Florida International University College of Law
eCollections

Faculty Publications | Faculty Scholarship

2005

Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional

Antony Page
Florida International University College of Law, apage@fiu.edu

Katy H. Yang

Follow this and additional works at: https://ecollections.law.fiu.edu/faculty_publications

Part of the First Amendment Commons

Recommended Citation
Antony Page and Katy Yang, Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional, 39 U.C. Davis L. Rev. 1, 84 (2005)

This Article is brought to you for free and open access by the Faculty Scholarship at eCollections. It has been accepted for inclusion in Faculty Publications by an authorized administrator of eCollections. For more information, please contact lisdavis@fiu.edu.

HEINONLINE

Citation:
Antony Page; Katy Yang, Controlling Corporate Speech:
Is Regulation Fair Disclosure Unconstitutional, 39 U.C.
Davis L. Rev. 1 (2005)
Provided by:
FIU College of Law

Content downloaded/printed from HeinOnline

Tue Nov 20 15:57:56 2018

-- Your use of this HeinOnline PDF indicates your
acceptance of HeinOnline's Terms and Conditions
of the license agreement available at
https://heinonline.org/HOL/License

-- The search text of this PDF is generated from
uncorrected OCR text.

-- To obtain permission to use this article beyond the scope
of your HeinOnline license, please use:

Copyright Information

Use QR Code reader to send PDF
to your smartphone or tablet device

U.C. DAVIS LAW REVIEW

VOLUME 39 NOVEMBER 2005 NUMBER 1

Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional?

Antony Page[*] *& Katy Yang*[**]

TABLE OF CONTENTS

INTRODUCTION 3
I. REGULATION FD 8
A. *The Problem of Trading and Information Asymmetry* 8
1. Who Is Covered? 12
2. Who Are the Enumerated Persons? 13
3. What Information Is Covered? 14
a. Material Information 14
b. Nonpublic Information 17
c. Reckless or Knowing Mental State 18
4. What Is Required Under Regulation FD? 18
B. *Application* 18

[*] Antony Page is an assistant professor of law at Indiana University School of Law – Indianapolis. J.D., Stanford Law School; M.B.A., Simon Fraser University; B.Comm., McGill University.

[**] Katy Yang was formerly a staff attorney at the Indiana Civil Liberties Union, an affiliate of the American Civil Liberties Union, where she litigated First Amendment cases. J.D., New York University Law School; B.A., Northwestern University. We would like to thank Professors Kenny Crews, Nicholas Georgakopoulos, Robert Katz, Elizabeth Nowicki, Malcolm Page, William Sjostrom, Kathleen Sullivan, and George Wright and Jacqueline Bowie Suess of the Indiana Civil Liberties Union for their comments on earlier versions of this Article. We would also like to thank Katey Allen and the staff of this law review.

1. Guiding Analysts to More Accurate Earnings Estimates 19
2. Disclosing Material Contracts 20
3. General Business Trends 20
4. Quantitatively Defining Qualitative Terms 21
5. Tone, Emphasis, and Demeanor 22
6. Confirming Prior Guidance 23

C. *Evaluations of Regulation FD* 26
1. Analyst Information Metrics 27
2. Public Information Metrics 30

II. THE FIRST AMENDMENT AND SEC REGULATIONS AFFECTING SPEECH 33
A. *Raising the First Amendment Against Securities Laws* 37
1. *Lowe* Suggests High Levels of Protection for SEC-Regulated Speech 37
2. *Wall Street*: Intermediate Protection at Most 38
3. Other Courts Give SEC-Regulated Speech Minimal Protection 40

B. *Threshold Questions: Speech and Content* 40
1. Does Regulation FD Target Speech Per Se? 40
2. Does Regulation FD Target the Speech's Content? 43

III. WHAT AND HOW DOES REGULATION FD REGULATE? 47
A. *Restricting Commercial Speech* 47
B. *Restricting Mixed Commercial Speech* 52
C. *Compelling Mixed Commercial Speech* 55
D. *Compelling Commercial Speech* 57
E. *How Should Regulation FD Be Analyzed?* 60

IV. APPLYING THE STANDARD OF REVIEW 66
A. *Government Interests?* 67
B. *How Does Regulation FD Relate to the SEC's Interests?* 71
1. Regulation FD's Scope 75
a. Overinclusiveness 76
b. Other Approaches 78
2. Underinclusive 80

CONCLUSION 83

INTRODUCTION

Regulation Fair Disclosure! On its face, who could be opposed?[1] Fair disclosure is intuitively appealing. Fairness is a core American value, and disclosure is almost invariably seen as desirable.[2] To some, introducing Regulation Fair Disclosure ("Regulation FD") was the "crowning achievement" of Arthur Levitt,[3] the longest serving Chairman of the Securities and Exchange Commission ("SEC").[4] To the investor community, it generated more interest than any previous regulation in the history of the SEC.[5]

Arthur Levitt stated that "[t]he intent of Reg FD is really quite simple. If a company wishes to pass on market-moving information, it must share the news with everyone at the same time."[6] Subject to certain safe-harbors, Regulation FD requires a company that discloses "material non-public" information to certain private audiences to also make that information public. In this sense, if a company wishes to speak, Regulation FD compels the company to speak publicly. If, however, the company does not want to speak publicly, for example, if the information is commercially sensitive, Regulation FD prevents the company from speaking privately.

The SEC, citing several press reports, claimed that the practice of selective disclosure is sufficiently widespread and harmful enough to justify Regulation FD.[7] Given the uncertainty surrounding the reach of U.S. insider trading laws, Regulation FD "fill[s] a gap in an issuer's disclosure duties that had been left open by the federal securities laws."[8]

---

[1] The name was in fact chosen deliberately to try to reduce opposition to the regulation. *See* ARTHUR LEVITT, TAKE ON THE STREET: WHAT WALL STREET AND CORPORATE AMERICA DON'T WANT YOU TO KNOW. WHAT YOU CAN DO TO FIGHT BACK 93 (Pantheon Books 2002) ("We purposely chose [the] name [Fair Disclosure] to make our opponents think twice about fighting it.").

[2] As Louis Brandeis put it about industrial diseases, "[s]unlight is said to be the best of disinfectants; electric light the most efficient policeman." LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY: AND HOW THE BANKERS USE IT 62 (Nat'l Home Library Ass'n 1933).

[3] *Farewell, Fair Disclosure?*, ECONOMIST, Feb. 10, 2001, at 73.

[4] Arthur Levitt, the 25th Chairman of the SEC, served from July 1993 to February 2001. Chairman Arthur Levitt — SEC Biography, http://www.sec.gov/about/commissioner/levitt.htm (last visited Oct. 17, 2005).

[5] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000).

[6] LEVITT, *supra* note 1, at 88.

[7] Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 n.11 (Dec. 28, 1999).

[8] Marc I. Steinberg & Jason B. Myers, *Lurking in the Shadows: The Hidden Issues of the Securities and Exchange Commission's Regulation FD*, 27 J. CORP. L. 173, 208 (2004) (noting also

Unlike the insider trading laws, however, Regulation FD targets the transmission of information, rather than the actual trading, if any, done on the information.[9] This, to put it mildly, was a "significant departure from the U.S. disclosure regime as it existed over the past 65 years."[10]

Despite its disarming title, many people oppose Regulation FD. Although small retail investors tend to support the Regulation,[11] many market professionals[12] and legal commentators[13] oppose it. Much of the argument has revolved around whether Regulation FD is a good policy choice. On one hand, supporters of the regulation argue that it will increase confidence in the integrity of the markets.[14] On the other hand,

---

that Regulation FD at least somewhat aligns U.S. laws with those of other jurisdictions).

[9] *See infra* notes 37-49 and accompanying text. Following the clarification included in Rule 10b-5(1), possession of material nonpublic information, rather than use, is all that is necessary. *See infra* note 481-83 and accompanying text.

[10] Letter from Securities Industry Association to Jonathan Katz, Secretary, SEC (Apr. 6, 2000), *available at* http://ftp.sec.gov/rules/proposed/s73199/spencer1.htm. The Securities Industry Association is a trade association of more than 600 securities firms.

[11] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000) (noting nearly 6000 comment letters on proposed rule of which "the vast majority . . . consisted of individual investors, who urged — almost uniformly — that we adopt Regulation FD").

[12] *Id.* "Market professionals" here refers both to the agents of large institutional investors, such as hedge and mutual funds, pension funds, insurance companies, and to security industry professionals, such as analysts and lawyers. Arguably, market professionals objected to the Regulation as they tended to be the beneficiaries of "unfair disclosure," or in more balanced terms, selective disclosure. Perhaps not surprisingly, the ratings agencies (Moody's, Standard & Poors, and Fitch) supported the Regulation once they were granted an exemption from its bite. *See infra* Part I.A.2. As a later empirical study showed, ratings agencies received a "strategic advantage" by becoming "privileged conduits of selective disclosure to the public." Philippe Jorion et al., *Informational Effects of Regulation FD: Evidence from the Rating Agencies*, 76 J. FIN. ECON. 309, 329 (May 2005).

[13] *See, e.g.*, Joanna E. Barnes, *Regulation FD Will Result in Poorer Disclosure and Increased Market Volatility*, 29 PEPP. L. REV. 609 (2002); Brian K. Barry, *The Securities and Exchange Commission's Regulation Fair Disclosure: Parity of Information or Parody of Information?*, 56 U. MIAMI L. REV. 645 (2002); Michael P. Daly & Robert A. Del Giorno, *The SEC's New Regulation FD: A Critical Analysis*, 16 ST. JOHN'S J. LEGAL COMMENT 457 (2002); Michael A. Harrison, *Regulation FD's Effect on Fixed-Income Investors: Is the Public Protected or Harmed?*, 77 IND. L.J. 189 (2002); Scott Russell, *Regulation Fair Disclosure: The Death of the Efficient Capital Market Hypothesis and the Birth of Herd Behavior*, 82 B.U. L. REV. 527 (2002); Andrea J. Sessa, *The Negative Consequences of Regulation FD on the Capital Markets*, 45 N.Y.L. SCH. L. REV. 733 (2002); Peter Talosig III, *Regulation FD — Fairly Disruptive? An Increase in Capital Market Inefficiency*, 9 FORDHAM J. CORP. & FIN. L. 637 (2004).

[14] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000); Stephen M. Cutler, Remarks before the Directors' Education Institute at Duke University: Staying the Course (Mar. 18, 2005), *available at* http://www.sec.gov/news/speech/spch031805smc.htm (quoting Letter from Business Roundtable to William Donaldson, SEC Chairman (Mar. 2, 2005), in which Donaldson stated: "We also believe

opponents generally argue that firms will respond by releasing a lower quality and quantity of information, which will reduce market efficiency.[15] Surprisingly, however, few commentators argue against the Regulation on free speech grounds.[16] This article focuses on this

---

that Regulation FD has had the important and beneficial effect of enhancing investor confidence in the marketplace."). Media commentators tended to support the regulation. *See, e.g.*, Bill Barnhart, *Disclosure Rule Put Investors on Equal Footing*, CHI. TRIB., Jul. 11, 2004, at C5; Robert J. Schiller, *Outlaw Selective Disclosure? Yes, Markets Must be Fair*, WALL ST. J., Aug. 10, 2000, at A18. Some companies also support Regulation FD. *See, e.g.*, Expeditors Int'l of Wash., Inc., Current Report (Form 8-K), at 3 (July 24, 2003), *available at* http://www.sec.gov/Archives/edgar/data/746515/000110465903015711/a03-1427_18k.htm ("Question: Do you think that spending time with sell-side analysts will tarnish your reputation? [Answer:] We've made our reputation as freight forwarders so the only folks we avoid are the competition. Much has been made lately of abuses on Wall Street and the board rooms of Main Street . . . . What we have to say about analysts, we will say. For a long time the rules rightly punished corporate insiders for any effort to profit from inside information, while looking the other way and allowing the sell side free reign to traffic in it. Honest analysis is valuable and we hope that the information put out in this forum gives everyone an equal opportunity to predict what our future holds."). Some academics have also supported the Regulation. *See generally* Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035 (2003) (arguing in favor of Regulation FD as means of reducing agency costs).

[15] Opponents included industry associations, law firms, and media commentators. Letter from Sullivan & Cromwell to Jonathan Katz, Secretary, SEC (Apr. 28, 2000), *available at* http://www.sec.gov/rules/proposed/s73199/sulcrom1.htm ("[P]arity of information sought by the Commission may in fact become a parity of non-information (or perhaps even misinformation)."). *See, e.g.*, SECURITIES INDUSTRIES INDUSTRY ASSOCIATION, COSTS AND BENEFITS OF REGULATION FAIR DISCLOSURE (2001); ASSOCIATION OF INVESTMENT MANAGEMENT RESEARCH, REGULATION FD E-SURVEY SUMMARY (2001), *available at* http://www/cfainstitute.org/pressroom/pdf/01RegFDtable.pdf; Lee Clifford, *The SEC Wants to Open the Info Vault: Regulation FD Sounds Great on Paper, but Will It Help Investors Know More About the Companies They Own?*, FORTUNE, Nov. 13, 2000, at 434; Daniel Gross, *A Little Democracy on Wall Street*, N.Y. TIMES, Oct. 23, 2000, at A25 ("[F]ull disclosure may mean . . . a stock market that is about as stable as an earthquake zone."); Kevin A. Hassett, *Outlaw Selective Disclosure? No, the More Information the Better*, WALL ST. J., Aug. 10, 2000, at A18; Matt Krantz, *Has Criticism Made Analysts Too Cautious?*, USA TODAY, Nov. 3, 2003, at 1B. Some researchers produced models demonstrating that Regulation FD might stifle firms' disclosure. *See* Anil Arya et al., *Unintended Consequences of Regulating Disclosures: The Case of Regulation Fair Disclosure*, 24 J. ACCT. & PUB. POL'Y 11 (2005). Occasionally, opponents argued that more information would be disclosed, but much of it would be nonmaterial and individual investors would find this difficult to interpret. *See* Laura S. Unger, SEC Commissioner, Public Address: Rethinking Disclosure in the Information Age: Can There Be Too Much of a Good Thing?, (June 26, 2000), *available at* http://www.sec.gov/news/speech/spch387.htm (noting negative effects of overabundant information).

[16] For exceptions see Nicholas Kappas, *A Question Of Materiality: Why the Securities and Exchange Commission's Regulation Fair Disclosure is Unconstitutionally Vague*, 45 N.Y.L. SCH. L. REV. 651 (2002); Larry Ribstein, *SEC "Fair Disclosure" Rule is Constitutionally Suspect*, 10 WASH. LEGAL FOUND. LEGAL OPINION LETTER 17 (Oct. 6, 2000) ("Regulation FD . . . demonstrates that the time has come to hold the SEC accountable under the First

neglected question: the constitutionality of Regulation FD.[17]

Free speech under the First Amendment also is a core American value. Although a corporation does not enjoy all of the same constitutional rights as a natural person,[18] it does possess First Amendment rights.[19] These rights include protection of a corporation's commercial[20] and political[21] speech and protection from being compelled to speak.[22] The level of protection, however, that the Supreme Court has provided for laws affecting a corporation's speech varies greatly. Depending on the nature of the regulation and of the regulated speech, the Court will apply rational review,[23] deferential intermediate scrutiny, biting intermediate scrutiny,[24] or strict scrutiny.[25]

Determining the appropriate standard of review applicable to Regulation FD is a difficult task.[26] Regulation FD solely targets speech,

---

Amendment."); Letter from Joseph McLaughlin, Partner, Sidley Austin Brown & Wood LLP, to Jonathan Katz, SEC Secretary, (June 30, 2000), *available at* http://www.sec.gov/rules/proposed/s73199/mclaugh1.htm (discussing potential First Amendment ramifications of Regulation).

[17] Recently, there has been much greater media attention to this question, due to the Siebel Systems, Inc. litigation and the U.S. Chamber of Commerce's high profile position on the constitutionality of the Regulation. *See, e.g.*, Floyd Norris, *Does the "Voice of Business" Think the Bill of Rights Covers Insider Tips?*, N.Y. TIMES, Feb. 4, 2005, at C1; Kathleen Pender, *Siebel Cites Free Speech in Challenging SEC Rule*, S.F. CHRON., Sept. 23, 2004, at C1; Phyllis Plitch, *"Fair Disclosure" Inhibits Speech, U.S. Chamber of Commerce Says*, WALL ST. J., Jan. 20, 2005, at C3; *see infra* notes 134-49 and accompanying text.

[18] *See generally* Carl J. Mayer, *Personalizing the Impersonal: Corporations and the Bill of Rights*, 41 HASTINGS L.J. 577, 664-67 (1990) (summarizing corporations' constitutional rights).

[19] *See, e.g.*, First Nat'l Bank v. Bellotti, 435 U.S. 765, 765 (1978).

[20] *See, e.g.*, Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557 (1980).

[21] *See, e.g.*, 435 U.S. at 784.

[22] *See, e.g.*, Dep't of Agric. v. United Foods, 533 U.S. 405, 416 (2001); Pac. Gas & Elec. Co. v. Pub. Util. Comm'n of Cal., 475 U.S. 1 (1986).

[23] *See infra* Part III.D.

[24] *See infra* Part III.A.

[25] *See infra* Part III.B-C.

[26] Some advocates argue that there is essentially a securities exemption, whereby the First Amendment provides no protection for speech regulated by federal securities laws. *See* Brief for Law Professors as Amicus Curiae in Opposition to Motion to Dismiss at 16-22, SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. June 29, 2004) (No. 04 CV 5130), *available at* 2005 WL 2100269. Relying primarily on dicta in the *Ohralik* case, discussed *infra* at text accompanying note 256-61, they argue that government can regulate the content of speech in numerous circumstances without running afoul of the First Amendment. *Id.* at 18 (citations omitted). It is difficult to respond to each circumstance relied on in the brief, since according to at least one commentator, all "currently available normative accounts" of the First Amendment diverge substantially from its application. Frederick Schauer, *The Boundaries of the First Amendment: A Preliminary Exploration of Constitutional Salience*, 117

acting either to compel it to a public audience or to suppress it to a private audience.[27] Regulation FD focuses on the actual content of a company's speech, which results in regulation of both less protected commercial speech and fully protected noncommercial speech.[28] The harm addressed by Regulation FD is not the targeted speech itself, but

HARV. L. REV. 1765, 1787 (2004). In many of these circumstances, the speech merely evinces the harmful conduct that the government seeks to prohibit, as in the case of sexual harassment where the harassing speech adversely affects the terms and conditions of employment. *See, e.g.*, Meritor Savings Bank v. Vinson, 477 U.S. 57, 67 (1986) (holding that Title VII prohibits abusive and discriminatory conduct that is so severe or pervasive as "to alter the conditions of the victim's employment and create an abusive working environment"). Regardless, such a sweeping First Amendment exemption for a securities regulation that directly targets speech (particularly when the "harmful" conduct related to the speech apparently remains lawful) requires more support than passing dicta in a case that was decided in the infancy of the protection for corporate speech. Even the SEC itself has acknowledged that, at least in some circumstances, securities regulation can raise "serious questions" under the First Amendment. *See* Regulation of Communications Among Shareholders, Release Nos. 34-31,326, IC-19031, 57 Fed. Reg. 48,276 (Oct. 22, 1992). This, the SEC continued, "is especially true where such intrusion is *not necessary* to achieve the goals of the federal securities laws." *Id.* (emphasis added). See Part IV.B for a discussion of how targeting speech is not necessary to achieve the SEC's goals.

We acknowledge that there is some tension in applying the First Amendment to Regulation FD without invalidating other securities regulations. First, we note that many of the securities regulations that implicate speech also involve some closely related conduct, such as those in the Securities Act of 1933 that require the sale of a security or in the Williams Act that are associated with a shareholder vote or tender. *See* 15 U.S.C. § 77c, e (2005); *id.* § 78n(d)-(e). Second, the purpose is often to prevent false or misleading disclosure, which consistently allows the state to regulate speech. *See infra* note 392-98 and accompanying text. Third, we note that the periodic reporting requirements, although compelling speech, are based on the SEC's determination of the minimum amount of information necessary "for the proper protection of investors and to insure fair dealing in the security." Securities Exchange Act of 1934 § 13(a), 15 U.S.C. § 78m(a) (2004). In this way, they are akin to other consumer protection regulations, such as those requiring warning labels on pharmaceutical products or nutrition labels on food. *See* Food, Drug & Cosmetic Act, 21 U.S.C. § 355 (2005); Nutrition Labeling and Education Act of 1990, 21 U.S.C. § 301 (2005). This contrasts with Regulation FD, which requires public disclosure based only on (and thereby burdening) prior private disclosures — private disclosures which have previously been found by the Supreme Court to be valuable. *See* Dirks v. SEC, 463 U.S. 646, 659 n.17 (1983). In addition, periodic reporting only acts to compel, rather than restrict, speech, and corporate compulsion is generally seen as less likely to violate the First Amendment. *See, e.g.*, PruneYard Shopping Ctr. v. Robins, 447 U.S. 74, 87 (1980); Alan Hirsch & Ralph Nader, *"The Corporate Conscience" and Other First Amendment Follies in* Pacific Gas & Electric, 41 SAN DIEGO L. REV. 483, 484 (2004). Finally, one might argue that it may be justifiable to uphold regulations that have been the settled law of the land for many decades, while it is not justifiable to uphold recently passed regulations. Alternatively, some commentators are willing to invalidate at least some securities regulations that appear unlikely to meet intermediate scrutiny. *See, e.g.*, sources cited *infra* notes 216-17.

[27] *See infra* Part III.E.

[28] *See infra* Part II.B.

rather the trading that may or may not occur as a result of the speech.[29] The curiosity is that Regulation FD directly "penalizes firms' truthful, valuable disclosures."[30]

Part I of this Article examines the reach of Regulation FD, the enforcement actions to date, and the currently available empirical data. Part II provides an introduction to the interaction between the First Amendment and SEC regulations affecting speech. There are currently no clear answers, since no court has yet reached the constitutional question in addressing a regulation like FD. Part III broadens the analysis in Part II to include regulations of commercial and mixed commercial/noncommercial speech. Part III also examines the varying treatment of compelled speech versus prohibited speech and applies these lessons to Regulation FD in light of the clear trend toward greater protection of corporate speech. Finally, Part IV analyzes the SEC's justifications for Regulation FD and evaluates how effectively Regulation FD achieves these goals. Regardless of whether a court applies strict scrutiny or intermediate scrutiny in its recent incarnations, this Article argues that Regulation FD should not survive a First Amendment challenge.

I. REGULATION FD

A. *The Problem of Trading and Information Asymmetry*

In the late 1990s, the SEC expressed concern over the trading in securities following an issuer's selective disclosure of information.[31] Until that time, U.S. securities laws never required issuers to disclose all

---

[29] If trading does occur, the trading and trader go unpunished under Regulation FD. *See infra* Part I.A.

[30] Ribstein, *supra* note 16; *see also* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,726 (Aug. 24, 2000) (stating that Regulation FD "is not an antifraud rule . . . [and] a violation of Regulation FD is not an antifraud violation"); Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,594 (Dec. 28, 1999) ("The approach we propose does not treat selective disclosure as a type of fraudulent conduct.").

