEO knew that the information was material and nonpublic, so the disclosure was "intentional" under Regulation FD, even though she did not originally plan to make it.

9. May an issuer provide material nonpublic information to analysts as long as the analysts expressly agree to maintain confidentiality until the information is public?

Yes.

10. If an issuer gets an agreement to maintain material nonpublic information in confidence, must it also get the additional statement that the recipient agrees not to trade on the information in order to rely on the exclusion in Rule 100(b)(2)(ii) of Regulation FD?

No. An express agreement to maintain the information in confidence is sufficient. If a recipient of material nonpublic information subject to such a confidentiality agreement trades or advises others to trade, he or she could face insider trading liability.

11. If an issuer wishes to rely on the confidentiality agreement exclusion of Regulation FD, is it sufficient to get an acknowledgment that the recipient of the material nonpublic information will not use the information in violation of the federal securities laws?

No. The recipient must expressly agree to keep the information confidential.

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12. Must road show materials in connection with a registered public offering be disclosed under Regulation FD?

Any disclosure made "in connection with" a registered public offering of the type excluded from Regulation FD is not subject to Regulation FD. That includes road shows in those offerings. All other road shows are subject to Regulation FD in the absence of another applicable exclusion from Regulation FD. For example, a disclosure in a road show in an unregistered offering is subject to Regulation FD. Also, a disclosure in a road show made while the issuer is not in registration and is not otherwise engaged in a securities offering is subject to Regulation FD. If, however, those who receive road show information expressly agree to keep the material nonpublic information confidential, disclosure to them is not subject to Regulation FD.

13. Can an issuer disclose material nonpublic information to its employees (who may also be shareholders) without making public disclosure of the information?

Yes. Rule 100(b)(1) states that Regulation FD applies to disclosures made to "any person outside the issuer." Regulation FD does not apply to communications of confidential information to employees of the issuer. An issuer's officers, directors, and other employees are subject to duties of trust and confidence and face insider trading liability if they trade or tip.

14. If an issuer has a policy that limits which senior officials are authorized to speak to persons enumerated in Rule 100(b)(1)(i) – (b)(1)(iv), will disclosures by senior officials not authorized to speak under the policy be subject to Regulation FD?

No. Selective disclosures of material nonpublic information by senior officials not authorized to speak to enumerated persons are made in breach of a duty of trust or confidence to the issuer and are not covered by Regulation FD. Such disclosures may, however, trigger liability under existing insider trading law.

15. A publicly traded company has decided to conduct a private placement of shares and then subsequently register the resale by those shareholders on a Form S-3 registration statement. The company and its investment bankers conduct mini-road shows over a three-day period during the private placement. Does the resale registration statement filed after completion of the private placement affect whether disclosure at the road shows is covered by Regulation FD?

No. The road shows are made in connection with an offering by the issuer that is not registered (i.e., the private placement), regardless of whether a registration statement is later filed for an offering by those who purchased in the private placement.

Additional Interpretations Issued December 2000

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16. Does the mere presence of the press at an otherwise non-public meeting attended by persons outside the issuer described in paragraph (b)(1) of Rule 100 under Regulation FD render the meeting public for purposes of Regulation FD?

Regulation FD states that a company can make public disclosure by filing or furnishing a Form 8-K or by disseminating information through another method (or combination of methods) that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public. Some companies may attempt to satisfy the latter method for public dissemination by merely having the press in attendance at a meeting to which the public is not invited or otherwise present. If it is attended by persons outside the issuer described in paragraph (b)(1) of Rule 100 under Regulation FD and if it is not otherwise public, the meeting will not necessarily be deemed public for purposes of Regulation FD by the mere presence of the press at the meeting. Whether or not the meeting would be deemed public would depend, among other things, on when, what and how widely the press reports on the meeting.

17. Is Regulation FD intended to replace the practice of using a press release to disseminate earnings information in advance of a conference call or webcast at which earnings information will be discussed?

No. In adopting Regulation FD, the Commission specifically indicated that it did not intend the regulation to alter or supplant the rules of self-regulatory organizations with respect to the use of press releases to announce material developments. In this regard, the Commission specifically endorsed a model for the planned disclosure of material information, such as earnings, in which the conference call or webcast is preceded by a press release containing the earnings information.

Rule 10b5-1**Form 144****1. On January 1, a person adopts a written plan for selling securities that satisfies the affirmative defense conditions of Rule 10b5-1(c). The first sale of securities under the plan will take place on March 1 in reliance on Rule 144. The person will need to file a Form 144. Does adoption of the Rule 10b5-1 plan change the due date for the Form 144?**

No. The Form 144 must be transmitted for filing concurrently with either the placement of a sell order for a brokerage transaction, or the execution of such sale directly with a market maker, as provided in Rule 144(h). The adoption of the plan itself may not be the same as placement of a sell order. The notice on Form 144 is effective for a maximum of three months, so that sales over longer periods will involve multiple requirements of notice under Rule 144(h).

2. **A person who has adopted a written trading plan or given trading instructions to satisfy Rule 10b5-1(c) plans to sell the securities in reliance on Rule 144. Can the person modify the Form 144 to state that the representation regarding the seller's knowledge of material information regarding the issuer is as of the date the Rule 10b5-1 plan was adopted or instructions given, rather than the date the person signs the Form 144?**

Yes. The seller should state in the Remarks section of the Form 144 that the sale is being made pursuant to a previously adopted plan or previously given trading instructions intended to comply with Rule 10b5-1(c). The seller should include the date the person adopted the plan or gave the trading instructions and indicate that the representation regarding the seller's knowledge of material information speaks as of that plan adoption or instruction date.

Additional Interpretations Issued May 2001

Trusts

3. **At a time when she is not aware of material nonpublic information, a person establishes a trust. In establishing the trust, she specifies that the trust shall sell 1,000 shares of issuer stock each quarter. Apart from this specification, she does not have or share any control over the trust's assets. Is a defense available under Rule 10b5-1(c)(1)(i)(B)(3) for the quarterly sales by the trust?**

Yes. Rule 10b5-1(c)(1)(i)(B)(3) contemplates that a person, while not aware of material nonpublic information, may delegate to a third party under a contract, instruction or written trading plan, all subsequent influence over how, when or whether to effect purchases or sales. Reliance on this affirmative defense does not prevent the person from setting some of the terms of the purchases or sales at the creation of the contract, instruction or plan so that no one has subsequent discretion as to those terms.

For example, this defense would be available if, in creating the contract, instruction or plan, the person specifies one or two of the amount, price or date of transactions. Whether or not any terms are set at creation, for a Rule 10b5-1(c)(1)(i)(B)(3) defense to be available, the person is not permitted to exercise any subsequent influence over how, when, or whether a transaction occurs. The third party who has been granted discretion must not be aware of material nonpublic information when exercising that discretion.

4. **At a time when he is not aware of material nonpublic information, a person will establish a blind trust to which he will contribute some, but not all, of the issuer securities that he owns. The person intends to delegate investment control over trust assets to the trustee so as to establish a defense under Rule 10b5-1(c)(1)(i)(B)(3) for trust transactions. Within the meaning of Rule 144(a)(2), the person and the trust will be a single person.**

During any three-month period, sales of issuer securities by the trust will share the Rule 144(e) volume limitation with the person's sales of other issuer securities he owns. Does the manner of allocating the Rule 144(e) volume limitation between sales by the trust and the person's other sales of issuer securities affect whether the person is permitted to exercise any subsequent influence over how, when, or whether to effect purchases or sales under the trust within the meaning of Rule 10b5-1(c)(1)(i)(B)(3)?