[31] *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 n.11 (Dec. 28, 1999) (listing newspaper articles); LEVITT, *supra* note 1, at 93 ("'[S]elective disclosure' had gotten out of hand in the 1990's . . . . That was wrong, plain and simple."); Thomas C. Newkirk, Associate Director, & Melissa A. Robertson, Senior Counsel, SEC Division of Enforcement, Remarks at the 16th International Symposium on Economic Crime (Sept. 19, 1998), *available at* http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm#footbody_22 (stating that trading resulting from selective disclosure was "an area of special concern to the Commission").

material information,[32] even though the SEC encouraged such disclosure.[33] Aside from a few required types of disclosures,[34] companies were free to disclose information as they saw fit.[35] To be sure, an issuer or its officers that bought or sold the issuer's own securities before disclosing otherwise nonpublic material information would generally be liable for insider trading.[36] Furthermore, in some circumstances, as

---

[32] *See, e.g.*, Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,591 (Dec. 28, 1999); Mitu Gulati, *When Corporate Managers Fear a Good Thing is Coming to an End: The Case of Interim Nondisclosure*, 46 UCLA L. REV. 675, 679 (1999) (observing that U.S. securities laws "do not create any standing rule or impose upon companies any general duty to disclose to the public all material information whenever such information becomes available to the company"). For example, SEC Rules 408 and 12b-20 are premised on the absence of a general requirement to disclose all material information. 17 C.F.R. §§ 230.408, 240.12b-20 (2005).

[33] *See, e.g.*, Report of Investigation in the Matter of Sharon Steel Corporation as It Relates to Prompt Public Disclosure, Exchange Act Release No. 18,271, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,049 (1981) (noting that "[t]he purpose of this Report is to summarize the importance of timely disclosure by public corporations of material developments in instances where it becomes apparent that persons may have access to non-public corporate information and may take unfair advantage of the company's other shareholders . . . ."). Also, the SEC has argued that the best practice is the prompt disclosure of material information. *See* Timely Disclosure of Material Corporate Developments, Securities Act Release No. 5092, 35 Fed. Reg. 16,733 (Oct. 15, 1970).

[34] Issuers, other than foreign issuers, are required to promptly report on Form 8-K certain material events, such as changes in control, resignation of directors, or events of bankruptcy. *See* 17 C.F.R. § 228 (2005). As a result of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 78m(1) (2005), the SEC recently adopted new rules that both increased the number of items that must be reported and reduced the filing deadlines for most reportable events to four business days. *See* Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Release No. 34-49,424, 2004 WL 53681 (Mar. 16, 2004). The stock exchanges also require prompt disclosure of some events. *See, e.g.*, National Association of Security Dealers, Rules 4310(c)(16), 4320(e)(14), and IM-4120-1 (2005), *available at* http://nasd.complinet.com/nasd/display/index.html (Disclosure of Material Information); NYSE, Inc., Listed Company Manual ¶ 202.05 (2005) (Timely Disclosure of Material News Developments). Finally, in some narrowly drawn circumstances there is a duty to update or a duty to amend. *See, e.g.*, *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1434 (3d Cir. 1997).

[35] *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 (Dec. 28, 1999) ("[T]he issuer determines how and to whom to make its initial disclosure."). There are several obvious reasons why a company would not want to promptly disclose all material events. For example, as in *Texas Gulf Sulphur*, a mining company that finds rich deposits in a particular area may not want to disclose this fact prior to purchasing mineral rights in the nearby land. *See* SEC v. Tex. Gulf Sulphur, 401 F.2d 833 (2d Cir. 1968).

[36] Such trading fits within the common law notion of fraud and is thus easily captured by the key U.S. insider trading rule, Rule 10b-5. 17 C.F.R. § 240.10b-5. *See, e.g.*, Strong v. Repide, 213 U.S. 419 (1909) (holding that corporation's director who bought corporation's stock knowing it was going to increase in value without disclosing his knowledge to outside seller had committed fraud). For a discussion of the economic harm of insider trading, see generally, Nicholas L. Georgakopoulos, *Insider Trading as a Transactional Cost:*

discussed below, if the issuer disclosed such information to third parties who then traded in the issuer's securities, the third party would also be liable for insider trading. Trading resulting from selective disclosure, however, is not always actionable insider trading.

The problem resulted from a quirk of securities law. Most restrictions on insider trading evolved from Section 10b of the Securities Exchange Act of 1934[37] and Rule 10b-5, the antifraud provision thereunder.[38] As the Supreme Court put it, "we deal with a judicial oak which has grown from little more than a legislative acorn."[39] Rule 10b-5 simply prohibits fraudulent conduct.[40] Nonetheless, lower courts initially understood Rule 10b-5 to also prohibit trading that resulted from the selective disclosure of inside information.[41]

When the insider trading cases reached the Supreme Court, however, the Court held that Congress had not authorized an "absolute equal information rule."[42] Therefore, courts could only impose liability on a trader who had a duty to disclose.[43] Thus, when the SEC tried to prevent a form of trading based on selective disclosure in *Dirks v. SEC*,[44] the

---

A Market Microstructure Justification and Optimization of Insider Trading Regulation, 26 CONN. L. REV. 1 (1993).

[37] 15 U.S.C. § 78j(b) (2005).

[38] 17 C.F.R. § 240.10b-5 (1998). The remaining U.S. federal prohibitions are sections 16 and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78p, 78n(e) (2005); Rule 14e-3, 17 C.F.R. § 240.14e-3 (2005); The Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (codified as amended in scattered subdivisions of 15 U.S.C. § 78 (2005)); and the Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (2005) (codified as amended in scattered subdivisions of 15 U.S.C. §§ 78, 80b-4a (2005)).

[39] Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) (adding "it would be disingenuous to suggest that either Congress in 1934 or the Securities and Exchange Commission in 1942 foreordained the present state of the law with respect to Rule 10b-5.").

[40] Rule 10b-5, which makes it unlawful for any person in connection with the purchase or sale of a security, states "(a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a [necessary] material fact, or (c) to engage in any act, practice or course of business which operates . . . as a fraud or deceit on any person." 17 C.F.R. § 240.10b-5 (2005).

[41] *See* Donald C. Langevoort, *Investment Analysts and the Law of Insider Trading*, 76 VA. L. REV. 1023, 1027 n.11 (1990) (citing three pre-*Chiarella* cases).

[42] Dirks v. SEC, 463 U.S. 646, 658 n.16 (1983); Chiarella v. United States, 445 U.S. 222, 231-32 (1980) (rejecting notion that federal securities laws were intended to provide equal access to all information).

[43] *Chiarella*, 445 U.S. at 231.

[44] Dirks was a broker dealer who received material nonpublic information from a former officer of Equity Funding America. Dirks subsequently investigated and confirmed the information and discussed it with clients and investors, some of whom subsequently sold their Equity Funding securities. During his investigation, Dirks also urged the *Wall*

Court limited insider trading to those cases in which the trader received the information "improperly."[45] "Improperly" meant that the information was conveyed in breach of the tipper's fiduciary duty.[46] In the case of selective disclosure, the trader could only be liable if a direct or indirect personal benefit to the tipper motivated the tipper's selective disclosure.[47] The selective disclosure targeted by Regulation FD, however, generally does not involve such a personal benefit. Rather, the benefit in question is to the corporation.[48] Therefore, Regulation FD can be seen as an end-run around the Supreme Court's jurisprudence in *Dirks* and other cases such as *Chiarella*.[49]

Regulation FD, where "FD" stands for "fair disclosure," became effective on October 23, 2000.[50] Regulation FD provides:

> Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any [enumerated] person . . . the issuer shall make public

---

Street Journal to report the information. Meanwhile, the stock price dropped 42%. The SEC censured Dirks, and this censure was upheld by the Court of Appeals for the D.C. Circuit. The Supreme Court reversed, rejecting the "idea that the antifraud provisions require equal information among all traders." *Dirks*, 463 U.S. at 646-52, 657.

[45] *Id.* at 660; *see also Chiarella*, 445 U.S. at 235 ("When an allegation of fraud is based upon nondisclosure, there can be no fraud (under § 10(b)) absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information."). Interestingly, the *Chiarella* Court of Appeals had held that "*[a]nyone* — corporate insider or not — who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose." United States v. Chiarella, 588 F.2d 1358, 1365 (2d Cir. 1978) (emphasis added).

[46] *Dirks*, 463 U.S. at 660-61.

[47] *Id.* at 662 ("Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach and thus no breach of Rule 10b-5."). Financial gain or a reputational benefit that will result in a financial gain are examples of direct or indirect personal benefits. *See id.* at 663. The SEC has settled at least one enforcement action that hinged on the tipper receiving a reputational benefit. SEC v. Stevens, Litigation Release 12,813, 1991 WL 296537 (Mar. 19, 1991). Since the case was settled, no court had occasion to rule on the theory. There do not appear to be any subsequent cases applying this theory.

[48] It seems as though there might also be at least an attenuated personal benefit if, for example, the tipper is also a stock or option holder; but there do not appear to have been cases which so hold.

[49] Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,593-94 (Dec. 28, 1999) (acknowledging need for and use of legal approach in Regulation FD different from that used for insider trading); Letter from Sullivan & Cromwell to Jonathan Katz, Secretary, SEC, *supra* note 15 ("[T]he Commission is, we believe, attempting to rewrite the laws of insider trading.").

[50] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000).

> disclosure of that information . . . : (1) Simultaneously, in the case of an intentional disclosure; and (2) Promptly, in the case of a non-intentional disclosure.[51]

The key terms of the regulation require further explanation.

1. Who Is Covered?

Regulation FD applies to "issuers," which are essentially all reporting companies,[52] including closed-end investment companies, but excluding all other types of investment companies.[53] Regulation FD, at least "at this time,"[54] does not cover foreign governments and foreign private issuers.[55] Foreign private issuers, however, are highly significant. There are over 1250 foreign companies registered and reporting with the SEC.[56] At the end of 2003, the New York Stock Exchange had nearly 3,000 listings of which 500, approximately 16%, were from outside the United States.[57] During 2003, investors traded over $729 billion worth of foreign stock on volume of roughly 35 billion shares on the NYSE.[58]

---

[51] 17 C.F.R. § 243.100 (2005).

[52] The Securities Exchange Act requires certain issuers, such as those listed on a national securities exchange or those with assets of over $10 million and a non-exempt security held by over 500 shareholders, to comply with the SEC's periodic information disclosure requirements. *See* 15 U.S.C. §§ 78m(a), 78l(b), 78l(g) (2002).

[53] 17 C.F.R. § 243.101(b) (2005).

[54] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,724 (Aug. 24, 2000).

[55] The SEC has always treated foreign governments gingerly, as they are sovereign entities. Foreign private issuers are often treated differently, in part because they face their own domestic rules that may be inconsistent with U.S. rules. For an interesting discussion supporting the SEC's decision to exempt foreign private issuers, see Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization's Strains and Opportunities*, 41 VA. J. INT'L L. 653 (2001) (arguing also that Regulation FD is undesirable). For the opposite perspective, see William K. S. Wang, *Selective Disclosure By Issuers, Its Legality and Ex Ante Harm: Some Observations in Response to Professor Fox*, 42 VA. J. INT'L L. 869 (2002).

[56] *See* Foreign Companies Registered and Reporting with the U.S. Securities and Exchange Commission, *available at* http://www.sec.gov/divisions/corpfin/internatl/geographic.htm (last visited Sept. 15, 2005).

[57] *See* NYSEdata.com, All NYSE Listed Stocks (Annual), http://www.nysedata.com/factbook/viewer_edition.asp?mode=table&key=2217&category=14 (last visited Oct. 17, 2005); NYSEdata.com, Geographic Breakdown of Stocks of Non-U.S. Corporate Issuers 2003, *available at* http://www.nysedata.com/factbook/viewer_edition.asp?mode=table&key=2906&category=6 (last visited Oct. 17, 2005). *See also* NASDAQ, NASDAQ International Companies, *available at* http://www.nasdaq.com/asp/NonUsOutput.asp (last visited Oct. 17, 2005) (listing foreign companies trading on NASDAQ, equal to approximately 10% of the total).

[58] *See* NYSEdata.com, All NYSE Listed Stocks, *supra* note 57; NYSEdata.com, Geographic Breakdown of Stocks of Non-U.S. Corporate Issuers 2003, *supra* note 57.

Regulation FD also applies to people acting on behalf of the issuer. This category, however, includes only the issuer's senior officials and anyone who "regularly communicates" with market professionals or the issuer's investors.[59] A person does not act on the issuer's behalf if she breaches a duty of trust or confidence owed to the issuer.[60]

2. Who Are the Enumerated Persons?

Regulation FD only covers disclosures to certain kinds of persons — in theory, "those who would reasonably be expected to trade securities on the basis of the information or provide others with advice about securities trading."[61] Most of these persons are securities market professionals: brokers and dealers and their associates,[62] investment advisers and managers and their associates,[63] and investment companies and their affiliates.[64] The other kind of person covered is "a holder of the issuer's securities," but only "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."[65] The SEC deliberately excluded disclosures to the media, government agencies, and persons in the ordinary course of business, such as vendors, customers, or strategic partners.[66]

Even when the disclosure is made to an enumerated person, Regulation FD still will not apply as long as that person either already owed a duty of confidentiality to the issuer or expressly agreed to keep the information confidential.[67] Regulation FD does not need to cover such disclosures because the existing insider trading regime, under either a "temporary insider"[68] relationship or "misappropriation

[59] 17 C.F.R. § 243.101(c) (2005).

[60] *Id.*

[61] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,719 (Aug. 24, 2000).

[62] 17 C.F.R. § 243.100(b)(1)(i) (2005).

[63] 17 C.F.R. § 243.100(b)(1)(ii) (2005).

[64] 17 C.F.R. § 243.100(b)(1)(iii) (2005).

[65] 17 C.F.R. § 243.100(b)(1)(iv) (2005).

[66] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,720 (Aug. 24, 2000). Presumably for evidentiary reasons, Regulation FD does not apply to people who are considering becoming security holders.

[67] 17 C.F.R. § 243.100(b)(2)(i) (2005).

[68] A temporary insider is an outsider, such as a lawyer or accountant, who has received corporate information because of her "special confidential relationship" with the issuer. Dirks v. SEC, 463 U.S. 646, 655 n.14 (1983).

theory,"[69] already applies to any resulting trades. Regulation FD also provides an exception for disclosures to ratings agencies and "in connection with [most] securities offering[s] registered under the Securities Act.[70]

3. What Information Is Covered?

a. Material Information

Regulation FD applies only to the disclosure of "material non-public information." Rather than attempt in the release to define (or redefine) the key term in the phrase, "material," the SEC relied on the pre-existing definition set forth by the Supreme Court.[71] "Information is material if 'there is a substantial likelihood that a reasonable shareholder would consider it important' in making an investment decision."[72] There must also be a substantial likelihood that the reasonable investor would view the information "as having significantly altered the 'total mix' of information made available."[73] A bright-line rule defining materiality was not possible, because "[w]hat is material depends on the unique facts and circumstances of each company."[74] More candidly, a bright-

[69] In *U.S. v. O'Hagan*, the Supreme Court finally endorsed the misappropriation theory of insider trading. 521 U.S. 642, 652 (1997). The Court had previously divided evenly on the theory in *Carpenter v. United States*, 484 U.S. 19, 24 (1987), and declined to decide it in *Chiarella v. United States* because the theory had not been presented to the jury. 445 U.S. 222, 235-37 (1980). Under the misappropriation theory, a trader can be found guilty of violating Rule 10b-5 if the trader owes a duty to the source of the confidential information upon which she bases her trade. *O'Hagan*, 521 U.S. at 652 ("[T]he misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.").

[70] 17 C.F.R. § 243.100(b)(2)(iv) (2005). The SEC apparently exempted securities offerings, where traditionally much information that is not in the issuers' prospectus is made available orally in the "road shows" to big investors, because it intended to address the issue in greater detail. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,725 (Aug. 24, 2000). The SEC's proposed rules on securities offerings were not issued until late in 2004. *See* Securities Offering Reform, Release Nos. 33-8501, 34-50,624, IC-26,649, 69 Fed. Reg. 67,392 (Nov. 17, 2004).

[71] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000).

[72] *Id.* at 51,721 (quoting TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)); *see also In re* Raytheon & Franklyn A. Caine, Securities Exchange Act Release No. 34-46,897, § III(D), 2002 WL 31643026 (Nov. 25, 2002) (citing Basic v. Levinson, 485 U.S. 224, 231-32 (1988)).

[73] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000) (quoting TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

[74] LEVITT, *supra* note 1, at 89.

line rule also was not possible because the Supreme Court had already ruled against that approach.[75]

Materiality has both a quantitative and a qualitative component.[76] Quantitatively, some issuers used 5% as a rule of thumb for materiality disclosures; the SEC, however, rejected this approach.[77] "[M]agnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment."[78]

The qualitative aspect is perhaps best illustrated by the statement of David B.H. Martin, the Director of the Division of Corporation Finance, that "a reasonable investor would likely consider it significant that a foreign company raising capital in the U.S. markets has business relationships with countries, governments or entities" facing certain types of U.S. economic sanctions.[79] Such business relationships need not necessarily be important to the company. Rather, they might *become* material because of public opposition to the business relationships.[80] The qualitative aspect of materiality may also be illustrated by the SEC's current exploration of whether a film studio that prescreened a movie to

---

[75] *See* Basic v. Levinson, 485 U.S. 224, 236 (1988) ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact specific finding such as materiality, must necessarily be overinclusive or underinclusive.").

[76] *See* SEC Staff Accounting Bulletin 99, 64 Fed. Reg. 45,150, 45,151 (Aug. 19, 1999).

[77] *Id.*

[78] *Id.* at 45,152.

[79] Memorandum from David B.H. Martin, Director, Division of Corporation Finance, SEC, to Laura Unger, Acting Chair, SEC (May 8, 2001), attachment to Letter from Laura S. Unger, Acting Chair, SEC, to Congressman Frank P. Wolf (May 8, 2001), *available at* 2001 SEC No-Act, LEXIS 579. Congress has since directed the SEC to establish an Office of Global Security Risk that would require every U.S.-listed company to disclose any involvement, "no matter how large or small," in designated terrorist sponsoring states. H.R. REP. NO. 108-221 (2004). This requirement is based on the asymmetric nature of the risk to corporate share value and reputation. *Id. See generally,* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency,* 112 HARV. L. REV. 1197, 1273-89 (1999) (arguing that SEC should require "corporate social disclosure," including such information "as what products a company sells, in what countries it does business, its employment and environmental records, (both domestic and global), and specified information about a company's community and political effects in the United States and elsewhere"); Note, *Should The SEC Expand Nonfinancial Disclosure Requirements?,* 115 HARV. L. REV. 1433 (2002) ("[A]s a normative matter, mandatory disclosure of socially relevant data — even financially immaterial data — would be desirable under certain circumstances . . . .").

[80] One law firm went so far as to suggest that foreign issuers may need to disclose activities that "would not be prohibited even for a U.S. company." Shearman & Sterling Client Publication, *Activities in Sanctioned Countries — New SEC Scrutiny* (June 8, 2001) (on file with authors).

analysts had selectively disclosed material information in violation of Regulation FD.[81]

Recognizing the difficulty of materiality determinations, the SEC produced a nonexclusive list for Regulation FD purposes, while cautioning that a bright-line standard would be inadequate:

> [T]he 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.[82]

The SEC also added that subdividing information into multiple, smaller pieces would not save the overall disclosure from Regulation FD's reach. It simultaneously noted that Regulation FD would not reach a situation where the recipient of the information pieces together smaller bits of information into something material without the issuer's knowledge.[83] Here, the SEC attempted to encourage investors and securities market professionals to continue (or at least not discourage them from continuing) the difficult work of analyzing company performance.

Notwithstanding the fact that the Supreme Court previously set forth these definitions of materiality,[84] the definitions were perhaps the most controversial part of Regulation FD. Many commentators criticized the

---

[81] *See* Merissa Marr, *Pixar Faces Informal SEC Probe Related to Disclosure of Results*, WALL ST. J., Aug. 26, 2005, at A3.

[82] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (Aug. 24, 2000). Item number three, in particular, is unhelpful, as it includes a very broad range of activities. The speech at issue in *Nike, Inc. v. Kasky*, 539 U.S. 654 (2003), is along these lines, in that it addresses working conditions in factories that supply Nike. *See infra* notes 335-44 and accompanying text.

[83] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721. This is known as the mosaic theory.

[84] *See supra* notes 71-73 and accompanying text.

materiality standard on the grounds that it was too vague.[85]

b. Nonpublic Information

The meaning of "nonpublic" raises fewer concerns than the definition of "materiality". The SEC, again relying on case law, defined "nonpublic" as information that "has not been disseminated in a manner making it available to investors generally."[86] It remains unclear, however, whether the SEC considers information to be public if the market knows of the information or only if the company itself discloses the information.[87] Making information public, given the widespread use of the Internet, is straightforward.[88] In particular, the SEC will consider the disclosure public if it occurs at a meeting that is webcast, that the public can call into,[89] or at a meeting of shareholders.[90]

---

[85] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,718 (Aug. 24, 2000). At least one academic commentator reached the same conclusion. *See* Kappas, *supra* note 16, *passim*; *see also* Joan Macleod Hemingway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1135 (2003) (arguing that all parties "would benefit from additional guidance in making materiality determinations in the insider trading context"). Although we agree that more guidance would be desirable, we are not convinced that the long-established judicial definition of materiality, based as it is on the views of a reasonable investor, poses any vagueness difficulties significantly greater than in other First Amendment contexts.

[86] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,721 (citing SEC v. Tex. Gulf Sulphur, 401 F.2d 833, 854 (2d Cir. 1968)). *Texas Gulf Sulphur* is one of the seminal cases in U.S. insider trading, as it was the first federal court decision to find a violation under Rule 10b-5. *See Tex. Gulf Sulphur*, 401 F.2d at 864; *see also*, *In re* Raytheon Co., Securities Exchange Act Release No. 34-46,897, § IV A&B, 2002 WL 31623026 (Nov. 25, 2002).

[87] To date, none of the enforcement actions address this point. The better answer is that if the market is aware of the information, its nonrelease is immaterial. *See* Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 516 (7th Cir. 1989) (stating that "knowledge abroad in the market" may reduce or eliminate any misleading nature of nondisclosure); *see also* Seibert v. Sperry Rand Corp., 586 F.2d 949, 952 (2d Cir. 1978) (holding omission immaterial because it had been reported nationwide).

[88] The issuer must either furnish or file a Form 8-K or alternatively, "[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." 17 C.F.R. § 243.101(e) (2005). In practice, few well-advised companies would file rather than furnish the 8-K, as furnishing an 8-K prevents liability under Section 11 of the Securities Act and Section 18 of the Securities Exchange Act.

[89] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,723 (Aug. 24, 2000).

[90] SEC, DIV. OF CORP. FINANCE, MANUAL OF PUBLICLY AVAILABLE TELEPHONE INTERPRETATIONS (4th Supp. Oct. 2000), *available at* http://www.sec.gov/interps/telephone/phonesupplement4.htm.

c. Reckless or Knowing Mental State

In addition to the requirement that the information be material and nonpublic, the SEC also added a definition of "intentional" in order to lessen the potential sting of Regulation FD. Under this requirement, a person must know or be reckless in not knowing that the disclosed information is both material and nonpublic.[91] The standard is not whether a proverbial reasonable person would have known that the information was material and nonpublic, but whether *any* reasonable person would have thought that the information was not material or public.[92] Thus, there is no liability for merely negligent behavior.

4. What Is Required Under Regulation FD?

Regulation FD requires that issuers who intentionally or recklessly disclose material nonpublic information privately to any enumerated persons must simultaneously disclose the information publicly.[93] In the case of nonintentional disclosure, the issuer must "promptly" disclose the information publicly as soon as the issuer's senior official knows, or is reckless in not knowing of the disclosure.[94] "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) . . . ."[95]

B. Application

The SEC's enforcement actions over the last four years have helped flesh out Regulation FD's meaning. Since Regulation FD became effective, the SEC has brought seven enforcement actions.[96] Five of these

---

[91] 17 C.F.R. § 243.101(a) (2005).

[92] *See* Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1569-70 (9th Cir. 1990) (citations omitted) (defining reckless conduct "as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care," and adding that it must be "so obvious that any reasonable man would be legally bound as knowing"). The SEC endorsed the *Hollinger* court's approach. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,722 (Aug. 24, 2000).

[93] 17 C.F.R. § 243.100(a)(1) (2005).

[94] 17 C.F.R. § 243.101(d) (2005).

[95] *Id.*

[96] The SEC also appears to have commenced several informal inquiries. *See, e.g.*, Amylin Pharmaceuticals, Inc. (Form 8-K) (Dec. 22, 2003), *available at* http://www.sec.gov/Archives/edgar/data/881464/000110465903029039/0001104659-03-

actions resulted in settlements, one resulted in a report of investigation, and one was recently dismissed at the district court level, although the SEC may yet appeal.[97]

1. Guiding Analysts to More Accurate Earnings Estimates

On November 25, 2002, in one of four initial enforcement actions initiated by the SEC, Raytheon and Raytheon's Chief Financial Officer agreed to a public cease and desist order.[98] Neither respondent, however, admitted guilt for violating Regulation FD.[99] The action arose from statements made during a webcast investor conference, in which Raytheon confirmed its expected annual earnings but did not disclose its expected quarterly earnings.[100] Afterwards, Raytheon's CFO individually called twelve sell-side analysts to tell them, among other things, that their quarterly earnings and revenue estimates were "too high," "aggressive," or "very aggressive."[101] The analysts then lowered their estimates by an average of five cents per share, and at least some of them discussed these estimates with their firms' sales forces.[102] In contrast, analysts who did not receive the selective disclosure did not

029039-index.htm (announcing SEC was "conducting an informal inquiry related to recent communications [about its diabetic drug] . . . . The Company believes that this inquiry relates to compliance with Regulation FD."); *see* Marr, *supra* note 81 (reporting informal inquiries into Pixar Animation Studios and DreamWorks Animation SKG); Terri Somers, *SEC Opens Inquiry into Amylin Conference Call*, SAN DIEGO UNION TRIB., Dec. 20, 2003, at C3.

[97] *See* SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (mem.) (dismissing complaint); *In re* Flowserve Corp., Securities Exchange Act Release No. 34-51,427, § I n.1, 2005 WL 677810 (Mar. 24, 2005) (settling case after defendants agreed to pay specified fines); *In re* Schering-Plough Corp., Exchange Act Release No. 34-48,461, § I, 2003 WL 22082153 (Sept. 9, 2003) (settling case under cease and desist order); *In re* Raytheon Co., Exchange Act Release No. 34-46,897, § IV A&B, 2002 WL 31623026 (Nov. 25, 2002) (resulting in cease and desist order); *In re* Secure Computing Corp., Exchange Act Release No. 34-46,895, § II, 2002 WL 31643024 (Nov. 25, 2002) (ending in settlement where parties agreed to cease and desist order); *In re* Siebel Sys., Inc., Exchange Act Release No. 34-46,896 (Nov. 25, 2002) (settling case using cease and desist order without admission of guilt); Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Motorola, Inc., Exchange Act Release No. 34-46,898, §I, 2002 WL 31650174 (Nov. 25, 2002) (reporting results of investigation but without prosecuting).

[98] Raytheon and Caine each agreed to cease and desist from committing or causing "any violations and any future violations of Section 13(a) of the Exchange Act or Regulation FD." *In re* Raytheon Co., Exchange Act Release No. 34-46,897, § IV A&B, 2002 WL 31623026 (Nov. 25, 2002).

[99] *Id.* § II.

[100] *Id.*

[101] *Id.* § III(A).

[102] *Id.* § III(C).

reduce their quarterly estimates.[103] The Raytheon action illustrated that the SEC would not permit companies to selectively guide analysts to more accurate forecasts.

2. Disclosing Material Contracts

In the second of the four initial cases, Secure Computing Corporation and its CEO also agreed to a cease and desist order without admitting guilt.[104] The CEO nonintentionally informed several securities market professionals that Secure Computing had obtained a contract with a distributor for the sale of its Internet security product.[105] The following day, the CEO selectively disclosed the information again, but this time it was intentional because he had learned that it was material nonpublic information.[106] Although information about the deal was posted on Secure Computing's website, the company had not publicly announced the deal and did not do so until after the market closed the following day.[107] Meanwhile, the volume of trades and the price of the stock increased significantly.[108] This enforcement action illustrated the point that information may remain nonpublic, even if it is publicly available.

3. General Business Trends

In the third of the four initial cases, Siebel Systems, Inc., concurrently agreed to a cease and desist order without admitting guilt[109] and a $250,000 civil penalty.[110] On November 5, 2001, Siebel's CEO, addressing an invitation-only technology conference, gave participants optimistic information regarding the company's expected sales and the overall business environment.[111] This statement came only nineteen days after

---

[103] *Id.*

[104] *In re* Secure Computing Corp., Exchange Act Release No. 34-46,895, § II 2002 WL 31643024 (Nov. 25, 2002).

[105] *Id.* § III(D). The disclosure was nonintentional because the CEO apparently believed that information on the company's website rendered it public information. *Id.*

[106] *Id.*

[107] *Id.* § III(F). Part of the problem was that the contract included a provision requiring that the other party consent before a public announcement. *Id.* § III(C).

[108] *Id.* § III(F).

[109] *In re* Siebel Sys., Inc., Exchange Act Release No. 34-46,896 (Nov. 25, 2002).

[110] In the Matter of Siebel Sys., Inc., Exchange Act Release No. 46,896, Litigation Release 17,860, 2002 WL 31643062 (Nov. 25, 2002).

[111] *In re* Siebel Sys., Inc., Exchange Act Release No. 34-46,896, § III(B)(4) (Nov. 25, 2002).

> [T]he business decisions appear to be quite normal right now, and so we're

the CEO's previous statement on a public conference call that since September 11, 2001, the market had been and would continue to be "quite tough."[112] Siebel's stock price had dropped 19% after the conference call, but increased 16.5% during and after the technology conference.[113] Participants in the conference were among the buyers in the post-conference stock price increase,[114] and they included enumerated persons, such as broker-dealers and investment advisers. The SEC determined that the disclosures were intentional because the CEO allegedly knew that the information he disclosed was material and had not previously been made public.[115] Furthermore, Siebel's Investor Relations Director knew that the technology conference was not open to the public.[116] Clearly, issuers cannot selectively reverse their previous predictions.

4. Quantitatively Defining Qualitative Terms

In the final case of the initial four, the SEC reported the results of an investigation of Motorola, Inc., regarding an alleged Regulation FD violation.[117] On February 23, 2001, Motorola publicly disclosed that it

> pretty optimistic about what we're seeing at this time. People are engaging . . . [in] . . . software selection, . . . contracts are getting signed, . . . they're expanding their existing previous appointments, so right now it appears we're seeing a return to normal behavior in IT buying patterns . . . . [T]he behavior of the market appears normal . . . . Right now, it appears to be, the processes appear to be back to more of a normal rate. It's not, it's not a depressed rate . . . as deals are moving through the pipeline . . . . I mean if we had seen continued geo-political dislocation, it could have been a nightmare out there in Q4. The good news is we're not seeing that. So, that's, that is a relief for everybody.

Id.

[112] *Id.* § III(B)(2). The CEO's remarks included, "Since September 11, we have faced an . . . environment for information technology that has been as difficult as any in the history of the information technology industry. Things have been tough. We think that they will continue to be quite tough in the short term. We have an exceptionally soft market for information technology . . . . Spending for tech products and services continues to slide. We expect things will be quite tough through the remainder of the year." *Id.*

[113] *Id.*

[114] *Id.* § III(B)(6).

[115] *Id.* § III(B)(7).

[116] *Id.* § III(B)(1). Presumably the SEC could not show that Siebel's CEO was aware that the conference was not public, and thus, he was not charged, unlike Secure Computing's CEO or Raytheon's CFO.

[117] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Motorola, Inc., Exchange Act Release No. 34-46,898, § I, 2002 WL 31650174 (Nov. 25, 2002).

suffered "significant weakness" in its sales and orders.[118] From March 6 to 12, 2001, Motorola's Director of Investor Relations disclosed in one-on-one telephone calls with approximately fifteen sell-side analysts that "significant" meant that sales and orders would be at least 25% lower than expected.[119] The SEC, however, chose not to take enforcement action because the Director of Investor Relations consulted with in-house counsel prior to speaking with the analysts.[120] The in-house lawyer determined that this definition of "significant" was neither material nor nonpublic, believing instead that "significant," "very large," and "25% or more" all conveyed the same thing.[121] Although the SEC disagreed, stating that the disclosed information was "clearly" material,[122] it recognized that, given this good faith attempt at compliance, punishment was unwarranted. The SEC cautioned, however, that having in this case refrained from a formal enforcement action, it "would be less likely in future cases to credit reliance on counsel for the advice rendered here."[123] Issuers were thus put on notice that they could not selectively disclose quantitative definitions of qualitative terms.

5. Tone, Emphasis, and Demeanor

On September 9, 2003, the SEC announced the agreement of Schering-Plough and its former CEO, Richard Kogan, to a cease and desist order[124] and to $1 million and $50,000 in civil penalties, respectively.[125] Neither Schering-Plough nor Kogan admitted guilt.[126] On September 30 and October 1, 2002, Kogan and another Schering executive met individually with four institutional analysts.[127] At each meeting, Kogan conveyed

---

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.* § III(1). According to the SEC, Motorola's in-house legal counsel "responsible for SEC reporting and disclosure issues" advised that it was acceptable to "provide quantitative definitions for certain qualitative terms that had been used in the February 23 announcements." *Id.* § II(D).

[122] *Id.* § III. The SEC noted that the fact that the Director of Investor Relations wanted to call the analysts to define significant belied the contention that the information conveyed was nothing new. *Id.*

[123] *Id.* § III(5).

[124] *In re* Schering-Plough Corp., Exchange Act Release No. 34-48,461, § I, 2003 WL 22082153 (Sept. 9, 2003).

[125] SEC Files Settled Regulation FD Charges Against Schering-Plough Corp. and Its Former Chief Executive, Litigation Release No. 18,330, 81 SEC Docket 153 (Sept. 9, 2003).

[126] *Id.*

[127] *In re* Schering-Plough, *supra* note 124, § III(A).

more negative information than previously disclosed to the public "through a combination of spoken language, tone, emphasis, and demeanor" about Schering's prospects.[128] Schering's stock price declined more than 17% on four times the typical volume, largely due to sales by the institutions who met with Kogan.[129] In addition, two of the four institutional analysts downgraded their ratings of Schering. On October 3, 2002, Schering finally issued a press release confirming what Kogan previously said.[130] After this enforcement action, issuers learned that maintaining a poker face might be necessary to avoid Regulation FD liability.

6. Confirming Prior Guidance

More recently, on March 24, 2005, Flowserve Corporation and its CEO, C. Scott Greer, agreed to pay $350,000 and $50,000, respectively, in connection with privately confirming prior earnings guidance in response to questioning by analysts from investment and brokerage firms.[131] Flowserve's written disclosure policy, however, stated that earnings guidance was effective as of the date given and the company would only update it publicly.[132] After one of the analysts issued a

---

[128] *Id.* The SEC does not conclude whether the disclosure was intentional or nonintentional. The release simply states:

> Although Kogan's *purpose* may not have been to suggest that institutional investors sell Schering stock, his conduct failed to meet the requirements of Regulation FD. Kogan's statements, demeanor and general expressions of concern for Schering's prospects during private meetings amounted to selective disclosure and prompted a significant sell-off in Schering stock.

Id. at 8 (emphasis added). This possibly unintentional demeanor evidence in the Schering action goes beyond the deliberate use of body language to convey information that had been mentioned in the Motorola investigation. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Motorola, Inc., *supra* note 117, at 4 (stating that "[i]ssuers may not evade the public disclosure requirements of Regulation FD by using 'code' words or 'winks and nods'").

[129] *In re* Schering-Plough, *supra* note 124, § III(C)(D)(4).

[130] *Id.* § III(C)(D)(5).

[131] *In re* Flowserve Corp., Exchange Act Release No. 34-51,427, § I n.1, 2005 WL 677810 (Mar. 24, 2005).

[132] *Id.* § III(C) (stating that Flowserve representatives must respond to questions by saying: "Although business conditions are subject to change, in accordance with Flowserve's policy, the current earnings guidance was effective at the date given and is not being updated until the company publicly announces updated guidance."). Presumably such a policy would not be necessary to find liability under Regulation FD, if, for example, the market no longer believes a company's estimates.

report noting the confirmation of the earnings guidance, Flowserve's stock price rose 6% on 75% greater than usual volume.[133]

The first Regulation FD enforcement action actually litigated was *SEC v. Siebel Systems, Inc.*[134] Even in its preliminary stages, the case generated national attention.[135] The SEC's complaint alleged that Siebel's CFO, Kenneth Goldman, and a Siebel Senior Vice President, Mark Hanson, knowingly or recklessly disclosed information at a one-on-one meeting with an institutional investor and at a dinner hosted by an investment bank.[136] In addition, the complaint alleged that they knowingly or recklessly failed to promptly and publicly disclose the information.[137] The SEC charged them with a violation not only of Regulation FD, but also of the previously issued cease and desist order.[138] At both the dinner and the meeting, Goldman allegedly made positive comments regarding overall business levels and the transaction pipeline, which conflicted with previously released negative public comments. Following the two events, Siebel's stock price increased by 8%[139] and several participants in these events purchased stock.[140] In addition, rumors of the company's optimism spread in the market.[141]

On September 1, 2005, the district court granted Siebel's motion to dismiss the SEC's lawsuit on the grounds that the "nature and content of the statements that the SEC alleges violated Regulation FD do not support the Commission's claim that Siebel Systems or its senior officials

---

[133] *Id.* § III(B).

[134] SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (mem).

[135] Both the Chamber of Commerce of the United States and a group of 24 securities law professors filed amici briefs, albeit on opposite sides of the constitutional issues. *See* Brief of the Chamber of Commerce of the United States as Amicus Curiae in Support of Motion to Dismiss, SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130), *available at* http://www.uschamber.com/nclc/caselist/briefsrtoz.htm; Brief of Law Professors as Amicus Curiae in Opposition to Motion to Dismiss, SEC v. Siebel Sys., (S.D.N.Y. 2005) (No. 04 CV 5130) (on file with authors); Phyllis Plitch, *Law Professors Back Reg FD, Take SEC Side vs. Challenge*, SMART MONEY, Mar. 11, 2005, *at* http://www.smartmoney.com/news/on/index.cfm?story=ON-20050311-001015-2046; *see also* Ann Woolner, *Disclosure Case May Clarify Rule; Court Challenge — Favored Few Got Company News; Did It Violate SEC Rule?*, SEATTLE TIMES, Mar. 27, 2005, at E5; *Siebel Claims SEC Rule Violates Free Speech*, L.A. TIMES, Nov. 17, 2004, at C4; sources cited, *supra* note 16.

[136] SEC Complaint at 1, 3, SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130), *available at* http://www.sec.gov/litigation/litreleases/lr18766.htm.

[137] *Id.* at 3.

[138] *See supra* notes 104-11 and accompanying text.

[139] *See* SEC Complaint, *supra* note 136, at 15.

[140] *Id.* at 13, 15.

[141] *Id.* at 15.

privately disclosed material nonpublic information."[142] In his decision, Judge George Daniels criticized the SEC for "scrutiniz[ing] at an extremely heightened level, every particular word used in the statement, including the tense of verbs and the general syntax of each sentence."[143] Company executives and spokespersons could not be expected to become "linguistic experts, or otherwise live in fear of violating Regulation FD" based on SEC "nitpicking."[144] The court also noted that a recipient's view of information as significant and presumably the action of trading on the information, by itself, was insufficient to show that the information was material.[145]

Although the court did not expressly reach the constitutional issue, the decision is in fact "classic constitutional avoidance."[146] Professor Kathleen Sullivan, in arguing the case before Judge Daniels, stressed that Regulation FD should be construed narrowly, and that if so construed, the court need not address the Regulation's facial validity and its serious First Amendment problems.[147] The decision is thus best read as taking account of the First Amendment argument (in particular, the Regulation's potential chilling effect on corporate speech),[148] albeit through interpretation of Regulation FD rather than through facial invalidation.[149] The SEC has not yet announced whether it will appeal the district court's decision.

Given the "literally tens of thousands of 'one-on-one' meetings" between issuers and securities market professionals,[150] the relatively few enforcement actions may mean that (a) issuers are complying with Regulation FD, (b) detection is difficult (since both parties have an

---

[142] SEC v. Siebel Sys., 384 F. Supp. 2d 694, 696 (S.D.N.Y. 2005) (mem.).

[143] *Id.* at 704.

[144] *Id.*

[145] *Id.* at 704.

[146] Telephone Conversation with Kathleen Sullivan, Stanley Morrison Professor of Law and Former Dean Stanford Law School, in Palo Alto, CA (Sept. 2, 2005). We are grateful to Professor Sullivan for first bringing this analysis to our attention.

[147] *Id.*

[148] *See, e.g.*, SEC v. Siebel Systems, 384 F. Supp. 2d. 694, 700-03, 707 (S.D.N.Y. 2005) (mem.) (emphasizing throughout opinion possibility that Regulation FD could chill corporate speech).

[149] Telephone Conversation with Kathleen Sullivan, *supra* note 146.

[150] *See* Louis M. Thompson, Jr., SEC Cites Investor Relations Officer for Failure to Maintain Proper Disclosure Controls to Avoid Violations of Regulation, National Investor Relations Institute's Executive Alert (July 7, 2004), http://www.niri.org/irresource_pubs/alerts/ea20040707.cfm (noting that survey showed that 97% of National Investor Relations Institute's members still conducted one-on-one meetings).

incentive to keep such disclosures secret), or (c) the SEC has been very restrained in choosing its targets. Despite the contention that the limited enforcement attempts illustrate Regulation FD's effectiveness, studies of the Regulation's actual impact prove inconclusive, as described below.

C. *Evaluations of Regulation FD*

Commentators have argued, and even the SEC has conceded, that Regulation FD might chill valuable issuer speech or reduce its usefulness.[151] Leaving aside constitutional concerns for a moment, this Article now turns to why selective disclosure might be desirable and what empirical studies reveal.

Professor Steven Choi highlights several reasons why selective disclosure may benefit investors.[152] Most importantly, allowing issuers to selectively disclose information may result in an increase in the timeliness, quality, and quantity of information reaching the market, which should make stock prices more accurate.[153] As Professors Ronald Gilson and Reinier Kraakman explain, different means of disclosure can result in differing pricing efficiency.[154] In other words, some forms of disclosure result in faster price adjustments. By prohibiting selective disclosure and thereby reducing analyst effectiveness,[155] Regulation FD may result in a less efficient market, which means more inaccurate prices.[156] Accurate stock prices, however, are better for both the issuer

---

[151] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,718 (Aug. 24, 2000); *see* Anil Arya et al., *supra* note 15, at 11 (finding unintended consequence of Regulation FD may be net decline in information reaching market); Anwer S. Ahmed & Richard A. Schneible, Jr., Did Regulation Fair Disclosure Level the Playing Field? Evidence from an Analysis of Changes in Trading Volume and Stock Price Reactions to Earnings Announcement, (Jan. 22, 2004), *available at* http://ssrn.com/abstract=498002; As one of the authors of the study, Professor Mittendorf, commented, "though Regulation FD was created with an eye on curbing the behavior of financial market miscreants, our research shows that the limitations inherent in the regulation may harm firms and analysts whose intentions are pure." PRnewswire.com, Regulation Fair Disclosure May Increase Analyst Herding, Inhibit Firm Disclosure According to Study by Yale School of Management, Ohio State University, and Carnegie Melon University (May 3, 2005), *available at* http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=109&STORY=/www/story/05-03-2005/0003539301&EDATE= .

[152] Stephen J. Choi, *Selective Disclosures in the Public Capital Markets*, 35 U.C. DAVIS L. REV. 533, 541-48 (2002).

[153] *Id.* at 541.

[154] *See* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 559 (1984).

[155] *See* Talosig, *supra* note 13, at 696-702.

[156] *Id.* at 703-05.

and the investor.[157]

In addition to increasing the accuracy of stock prices, selective disclosure may be used to encourage analysts and significant shareholders to engage in activities that benefit all shareholders, such as monitoring management.[158] However, selective disclosure also presents potential harms to investors, such as uninformed traders bearing higher costs.[159] As a result, Professor Choi concludes that "whether selective disclosure results in net benefits or harms to investors is indeterminate."[160]

Finally, Professor Choi argues that, although Regulation FD covers a broad range of disclosure, it is potentially an inadequate response. Its inadequacy arises from the fact that it may not prevent management from favoring selected market participants.[161] Likewise, Peter Talosig III concludes that, although Regulation FD is a "noble" attempt, "[i]nvestors have received little benefits from the regulation and many more disadvantages."[162] Empirical studies have yielded extensive, but ultimately conflicting and inconclusive results. In studying Regulation FD's effects, empirical researchers have examined data based on both analyst information and public information metrics.

1. Analyst Information Metrics

Analyst information metrics include analyst earnings forecast accuracy[163] and forecast dispersion.[164] The theory is that if, after Regulation FD, analysts no longer receive privileged access to information, then their forecasts may become less accurate and more

[157] *See* Choi, *supra* note 152, at 543-44 (explaining that issuers with more accurate stock pricing may be able to pay their executives less, make acquisitions using lower value of stock, and reduce risk facing their investors); *see also* Talosig, *supra* note 13, at 705-06.

[158] *See, e.g.*, Choi, *supra* note 152, at 544-47; Stephen J. Choi & Eric L. Talley, *Playing Favorites with Shareholders*, 75 S. CAL. L. REV. 271, 294-95 (2002) (arguing that large investors may be usefully subsidized by selective disclosure for monitoring management).

[159] *See* Choi, *supra* note 152, at 548-52 (listing potential harms).

[160] *Id.* at 552.

[161] *Id.* at 564-68; *see also infra* Part IV.B.2.

[162] Talosig, *supra* note 13, at 712, 714 (suggesting that Regulation FD may result in *all* investors being less knowledgeable about issuers).