Yes. If during the term of the trust the person can control what portion of the Rule 144(e) volume limitation is available for trust sales, the person would be permitted to exercise subsequent influence over trust sales within the meaning of Rule 10b5-1(c)(1)(i)(B)(3). As a

result, the Rule 10b5-1(c)(1)(i)(B)(3) defense would be unavailable.

However, the person would not be permitted to exercise subsequent influence over trust sales if the instrument creating the trust specified either (1) the percentage of the volume limit to be allocated to sales by the trust and other sales by the person, or (2) that the trustee would determine that allocation for each applicable three-month period without consulting the person.

Options

5. **At a time when he is not aware of material nonpublic information, a person buys a put option, giving him the right at any time during the 12-month term of the option to sell 10,000 shares at a fixed exercise price. Two months later, he wishes to exercise the option. If he is aware of material nonpublic information at the time of exercise, can he rely on a Rule 10b5-1(c) defense in exercising the option?**

No. The exercise of the option is a separate investment decision from the purchase of the option. See Release 33-7881 at n. 115. For a defense to be available under Rule 10b5-1(c), each of the amount, price and date of the transaction must be specified or determined by formula, or all subsequent discretion over purchases and sales must be delegated to a third party who must not be aware of material nonpublic information when exercising that discretion. The person must make this specification or delegation in good faith before becoming aware of material nonpublic information.

In this example, the person has retained discretion over the timing of the option exercise. Consequently, if he is aware of material nonpublic information at the time of exercise, no defense will be available under Rule 10b5-1(c). The same analysis applies whether the option is a put or a call.

6. **At a time when he is not aware of material nonpublic information, a person purchases a put option. At the same time, the person instructs his broker to exercise the option on its expiration date, June 30, 2001, if the option is in-the-money on that date. Is the exercise of the option covered by a Rule 10b5-1(c)(1)(i)(B)(1) defense despite the fact that the amount, price and date are not specified by the same method?**

Yes. The terms of the option, which is a binding contract within the meaning of Rule 10b5-1(c)(1)(i)(A)(1), specify the amount of shares to be sold and the price at which they will be sold under the option. The instruction to the broker, which is an instruction to another person within the meaning of Rule 10b5-1(c)(1)(i)(A)(2), specifies the date of the transaction and imposes a limit on the price, within the meaning of Rule 10b5-1(c)(1)(iii)(B). Viewed together, the option and the instruction specify the amount of securities, the price and the date of the transaction for purposes of Rule 10b5-1(c)(1)(i)(B)(1). The same analysis applies whether the option is a put or a call.

7. **At a time when she is not aware of material nonpublic information, a person writes a call option, giving the option purchaser the right at any time during the life of the option to buy 10,000 shares from her at a fixed exercise price. Two months later, the option writer receives an exercise notice, requiring her to sell the shares to the counterparty at the exercise price. Is the sale pursuant to the option exercise covered by an affirmative defense under Rule 10b5-1(c)?**

Yes. As long as the terms of the option contract do not permit the person to exercise any subsequent influence over how, when or whether she sells the shares covered by the option, and she does not in fact influence the timing of the option exercise, a defense would be available under Rule 10b5-1(c)(1)(i)(B)(3).

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Loans and Pledges

8. **At a time when she is not aware of material nonpublic information, a person obtains a bank loan to invest in real estate, and pledges securities as collateral. She fails to pay the loan as due. The bank proceeds against the stock that was posted as collateral and sells it in the open market. Is the Rule 10b5-1(c)(1)(i)(B)(3) defense available to the person when the bank sells the stock?**

No. The sale was not pursuant to a contract, instruction or plan that did not permit the person to exercise any subsequent discretion over how, when, or whether to effect purchases or sales. First, the person could have exercised discretion not to pay the loan, resulting in default and the transfer of the securities. Also, she may have had the discretion to substitute collateral or provide additional collateral or cash to prevent foreclosure and sale of the stock.