[163] Forecast accuracy refers to the difference between the analyst's earnings forecast and the company's actual earnings. JENNIFER FRANCIS ET AL., SECURITY ANALYST INDEPENDENCE 69-70 (Research Foundation of CFA Institute (2004)).

[164] Forecast dispersion refers to the amount of disagreement among analysts regarding a company's earnings for a given quarter. *Id.* at 70. The higher the dispersion, the greater the disagreement, and thus likely the higher the amount of uncertainty. *Id.*

dispersed. If forecasts are less accurate, those investors who use such forecasts will be hurt. Analysts may also have to work harder to obtain their information, which will mean that they cover fewer companies.

In an early and often cited study that is perhaps most favorable to Regulation FD, Professor Frank Heflin and colleagues looked specifically at the financial information received by the markets before quarterly earnings announcements.[165] Following Regulation FD, they found "no reliable evidence of change in analysts' earnings forecast errors or dispersion."[166]

Professor Philip Shane and his co-authors in another early study examined analysts' forecasts.[167] Based on a comparison of forecasts in the year preceding and following the introduction of Regulation FD, they found that forecasts made early in the preceding quarter were less accurate in the post-FD period, but that forecasts made late in the preceding quarter were more accurate (at least after controlling for the direction of the forecast error and the size of the earlier inaccuracy).[168] They interpreted this result to mean that analysts had found a way of overcoming information discrepancies, perhaps through more adept information-processing or gathering.[169]

Although Professors Partha Mohanram and Shyam Sunder confirmed some of the above results,[170] they also found that analyst forecasts became less accurate and that the forecast dispersion increased.[171] Interestingly, more skilled analysts suffered a lower decline in

---

[165] Frank Heflin et al., *Regulation FD and the Financial Information Environment: Early Evidence*, 78 ACCT. REV. 1, 1 (2003).

[166] *Id.*

[167] Philip B. Shane et al., *Earnings and Price Discovery in the Post-Reg. FD Information Environment: A Preliminary Analysis*, at 4-5 (Working Paper, 2001), *available at* http://ssrn.com/abstract=291082.

[168] *Id.*

[169] *Id.* ("[O]ur evidence suggests that in the post-Reg. FD period, analysts gather relatively more uncertainty-relieving information between earnings announcements and, by the end of the quarter, their forecasts are as accurate as they were in the prior year.").

[170] Partha S. Mohanram & Shyam V. Sunder, *How Has Regulation Fair Disclosure Affected the Functioning of Financial Analysts?* 29-30 (Working Paper No. 29, Jan. 2004), *available at* http://ssrn.com/abstract=297933; *see also* Warren Bailey et al., *Regulation Fair Disclosure and Earnings Information: Market, Analyst and Corporate Responses*, 58 J. FIN. 2487, 2487 (2003) (finding no change in forecast accuracy but increase in forecast dispersion); Afshad J. Irani & Irene Karamanou, *Regulation Fair Disclosure, Analyst Following, and Analyst Forecast Dispersion*, 17 ACCT. HORIZONS 15, 15 (2003) (finding increase in forecast dispersion subsequent to Regulation FD).

[171] Mohanram & Sunder, *supra* note 170, at 29-30.

accuracy.[172] They concluded that analysts relied more on "idiosyncratic information discovery" and analysis.[173] This conclusion is consistent with their finding that analysts covered fewer firms and firms with fewer analysts following them[174] and with anecdotal reports that the analyst's job is tougher post Regulation FD.[175]

In a recent study based on more extensive data, however, Professor Anup Agrawal and colleagues also found a decrease in forecast accuracy.[176] While earlier studies generally only looked at the short-term impact of Regulation FD (i.e., a few quarters after its introduction), they analyzed the medium-term impact (after fifteen quarters).[177] In addition, unlike Heflin et al. their study analyzed not just the last forecasts issued before the earnings release, but also earlier forecasts.[178] They found that "earnings forecasts become less accurate following Reg FD, both at the level of the individual analyst and the consensus."[179] They also found that there is greater dispersion of analyst forecasts following Regulation FD.[180] Overall, they concluded that Regulation FD has been effective, in the sense of reducing selective guidance, but that it has also resulted in lower quality analyst forecasts.[181] Furthermore, the forecasts have become worse over time.[182]

---

172 *Id.* *But cf.* Andreas Gintschel & Stanimir Markov, *The Effectiveness of Regulation FD*, 37 J. ACCT. & ECON. 293, 294, (2004), *available at* http://gbspapers.library.emory.edu/archive/00000166/(finding that following Regulation FD, difference in stock price impact of information distributed by high-status brokerage houses and other brokerage houses declined by 50%).

173 Mohanram & Sunder, *supra* note 170, at 29-30.

174 Irani & Karamanou, *supra* note 170, at 30.

175 *See, e.g.*, Daniel Rome Levine, *Reg FD: Failed Directive Nearly 5 Years into New Disclosure Rule, Some Say Communication Has Gotten Worse*, CRAIN'S CHI. BUS., May 16, 2005, at 37.

176 Anup Agrawal et al., *Who is Afraid of Reg FD? The Behavior and Perfomance of Sell-Side Analysts Following the SEC's Fair Disclosure Rules*, J. BUS., *1 (forthcoming 2005-2006), *available at* http://bama.ua.edu/~aagrawal/regfd.pdf.

177 *Id.* at 3.

178 *Id.* at 14-15 (noting that median age of their early and late consensus forecasts were 14 and 131 days, respectively).

179 *Id.* at 21.

180 *Id.* at 20.

181 *Id.* at 22.

182 *Id.* at 21. *See also* Talosig, *supra* note 13, at 689 (arguing that studies "prove that analysts' earnings forecasts for individual companies are becoming less accurate").

2. Public Information Metrics

Public information metrics include stock return volatility,[183] stock trading volumes, informational efficiency,[184] and information asymmetry.[185] If Regulation FD results in better information flow to the public, stock prices should change more quickly and accurately, resulting in reduced return volatility and increased trading volumes. Alternatively, if Regulation FD worsens the information flow, then stock prices may become more volatile.[186]

The empirical research, however, yields mixed results.[187] Another study by Professor Frank Heflin and colleagues found that Regulation FD reduced return volatility around earnings announcements and earnings pre-announcements,[188] as did at least one other study.[189] These studies did not, however, allow for the concurrent effect of decimalization, which led to a reduction in the minimum tick size.[190] Studies that adjusted for decimalization found no significant difference in return volatility before and after Regulation FD.[191] Another study also

---

[183] Return volatility is a measure intended to capture the market's perception of the impact or information content of an event. FRANCIS, *supra* note 163, at 60.

[184] Informational efficiency is a measure for how well stock prices reflect information before it is publicly released. *Id.* at 63.

[185] Information asymmetry is the "gap between knowledge possessed by informed traders and uninformed traders." *Id.* at 67. One commonly used measure of information asymmetry is the market maker's bid-ask spread, which is itself a function of order processing and inventory costs and adverse selection costs. *Id.* Adverse selection cost is the risk premium that market makers charge to mitigate their losses in transaction with informed traders. *Id.*

[186] Noise trading or trading on rumors may also increase between companies' more infrequent public announcements.

[187] *But see* Talosig, *supra* note 13, at 687 ("Recent studies overwhelmingly conclude stock price volatility has increased after Reg. FD's effective date.").

[188] Frank Heflin et al., *Stock Return Volatility Before and After Regulation FD* 4-5 (Soc. Sci. Research Network, Working Paper No. 5, 2001), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=292879 (documenting higher return volatility overall post Regulation FD, but concluding that Regulation FD was not cause).

[189] *See* Shane et al., *supra* note 167, at 20 (finding decreased return volatility after controlling for uncertainty levels at beginning of quarterly earnings information periods).

[190] *See* Baljit Sidhu et al., *Regulation Fair Disclosure and the Cost of Adverse Selection* 7 (Duke Univ., Working Paper, 2005), *available at* http://faculty.fuqua.duke.edu/~whaley/pubs/SSW1.pdf.

[191] *See, e.g.*, Bailey et al., *supra* note 170 (also finding increased trading volumes post Regulation FD); Venkat R. Eleswarapu et al., *The Impact of Regulation Fair Disclosure: Trading Costs and Information Asymmetry*, 39 J. FIN. AND QUANTITATIVE ANALYSIS 10 (June 2004), *available at* http://www.fundp.ac.be/chercher/index_eng.html (search under author's name and select article's hyperlink). *See also* Chun I. Lee et al., *Effect of Regulation FD on Asymmetric Information*, 60 FIN. ANALYSTS J. 79, 79 (2004) (finding no significant

found greater volatility in the stock prices of firms that previously held closed conference calls.[192]

In their analysis examining information asymmetry, Professor Venkat Eleswarapu and colleagues looked at the bid-asked spread and order-flow imbalance.[193] Their study found that after Regulation FD, there was less information asymmetry, particularly for less liquid stocks, at least as shown by trading costs.[194] This effect, however, only applied for stocks that were decimalized. Professor Chiraphol Chiyachantana and colleagues also reported that Regulation FD has effectively reduced the level of information asymmetry in the days immediately before and after earnings announcements.[195] Their study also showed that the reduction is closely associated with reduced institutional trading.[196]

In contrast, Vesna Straser, who studied measures of information asymmetry using both the bid-ask spread and a measurement based on transactional stock data, found an increase after Regulation FD.[197] He concluded that "at least initially, companies responded to the regulation by providing more public information of lower quality."[198] Another recent study found evidence suggesting that "the probability of informed trading and the magnitude of the adverse selection cost component [that indicates information asymmetry] incurred by investors have risen."[199] Professor Baljit Sidhu and co-authors interpreted this result to mean that Regulation FD had a chilling effect, in that inside information actually

---

increase in volatility post Regulation FD).

[192] Brian J. Bushee et al., *Managerial and Investor Responses to Disclosure Regulation: The Case of Reg FD and Conference Calls*, 79 ACCT. REV. 617, 640 (2004). This result is consistent with arguments that the volatility may be "a result of unsophisticated investors trading on information without the benefit of professional analysis." *Id.* at 641.

[193] Eleswarapu et al., *supra* note 191 (finding decline in adverse selection component of trading costs). The bid-asked spread is the difference between the price a buyer is offering for a security and the price a seller is willing to pay. Order flow imbalance refers to an imbalance between buy and sell orders. Other proxies for information asymmetry include "depths, volume, price volatility, [and] probability of private information trading." Vesna Straser, *Regulation Fair Disclosure and Information Asymmetry* 3 n.6 (Soc. Sci. Research Network, Working Paper No. 1, 2002), *available at* http://ssrn.com/abstract=311303.

[194] Eleswarapu, *supra* note 191, at 19-20; *see also* Lee et al., *supra* note 191, at 79-80 (finding little or no increase in information asymmetry as measured by adverse-selection portion of bid-asked spread).

[195] Chiraphol N. Chiyachantana et al., *The Impact of Regulation Fair Disclosure on Information Asymmetry and Trading: An Intraday Analysis*, 39 FIN. REV. 549, 575 (2004).

[196] *Id.*

[197] Straser, *supra* note 193, at 1.

[198] *Id.*

[199] Sidhu et al., *supra* note 190, at 4.

became *more* valuable because it was longer lasting and shared by fewer recipients; thus market makers were forced to demand a larger risk premium.[200]

A significant criticism of the above studies is that their research design — comparing metrics in pre- and post-Regulation FD time periods — fails to allow for most or all other potential confounding causes for change (or lack of change) in the metric.[201] Professor Jennifer Francis and colleagues note several other reasons besides Regulation FD that may have altered firms' disclosure practices in the 2000-2002 period. These reasons include the recession; the collapse of Internet stocks; decimalization at the NYSE, NASDAQ, and AMEX; the high-profile Enron implosion; Worldcom's bankruptcy filing; and the Andersen failure.[202]

Shedding further light on this issue, several teams of researchers have compared domestic issuers with foreign issuers who have American Depositary Receipts ("ADRs") listed on the NYSE and NASDAQ.[203] Because foreign issuers are exempt from Regulation FD,[204] they may provide a good natural control sample.[205] Francis and her co-authors

---

[200] *Id.* at 26. This finding depends on the insight that multiple recipients of identical inside information will lead to an immediate price change in the security and an expected profit of zero. *See* sources cited *infra* note 439.

[201] Jennifer Francis et al., *Re-examining the Effects of Regulation Fair Disclosure Using Foreign Listed Firms to Control for Concurrent Shocks* 2 (Duke Univ. Fuqua School of Business, Working Paper No. 1-2, April 2005), *available at* http://faculty.fuqua.duke.edu/~jfrancis/bio/Francis,%20Nanda%20and%20Wang%20%5BSept%202005%5D.pdf.

[202] *Id.* at 1 n.1.

[203] Prem G. Mathew, et al., *A Reexamination of Information Flow in Financial Markets: The Impact of Regulation FD and Decimalization*, 43 Q.J. OF BUS. & ECON. 123, 124 (2004); *Id.*; Armando R. Gomes et al., *SEC Regulation Fair Disclosure, Information, and the Cost of Capital* 32-33 (Rodney L. White, Center for Fin. Research, Wharton, Working Paper No. 10567, Mar. 29, 2004), *available at* http://finance.wharton.upenn.edu/~rlwctr/papers/0413.pdf. Another approach was to compare the relative effects of Regulation FD on different kinds of companies: those that had previously held open conference calls and those that had previously held closed calls. Brian J. Bushee et al., *supra* note 192, at 617. The study concluded that, although the effect was not strong, the latter group of companies were less likely to continue hosting conference calls after Regulation FD. *Id.*

[204] *See supra* notes 54-58 and accompanying text.

[205] Francis et. al, *supra* note 201, at 1-2. There are other competing explanations, such as the fact that foreign firms may have followed Regulation FD's restrictions without being required to do so. *Id.* at 3; *see also* Prem G. Mathew et al., How Has Regulation Fair Disclosure Affected Liquidity?, at 4 (Working Paper), *available at* http://207.36.165.114/Denver/Papers/liquidityRFD.pdf (noting that "some non-U.S. issuer[s] feel that it is important to follow the guidelines" of Regulation FD, and listing reasons) (last visited Oct. 17, 2005).

found no significant relative differences in various measures of public and analyst information, both pre- and post-Regulation FD.[206] These results suggest that events other than the implementation of Regulation FD affected the public information environment.[207] They also found that the informativeness of analysts' reports declined for U.S. firms both when compared to pre-Regulation FD and relative to foreign firms with ADRs.[208] A more limited study by Professor Prem Mathew and co-authors found an increase in return volatility for U.S. firms in the first quarter after Regulation FD's effective date when compared to foreign firms with ADRs, but the data was "consistent with this impact being only temporary."[209]

Overall, it is safe to say that Regulation FD has not had a calamitous effect on the securities market, even if the desirability of the effect — or whether there was any effect at all — remains disputed. Of course, just because Regulation FD may not have been harmful, or was not as harmful as expected, does not demonstrate that Regulation FD is desirable or that other alternative approaches would not be better. It also fails to prove that Regulation FD is consistent with the First Amendment.[210]

II. THE FIRST AMENDMENT AND SEC REGULATIONS AFFECTING SPEECH

The First Amendment guarantees the right to engage in a variety of expressive activities, including speech, free of government intervention.[211] Until the last twenty-five years or so, plaintiffs rarely if ever used the First Amendment to challenge federal securities regulations.[212] Up until then, the courts perceived the government's

---

[206] Francis et al., *supra* note 201, at 16.

[207] *Id.*

[208] *Id.* at 17.

[209] Mathew et al., *supra* note 203, at 124. The authors also accept that limited enforcement may explain their results. *Id.* at 133.

[210] *See infra* Part IV.

[211] U.S. CONST. amend. I states as follows: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances."

[212] *See* Arthur Pinto, *The Nature of the Capital Markets Allows a Greater Role for the Government*, 55 BROOK. L. REV. 77, 77-78 (1989) (noting that dearth of First Amendment challenges may be due, in part, to fact that speech regulated by federal securities laws did not obviously touch upon traditional First Amendment concerns, such as political, religious, or artistic speech); *see also*, Allen Boyer, *Free Speech, Free Markets, and Foolish Consistency*, 92 COLUM. L. REV. 474, 495 (1992) (reviewing NICHOLAS WOLFSON, CORPORATE

ability to mandate the full and fair disclosure of information by a company subject to federal securities laws as essential to preserving the integrity of the capital markets.[213]

While still limited in number, an increasing number of plaintiffs have raised the First Amendment to attack a number of federal securities regulations,[214] including Regulation FD.[215] The expansion of First Amendment jurisprudence into the realm of securities regulation stems from a variety of factors, including a willingness by scholars and the courts to recognize that economic rights can be closely aligned with the traditional rights protected by the First Amendment.[216]

FIRST AMENDMENT RIGHTS AND THE SEC (1990)) (arguing that "the [Supreme] Court has ... rejected any implication that the First Amendment should be applied in the securities field"). Likewise, it was not clear that commercial speech was protected by the First Amendment until 1976. *See infra* Part III.A.

[213] Congress enacted federal securities laws during the New Deal to address the perceived fraud and other abuses endemic to both the sale and trading of securities. *See* Joel Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1, 51 (1983); *see also* SEC v. Wall St. Publ'g Inst., Inc., 851 F.2d 365, 373 (D.C. Cir. 1988) (citation omitted) (stating that "[i]f speech employed directly or indirectly to sell securities were totally protected, any regulation of the securities market would be infeasible — and that result has long since been rejected").

[214] *See, e.g.*, SEC v. Lipson, 278 F.3d 656, 664 (7th Cir. 2002) (rejecting defendant's claim that district court violated his First Amendment rights because court was unduly influenced by defendant's claims of innocence and by defendant's allegations that government's imposition of maximum civil penalty for insider trading violations resulted from government conspiracy); United States v. Wenger, 292 F. Supp. 2d 1296, 1309 (D. Utah 2003) (rejecting First Amendment challenge); SEC v. Corp. Relations Group, NOV 6:99-CV-1222-Orl-28KRS, 2003 U.S. Dist. Lexis 24925, at *43-46 (M.D. Fla. Mar. 28, 2003) (rejecting First Amendment challenge to application of Section 17(b) to publisher who discloses that its publication is paid advertisement); SEC v. Huttoe, 96-2453(GK), 1998 U.S. Dist. Lexis 23211, at *38-44 (D.D.C. Sept, 14, 1998) (rejecting First Amendment challenge); *Wall St. Publ'g. Inst.*, 851 F.2d at 373 (accepting that First Amendment does limit regulation in securities field); *cf.* Commodity Trend Serv., Inc. v. Commodity Futures Trading Comm'n, 149 F.3d 679, 686 (7th Cir. 1998) (reviewing provision of Commodity Exchange Act requiring registration of commodities investment advisors and concluding that independent investment advice is not commercial speech, but rather fully protected speech); SEC v. Blount, 61 F.3d 938, 941-43 (D.C. Cir. 1995) (applying strict scrutiny under First Amendment to SEC rule restricting sellers of municipal securities from making political contributions); SEC v. Blavin, 557 F. Supp. 1304, 1309-10 (E.D. Mich. 1983) (showing that although not raised by parties, court considered sua sponte First Amendment implications of enjoining unregistered investment adviser from publishing investment advice regarding companies in which adviser had personal and financial interest).

[215] *See* SEC v. Siebel Sys., 384 F. Supp. 2d 694, 696 (S.D.N.Y. 2005) (mem.). Discussed *supra* at notes 134-49 and accompanying text.

[216] *See* NICHOLAS WOLFSON, CORPORATE FIRST AMENDMENT RIGHTS AND THE SEC 113-19 (Quorum Books (1990)); Aleta G. Estreicher, *Securities Regulation and the First Amendment*, 24 GA. L. REV. 223, 225-26 (1990) (arguing that to view commercial speech "as some second-

Although a number of courts and commentators have recognized that *some* constitutional scrutiny should apply to federal securities laws,[217]

class species of expression is to ignore the contribution such speech makes to the societal commitment to decentralized decision making . . . such speech . . . [is] an integral part of the 'system of freedom of expression'"); Nicholas Wolfson, *The First Amendment and the SEC*, 20 CONN. L. REV. 265, 276-77 (1988) (arguing that "SEC speech" is form of commercial speech which nonetheless deserves full constitutional protection because commercial speech and political speech are indistinguishable); *see also* Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 764 (1976) (noting that "[e]ven an individual advertisement, though entirely 'commercial,' may be of general public interest," thus touching upon speech traditionally protected by First Amendment (citing Bigelow v. Virginia, 421 U.S. 809, 822 (1975), for proposition that "[p]urely factual matter of public interest may claim protection")). Arthur Pinto has catalogued other factors that have led to an increase in First Amendment challenges. *See* Pinto, *supra* note 212, at 78 n.5 (citations omitted) (noting law and economics movement raises questions about all forms of government regulation that interferes with efficient operations of markets; belief by some commentators that private arrangements as opposed to government intervention is proper mode of dealing with issues of corporate law; growing acceptance of efficient capital market hypothesis, which questions system of disclosure that underlies 1934 Securities Exchange Act because Act creates system that is concerned with timing and use of past information presented in particular form to investors; institutionalization of markets, which means that large economic players are involved in market and can protect against insufficient and improper information reaching those markets; and political aspects of securities law have become more apparent, and thus, speech may involve political speech protected traditionally by First Amendment).

[217] *See* SEC v. Wall Street Publ'g. Inst., Inc., 851 F.2d 365, 373 (D.C. Cir. 1988) (accepting that First Amendment applies to securities regulation); Henry N. Butler & Larry E. Ribstein, *Corporate Governance Speech and the First Amendment*, 43 U. KAN. L. REV. 163, 194-202 (1994) (concluding that some securities regulations may violate First Amendment); Donald E. Lively, *Securities Regulation and the First Amendment: Toward a Marketplace of Ideas in the Marketplace of Investment*, 60 WASH. L. REV. 843, 843 (1985) (arguing that ever since commercial speech was granted constitutional protection, securities regulations "must comport" with First Amendment); Burt Neuborne, *The First Amendment and Government Regulation of Capital Markets*, 55 BROOK. L. REV. 37 (1989); Pinto, *supra* note 212, at 87-88 (agreeing with application of First Amendment to securities regulation, but generally arguing that complexities of capital markets justifies significant government regulation, particularly as it relates to mandatory disclosure requirements); Lloyd L. Drury III, Disclosure is Speech: Imposing Meaningful First Amendment Constraints on SEC Regulatory Authority (Aug. 26, 2005), *available at* http://ssrn.com/abstract=791706 (arguing that First Amendment should be applied to SEC regulations, but that bulk of regulations will survive strict scrutiny). *But cf.* Michael P. Dooley, *The First Amendment and the SEC: A Comment*, 20 CONN. L. REV. 335, 352 (1988) (arguing that First Amendment commercial speech doctrine should not be extended to other areas of federal securities regulation, besides solicitation rules, unless courts are willing to resurrect *Lochner*-like "substantive due process" review of economic legislation); Schauer, *supra* note 26, at 1765 ("[S]ecurities Regulation . . . involve[s] legal control of speech lying well beyond the boundaries of the First Amendment's concern."). Schauer's claim is later moderated to one that says securities regulation is "a domain largely outside the coverage of the First Amendment." *Id.* at 1780. This is correct, because as Schauer notes, the SEC is normally concerned with whether information is false and misleading. *Id.* at 1778-79. False and misleading speech is a category of speech that has never been protected by the First

there is no consensus and no definitive statement from the Supreme Court[218] as to whether traditional First Amendment protections should apply or a more limited commercial speech analysis[219] should govern.[220]

First, this section examines the cases applying the First Amendment to federal securities regulations in general.[221] While there is a notable lack of consistency among the courts in resolving First Amendment attacks on federal securities regulations, there are some relevant threshold considerations in analyzing Regulation FD. Among these considerations

---

Amendment. Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 772 (1976) (stating that "[u]ntruthful speech, commercial or otherwise, has never been protected for its own sake" (citing Gertz v. Robert Welch, Inc., 418 U.S. 323, 340 (1974); Konigsberg v. State Bar, 366 U.S. 36, 49, 51 n.10 (1961))). False and misleading information, however, is not Regulation FD's concern.

[218] *See, e.g.*, Lowe v. SEC, 472 U.S. 181, 234 (1985) (declining to directly address whether speech regulated by SEC is "commercial"); *cf.* Riley v. Nat'l Fed'n of the Blind, 487 U.S. 781, 796 n.9 (1988) (hinting that regulation of securities field involved purely commercial speech).

[219] *See* Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n., 447 U.S. 557, 563 (1980) (stating that "Constitution affords a lesser protection to commercial speech than to other constitutionally guaranteed expression"); Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 456 (1978). ("To require a parity of constitutional protection for commercial and noncommercial speech alike could invite dilution, simply by a leveling process, of the force of the Amendment's guarantee with respect to the latter kind of speech. Rather than subject the First Amendment to such a devitalization, we instead have afforded commercial speech a limited measure of protection, commensurate with its subordinate position in the scale of First Amendment values, while allowing modes of regulation that might be impermissible in the realm of noncommercial expression."). *But see* Nicole B. Casarez, *Don't Tell Me What To Say: Compelled Commercial Speech and the First Amendment*, 63 MO. L. REV. 929, 930 n.10 (1998) (citing William Van Alstyne, *Remembering Melville Nimmer: Some Cautionary Notes on Commercial Speech*, 43 UCLA L. REV. 1635, 1640 (1996) (stating that "like treatment of commercial and noncommercial speech is an idea who[se] time has evidently arrived")); Martin H. Redish, *First Amendment Theory and the Demise of the Commercial Speech Distinction: The Case of the Smoking Controversy*, 24 N. KY. L. REV. 553, 555 (1997) (opining that Court in *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484 (1996), "appeared to reject the 'step child' status of commercial speech in everything but name").

[220] *See, e.g.*, United States v. Wenger, 292 F. Supp. 2d 1296, 1309 (D. Utah 2003) (applying commercial speech analysis to Section 17(b) of Securities Act that required defendant to announce receipt of consideration for promoting stock); *see also* WOLFSON, *supra* note 216, *passim* (1988) (arguing that speech regulated by SEC, although characterized as commercial speech, is more akin to political-artistic speech which deserves full constitutional protection); Neuborne, *supra* note 217, at 37 (arguing for application of expanded commercial speech doctrine in federal securities law area which would greatly increase burden on government to justify regulating speech in this context); *cf.* Lowe v. SEC, 472 U.S. 181, 233 (1985) (White, J., concurring) (noting that, although majority opinion avoided deciding case based on constitutional question, regulation of investment advisers under Investment Advisers Act of 1940 operated as "a direct restraint on freedom of speech and of press subject to searching scrutiny called for by First Amendment").

[221] We also examine analogies drawn from case law in the commodities context.

are whether Regulation FD targets speech per se and whether Regulation FD depends on the content of the speech. This section concludes by finding that Regulation FD targets speech per se as well as its content.

A. *Raising the First Amendment Against Securities Laws*

1. *Lowe* Suggests High Levels of Protection for SEC-Regulated Speech

The first time the Supreme Court considered applying the First Amendment to federal securities regulations was in *Lowe v. SEC.*[222] In *Lowe*, the Supreme Court held that publishers who were not registered as investment advisers could not be permanently enjoined from publishing nonpersonalized investment advice and commentary in securities newsletters because the newsletters fell within an exception to the Investment Advisers Exclusion Act.[223] Although the majority opinion decided the case on statutory grounds, the Court noted that because the expression of a factual opinion about a commercial product is protected by the First Amendment, "it is difficult to see why the expression of an opinion about a marketable security should not also be protected."[224]

Justice White's concurring opinion, joined by Chief Justice Burger and Justice Rehnquist, is of greater interest, for it directly confronts the constitutional claim. The concurrence would have found that the Investment Advisers Exclusion Act violated the First Amendment because the Act banned legitimate, disinterested investment advice, as well as fraudulent, deceptive, or manipulative advice; thus, the Act operated as a presumptively invalid prior restraint on fully-protected speech.[225] Although the defendant in *Lowe* argued that the expression

---

[222] 472 U.S. 181 (1985).

[223] 15 U.S.C. §§ 80b-2(a)(11)(D) (2005) (providing exception from Investment Advisors Exclusion Act for publisher of any bona fide newspaper, news magazine, or business or financial publication of general and regular circulation). The Court had previously noted that the penalizing of a negligent misstatement on a registration statement was an example, along with mail fraud and common law fraud, "that the right to communicate information of public interest is not 'unconditional.'" Curtis Publ'g Co. v. Butts, 388 U.S. 130, 150 n.14 (1967) (referring to 15 U.S.C. § 77k).

[224] 472 U.S. at 210 n.58.

[225] *Id.* at 234. In both *Virginia State Board of Pharmacy* and *Central Hudson*, the Supreme Court noted that the "greater objectivity and hardiness of commercial speech make it less necessary to tolerate inaccurate statements for fear of silencing the speaker" and "may also make inapplicable the prohibition against prior restraints." Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n., 447 U.S. 557, 571 n.13 (1980); Va. State Bd. of Pharmacy v. Va.

contained in the newsletters should enjoy full constitutional protection because it did not propose a commercial transaction between the speaker and his audience and, therefore, was not commercial speech, the concurring opinion declined to address this point.[226]

Relying in part on *Lowe*, the Seventh Circuit in *Commodity Trend Services, Inc. v. Commodity Futures Trading Commission*, concluded that independent investment advice regarding commodities trading was fully protected speech.[227] The type of investment advice contained in the defendant's newsletter included, among other things, historical price ranges for various markets, "hot picks" (impersonal trading recommendations and market commentaries), general instructions on how to trade in the commodities markets, methods of reducing trading risk, and extrapolating useful information from long-term market trends. Applying the narrower definition of commercial speech to the speech contained in the defendant's newsletter, namely "speech which does no more than propose a commercial transaction,"[228] the Seventh Circuit concluded that the regulated speech did not propose a commercial transaction between the defendant and a specific customer.[229] Instead, the speech was analogous to a restaurant review or a *Consumer Reports* article, which are fully protected by the First Amendment.[230]

2. *Wall Street*: Intermediate Protection at Most

Three years after the *Lowe* decision, in *SEC v. Wall Street*, the D.C. Circuit examined the SEC's attempt to enjoin a publisher of a financial investment magazine from publishing articles featuring particular companies' securities without disclosing that it received consideration

---

Citizens Consumer Council, Inc., 425 U.S. 748, 772 n.24 (1976). The concurring opinion's use in *Lowe* of the prior restraint analytical framework suggests that those three Justices considered the speech at issue, financial investment advice, deserving of more protection than — or at least different from — commercial speech. 472 U.S. at 210.

[226] 472 U.S. at 210.

[227] Commodity Trend Serv., Inc. v. Commodity Futures Trading Comm'n, 149 F.3d 679, 684-86 (7th Cir. 1998) (reviewing challenge to provision of Commodity Exchange Act, analogous to section 17(b) of Investment Advisers Act, that required commodity investment advisers to register with Commodity Futures Trading Commission).

[228] *Id.* at 684 (quotations omitted). See *infra* Part III.A for a discussion of different Supreme Court definitions of commercial speech.

[229] *Commodity Futures*, 149 F.3d at 686.

[230] *Id.* Wolfson takes this same point even further, arguing that there is no real distinction between an advertisement for shampoo and a book that extols the advantages of a brand of shampoo. *See* WOLFSON, *supra* note 216, at 2.

from those companies under Section 17(b) of the Securities Act of 1933.[231] The consideration included free text, drafted and provided by the company, which the publisher incorporated into the magazine articles.[232] The D.C. Circuit suggested that the articles about companies and their stocks were not commercial speech because they did not contain speech that was concededly an advertisement, referred to a specific product, and was motivated by economic interests.[233]

Despite these findings, the D.C. Circuit did not grant full First Amendment protection to the speech as Justice White did in *Lowe*.[234] Rather, the D.C. Circuit characterized the speech as a "distinct category of communications in which the government's power to regulate is at least as broad as with respect to the general rubric of commercial speech."[235] The D.C. Circuit justified this characterization based on "the federal government's broad powers to regulate the securities industry."[236] However, it also conceded that after the Supreme Court's decision in *Lowe*, "it would be an overstatement to assert that the First Amendment does not *limit* regulation in the securities area."[237] The D.C. Circuit simultaneously acknowledged that the disclosure requirement could not depend on the content of the publication.[238] If a determination of the payment of consideration required the court to consider the degree to which the featured company contributed to the article's content, the "SEC and the federal judiciary would be propelled into what is very close to content regulation of speech,"[239] which is "particularly repugnant to core First Amendment concerns."[240]

---

[231] SEC v. Wall St. Publ'g Inst., Inc., 851 F.2d 365 (D.C. Cir. 1988). Section 17(b) prohibits publishing a description of a security in exchange for undisclosed consideration. 15 U.S.C. § 77q(b) (2005).

[232] 851 F.2d at 374.

[233] *Id.* at 372 (applying formulation of commercial speech contained in *Bolger v. Youngs Drug Products Corp.*, 463 U.S. 60, 66-67, 103 (1983)); *cf.* United States v. Wenger, 292 F. Supp. 2d 1296, 1298 (D. Utah 2003) (finding that section 17(b) of Investment Advisors Act regulates only commercial speech and, therefore, is not subject to strict scrutiny).

[234] The D.C. Circuit distinguished *Lowe* on several grounds, including the absence in *Lowe* of any allegation that the investment publication in that case disseminated fraudulent or misleading information. *Wall Street Publ'g Inst., Inc.*, 851 F.2d at 371.

[235] *Id.* at 373.

[236] *Id.* at 372.

[237] *Id.* at 373.

[238] *Id.* at 375.

[239] *Id.* (citation omitted).

[240] *Id.* at 374 (citation omitted).

3. Other Courts Give SEC-Regulated Speech Minimal Protection

Subsequently, courts reviewing First Amendment challenges to Section 17(b) of the Securities Act, the same section reviewed in *Wall Street*, concluded that the Regulation did no more than compel commercial speech to prevent fraudulent or misleading statements and thus deserved only minimal constitutional protection.[241] For example, the district court in *United States v. Wenger* applied the rational basis test to find that Section 17(b) was "reasonably related to the State's interest in preventing deception of consumers."[242] Similarly, in *SEC v. Huttoe*, the district court applied the rational basis test to hold that Section 17(b) did not violate the First Amendment because the SEC did not seek to regulate the content of the defendant's investment articles, but rather required defendant to disclose that he received consideration for touting particular stocks to protect the investing public.[243]

Different applications of the level of First Amendment protection demonstrate that there is no monolithic approach to the broad field of securities regulation. At a minimum, however, a court should address the following threshold issues: does the regulation target speech per se and does the regulation target the content of the speech?

B. *Threshold Questions: Speech and Content*

1. Does Regulation FD Target Speech Per Se?

At first glance, it appears fairly obvious that Regulation FD targets speech, in that disclosure necessitates speech.[244] However, in heavily regulated industries such as the legal profession,[245] fruit growing,[246] and

---

[241] United States v. Wenger, 292 F. Supp. 2d 1296, 1298 (D. Utah 2003); SEC v. Huttoe No. 96-2453(GK), 1998 WL 34078092, at *10 (D.D.C. Sept. 14, 1998) (applying rational basis test). See *infra* Part III.D for a discussion of compelled commercial speech.

[242] *Wenger*, 292 F. Supp. 2d at 1298.

[243] *Huttoe*, 1998 WL 34078092 at *10.

[244] *See* 17 C.F.R. § 243.100 (2005). Even the nonverbal conduct at issue in *Schering-Plough* qualifies as expressive conduct. *See supra* notes 124-30 and accompanying text.

[245] *See* Ohralik v. Ohio State Bar Ass'n, 436 U.S. 447, 468 (1978) (rejecting First Amendment challenge to state bar disciplinary rule).

[246] *See* Glickman v. Wileman Bros. & Elliott, Inc., 521 U.S. 457, 469-70 (1997) (justifying forced contributions by California fruit growers to generic advertising because of extensive federal regulation of fruit growers generally established by Agricultural Marketing Agreement Act of 1937); *infra* notes 363-66 and accompanying text.

gambling,[247] courts hesitate to strike down regulations affecting speech because of the government's vast authority to regulate these businesses. Even in the context of a highly regulated industry, however, there exists a key distinction between regulations targeting the speech itself[248] and regulations targeting an industry's conduct that may evince itself through speech.[249] The Supreme Court in *Ohralik v. Ohio State Bar Association* explained the latter type of regulation as follows:

> It has never been deemed an abridgement of freedom of speech or press to make a course of conduct illegal merely because the conduct was *in part* initiated, evidenced, or carried out by means of language, either spoken, written, or printed. Numerous examples could be cited of communications that are regulated without offending the First Amendment, such as the exchange of information about securities, corporate proxy statements, the exchange of price and production information among competitors, and employers' threats of retaliation for the labor activities of employees. Each of these examples illustrates that the State does not lose its power to regulate commercial activity deemed harmful to the public whenever speech is a component of that activity.[250]

The government, however, cannot go too far and attempt to regulate the speech itself without implicating the First Amendment.[251] As Justice White explained in his concurrence in *Lowe* "the principle that the government may restrict entry into professions and vocations through licensing schemes has never been extended to encompass the licensing of speech per se . . . ." Justice White further noted that "[a]t some point, a measure is no longer a regulation of a profession but a regulation of speech or of the press; beyond that point, the statute must survive the

---

[247] *See* Posadas de P. R. Assocs. v. Tourism Co. of P.R., 478 U.S. 328 (1986) (holding that prohibiting advertising by casino, which has traditionally been subject to heavy governmental regulation, did not violate First Amendment); *see also* 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 509-10 (1996) (plurality opinion) (declining to give force to *Posadas's* "highly deferential approach," stating that "we are now persuaded that *Posadas* erroneously performed the First Amendment analysis").

[248] *See, e.g.*, Lowe v. SEC, 472 U.S. 181, 229-30 (1985) (discussed *supra* in Part II.A.1).

[249] *See Ohralik*, 436 U.S. at 468; *cf.* Paris Adult Theatre I v. Slaton, 413 U.S. 49, 67 (1973) (stating that "[w]here communication of ideas, protected by the First Amendment, is not involved, or the particular privacy of the home protected by *Stanley*, or any of the other 'areas or zones' of constitutionally protected privacy, the mere fact that, as a consequence, some human 'utterances' or 'thoughts' may be incidentally affected does not bar the State from acting to protect legitimate state interests").

[250] 436 U.S. at 457 (citations omitted) (emphasis added).

[251] *Lowe*, 472 U.S. at 229-30 (White, J., concurring).

level of scrutiny demanded by the First Amendment."[252]

Recently in *Department of Agriculture v. United Foods*, the Supreme Court drew attention to this distinction between regulations that target speech per se and regulations of an industry's conduct that may evince itself through speech.[253] The Court affirmed that it has "not upheld compelled subsidies for speech in the context of a program where the principal object is speech itself."[254]

Like the agricultural industry in *United Foods*, commentators often cite the securities industry as an example of a heavily regulated industry that justifies substantial government regulation.[255] Indeed, the Supreme Court in *Ohralik* referred explicitly to the "exchange of information about securities" as an example of permissible government regulation.[256] The question then becomes, does Regulation FD target speech per se, or does it attempt to regulate conduct that merely evinces itself through speech?

In an unprecedented departure from prior SEC regulations requiring affirmative disclosure to avoid fraud[257] or prevent insider trading,[258] Regulation FD requires no conduct whatsoever, besides the speech itself, to trigger liability.[259] Liability attaches instantly when a corporate speaker intentionally disseminates material nonpublic information to some individuals but not others.[260] The Supreme Court's language in

---

[252] *Id.* (citations omitted).

[253] U.S. Dep't of Agric.v. United Foods, Inc., 533 U.S. 405, 415 (2001).

[254] *Id.*; *see also* RODNEY A. SMOLLA, 2 SMOLLA & NIMMER ON FREEDOM OF SPEECH § 20:43 (Oct. 2004) (citations omitted) ("For it is *only* the linkage between commercial speech and a commercial transaction that gives the government the theoretical leverage to presume to regulate the speech at all . . . . In classic First Amendment terms, however, the one thing that government *may not do* is regulate speech because it 'sells' a lifestyles, fantasy, ethos, identity, or attitude that happens to be regarded by most as socially corrosive.").

[255] *See, e.g.*, Dun & Bradstreet, Inc. v. Greenmoss Builders, 472 U.S. 749, 758-59 (1985) (plurality opinion) (exchange of information relating to securities is area of permissible regulation); *Ohralik*, 436 U.S. at 456; Bangor & Aroostock R.R. Co. v. Interstate Commerce Comm'n, 574 F.2d 1096, 1107 (1st Cir. 1978) (stating that "the First Amendment has not yet been held to limit regulation in areas of extensive economic supervision, such as the securities, antitrust, and transportation fields, where the exchange of information can be a vital element in an illegal scheme"); Boyer, *supra* note 212, at 495 (arguing that "the [Supreme] Court has . . . rejected any implication that the First Amendment should be applied in the securities field"); Pinto, *supra* note 212, at 77-78 (arguing for extensive government regulation of securities industry and minimal role for First Amendment).

[256] 436 U.S. at 456.

[257] *See, e.g.*, Securities Exchange Act of 1933, 15 U.S.C. § 17(b) (2005) (requiring defendant to announce receipt of consideration for promoting stock).

[258] *See, e.g.*, 15 U.S.C. § 78j(b) (2005); 17 C.F.R. § 240.10b-5 (2005).

[259] *See* 17 C.F.R. § 243.100 (2005) (requiring only disclosure).

[260] *See supra* Part I.A.

Ohralik indicates that the Court may approve a regulation of speech that is only incidental to the prohibited commercial activity, such as insider trading. The Court in *Ohralik*, however, did not contemplate the SEC's regulation of speech per se that is not incidental to any commercial activity, as is the case with Regulation FD.[261] Even in *SEC v. Wall Street*, the D.C. Circuit suggested that the SEC's broad regulatory powers cannot extend to content-based regulations of speech per se with no additional conduct required to impose liability.[262] Given that Regulation FD targets pure speech, the next question is whether it targets the content as well.

2. Does Regulation FD Target the Speech's Content?

As discussed in the prior section, the securities laws not only regulate the affirmative disclosure of information that the SEC believes investors need to avoid fraud,[263] but may also restrict the time, place, and manner of speech.[264] The SEC argues that Regulation FD is only a time, place, and manner regulation of speech because it mandates disclosure to the public of information previously or simultaneously disclosed only to select individuals.[265] In other words, Regulation FD does not mandate the disclosure of new information, but rather regulates the manner and

---

[261] The SEC mandates the disclosure of some categories of corporate information on a periodic basis. *See, e.g.*, Reg. S-K, SEC Rule 12b-20, Items 1-2 of Form 10, Form 8-K, § 12(b)(1). The information required includes such topics as the "organization, structure and nature of the business." 15 U.S.C. § 78l(b)(1)(A) (2005). The justification for such mandatory disclosure requirements is to regulate speech to effectuate the broad goals of the federal securities laws, including the full disclosure of some information. These disclosure requirements, however, are not triggered by a corporation's speech to a private audience, as is the case with Regulation FD.

[262] SEC v. Wall St. Publ'g Inst., Inc., 851 F.2d 365 (D.C. Cir. 1998); *see supra* notes 234-37 and accompanying text.

[263] *See, e.g.*, Securities Exchange Act of 1933, 15 U.S.C. § 17(b) (2005).

[264] *See* Pinto, *supra* note 212, at 89.

[265] SEC Opposition to Motion to Dismiss at 17-22, SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130), *available at* 2004 WL 3142263 [hereinafter SEC Opposition]. The SEC has also argued that because it has no animus for the ideas expressed in the material, nonpublic information, Regulation FD does not regulate content. *Id.* The Supreme Court, however, has expressly rejected the argument that "discriminatory . . . treatment is suspect under the First Amendment only when the legislature intends to suppress certain ideas." *See* City of Cincinnati v. Discovery Networks, Inc., 507 U.S. 410, 429 (1993) (citation omitted); *see also* Ward v. Rock Against Racism, 491 U.S. 781, 791 (1989) ("[g]overnment regulation of expressive activity is content neutral so long as it is '*justified* without reference to the content of the regulated speech.'").

timing of the disclosure of previously-disclosed information.[266] Thus, the SEC argues, Regulation FD is not a content-based regulation that would trigger heightened First Amendment scrutiny.[267]

Unlike true time, place, and manner regulations that are content-neutral,[268] Regulation FD is content-based on three grounds.[269] First, Regulation FD explicitly targets only "material, nonpublic information," which is a specific category of information distinguished by its "material" and "nonpublic" nature.[270] Indeed, the SEC is only concerned that corporate speakers generally disclose "material, nonpublic" information, as opposed to all information, because the investing public is presumably only interested in a company's "material" information (i.e. information that could affect stock prices, and therefore, the public's investment decisions).[271] For example, if a company announces publicly that its earnings are expected to be $1 billion next quarter but announces in private that it will be $1.01 billion, the difference is unlikely to be material. Regulation FD would not apply to the disclosure. If instead, however, the company states in private that its earnings will be $1.1 billion, this would probably be material, and Regulation FD should apply. The content, $1.1 billion as opposed to $1.01 billion, is not mere rounding error; it determines the applicability of the regulation.

---

[266] SEC Opposition, *supra* note 265, at 17-18.

[267] *Id.; see also* Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 771 (1976) (noting that time, place, and manner restriction on prescription drug advertising would be acceptable if justified without reference to content of regulated speech).

[268] *See, e.g., Ward,* 491 U.S. at 791; *cf.* Hill v. Colorado, 530 U.S. 703, 721 (2000) (upholding Colorado statute restricting picketers and others engaging in oral protest, education, or counseling from approaching individuals outside abortion clinics as valid time, place, and manner restriction, and conceding that some limited review of picket signs' content may be necessary, but only to determine whether "rule of law applies to a course of conduct").