9. **At a time when he is not aware of material nonpublic information, a person obtains a \$1 million loan from a brokerage firm and places \$2 million of stock in a margin account with the broker. The stock's price falls and the broker issues a margin call. The person does not deposit additional securities in the margin account (although he could have), so the broker sells sufficient margined securities to satisfy the margin call. Is the Rule 10b5-1(c)(1)(i)(B)(3) defense available to the person for the broker's sales?**

No. Where the person retains any discretion to substitute or provide additional collateral, or to repay the loan before the pledged securities may be sold, Rule 10b5-1(c)(1)(i)(B)(3) does not provide a defense. This is because the terms of the margin account contract would permit him to exercise subsequent influence over how, when, or whether to effect purchases or sales.

If the margin account contract did not permit the insider to exercise any subsequent influence over how, when, or whether to effect purchases or sales, and the broker did not in fact give the person the opportunity to substitute or provide additional collateral or cash, a defense would be available under Rule 10b5-1(c)(1)(i)(B)(3) if the broker is not aware of material nonpublic information in selling the margined securities.

Written Trading Plans

10. **At a time when she is not aware of material nonpublic information, a person establishes a written trading plan to sell 5,000 shares each month, on a date to be selected by her broker during the second or third week of each month, at or above \$20 per share. The person does not communicate any information to the broker that could influence when sales would occur. Does Rule 10b5-1(c)(1)(i)(B)(3) provide a defense for sales under this plan?**

Yes, assuming two additional facts are present: (1) the terms of the plan do not permit her to exercise any subsequent influence over the timing of sales under the plan; and (2) the broker is not aware of material nonpublic information when selling securities under the plan.

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11. **At a time when she is not aware of material nonpublic information, a person establishes a written trading plan to sell 10,000 shares each month, at or above \$20 per share. To implement the sales, the plan provides that on the last day of each month the person will place a limit order with a broker, valid until the last day of the next month, to sell 10,000 shares at or above \$20 per share. The person may be aware of material nonpublic information when she places the limit order.**

(a) Do Rules 10b5-1(c)(1)(i)(A)(3) and (B)(1) provide a defense for sales under this plan if the limit order is non-discretionary (requiring the broker to execute a sale as soon as a buyer is available at or above \$20 per share)?

Rules 10b5-1(c)(1)(i)(A)(3) and (B)(1) could provide a defense if the limit order is non-discretionary. The written trading plan would need to specify the amount, price and dates of the sales. As defined in Rule 10b5-1(c)(1)(iii)(C), in the case of a limit order, "date" means a day of the year on which the limit order is in force. For Rules 10b5-1(c)(1)(i)(A)(3) and (B)(1) to provide a defense, the terms of the plan must specify the dates on which the monthly non-discretionary limit orders will be in force.

(b) How does the analysis change if the written trading plan doesn't specify when the non-discretionary limit order will be in force?

If the written trading plan by its terms doesn't specify these dates, the analysis would focus on each transaction, and depend on whether the person is aware of material nonpublic information at each time she places a non-discretionary limit order. A defense would be available under Rule 10b5-1(c)(1)(i)(A)(2) and (B)(1) if: (1) she acts in good faith and is not aware of material nonpublic information at the time she instructs the broker; and (2) in placing a non-discretionary limit order, she specifies the dates on which that limit order will be in force.

(c) Do Rules 10b5-1(c)(1)(i)(A)(3) and (B)(1) provide a defense for sales under the plan when the limit order is discretionary (where the broker is granted discretion such that the broker is not required to execute a sale as soon as a buyer is available at or above \$20 per share)?

If a limit order is discretionary, the discretion granted to the broker over the timing of a sale would require the conditions of Rule 10b5-1(c)(1)(i)(B)(3) to be satisfied for a defense to be available. Rule 10b5-1(c)(1)(i)(B)(1) would not be available.

12. **Assume that the written trading plan described in Q&A 11(a) also includes a provision requiring the number of securities to be sold during each month to be reduced, if necessary, to comply with applicable volume limitation under Rule 144 (e). What effect does this have on the availability of a Rule 10b5-1(c) defense?**

The analysis depends on the manner in which the adjustment is effected:

(a) First, the written plan could provide for adjustment of the amount of securities to be sold each month based on a written formula specified in the plan within the meaning of Rule 10b5-1(c)(1)(i)(B)(2). Where a written formula specifies one or more of the price, amount and dates of transactions that are all specified in a contract, instruction or written plan, the Rule 10b5-1(c)(1)(i)(B)(2) defense would apply.

(b) Alternatively, the written plan could provide for adjustment of the amount of securities to be sold each month based on a delegation of discretion to the broker. In this case, where one or more of the price, amount and dates of transactions under a contract, instruction or written plan are to be determined based on a delegation of discretion to another person, the availability of a defense depends upon satisfaction of the conditions of Rule 10b5-1(c)(1)(i)(B)(3).

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13. **During a month when the written trading plan described in Q&A 11(a) is in effect, the person calls the broker to place an order to sell an additional 15,000 shares at the market. How is this transaction analyzed for purposes of Rule 10b5-1(c)?**

(a) The written trading plan defense is not available for the market order to sell the 15,000 additional shares. Instead, the analysis would focus on whether the person was aware of material nonpublic information at the time she places the market order.

(b) The market order transaction would not affect the availability of the written trading plan defense for the limit order sales under the written trading plan. The market order does not effect an alteration or deviation of a plan transaction within the meaning of Rule 10b5-1(c)(1)(i)(C) because the 10,000 share limit order under the plan will continue to be executed when the price limit is met. The market order is not a corresponding or hedging transaction within the meaning of Rule 10b5-1(c)(1)(i)(C) because it does not reduce or eliminate the economic consequences of the limit order sales under the written trading plan.

14. **During a month when the written trading plan described in Q&A 11(a) is in effect, the person calls the broker to increase the non-discretionary limit order currently in force from 10,000 shares to 15,000 shares. How is this analyzed for purposes of Rule 10b5-1(c)?**

Changing the amount to be sold under a written limit order trading plan currently in force effects an alteration or deviation within the meaning of Rule 10b5-1(c)(1)(i)(C). Consequently, sales pursuant to the altered limit order would not be pursuant to the existing plan.

Release 33-7881 at n. 111 provides that "a person acting in good faith may modify a prior contract, instruction, or plan before becoming aware of material nonpublic information. In that case, a purchase or sale that complies with the modified contract, instruction, or plan will be considered pursuant to a new contract, instruction, or plan."

15. **After the written trading plan described in Q&A 11(a) has been in effect for several months, the person terminates the selling plan by calling the broker and canceling the limit order.**

(a) Does the act of terminating a plan while aware of material nonpublic information result in liability under Section 10(b) and Rule 10b-5?

No. Section 10(b) and Rule 10b-5 apply "in connection with the purchase or sale of any security." Thus, a purchase or sale of a security must be present for liability to attach. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

(b) Does termination of a plan affect the availability of the Rule 10b5-1(c) defense for prior plan transactions? Does canceling one or more plan transactions affect the availability of the Rule 10b5-1(c) defense for prior plan transactions?

Termination of a plan, or the cancellation of one or more plan transactions, could affect the availability of the Rule 10b5-1(c) defense for prior plan transactions if it calls into question whether the plan was "entered into in good faith and not as part of a plan or scheme to evade" the insider trading rules within the meaning of Rule 10b5-1(c)(1)(ii). The absence of good faith or presence of a scheme to evade would eliminate the Rule 10b5-1(c) defense for prior transactions under the plan.

(c) Does canceling one or more plan transactions affect the availability of the Rule 10b5-1(c) defense for future plan transactions?

The cancellation of one or more plan transactions would be an alteration or deviation from the plan, which would terminate that plan. The Rule 10b5-1(c) defense would be available

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for transactions following the alteration only if the transactions were pursuant to a new contract, instruction or plan that satisfies the requirements of Rule 10b5-1(c). See Release 33-7881 at n. 111 and [Answer 14](#), above.