[269] The claim that Regulation FD is content-based was also made by Siebel. *See, e.g.,* Memorandum of Points and Authorities in Support of Defendant's Motion to Dismiss the Complaint at 17-18, SEC v. Siebel Sys., 384 F. Supp. 2d 694 (S.D.N.Y. 2005) (No. 04 CV 5130), *available at* 2004 WL 3142264 ("There can be no dispute that Regulation FD regulates speech on the basis of content . . . depending on whether a covered speaker has uttered material nonpublic information."); *see also* Ribstein, *supra* note 16 (stating that Regulation FD "clearly regulates the content of speech since it reaches only statements that are 'material' to reasonable investors").

[270] *See supra* Part I.A.3; *see also* Consol. Edison Co. v. Pub. Serv. Comm'n, 447 U.S. 530, 537 (1980) ("The First Amendment's hostility to content based regulation extends not only to restrictions on particular viewpoints, but also to prohibition of public discussion of an entire topic.").

[271] *See supra* notes 72-74 and accompanying text.

Second, the Supreme Court's rationale in *Miami Herald Publishing Co. v. Tornillo*[272] is relevant to showing that Regulation FD is content-based. There, the Supreme Court reasoned that making a corporation speak under circumstances in which it otherwise would not speak necessarily changes the content of the speech. In *Miami Herald*, Florida's right of reply statute, which compelled the defendant newspaper to publish the counterarguments of those individuals it previously criticized, interfered with the newspaper's exercise of editorial control and judgment by forcing the newspaper to tailor its speech to an opponent's agenda and to respond to a candidate's argument when it wished to remain silent.[273] The Court thus concluded that this was a content-based restriction on free speech.[274]

Like the right of reply statute in *Miami Herald*, Regulation FD imposes a content-based restriction on corporate speech. Under Regulation FD, even if a corporate speaker ends up making the same speech twice, the Regulation forces the corporate speaker to make the speech a second time publicly and to an audience not of its own choosing.[275] If a company knows that it will have to make the same speech to a different audience, the company may well alter the content of the speech in the first instance or forego speaking completely.[276]

Third, Regulation FD targets the "communicative impact" of the speech on the listener. In *Boos v. Barry*, the Supreme Court drew a distinction between regulations that are "justified without reference to

---

[272] 418 U.S. 241, 258 (1974).

[273] *Id.*

[274] *Id.* at 256.

[275] The freedom to associate with whomever one chooses to advance one's beliefs is a well-established right protected by the First and Fourteenth Amendments. *See, e.g.*, Abood v. Detroit Bd. of Educ., 431 U.S. 209, 233 (1977) (stating that "[o]ur decisions establish with unmistakable clarity that the freedom of an individual to associate for the purpose of advancing beliefs and ideas is protected by the First and Fourteenth Amendments . . . ."); NAACP v. Alabama, 357 U.S. 449, 460-61 (1958) (stating that "[i]t is beyond debate that freedom to engage in association for the advancement of beliefs and ideas is an inseparable aspect of the 'liberty' assured by the Due Process Clause of the Fourteenth Amendment, which embraces freedom of speech . . . . Of course, it is immaterial whether the beliefs sought to be advanced by association pertain to political, economic, religious or cultural matters, and state action which may have the effect of curtailing the freedom to associate is subject to the closest scrutiny.").

[276] *See, e.g.*, Miami Herald, 418 U.S. at 258; *see infra* note 379-82 and accompanying text; *see also* Riley v. Nat'l Fed'n of the Blind of N.C., Inc., 487 U.S. 781, 795 (1988) (finding that statute compelling disclosure by professional fundraisers to potential donors was content-based because "mandating speech that a speaker would not otherwise make necessarily alters the content of the speech").

the content of the regulated speech"[277] and "regulations that focus on the direct impact of speech on its audience."[278] The first type of regulation is content-neutral, whereas the second type of regulation is content-based.[279] In other words, if a regulation is justified based on the listener's reaction to the communication, then such a regulation is content-based.[280] The SEC's purposes in enacting Regulation FD, which are discussed in more detail in Part IV, hinge on the importance of "material, nonpublic information" to the audience — both to securities market professionals and to the public. Thus, Regulation FD is *only* justified with reference to the content of the regulated speech. Furthermore, Regulation FD targets the impact that the disclosure of "material, nonpublic information" may have on the behavior of the people who hear the information (i.e., trading, or in the case of analysts, changing a recommendation) and on the public in general (i.e., increased investor confidence in the marketplace).

As described above, Regulation FD is best analyzed as a content-based regulation on pure speech. If the speech involves topics traditionally protected by the First Amendment, regulations on such speech are subject to strict scrutiny.[281] Because Regulation FD mandates the disclosure of "material, nonpublic information" by corporate speakers in the world of securities, the level of scrutiny depends on how the court characterizes the speech.

Regulation FD may target both disclosures resembling commercial speech ("you should buy our stock because we will meet our earnings forecast") and non-commercial protected speech ("we have decided to terminate our joint venture in Burma because we are concerned about human rights abuses").[282] In addition, Regulation FD may compel speech, in that it forces a corporation to make information public. It may also restrict private speech, in that a corporation simply will not disclose proprietary business or other types of confidential information if it knows it must then make the information public.[283] The next part examines the four most likely ways that the courts may characterize

[277] 485 U.S. 312, 320 (1988) (citations omitted).

[278] *Id.* at 320.

[279] *Id.* at 320-21.

[280] *Id.*; *see also* United States v. Eichman, 496 U.S. 310, 317 (1990).

[281] *See* Lowe v. SEC, 472 U.S. 181, 210 (1985) (White, J., concurring).

[282] Such speech may well be material. *See* Doe v. Unocal Corp., 248 F.3d 915, 920 (2001) (affirming dismissal of long running case claiming international human rights violations by Unocal in Burma); *infra* notes 3335-44 and accompanying text.

[283] *See infra* notes 379-87 and accompanying text.

Regulation FD speech.[284]

III. WHAT AND HOW DOES REGULATION FD REGULATE?

The Supreme Court applies a different standard of review based on whether the government regulates commercial speech or non-commercial speech.[285] The appropriate standard of review also depends on whether the regulation compels or prohibits speech.[286] This part examines these different categories of speech and regulation.

A. *Restricting Commercial Speech*

The Supreme Court's commercial speech jurisprudence is far from consistent.[287] The difficulties of identifying commercial speech coupled

---

[284] The following table showing the four possible outcomes based on the interaction of the nature of the regulation and the nature of the speech may be helpful:

restricting mixed commercial/political speech	compelling mixed commercial/political speech
restricting pure commercial speech	compelling pure commercial speech

As discussed *supra* at note 26, some commentators would presumably argue that actually Regulation FD should be analyzed in a completely separate box:

Beyond the scope of the First Amendment
Securities regulation Economic regulations

See Schauer, *supra* note 26, at 1771. Before *Virginia Pharmacy*, the argument would have been that commercial speech should also be in this box. *See infra* Part III.A.

[285] *See* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 787-88 (1978) (applying strict scrutiny to regulation of corporate speech on matters of public interest); *cf.* Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 564-71 (1980) (applying intermediate-type scrutiny to commercial speech).

[286] *See, e.g.*, Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 652 (1985) (applying rational basis-type test to compelled commercial speech); *cf. Cent. Hudson*, 447 U.S. at 564-71 (applying intermediate-type scrutiny to prohibitions on commercial speech).

[287] Commentators have already written extensively on the inconsistencies and vagaries of the commercial speech doctrine, and their analysis will not be repeated here. However, the overarching consensus appears to be that the definition of commercial speech "cannot be reduced to any simple rule or determinate criteria." Robert Post, *The Constitutional Status of Commercial Speech*, 48 UCLA L. REV. 1, 17 (2000); *see, e.g.*, Estreicher, *supra* note 216, at 224 (arguing that "the Court's [commercial speech] doctrine lacks conceptual coherence"); Ronald J. Krotoszynski, Jr., *Into The Woods: Broadcasters, Bureaucrats, and Children's Television Programming*, 45 DUKE L.J. 1193, 1212-13 (1996) (observing that Supreme Court "never has defined precisely what constitutes commercial speech, nor has it

with its increasing protection[288] prompts commentators to recommend that the Court should eliminate the distinction altogether.[289] Given, however, that the classification currently remains the law of the land, a brief overview of the leading cases is necessary.

Before 1976, the Supreme Court refused to apply First Amendment protection to purely commercial speech.[290] In a 1942 case, *Valentine v. Chrestensen*, the Supreme Court stated that "[w]e are . . . clear that the Constitution imposes no such restraint on government as respects purely commercial advertising."[291] The Court cited to no authority, and as a

---

provided a set of analytical tools one can use to accurately and efficiently separate commercial speech from non-commercial speech"); Martin H. Redish & Howard M. Wasserman, *What's Good for General Motors: Corporate Speech and the Theory of Free Expression*, 66 GEO. WASH. L. REV. 235, 237-38 (1998) (arguing against separate classification and lower level of review for commercial speech). At least one Supreme Court Justice has suggested that he "doubt[s] whether it is even possible to draw a coherent distinction between commercial and noncommercial speech." Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 575 (2001) (Thomas, J., concurring); *see also* Rubin v. Coors Brewing Co., 514 U.S. 476, 493 (1995) (Stevens, J., concurring) (stating that "borders of the commercial speech category are not nearly as clear as the Court has assumed"); Edenfield v. Fane, 507 U.S. 761, 765 (1993) ("ambiguities may exist at the margins of the category of commercial speech"); City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 419 (1993) (recognizing "the difficulty of drawing bright lines that will clearly cabin commercial speech in a distinct category"). Other Supreme Court decisions applying the commercial speech doctrine include: *In re* R.M.J., 455 U.S. 191, 199-207 (1982) (finding rules preventing attorneys from using non-deceptive terminology to describe their fields of practice impermissible); Metromedia, Inc. v. City of San Diego, 453 U.S. 490, 498-521 (1981) (discussing outdoor advertising); *In re* Primus, 436 U.S. 412, 436-38 (1978) (finding letter by civil rights lawyer to prospective members of litigant class protected by First Amendment); Bates v. State Bar of Ariz., 433 U.S. 350, 366-79 (1977) (addressing blanket bans on price advertising by attorneys unconstitutional); Carey v. Population Services Int'l, 431 U.S. 678, 700-02 (1977) (scrutinizing contraceptive ads); Linmark Assocs. v. Township of Willingboro, 431 U.S. 85, 91-98 (1977) (striking ban on "for sale" signs outside of houses).

[288] *See, e.g.*, Rodney A. Smolla, *Afterword: Free the Fortune 500! The Debate Over Corporate Speech and the First Amendment*, 54 CASE W. RES. L. REV. 1277, 1293 (2004) ("The cases sustaining restrictions on commercial speech pale, however, in number and in force, when compared to the overwhelming body of precedent striking restrictions down."); Nat Stern, *In Defense of the Imprecise Definition of Commercial Speech*, 58 MD. L. REV. 55, 88 (1999) ("[T]he notion that classifying speech as commercial regulates it to a First Amendment backwater has become increasingly antiquated."); *see also infra* notes 304-11 and accompanying text.

[289] *See* Alex Kozinski & Stuart Banner, *Who's Afraid of Commercial Speech?*, 76 VA. L. REV 627, 638 (1990) (arguing that commercial and non-commercial speech should receive equal protection); Sean P. Costelllo, Comment, *Strange Brew: The State of Commercial Speech Jurisprudence Before and After* 44 Liquormart, Inc. v. Rhode Island, 47 CASE W. RES. L. REV. 681, 686 (1997) (noting that majority of Supreme Court Justices appear ready to apply strict scrutiny review to some forms of commercial speech).

[290] Va. State Board of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 754-61 (1976) (discussing history of Court's commercial speech jurisprudence).

[291] Valentine v. Chrestensen, 316 U.S. 52, 54 (1942).

later Justice suggested, "[t]he ruling was casual, almost offhand."[292]

The Supreme Court first expressly extended First Amendment protection to commercial speech[293] in the 1976 case of *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council.* There, the Supreme Court used the First Amendment to strike down a Virginia statute prohibiting pharmacists from publishing advertising that contained pricing and other information about the prescription drugs they sold.[294] The Court described the protected speech at issue as bereft of any "editorializ[ing]" on "cultural, philosophical or political" matters or of any "generalized observations even about commercial matters."[295] The only "idea" the pharmacist wished to communicate was "I will sell you the X prescription drug at the Y price."[296] The Court held that in the case of advertising of prescription drugs by pharmacists, such concededly truthful speech that did no more than describe a lawful commercial transaction was commercial speech that deserved First Amendment protection.[297] The Court further noted how easily purely "commercial speech" could become protected speech involving "general public interest."[298]

Four years later in *Central Hudson Gas & Electric Corp. v. Public Service Commission,* the Supreme Court struck down a ban on promotional

---

[292] Cammarano v. United States, 358 U.S. 498, 514 (1959) (Douglas, J., concurring).

[293] The Court had previously decided that not all advertisements were commercial speech. *See, e.g.,* N.Y. Times Co. v. Sullivan, 376 U.S. 254, 266 (1964) (applying First Amendment to advertisement that "communicated information, expressed opinion, recited grievances, protested claimed abuses, and sought financial support on behalf of a movement whose existence and objectives are matters of the highest public interest and concern").

[294] Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 773 (1976). The *Virginia Pharmacy* decision addressed the First Amendment question left open by *Pittsburgh Press Co. v. Pittsburgh Commission on Human Relations,* in which the Court denied First Amendment protection on the grounds that the advertised activity was illegal employment discrimination. 413 U.S. 376, 388-89 (1973). However, the Court declined to resolve whether the First Amendment would outweigh the government's interest in regulating advertising where the activity involved is not illegal. *Id.*

[295] *Va. Pharmacy,* 425 U.S. at 761.

[296] *Id.*

[297] *Id.* at 770.

[298] *Id.* at 764 (citing Bigelow v. Virginia, 421 U.S. 809 (1975) (involving advertisements stating that referral services for legal abortions are available)); Chi. Joint Bd. v. Chi. Trib. Co., 435 F.2d 470, 478 (7th Cir. 1970) (involving domestic producer who advertises his product as alternative to imports that tend to deprive American residents of their jobs); Fur Info. & Fashion Council, Inc. v. E.F. Timme & Son, 364 F. Supp. 16 (S.D.N.Y. 1973) (involving manufacturer of artificial furs who promotes his product as alternative to extinction by his competitors of fur-bearing mammals).

advertising by an electrical utility.[299] In so doing, it crafted a new definition of commercial speech and a new intermediate standard of review.[300] The Court stated that "[t]he First Amendment's concern for commercial speech is based on the informational function of advertising."[301] It also defined commercial speech as "expression related solely to the economic interests of the speaker and its audience,"[302] an expanded definition compared to that in *Virginia Pharmacy*.[303]

The Supreme Court once again affirmed that "speech which does no more than propose a commercial transaction" constitutes the core of the commercial speech doctrine in *Bolger v. Youngs Drug Products Corp.*[304] Significantly, the Court did not use the broader definition of commercial speech first articulated in *Central Hudson*.[305] The Court instead identified three neither necessary nor sufficient characteristics of commercial speech: speech that 1) is *concededly* an advertisement, 2) refers to a specific product, and 3) is motivated by economic interest.[306]

In a more recent commercial speech case, *Board of Trustees of State University of New York v. Fox*,[307] the Supreme Court once again declined to use the broader definition of commercial speech articulated in *Central*

---

[299] 447 U.S. 557, 572 (1980).

[300] *Central Hudson's* four-part intermediate test for analyzing commercial speech requires that: (1) the communication is neither misleading nor related to unlawful activity; (2) the government must assert a substantial interest; (3) the restriction must directly advance the governmental interest involved; and (4) the restriction must not be more extensive than necessary to serve that interest. *Id.* at 564-71.

[301] *Id.* at 563.

[302] *Id.* at 561.

[303] *Cent. Hudson*, 447 U.S. at 579-80 (Stevens, J., concurring) (arguing that majority opinion's definition of commercial speech as "expression related solely to economic interests of the speaker and its audience" is too broad and definition of commercial speech as "speech proposing a commercial transaction" in *Virginia Pharmacy* is too narrow, citing Daniel A. Farber, *Commercial Speech and First Amendment Theory*, 74 NW. U. L. REV. 372, 382-83 (1979)).

[304] 463 U.S. 60, 66-67 (1983) (holding that federal statute prohibiting mailing of unsolicited advertisements for contraceptives could not be applied to appellee's promotional materials).

[305] *See* City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 422 (1993) (noting pointedly that Court did not use "expression related solely to the economic interests of the speaker and its audience" definition of commercial speech in either *Bolger* or *Board of Trustees of State University of N.Y. v. Fox*, 492 U.S. 469, 480 (1989)).

[306] *Discovery Network, Inc.*, 507 U.S. at 422. The D.C. Circuit in *SEC v. Wall Street*, discussed *supra* note 231-40 and accompanying text, relied on the definition of commercial speech in *Youngs Drug* to conclude that the speech regulated by section 17(b) of the Securities Exchange Act of 1933 did not fall neatly into the category of commercial speech. 851 F.2d 365 (D.C. Cir. 1988).

[307] 492 U.S. at 480.

Hudson. Rather, the Court described the category of commercial speech even more narrowly. The Court characterized the "proposal of a commercial transaction" as "the test for identifying commercial speech."[308]

The trend towards protecting commercial speech continued during the last decade. A plurality of the Supreme Court appeared to grant even more First Amendment protection to commercial speech in *44 Liquormart, Inc. v. Rhode Island*.[309] The Court examined a Rhode Island statute prohibiting the publication or broadcast of the price of any alcoholic beverages in any advertising within the state.[310] Beginning with a discussion of the importance of advertising in American history,[311] the plurality reviewed the history of its commercial speech jurisprudence. It noted that the "State retains less regulatory authority when its commercial speech restrictions strike at the 'substance of the information communicated'" rather than the "commercial aspect of [it] — with offerors communicating offers to offerees."[312] Moreover, the plurality appeared to reject the long-held rationale that the "greater hardiness" and "greater objectivity" of commercial speech justified a more deferential standard of review.[313] Although the Court applied the "less than strict" standard for commercial speech to the Rhode Island statute, the Court still held that the statute violated the First Amendment.[314]

Subsequent cases continue to formally apply the *Central Hudson* test; however, the government usually loses.[315] *Lorillard Tobacco Co. v. Reilly*, which involved restrictions on tobacco advertisements in order to protect children, was perhaps the strongest case for the government. In *Lorillard*,

---

[308] *Id.* at 473-74. *Fox* further refined the intermediate scrutiny standard of review for commercial speech by establishing that the government has the burden to prove a reasonable "fit" between the legislature's ends and the means chosen to accomplish those ends. *Id.* at 480.

[309] 517 U.S. 484, 501 (1996). *See, e.g.*, Kathleen M. Sullivan, *Cheap Spirits, Cigarettes, and Free Speech: The Implications of* 44 Liquormart, 1996 SUP. CT. REV. 123, 126 (stating that "[a]fter *44 Liquormart*, it is unclear why 'commercial speech' should continue to be treated as a separate category of speech isolated from general First Amendment principles").

[310] *44 Liquormart*, 517 U.S. at 490.

[311] *Id.* at 495-96.

[312] *Id.* at 499.

[313] *Id.*

[314] *Id.* at 488, 507.

[315] *See, e.g.*, Thompson v. W. States Med. Ctr., 535 U.S. 357, 360 (2002) (compound drug advertisements); Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 575 (2001) (tobacco advertisements); Greater New Orleans Broad. Ass'n v. United States, 527 U.S. 173, 176 (1999) (casino advertisements).

the Supreme Court struck down restrictions on outdoor cigar advertising within one thousand feet of a school, despite the compelling nature of the state's interest — protecting children's health.[316] The Court did so even after it accepted Massachusetts' showing of a link between advertising and demand.[317] The Supreme Court found that the regulations were not a "reasonable fit between the means and the ends" and were overbroad.[318]

B. *Restricting Mixed Commercial Speech*

The difficulties of defining commercial speech are particularly apparent when regulations restrict speech that is both concededly commercial and fully-protected. The test for evaluating this "mix" of commercial and fully protected speech involves determining whether the two types of speech are "intertwined."[319] A brief review of the mixed commercial speech case law reveals that, "the difference between commercial and noncommercial speech is often a 'matter of degree.'"[320]

In *Village of Schaumburg v. Citizens for a Better Environment*, the Court held that a municipal ordinance that prohibited in-person solicitation of contributions by charitable organizations not using at least 75% of their receipts for "charitable purposes" violated the First Amendment.[321] The Court dissected the content of the speech at issue, a charitable appeals for funds.[322] The Court also noted that it will treat speech involving a variety of interests, including interests that are traditionally within the protection of the First Amendment, as fully protected speech.[323] The Court found that the speech communicated information, disseminated and propagated views and ideas, and advocated for causes.[324] Because "solicitation is characteristically intertwined with informative and perhaps persuasive speech seeking support for particular causes or for particular views on economic, political, or social issues," the Court

---

[316] *Lorillard*, 533 U.S. at 555. The Court did uphold a restriction on sales practices for cigars and chewing tobacco. *Id.* at 561.

[317] *Id.* at 560.

[318] *Id.* at 561.

[319] Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 632 (1980).

[320] Jean Wegman Burns, *Confused Jurisprudence: False Advertising Under the Lanham Act*, 79 B.U. L. REV. 807, 856 n.209 (1999) (citing City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 423 (1993)).

[321] 444 U.S. at 620.

[322] *Id.* at 632.

[323] *Id.*

[324] *Id.*

treated the solicitation for funds as fully protected speech.[325] In rejecting the argument that the speech was purely commercial, the Court articulated yet another definition of commercial speech, stating that: "because charitable solicitation does more than inform private economic decisions and is not primarily concerned with providing information about the characteristics and costs of goods and services, it has not been dealt with in our cases as a variety of purely commercial speech."[326]

The Supreme Court's opinion in *Bolger v. Youngs Drug Products Corp.* exemplified the general criticism that "[t]he 'inextricably intertwined' test does not apply where noncommercial speech is simply tacked onto commercial speech that proposes a commercial transaction."[327] In *Youngs Drug,* the Supreme Court considered the application of a federal statute prohibiting the unsolicited mailing of advertising for contraception to a mailing that included discussions on family planning and venereal diseases.[328] After noting that the advertising contained characteristics of both commercial and fully protected speech,[329] the Court nonetheless classified the speech as commercial. In doing so, it relied on the principle that "advertising which 'links a product to a current public debate' is not thereby entitled to the constitutional protection afforded noncommercial speech."[330]

Similarly, in *Board of Trustees of State University of New York v. Fox,*[331] the Supreme Court unraveled the ties between commercial and fully protected speech. The Court reviewed a university regulation that prohibited private companies from, inter alia, selling products to students on campus.[332] When the state prevented the defendant company from selling housewares to students, the defendant argued that its communication to students was protected by the First Amendment. The defendant claimed its communications were "inextricably linked" commercial and fully protected components, which made the entire speech fully protected.[333] The Court rejected this argument, stating that:

---

[325] *Id.* at 633; *cf. id.* at 639-44 (Rehnquist, J., dissenting) (arguing that speech at issue warranted no more protection than commercial speech).

[326] *Id.*

[327] Burns, *supra* note 320, at 855 n.208 (citing THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION, §§ 31:147, 31:213 (4th ed. 1997)).

[328] 463 U.S. 60, 61-62 (1983).