401(k) Plan Transactions

16. **A person purchases employer stock through her participation in the employer's 401(k) plan. These purchases are made pursuant to bi-weekly payroll deductions. The 401(k) plan also allows employees to transfer the assets in their accounts among funds within the plan (including the employer stock fund) through fund-switching transactions.**

(a) Is a Rule 10b5-1(c) defense available for payroll deduction purchases under the 401(k) plan?

If an employee acts in good faith and is not aware of material nonpublic information at the time she provides written or oral instructions as to payroll deduction purchases, a defense would be available for those purchases under Rule 10b5-1(c). See Release 33-7881, text at nn. 117-121.

(b) Is a Rule 10b5-1(c) defense available for fund-switching transactions under the 401(k) plan that result in purchases or sales of employer stock?

If an employee acts in good faith and is not aware of material nonpublic information at the time she provides written or oral instructions as to a fund-switching transaction under the 401(k) plan, a defense would be available for that transaction under Rule 10b5-1(c). See Release 33-7881, text at nn. 117-121.

(c) Could fund-switching transactions under the 401(k) plan be considered "corresponding or hedging transactions" within the meaning of Rule 10b5-1(c)(1)(i)(C) with respect to payroll deduction purchases under the 401(k) plan?

Possibly, depending upon the facts and circumstances. Rule 10b5-1(c)(1)(i)(C) requires, as a condition to the exemption, that the purchase or sale be pursuant to the contract, instruction, or plan. The rule provides that a purchase or sale is not "pursuant to a contract, instruction, or plan" if, among other things, the person entered into or altered a corresponding or hedging transaction or position with respect to those securities.

As a general matter, a fund-switching transaction that effects a sale could be a corresponding or hedging transaction under Rule 10b5-1(c)(1)(i)(C) with respect to a payroll deduction purchase under the 401(k) plan. If, however, the person is acting in good faith and provides instructions for the fund-switching transaction at a time when she is not aware of material nonpublic information, the fund-switching transaction would not disturb the Rule 10b5-1(c) defense for a payroll deduction purchase under the 401(k) plan.

Contracts

17. **Under applicable state law, an oral agreement would be considered a binding contract. Does the contract nevertheless need to be written to establish a defense under Rule 10b5-1(c)?**

No. The rule specifies when a writing is necessary to establish a defense. The rule does not require a binding contract (Rule 10b5-1(c)(1)(i)(A)(1)) or an instruction to another person (Rule 10b5-1(c)(1)(i)(A)(2)) to be written. In contrast, the rule requires a plan for trading securities (Rule 10b5-1(c)(1)(i)(A)(3)) and a formula, algorithm or computer program for determining amounts, prices and dates of transactions (Rule 10b5-1(c)(1)(i)(B)(2)) to be written.

<http://www.sec.gov/interp/telephone/phonesupplement4.htm> (10 of 12)/8/10/2005 8:21:26 AM

<http://www.sec.gov/interp/telephone/phonesupplement4.htm> (11 of 12)/8/10/2005 8:21:26 AM

Institutional Defense

18. Is the institutional defense provided by Rule 10b5-1(c)(2) available to the issuer of the securities for a repurchase plan?

Yes, assuming the conditions of that rule are satisfied.

<http://www.sec.gov/interp/telephone/phonesupplement4.htm>

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Authorized Spokespersons

Investment Community –The following individuals are authorized to communicate with the investment community (including analysts, stockbrokers, individual and institutional shareholders but excluding the media and rating agencies):

- Chairman/CEO
- Vice Chairman
- Vice President, Finance/CFO
- Corporate Treasurer
- Vice President, Investor Relations
- Director, Investor Relations
- Corporate Secretary

For purposes of these Guidelines, these individuals are referred to as "Authorized Investment Community Contacts."

End of Quarter Communications and Meetings

1. Quiet Period – The period beginning two weeks prior to the end of the quarter and ending at the time of the earnings release for that quarter should be observed as a quiet period with no general business discussions with analysts and investors. Exceptions may occur at the company's discretion based on need to discuss breaking news.
2. Analyst Meetings/Conference Calls - All analyst meetings/conference calls to discuss quarterly and annual financial and business information should be simultaneously broadcast over the internet or via telephone conference call to all interested members of the public. Appropriate advance notice of the meeting, and the simultaneous broadcast, should be made in a press release or other method of communication in compliance with Regulation FD.
3. Earnings Press Release – Earnings Press Release will be released to PR Newswire and posted on the Corporate Website at or prior to the commencement of meeting/call as determined by Investor Relations and the Chief Financial Officer.
4. Guidance, relative to the First Call EPS range for the year, will be provided at each quarter.

Communications with Analysts

1. Review of Analyst Draft Reports – When asked to review analyst draft reports, the Investor Relations Department should limit review and comment to the following:
 - (a) Correcting historical factual information only.
 - (b) Pointing out information that is in the public domain,
 - (c) Providing information the company believes is clearly nonmaterial.
 - (d) Discussing generally the factors that might influence the underlying assumptions used for future projections.

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2. Review of Earnings Models – The Investor Relations Department should not review earnings models.

3. Analyst Meetings/Conference Calls - All analyst meetings/conference calls (to discuss other than quarterly and annual financial and business information) should be simultaneously broadcast over the internet or via telephone conference call to all interested members of the public. Appropriate advance notice of the meeting and the simultaneous broadcast, in light of the communication, should be made in a press release or other method of communication in compliance with Regulation FD.

Product Pipeline Information

The following information regarding the pipeline of new drugs (including line extensions) may be disclosed:

- Chemical name
- Brand name (if available)
- Indication
- Patent Expiration Date
- Clinical stage (if appropriate)
- Mechanism of Action
- Market size/market factors

Projected FDA filing dates or estimated approval dates for any products, regardless of stage, should not be disclosed. The Company's policy is generally to highlight only those products that are in Phase III clinical and beyond. Products in Phase II clinical stage and earlier are generally higher risk and typically many years from the marketplace and generally should not be discussed. Public disclosure related to the Pipeline will take place at key points in the development process (e.g., entering Phase III or a regulatory filing) and will be made in compliance with Regulation FD.

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Session 409: What Can You Say & When— Guidance to Give to Your CEO & CFO

Leslie O'Donoghue
Sr. VP, General Counsel & Corporate Secretary

Agrium

ACC's 2005 Annual Meeting: Legal Underdog to Corporate
Superhero—Using Compliance for a Competitive Advantage

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Agrium

- Canadian Company headquartered in Calgary, Alberta and listed on the TSX and the NYSE
- Market capitalization of about U.S. \$3 billion/5,000 employees
- Global producer and marketer of agricultural nutrients and industrial products
- Operations in Canada, U.S. and Argentina with retail facilities through North America and South America

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Agrium Results Influenced by Many Variables

- Natural gas prices
- Transportation costs
- Farm income and agricultural product prices
- Fertilizer prices (diverse product/market mix)
- Weather - Farm planting season

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Agrium Guidance Policy

- Historical policy - press release guidance
- Because of the seasonality, guidance given semi-annually after the spring/fall planting season for 1st half, 2nd half
- Recent review of guidance policy
 - Canadian securities law amendments heighten liability concerns
 - Volatility of input and commodity prices challenging
 - Other issuers renouncing guidance (Coca-Cola)



Abstaining from Providing Guidance

- Reduce market emphasis on short-term focus
- Reduce pressure to manage for the short-term
- Changes in guidance can affect management's credibility
- Legal liability concerns



Providing Guidance Still Has Advantages

- Reduce volatility of industry/share price
- Business has many different drivers, which makes analysts forecasts more difficult
- May be necessary to attract analyst coverage
- Competitors are providing guidance
- Ceasing guidance will not affect the short-term focus of market
- Ceasing guidance may be misinterpreted by market as expecting declining performance
- Reduce risks of selective disclosure?