[329] *Id.* at 67-68.

[330] *Id.* at 68 (citation omitted).

[331] Bd. of Trs. of State Univ. of N.Y. v. Fox, 492 U.S. 469 (1989).

[332] *Id.* at 471-72.

[333] *Id.* at 473-74. The fully protected speech included discussions of financial

> No law of man or of nature makes it impossible to sell housewares without teaching home economics, or to teach home economics without selling housewares. Nothing in the resolution prevents the speaker from conveying, or the audience from hearing, these noncommercial messages, and nothing in the nature of things requires them to be combined with commercial messages.[334]

Relying on *Fox*, the California Supreme Court recently decided the high profile case of *Kasky v. Nike, Inc.*[335] The California Supreme Court held that Nike's attempts to rebut long-standing allegations about exploitative labor practices in third world countries through a public relations campaign was "commercial speech" and thus subject to intermediate scrutiny.[336] The speech at issue was not advertising of a particular product, but rather involved a defense of Nike's labor practices through press releases, letters to newspapers, letters to university presidents and athletic directors, lobbying efforts, and other documents aimed at stockholders, policymakers, and the general public.[337] The majority opinion acknowledged that Nike's speech involved non-commercial components, including discussions of policy issues regarding the degree of responsibility domestic companies should hold for working conditions in factories located in other countries and the merits and effects of globalization generally.[338] The opinion,

---

responsibility and running an efficient home.

[334] *Id.* at 474. The Court distinguished *Riley* by characterizing the commercial components of the speech in *Riley* as required by the government to be part of the non-commercial speech, thus making the commercial and fully protected speech inextricably interlinked. *Id.* The Court did not address *Schaumburg*, discussed *supra* at text accompanying notes 319-26, which did not involve a state mandated intertwining of commercial and fully protected speech.

[335] Kasky v. Nike, Inc., 27 Cal. 4th 939 (2002), *modified* (May 22, 2002), *cert. granted*, 537 U.S. 1099 (2002), *appeal dismissed as improvidently granted*, 539 U.S. 654 (2003). *Nike* was appealed to the U.S. Supreme Court, which granted certiorari, but then dismissed the case on the grounds that certiorari had been improvidently granted. In so deciding, however, the Supreme Court characterized the case as a novel twist on the developing line of mixed-commercial cases. *See* Nike, Inc. v. Kasky, 539 U.S. 654, 663 (2003) (stating that "[t]his case presents novel First Amendment questions because the speech at issue represents a blending of commercial speech, noncommercial speech and debate on an issue of public importance"); *cf. id.* at 677 (Breyer, J., dissenting) (stating that noncommercial and commercial characteristics of Nike's speech are "inextricably intertwined"); *Kasky*, 27 Cal. 4th at 975 (Chin, J., dissenting) (same); *id.* at 992 (Brown, J., dissenting) (same).

[336] *Kasky*, 27 Cal. 4th at 968.

[337] *Id.* at 947-48.

[338] *Id.* at 966.

however, went on to characterize the commercial components of the speech as containing false and misleading statements, which can be regulated under California's fraudulent business and false advertising laws.[339]

Some commentators viewed the *Nike* decision as "highly questionable,"[340] given that the speech at issue could not be easily characterized as commercial, and in fact, appeared to raise issues of political and social concern.[341] The key distinction between *Nike* and prior mixed-commercial speech cases, however, revolves around the allegation that the commercial speech components contain false and misleading statements.[342] *Nike* is of limited use in analyzing Regulation FD in light of the lack of any implication that the failure to disclose material, nonpublic information is fraudulent or deceptive.[343] In addition, whether courts classify speech as commercial or non-commercial matters less than it used to since the Supreme Court heightened its level of scrutiny.[344]

Regulation FD may implicate restrictions on both commercial and fully protected speech. The inquiry, however, does not end there. In addition to restricting speech, Regulation FD also compels speech.

C. *Compelling Mixed Commercial Speech*

Compelling fully protected speech is equally offensive to the First Amendment as is restricting such speech.[345] In *Wooley v. Maynard*, the Supreme Court affirmed the principle that "[t]he right to speak and the right to refrain from speaking are complementary components of the

---

[339] *Id.*

[340] *See, e.g.*, SMOLLA, *supra* note 254, § 20:17.

[341] Professor O'Neil argues that at least some of the communication in the *Nike* case would have been fully protected as political speech before 1976. *See* Robert M. O'Neil, *Nike v. Kasky — What Might Have Been . . .*, 54 CASE W. RES. L. REV 1259, 1261 (2004). He notes that "[i]t would be ironic in the extreme if a consequence of *raising* the level of protection for advertising were to *lower or diminish* protection for non-advertising corporate messages." *Id.* at 1261.

[342] Kasky v. Nike, Inc., 27 Cal. 4th 939, 965 (2002).

[343] *See supra* note 30.

[344] *See supra* notes 309-18 and accompanying text.

[345] The right not to speak is well established for individuals whose silence itself becomes a religious or political statement. *See, e.g.*, Wooley v. Maynard, 430 U.S. 705, 714 (1977) (holding that person could not be compelled to display slogan "Live Free or Die"); W. Va. State Bd. of Educ. v. Barnette, 319 U.S. 624, 642 (1943) (holding that student cannot be forced to recite Pledge of Allegiance).

broader concept of 'individual freedom of mind.'"[346] More recently, the Court reaffirmed that "the essential thrust of the First Amendment is to prohibit improper restraints on the *voluntary* public expression of ideas."[347] As a result, the Supreme Court acknowledged that "[t]here is necessarily and within suitably defined areas, a concomitant freedom *not* to speak publicly, one which serves the same ultimate end as freedom of speech in its affirmative aspect."[348]

The right not to speak extends to corporations, such as when they are compelled to give equal "extra space" to the views of third parties.[349] For example, in *Pacific Gas & Electric Co. v. Public Utilities Commission*, the Supreme Court's plurality opinion held that the government could not compel a private utility company to include in its billing envelopes speech with which the utility disagreed because it impermissibly burdened the utility's First Amendment rights.[350] A monthly newsletter distributed by the utility to its customers in the same envelope as their monthly bill contained the speech in question. The newsletter contained straightforward information about utility services and bills, as well as political editorials, feature stories on matters of public interest, and tips on conservation.[351] The plurality found that the newsletter received the full protection of the First Amendment because the newsletter extended "well beyond" speech proposing a business transaction and it included the kind of discussion of "matters of public concern" that the "First Amendment both fully protects and implicitly encourages."[352]

As *Pacific Gas* indicates, even if compelled speech contains both commercial and fully protected components, a court may elect to treat the speech as fully protected and subject to strict scrutiny.[353] *Riley v. National Federation of the Blind of North Carolina* illustrates this.[354] In *Riley*, the Supreme Court used the First Amendment to strike down a North

---

[346] *Wooley*, 430 U.S. at 714 (citations omitted).

[347] Harper & Row Publishers, Inc. v. Nation Enters., 471 U.S. 539, 559 (1985) (citation omitted).

[348] *Id.*

[349] *See, e.g.*, Pac. Gas & Elec. Co. v. Pub. Utils. Comm'n of Cal., 475 U.S. 1, 6 (1986); Miami Herald Publ'g Co. v. Tornillo, 418 U.S. 241, 256 (1974) (holding that right-of-reply statute that required newspapers to give reply space of equal prominence to those they editorially criticized violated First Amendment).

[350] 475 U.S. at 21 (plurality opinion).

[351] *Id.* at 5.

[352] *Id.* at 9 (citations omitted).

[353] *Id.*

[354] Riley v. Nat'l Fed'n of the Blind of N.C., 487 U.S. 781, 803 (1988).

Carolina statute requiring professional fundraisers to disclose to potential donors the percentage of charitable contributions actually turned over to charity.[355] The Court rejected the argument that the speech was commercial and, therefore, deserving of less stringent First Amendment protection.[356] It stated that "we do not believe that the speech retains its commercial character when it is inextricably intertwined with otherwise fully protected speech."[357] Based on this fundamental principle, the Court found that "thus, where, as here, the component parts of a single speech are inextricably intertwined, we cannot parcel out the speech, applying one test to one phrase and another test to another phrase. Such an endeavor would be both artificial and impractical."[358] The Court ultimately found that the disclosure requirement for professional fundraisers "clearly and substantially burden[ed]" the protected speech and subjected the state law to "exacting First Amendment scrutiny."[359]

D. *Compelling Commercial Speech*

Unlike compelled fully protected speech or mixed commercial speech, however, compelled pure commercial speech has traditionally enjoyed less First Amendment protection.[360] In *Zauderer v. Office of Disciplinary*

---

[355] *Id.*

[356] *Id.* at 795-96.

[357] *Id.* at 796. Although Regulation FD's disclosure requirements would sometimes compel the disclosure of facts, as opposed to opinions, the Supreme Court in *Riley* drew no distinction between these types of speech, stating that "either form of compulsion burdens protected speech." *Id.* at 797-98.

[358] *Id.* at 796. In a footnote, the Court stated as follows: "Of course, the dissent's analogy to the securities field entirely misses the point. Purely commercial speech is more susceptible to compelled disclosure requirements." *Id.* at n.9 (*aff'g* Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626 (1985)). Some commentators have interpreted this footnote as indicating that the Court would view any regulation of the securities industry as involving purely commercial speech. *See, e.g.*, Boyer, *supra* note 212, at 480. A more plausible inference, however, is that the Court views at least some regulation of the securities field as involving purely commercial speech. Regulation FD, however, covers *any* "material, nonpublic information," which encompasses much more than commercial speech. It may also regulate some purely commercial speech, especially when applying one of the broader definitions. *See infra* notes 388-409 and accompanying text.

[359] *Riley*, 487 U.S. at 798. In a similar case, *Ill. ex rel. Madigan v. Telemarketing Assocs., Inc.*, the Supreme Court, citing *Riley*, reaffirmed that the compelled disclosures by telemarketers of the percentage of commission they received from any charitable donations violated the First Amendment. 538 U.S. 600, 616-17 (2003).

[360] *See* Boyer, *supra* note 212, at 480-82; Pinto, *supra* note 212, at 89; *see also* Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 772 (1976) (stating that state may require commercial messages to "appear in such a form, or include such additional

Counsel,[361] the Supreme Court established that it would review at least some regulations compelling disclosure of commercial speech by implicating First Amendment rights under a rational basis type test.[362] The Court justified this lower level of scrutiny under the rationale that "because disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech, 'warning[s] or disclaimer[s] might be appropriately required . . . in order to dissipate the possibility of consumer confusion or deception.'"[363]

Some commentators feared that compelled commercial speech lost all First Amendment protection after the Supreme Court's decision in *Glickman v. Wileman Brothers & Elliot, Inc.*[364] In *Glickman*, the Court held that federal regulations requiring fruit tree growers, processors, and handlers to contribute funds for generic advertising promoting California fruit did not invoke any First Amendment concerns.[365] The Court distinguished the facts in *Glickman* from prior compelled speech cases by noting that the federal regulations did not "compel any person to engage in any actual or symbolic speech."[366] Moreover, the Court viewed the coerced contributions to collective advertising as part and parcel of the entire federal regulatory scheme that compels "cooperation among producers in making economic decisions that would be made independently in a free market."[367]

In a curious about-face four years after *Glickman*, the Supreme Court appeared to expand protection for compelled commercial speech in

---

information, warnings, and disclaimers, as are necessary to prevent its being deceptive")

[361] *Zauderer*, 471 U.S. at 626 (upholding Ohio Disciplinary Rule requiring attorneys to disclose in advertising that clients may bear certain expenses, even if they are represented on contingency-fee basis).

[362] *Id.* at 651 (recognizing "that unjustified or unduly burdensome disclosure requirements might offend the First Amendment by chilling protected commercial speech," but holding "that an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers").

[363] *Id.* (citation omitted). There are, of course, a plethora of federal and state statutes which require disclosure of product or other commercial information to prevent fraud or deception. *See, e.g.*, 15 U.S.C. § 1333 (2005) (tobacco labeling); 21 U.S.C. § 343(q)(1) (2004) (nutritional labeling); 21 C.F.R. § 202.1 (2005) (prescription drug advertisements); 29 C.F.R. § 1910.1200 (2005) (workplace hazards).

[364] 521 U.S. 457 (1997); *see also* Casarez, *supra* note 219 (1998) (arguing that *Glickman* demonstrates regression in Court's compelled commercial speech jurisprudence).

[365] *Glickman*, 521 U.S. at 470.

[366] *Id.* at 469.

[367] *Id.* at 475.

Department of Agriculture v. United Foods, Inc.[368] In *United Foods*, the Supreme Court reviewed a First Amendment challenge to a federal statute that authorized a federally-established Mushroom Council to impose mandatory assessments on growers of mushrooms to pay for, inter alia, generic advertising to promote mushrooms.[369] The Court briefly reviewed its commercial speech jurisprudence, stating that "[a] quarter of a century ago, the Court held that commercial speech, usually defined as speech that does no more than propose a commercial transaction, is protected by the First Amendment."[370] After characterizing the mandatory assessments as compelled contributions to speech that was commercial in nature,[371] the Court ultimately held that the assessment requirement was unconstitutional.[372] In reaching this holding, the Court appeared to equate commercial speech with other types of traditionally protected speech, noting that "[t]he commercial marketplace, like other spheres of our social and cultural life, provides a forum where ideas and information flourish,"[373] and that "[t]he fact that the speech is in aid of a commercial purpose does not deprive respondent of all First Amendment protection."[374]

Although *United Foods* seemed to expand the protection for compelled commercial speech, it failed to clarify the contours of the compelled commercial speech doctrine.[375] The Court did, however, identify several important constitutional principles that are relevant to Regulation FD. First, the Court noted "that the speaker and the audience, not the government, [should] assess the value of the information presented."[376] In addition, the Court distinguished *Zauderer v. Office of Disciplinary Counsel*[377] by noting that there was no suggestion that compelling some

[368] U.S. Dep't of Agric. v. United Foods, Inc., 533 U.S. 405 (2001).

[369] *Id.* at 408.

[370] *Id.* at 409 (citing Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, 425 U.S. 748, 762 (1976)).

[371] *Id.* at 410 (citing, in support, host of compelled non-commercial speech cases, including *Keller v. State Bar*, 496 U.S. 1 (1990) (attorney bar dues); *Abood v. Detroit Board. of Education.*, 431 U.S. 209 (1977) (union dues); *Wooley v. Maynard*, 430 U.S. 705 (1977) (license plates); *West Virginia Board of Education v. Barnette*, 319 U.S. 624 (1943) (flag salute)).

[372] *United Foods*, 533 U.S. at 408.

[373] *Id.* at 409 (citing Edenfield v. Fane, 507 U.S. 761, 767 (1993)).

[374] *Id.* at 410.

[375] In the most recent mandatory assessment speech case, the Supreme Court chose to avoid the compelled corporate speech question by ruling that the marketing program was, in fact, government speech. Johanns v. Livestock Mktg. Assoc., 125 S.Ct. 2055, 2062 (2005).

[376] *United Foods*, 533 U.S. at 411 (citation omitted).

[377] 471 U.S. 626 (1985).

mushroom growers to pay for generic advertising was necessary to prevent consumer deception.[378] Likewise, the SEC does not suggest that compelling companies to disclose "material, nonpublic information" is necessary to prevent deception among the investing public. Rule 10b-5 already addresses situations involving deception. Since compelling corporate speech is not necessary to address real harms, such as investor deception, the case for compelling such speech at all is greatly weakened.

E. *How Should Regulation FD Be Analyzed?*

In order to evaluate the First Amendment challenge to Regulation FD, one must determine the nature of the speech Regulation FD regulates and the nature of the government regulation. With regard to the latter, Regulation FD both compels and restricts speech. Regulation FD compels speech by requiring corporations to disclose to the general public information which it would rather not disclose (e.g., you *must* disclose publicly any privately disclosed material information). Regulation FD also acts as a content-based restriction on speech by preventing a company from speaking to select individuals but not to the public at large (e.g., you may not privately convey material nonpublic information that is not also made public). In addition, Regulation FD serves as a content-based burden on speech (e.g., privately conveyed material nonpublic information is specially burdened by the public disclosure requirement and the necessity of making a materiality determination).

Although it is true that Regulation FD only acts as a restriction on private speech to the extent that a company is unwilling to disclose nonpublic information publicly, there are legitimate reasons for this. Professor Donald Langevoort, among others, developed in some detail reasons why an issuer might reasonably prefer to selectively disclose information rather than make public disclosures.[379] Langevoort notes first that an issuer will not want to disclose publicly certain kinds of confidential information, such as information that might give a competitor an advantage.[380] Second, an issuer may also fear liability for

---

[378] *United Foods*, 533 U.S. at 416.

[379] Langevoort, *supra* note 41, at 1028-31.

[380] *Id.* at 1029; *see also* Irani & Karamanou, *supra* note 170 (noting that companies can require analysts to use information solely for purpose of forecasting earnings); Robert B. Thompson & Ronald King, *Corporate Accountability: Credibility and Information in Securities Regulation After Regulation FD*, 79 WASH. U. L.Q. 615, 620 (2001) (noting issuer will first want to disclose information that gives it competitive advantage).

public forward-looking statements that prove incorrect[381] or for oversimplified comment, that an expert like an analyst can understand, but that are difficult for the lay person to process.[382] Third, selective disclosure allows an issuer to bond the accuracy of its information in a way that simultaneous public disclosure does not allow.[383] Finally, selective disclosure can be used to encourage analysts to devote the resources necessary to covering the company.[384] The analyst gets a higher return, whereas the company gets the benefits of coverage.[385]

A further reason for selective disclosure arises when a company wants nonpublic information to be made public, but does not want to be associated with the information. For example, a software company might want to publicize that computer sales will be down in the next quarter in order to lower earnings expectations for the industry without drawing particular attention to itself as the forecaster. Informing an analyst of the forecast would constitute selective disclosure, since the analyst would know who provided her with the forecast, but the general public would not necessarily have to know the source of the information.[386] The analyst, however, could better evaluate its reliability.

---

[381] This fear should be less than it was when Langevoort was writing, due to the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. 15 U.S.C.A. § 78u-4(b)(1) (2004).

[382] Langevoort, *supra* note 41, at 1029-30; *see also* Bushee et al., *supra* note 192 (finding that pre-Regulation FD companies with more complex information were more likely to hold closed conference calls); Gomes et al., *supra* note 203, at 27 (finding that more complex firms were more negatively affected by Regulation FD, suggesting that they were better served by one-on-one interaction); David A. Hirshleifer & Siew Hong Teoh, *Limited Attention, Information Disclosure, and Financial Reporting*, 36 J. ACCT. AND ECON. 337-86 (2003) (discussing impact of financial information presentation on market prices); Thompson & King, *supra* note 380, at 620 (noting that issuers may have information that general public will initially misunderstand).

[383] Langevoort, *supra* note 41, at 1030.

[384] *Id.* at 1031; *see also* Zohar Goshen & Gideon Parchomovsky, *On Insider Trading, Markets, and "Negative" Property Rights in Information*, 87 VA. L. REV. 1229, 1270 (2001); Thompson & King, *supra* note 380, at 620. Professors Ayres and Choi add that selective disclosure may "help compensate an investor for taking on the undiversified risk of assembling a block of shares in situations where the block monitors management for agency problems." Ian Ayres & Stephen Choi, *Internalizing Outsider Trading*, 101 MICH. L. REV. 313, 358 (2002). They conclude that "selective disclosures may provide net benefits in certain specific instances." *Id.*

[385] A recent empirical study confirms that Regulation FD has increased the cost of capital for small firms, in part because fewer analysts now follow them. *See* Gomes et al., *supra* note 203, at 33. The study found that on average small firms lost 17% of their analyst following and mid-size firms lost 5%. *Id.* at 12.

[386] An analyst is unlikely to put much credence in an anonymous email. By contrast, the public may well give credence to an analysts report on market conditions attributed to

Regulation FD would prevent such anonymous speech that, at least in other contexts, is clearly protected by the First Amendment.[387]

With regard to the nature of the speech, several factors weigh in favor of not characterizing the speech as commercial, but rather as speech traditionally protected by the First Amendment. First, a common thread running through the Court's application of the commercial speech doctrine is the principle that the First Amendment's concern with commercial speech is based on the "informational function of advertising."[388] Of course, although advertising *can be* commercial speech, advertising is not necessarily commercial speech.[389] Arguably, the Supreme Court has narrowed the definition of commercial speech even further so that it now includes only "the proposal of a commercial transaction."[390] When an issuer informs an existing investor that it will meet its earning forecasts, it is not proposing an economic transaction with itself. This applies a fortiori when an issuer informs an analyst of the same thing. Rather than proposing an economic transaction, the

---

anonymous sources.

[387] *See* McIntyre v. Ohio Elections Comm'n, 514 U.S. 334, 342 (1995) (noting that "decision to remain anonymous, like other decisions concerning omissions or additions to the content of a publication, is an aspect of the freedom of speech protected by the First Amendment").

[388] *See, e.g.*, 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 495-98 (1996) (plurality opinion) (reasoning that commercial speech is best understood as speech that merely advertises product or service for business purposes); *see also* United States v. Wenger, 292 F. Supp. 2d 1296, 1301 (D. Utah 2003) (suggesting that Supreme Court's commercial speech cases are history of advertising).

[389] Concluding otherwise would "run up against *New York Times Co. v. Sullivan* and *Buckley v. Valeo*, which gave full First Amendment protection to advertisements regarding issues of public controversy and political campaigns." Kozinski & Banner, *supra* note 289 at 638. One could add *Bigelow v. Virginia*, 421 U.S. 809 (1975), to the list as well.

[390] City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 423 (1993) (noting that *Fox* "described the category [of commercial speech] even more narrowly, by characterizing the proposal of a commercial transaction as '*the test* for identifying commercial speech'") (emphasis added). Those who argue that commercial speech protection should be expanded to more than the intermediate level of review note that the argument for even *reducing* the level of protection to the intermediate standard of review granted by existing First Amendment doctrine is theoretically sound only as to a limited subclass of advertising: that subclass of advertising that does '*no more* than propose a commercial transaction' . . . . For it is *only* the linkage between commercial speech and a commercial transaction that gives the government the theoretical leverage to presume to regulate the speech at all . . . . In classic First Amendment terms, however, the one thing that government *may not do* is regulate speech because it 'sells' a lifestyles, fantasy, ethos, identity, or attitude that happens to be regarded by most as socially corrosive. SMOLLA, *supra* note 254, § 20:43 (citations omitted). The proposal of *no more* than a commercial transaction must also be a proposal for a transaction with the speaker in order to fit squarely within the commercial speech doctrine.

issuer is attempting to affect the analyst's *Consumer Reports*-like recommendation about the company.[391]

There is an even narrower concern animating the Court's decision: the need to prevent "deception" of potential customers of a product or service by either ensuring disclosure of the necessary information relating to that product or service[392] or prohibiting deceptive information.[393] This is particularly the case in the securities context, where the federal securities laws require affirmative disclosure to prevent fraud or deception to the investing public.[394] However, Regulation FD is not aimed at preventing fraud, deception, or curing any misinformation the public may have about the company or its securities.[395] Regulation FD is not even about the advertising or the promotion of securities that the company intends to sell.[396] Rather, Regulation FD is primarily concerned with promoting investor confidence in the marketplace.[397] Regulation FD affects expression that exceeds even the most expansive definition of commercial speech as "expression related *solely* to the economic interests of the speaker and its audience."[398]

---

[391] *See* Bose Corp. v. Consumers Union of U.S., Inc., 466 U.S. 485, 513 (1984) (holding that expressing opinion about product is protected by First Amendment).