Review of Process

- Discussions with all Board members
- Discussions with Senior Leadership Team
- Canadian/U.S. counsel
- Discussions with auditors
- Inquiries to Working Council for Chief Financial Officers
- Surveyed members of the Assoc. of Cdn. General Counsel

Conclusion: "No one size fits all".



Consideration for Corporate Counsel in Developing a Guidance Policy

- What should be disclosed?
 - Assumptions underpinning guidance?
 - Company's key drivers?
 - Sensitivities (upside-downside factors) impacting guidance?
 - Financial information (EPS, revenue)?
 - Operational information (production, pricing)?
 - Corporate counsel input
 - Risk management
 - Cautionary/safe harbour language

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Consideration for Corporate Counsel in Developing a Guidance Policy (Cont'd)

- Timing of Guidance
 - Quarterly or less frequently
- Corporate Counsel Role in Preparation of Relevant Information
 - Financial model
 - Input sources (availability and right to use information)
 - Internal review and diligence (ensure process for review)
 - Internal audit (verification and feedback)
- Corporate Counsel Role in Developing the Disclosure
 - Role of senior management (use of good judgement)
 - Role of disclosure committee
 - Audit committee review

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Consideration for Corporate Counsel in Developing a Guidance Policy (Cont'd)

- Corporate Counsel Role in the Disclosure Process
 - Press release
 - Ensure appropriate presentation
 - Obtain outside counsel review where necessary
- Corporate Counsel Role in the Earnings Call
 - Participate in call
 - Brief speaker as necessary on public disclosure record to avoid selective disclosure
 - Participate in preparation for all (mock Q&A, role-playing)

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Consideration for Corporate Counsel in Developing a Guidance Policy (Cont'd)

- Monitor for mistakes
- Follow-up
 - Immediate feedback
 - Assess need for corrections
- Dealing with a misstatement
 - Correcting during the call
 - Corrective release post-call
- Corporate Counsel Role in Analyst and Investor Discussions
 - Emphasize consistent guidance
 - Set a tone of avoiding selective disclosure
 - Provide support to IR as needed

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Consideration for Corporate Counsel in Developing a Guidance Policy (Cont'd)

Monitoring guidance

- Internal
 - Updating the internal model
 - Monitoring changes to input data
- External
 - Analyst numbers differing from Agrium's
 - Competitors changing their guidance
 - Feedback from investor relations

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Consideration for Corporate Counsel in Developing a Guidance Policy (Cont'd)

➤ Updating guidance

- Decision to update
- Review process
- Manner of updating
 - Avoid selective disclosure

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Marriott Wardman Park Hotel



Agrium's Approach

1. Internal policies (compliance/updated)
2. Integrated with disclosure practices (SOX process)
3. Due diligence inquiries/documentation
4. Monitor analyst estimates vs. internal management forecasts
5. Monitor changes in key assumptions/business drivers
6. Proactive review prior to earnings calls, analysts' conferences, investor meetings, press interviews
7. Post event review (enhances education)



Who's Involved

- Senior Leadership Team
- Operating Committee
- Disclosure Committee
- Audit Committee
- External Auditors
- Internal Audit review
- External Counsel
- Back-up Certifications to support CFO/CEO certification



Disclosure Practices

- Designated Spokespersons/Coordination of Information
- Preparation and Review of Disclosure Documents/Approvals Required
- Conference Calls
- Forward-Looking Information
- Contacts with Analysts, Investors and the Media
- Rumours
- Maintaining Confidentiality
- Quiet Periods Extended
- Trading Restrictions and Blackout Periods Extended
- Confirming Guidance
- Internal monitoring and verification of documentation