[392] *See, e.g.*, Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626 (1985) (disclosure of information in attorney advertising necessary to prevent deception to public); *cf.* Dept. of Agric. v. United Foods, 533 U.S. 405, 416 (2001) (noting that there was no suggestion that compelling some mushroom growers to pay for generic advertising is necessary to prevent consumer misperception).

[393] Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 563 (1980) (stating that government can ban commercial speech that is "more likely to deceive the public than to inform it").

[394] *See, e.g.*, United States v. Wenger, 292 F. Supp. 2d 1296 (D. Utah 2003) (permitting compelled disclosure); SEC v. Wall St. Publ'g Inst., Inc., 851 F.2d 365 (1988) (justifying compelled disclosure to prevent deception to public).

[395] *See supra* note 30.

[396] Regulation FD does not apply to primary offerings. *See supra* note 70 and accompanying text.

[397] *See infra* notes 426-36 and accompanying text.

[398] *Cent. Hudson*, 447 U.S. at 561 (noting expansive definition of commercial speech) (citations omitted) (emphasis added); *see also* Bruce E. Johnson & Jeffrey L. Fisher, *Why Format, Not Content, Is the Key to Identifying Commercial Speech*, 54 CASE W. RES. L. REV. 1243, 1253-54 (2004) (arguing that corporate speech should not be classified as commercial speech when it concerns company's business operations and is transmitted by media in form other than paid advertisements); Smolla, *supra* note 288, at 1281 n.20 (2004) (saying that there is much to commend this view). We need only mention the concerns of investors or analysts who are not *solely* concerned with economic interests, but are also interested in corporate social responsibility. *See generally* David Monsma & John Buckley, *Non-Financial Corporate Performance: The Material Edges of Social and Environmental Disclosure*, 11 U. BALT.

In the case of Regulation FD, the characterization of the disclosure of material, nonpublic information as core commercial speech just does not fit. Although Regulation FD regulates speech made by corporations, which often touches upon economic subjects, this does not necessarily make the speech commercial[399] and thus subject to less protection.[400] This is particularly true where the regulation strikes at "the substance of the information communicated" rather than the "commercial aspect of [i]t — with offerors communicating offers to offerees."[401] Although the Supreme Court in *44 Liquormart* directed this comment at the state's licensing of liquor retailers, the same analysis applies to the federal government's regulation of public companies: "Even though government is under no obligation to provide a person, or the public, a particular benefit, it does not follow that conferral of the benefit may be conditioned on the surrender of a constitutional right."[402] Corporations do not surrender all of their First Amendment rights just because they submit to regulation by the SEC in order to avail themselves of the public capital markets.

Because the information regulated by federal securities laws, such as in the case of Regulation FD, does not fit neatly into the category of advertising a simple commercial transaction, the analytical framework breaks down.[403] The Supreme Court in *Lowe* and the D.C. Circuit in *Wall*

J. ENVTL. L. 151 (2004) (discussing companies' potential legal obligation to disclose nonfinancial information); Social Investment Forum, *available at* http://www.socialinvest.org/ (last visited Oct. 17, 2005) (national organization "promoting the concept, practice and growth of socially responsible investing").

[399] *See* Riley v. Nat'l Fed'n of the Blind, 487 U.S. 781, 795-96 (1988) (stating that "[i]t is not clear that a professional's speech is necessarily commercial whenever it relates to that person's financial motivation for speaking"); Estreicher, *supra* note 216, at 227 (citing Steven Shiffrin, *The First Amendment and Economic Regulation: Away From a General Theory of the First Amendment*, 78 NW. U. L. REV. 1212, 1215 (1983)).

[400] *See* First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 784 (1978) ("We thus find no support in the First or Fourteenth Amendment, or in the decisions of this Court, for the proposition that speech that otherwise would be within the protection of the First Amendment loses that protection simply because its source is a corporation . . . ."); *accord*, Pac. Gas & Elec. Co. v. Pub. Utilities Comm'n of Cal., 475 U.S. 1, 19 (1986); Daniel A. Farber, *Commercial Speech and First Amendment Theory*, 74 NW. U. L. REV. 372, 382-83 (1979) (stating that "[e]conomic motivation could not be made a disqualifying factor [from maximum protection] without enormous damage to the first amendment. Little purpose would be served by a first amendment which failed to protect newspapers, paid public speakers, political candidates with partially economic motives and professional authors.").

[401] 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 499 (1996) (citation omitted).

[402] *Id.* at 513 (citation omitted). *See generally*, Kathleen M. Sullivan, *Unconstitutional Conditions*, 102 HARV. L. REV. 1415 *passim* (1989).

[403] Commentators have noted that the Supreme Court's focus on advertising as a form

Street declined to characterize the speech contained in the investment newsletters as commercial[404] presumably due in large part to the great difficulties in trying to squeeze a square peg into a round hole.[405] As the Supreme Court in *Lowe* opined, why shouldn't opinions about marketable securities (or a company's operations) not be fully protected?[406]

In addition, courts should evaluate the speech that Regulation FD seeks to affect as a whole, based on the standard set forth in the Supreme Court's opinions in *Riley* and *Schaumburg*.[407] Although some speech captured by Regulation FD may involve explicit promotions of a corporate security,[408] the Regulation may also trench upon fully protected speech, which will have little, if any, promotional value for the company or its stock. "Material, nonpublic" information may not only involve economic subjects, but the speech may also concern corporate attitudes toward or involvement with world events, political happenings, and other issues which may affect a company's business.[409]

of commercial speech cannot be easily analogized to federal securities laws. *See* Dooley, *supra* note 217, at 336. While a 1933 Act prospectus may be analogized to an advertisement of the securities described therein, "the analogy becomes strained in the case of an annual proxy statement, where there is typically little in the way of 'campaign advertising' for uncontested director seats, and falls apart in the case of the period reporting requirements of the 1934 Act." *Id.*

[404] *See infra* Part II.A.1-2.

[405] *See* City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 419 (1993) (recognizing "the difficulty of drawing bright lines that will clearly cabin commercial speech in a distinct category"); Estreicher, *supra* note 216, at 225 (arguing that current commercial speech jurisprudence is effectively ad hoc line drawing).

[406] Lowe v. SEC, 472 U.S. 181, 210 n.58 (1985).

[407] *See* Riley v. Nat'l Fed'n of the Blind, 487 U.S. 781, 796 (1987) (stating that "where, as here, the component parts of a single speech are inextricably intertwined, we cannot parcel out the speech, applying one test to one phrase and another test to another phrase. Such an endeavor would be both artificial and impractical."); *see also* Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 622 (1980); Krotoszynski, *supra* note 287, at 1212-22 (arguing for intent test for distinguishing whether mixed speech is commercial or noncommercial). *But see* Bd. of Trustees of State University of N.Y. v. Fox, 492 U.S. 469, 474 (1989).

[408] For example, a company might suggest to an investor that she should buy its securities because it was going to hit its earnings forecasts. Even this does not fit exactly as the proposal of a commercial transaction, unless the company is selling the security itself rather than promoting its purchase in the open market.

[409] Although the promotional advertising in *Central Hudson* was only afforded limited protection under the commercial speech doctrine, the majority opinion noted that the ban excluded institutional and informational messages and that utilities enjoy the full panoply of First Amendment protections for their direct comments on public issues. Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 562 n.5 (1980). Regulation FD does not carve out institutional or informational messages, or direct comments on public issues.

For example, an executive may want to comment privately on the general state of the economy and the President's policies, how the war in Iraq might affect business, whether privatizing social security is desirable, or how companies may react to a Medicare drug benefit.

Regulation FD acts both to restrict speech (to private audiences) and to compel speech (to the public). Regulation FD arguably affects commercial speech and definitely affects noncommercial protected speech. How then should the appropriate standard of review be applied?

IV. APPLYING THE STANDARD OF REVIEW

As described above, Regulation FD is a peculiar hybrid. It can restrict, burden, or compel commercial, noncommercial, or mixed speech. Theoretically, depending on how it chose to weigh the Supreme Court's precedents, a court could apply rational review,[410] intermediate *Central Hudson* review,[411] or strict scrutiny.[412] Regardless of the standard of review, a court would analyze the nature of the government's interest and how well the regulation relates to or fits the interest. Because a court should not apply only rational review (and if it did, the SEC would undoubtedly prevail) this section examines the interests and fit in light of intermediate and strict scrutiny.

Under strict scrutiny, Regulation FD may persist only if it is narrowly tailored to achieve compelling government interests.[413] Under *Central Hudson* intermediate scrutiny, the government must assert a substantial interest; Regulation FD must directly advance the governmental interest involved and must not be more extensive than necessary to serve that interest.[414] As noted above, because the Supreme Court applies *Central Hudson* with teeth,[415] the intermediate scrutiny test is not as different

[410] Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626 (1985) (compelled commercial). *But see* Dept. of Agric. v. United Foods, 533 U.S. 405 (2001).

[411] *Cent. Hudson*, 447 U.S. at 557 (restricted commercial).

[412] *Riley*, 487 U.S. 781; *Schaumburg*, 444 U.S. at 620 (1980) (addressing compelled or restricted non-commercial or mixed speech). Of course, a court could also invent a new standard of review. *See* Nike v. Kasky, 27 Cal. 4th 939 (2002).

[413] First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 784-86 (1978) (discussing strict scrutiny test in context of political contributions by corporations). This strict scrutiny test has been set forth in numerous First Amendment Cases. *See, e.g.*, Austin v. Mich. Chamber of Commerce, 494 U.S. 652, 655 (1990); Cornelius v. NAACP Legal Defense and Educ. Fund, Inc., 473 U.S. 788, 800 (1985).

[414] Thompson v. W. States Med. Ctr., 535 U.S. 357, 367 (2002) (applying *Central Hudson).*

[415] *See supra* notes 309-18 and accompanying text.

from the strict scrutiny test as the bare language might suggest.

A. *Government Interests?*

Both standards of review require the court to ask itself whether, normatively, the government's interest is "important enough to justify a speech restriction?"[416] The SEC advances three main interests to justify Regulation FD. A court could find that these justifications are compelling and should find that they are substantial.

The first justification is somewhat of a moral argument. Arthur Levitt stated that selective disclosure "is a stain on our markets . . . [that] undermines the fundamental principle of fairness."[417] The SEC believes that it is unfair if "other participants may exploit 'unerodable informational advantages' derived not from hard work or insights, but from their access to corporate insiders" in order to profit from stock trading.[418] Regulation FD was thus intended to level the playing field. This closely resembles the parity of information theory. Until Regulation FD, U.S. securities laws mandated parity of required information rather than parity of all material information.

The Supreme Court in *Chiarella* and *Dirks* rejected a parity of all material information approach.[419] In *Chiarella*, the Court suggested that imposing such a theory would "depart radically from established doctrine"[420] and that to do so would require explicit congressional intent.[421] In *Dirks*, the Court reiterated that an absolute equal information

---

[416] Eugene Volokh, *Freedom of Speech, Permissible Tailoring and Transcending Strict Scrutiny*, 144 U. PA. L. REV. 2417, 2418 (1996).

[417] Arthur Levitt, SEC Chairman, Address Before the Economic Club of New York: Quality Information: The Lifeblood of Our Markets (Oct. 18, 1999), *available at* http://www.sec.gov/news/speech/speecharchive/1999/spch304.htm.

[418] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000) (quoting 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))).

[419] Both *Chiarella* and *Dirks* denied SEC authority to impose equal information rule under sections 17 and 10(b). Dirks v. SEC, 463 U.S. 646, 658 (1983); Chiarella v. United States, 445 U.S. 222, 225-26 (1980).

[420] *Chiarella*, 445 U.S. at 233. The Court was overruling the Second Circuit which had stated that anyone who "regularly receives material nonpublic information" could not use the information for trading. *Id.* at 231 (quoting United States v. Chiarella, 588 F.2d 1358, 1365 (2d Cir. 1978)).

[421] *Chiarella*, 445 U.S. at 233; *see also* Commissioner Laura S. Unger, SEC Commissioner, Remarks at U.S. Securities & Exchange Commission Glasser LegalWorks Conference on SEC Regulation FD: Fallout from Regulation FD: Has the SEC Finally Cut the Tightrope? (Oct. 27, 2000) *available at* http://www.sec.gov/news/speech/spch421.htm ("I am all for

rule would be "a radical view of securities trading."[422] The Court also observed that analysts often obtain information directly from an issuer's officers and that "[i]t is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[423]

The Supreme Court is not alone in rejecting the parity of information approach. Academics, starting with Henry Manne, consistently reject the proposition that trading with an unerodable informational advantage is unfair.[424] Professor Ian Lee summarized the myriad objections to the parity of information theory: "insider trading is a victimless crime; . . . equality of information is inconsistent with the inegalitarianism inherent in the securities market; . . . mandatory information sharing would undermine incentives to search for information; and . . . a mandatory rule against insider trading harms outside shareholders by preventing them from concluding the bargains they prefer."[425]

The second interest put forth by the SEC is the market-related contention that "the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets."[426] A loss of confidence would then result in less participation in the market and, therefore, decreased liquidity.[427] Regulation FD can be compared to the

---

more information — meaningful information — but ensuring parity of information is not the SEC's mandate.").

[422] *Dirks*, 463 U.S. at 658 n.16.

[423] *Id.* at 658-59.

[424] HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 93 (1966) (arguing that insider trading does not harm investors and thus cannot be unfair).

[425] Ian B. Lee, *Fairness and Insider Trading*, 2002 COLUM. BUS. L. REV. 119, 158 (2002); *see also* Fox, *supra* note 55, at 656 ("selective disclosure does not appropriately raise fairness concerns"); Kimberly D. Krawiec, *Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443, 478 (2001) (arguing that parity of information theory is "not only unworkable, but nonsensical," since there is no clear distinction between erodable and unerodable informational advantage); Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 405 (1999) (citations omitted) ("an intuitive sense of fairness is too vague and unreliable to serve as a basis of legal decision making").

[426] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716 (Aug. 24, 2000). More precisely, it is the rapid price changes of a security in advance of public information, rather than selective disclosure itself, that would cause the projected loss of confidence. *Id.* This necessarily requires conduct (e.g., trading in the security).

[427] The SEC also argued that increased liquidity would result from lower stock market transaction costs attributable to the elimination of selective disclosure. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,731 (Aug. 24, 2000) (citations omitted) ("Economic theory and empirical studies have shown that stock market

broad, prophylactic rule in *Riley v. National Federation of the Blind*, which compelled the disclosure of financial information by professional fundraisers.[428] The statute in *Riley* attempted to cure donor misperception by compelling professional fundraisers to provide donors with more financial information regarding the donors' potential donations to particular charities.[429] Similarly, Regulation FD attempts to preserve investor confidence by compelling corporations to disclose to the public material, nonpublic information (or preventing them from disclosing this information) regarding the companies in which investors may potentially purchase securities. Notably, the Supreme Court in *Riley* found that the state's interest in dispelling the donors' "alleged misperception" was not as "weighty" as the government asserted.[430]

For this interest at least, the SEC has some support from the Supreme Court. In *United States v. O'Hagan*, the Court asserted that even though "informational disparity is inevitable in the securities markets," trading on misappropriated information would have an "inhibiting impact on market participation."[431] The Court also noted that "an animating purpose of the Exchange Act [is] to ensure honest markets and thereby promote investor confidence."[432]

Reduced liquidity, of course, is not the only issue. Market efficiency, essentially meaning accurate pricing, is also important, and it is unclear whether selective disclosure increases or decreases efficiency.[433] To the

---

transaction costs increase when certain traders may be aware of material, undisclosed information. A reduction in these costs should make investors more willing to commit their capital.").

[428] "Broad prophylactic rules in the area of free expression are suspect. Precision of regulation must be the touchstone in an area so closely touching our most precious freedoms." Riley v. Nat'l Fed'n of the Blind, 487 U.S. 781, 801 (citing NAACP v. Button, 371 U.S. 415, 438 (1963)).

[429] *Riley*, 487 U.S. at 798.

[430] *Id.*

[431] 521 U.S. 642, 658-59 (1997). It is perhaps no coincidence that the "*O'Hagan* decision has been swamped by a flood of critical articles." Randall W. Quinn, *The Misappropriation Theory of Insider Trading in the Supreme Court: A (Brief) Response to the (Many) Critics of* United States v. O'Hagan, 8 FORDHAM J. CORP. & FIN. L. 865, 866 (citing 15 critical articles). Market participation is probably better understood as fewer trades, rather than less investment. *See* Georgakopoulos, *supra* note 36, at 36.

[432] *O'Hagan*, 521 U.S. at 658.

[433] *See, e.g.*, Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 630-32 (1984) (less efficient); Henry G. Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 565-76 (1970) (more efficient). *See also* Arya et al., *supra* note 15 (providing model of how Regulation FD may lead to increased inefficiency).

degree that Regulation FD increases volatility,[434] it may actually *reduce* confidence in the market.[435] Even if promoting confidence in the market is a compelling or substantial interest, courts should weigh it against other desirable interests. Even under the *Central Hudson* test, a court must consider all relevant government interests.[436]

The third justification propounded by the SEC depends on the possible effects of selective disclosure on the parties directly involved. For the issuer, there is the possibility that corporate management may misuse the selective disclosure of information as a bribe to influence or reward particular investors or market professionals.[437] For the analysts receiving information, there is the fear that analysts will bias their reports in order to retain company favor.[438] Although the SEC does not say this, for the information to function as a bribe or to bias reports, it must have value, which ultimately will depend on whether a recipient can profitably trade on the information (or write a report that will allow others to trade). Notably, some academic literature shows that as long as there are multiple informed traders, as is the case when a company selectively discloses the same information simultaneously to several market professionals, the expected trading profit is actually nil.[439]

Here too, preventing the misuse of information is not the only interest. The SEC is also interested in analysts functioning effectively. In *Dirks*, the Supreme Court stated that the SEC recognizes that analysts are

---

[434] *See* Talosig, *supra* note 13, at 396; *see also* Robert E. Pinsker, Individual Investors' Overreactions to Information Presented in Accordance with Regulation FD: Addressing Some Research Gaps in the Laboratory (Sept. 9, 2004), *available at* http://ssrn.com/abstract=588948 (presenting results of laboratory investigation suggesting that disclosure patterns resulting from Regulation FD may harm unsophisticated investors in part due to excess volatility). *See supra* notes 187-92 and accompanying text.

[435] Although investors love to see their securities increase rapidly in price, generally they hate it even more when their securities decline rapidly in price. *See, e.g.*, Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979). Increased volatility results in investors requiring a higher risk premium, and increases uncertainty by raising the probability of government interference. *See* Clifford W. Smith, Jr., *Market Volatility: Causes and Consequences*, 74 CORNELL L. REV. 953, 956 (1989).

[436] *See, e.g.*, Thompson v. W. States Med. Ctr., 535 U.S. 357, 369 (2002) (comparing government's stated interest in effectiveness of drug approval program with government's interest in allowing patients to get needed medications).

[437] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,716-17 (Aug. 24, 2000).

[438] *Id.*

[439] *See* F. Douglas Foster & S. Viswanathan, *Strategic Trading When Agents Forecast The Forecasts of Others*, 51 J. FIN. 1437 (1996); Craig W. Holden & Avanidhar Subrahmanyam, *Long-Lived Private Information and Imperfect Competition*, 47 J. FIN. 247 (1992).

"*necessary* to the preservation of a healthy market."[440] More recently, the SEC acknowledged that a company's market capitalization and public float "are closely and positively associated with the number of analysts that follow firms."[441] In July 2005, the SEC accepted that "[t]he value of [analysts'] research reports in continuing to provide the market and investors with information about reporting issuers cannot be disputed."[442] Regulation FD may harm the functioning of analysts and thus the market if it results in reports conveying less accurate or useful information.[443]

Finally, evidence of under-inclusiveness implies that the government's interest is not compelling. A regulation's underinclusiveness "suggests that the government itself doesn't see the interest as compelling enough to justify a broader statute."[444] Regulation FD is underinclusive, as discussed below in Part IV.B.1.

B. *How Does Regulation FD Relate to the SEC's Interests?*

A court may or may not find that the government's interests are compelling. In any case, a court is more likely to strike down Regulation FD due to its weak relation to the SEC's interest.[445] The SEC must show that Regulation FD actually does advance its legitimate interests.[446]

Leaving aside the contested interest of the market's fairness or perceived fairness, with respect to the second interest, the proposition that insider trading results in less market participation is dubious.

---

[440] Dirks v. SEC, 463 U.S. 646, 658 (1983) (emphasis added).

[441] The Regulation of Securities Offerings, 63 Fed. Reg. 67,174, 67,185 n.79 (Dec. 4, 1998); *see also* Securities Offering Reform, Release Nos. 33-8591, 34-52,056, IC-26,993, 70 Fed Reg. 44,722, 44,728 (July 19, 2005) ("[h]igh levels of analyst coverage . . . are useful indicators of the scrutiny that an issuer receives from the market").

[442] Securities Offering Reform, Release Nos. 33-8591, 34-52,056, IC-26,993, 70 Fed Reg. 44,722, 44,761 (July 19, 2005).

[443] *See e.g.*, Arya et al., *supra* note 15; Larry E. Ribstein, *Market v. Regulatory Response to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 49-51 (2002) (listing several ways that Regulation FD may reduce effectiveness of analysts); Jeff D. Opdyke, *SEC Discuss "Reg FD" at Roundtable*, WALL ST. J., Apr. 25, 2001, at C16 (noting that analysts at SEC roundtable complained of significant reduction in quality of corporate disclosure after Regulation FD). *See also supra* notes 163-82 and accompanying text. Of course, some commentators have argued that analyst distortions "currently are more likely to decrease market efficiency than increase it." *See* Fisch & Sale, *supra* note 14, at 1086.

[444] Carey v. Brown, 447 U.S. 455, 465 (1980); Volokh, *supra* note 416, at 2420 (citing Fla. Star v. B.J.F., 491 U.S. 524, 542 (1989) (Scalia, J., concurring in part and in judgment)).

[445] Volokh, *supra* note 416, at 2421 ("Most cases striking down speech restrictions . . . rely primarily on the narrow tailoring prong . . . .").

[446] *Id.* at 2422.

Professor Larry Ribstein noted several weaknesses in the theory,[447] such as how unclear rules against insider trading could reduce legitimate outsider trading and thereby reduce liquidity.[448] Professor Stephen Bainbridge concluded that the robust stock market performance observed following high-profile insider trading episodes undercuts the theory.[449] Another commentator, Stanislav Dolgopolov, noted that neither corporations, which would benefit from increased liquidity by a lower cost of capital, nor market makers, which are claimed to raise the bid-asked spread to cover the costs of insider trading thereby reducing liquidity, objected to insider trading, thus raising doubts about the proposition.[450] The empirical evidence appears both "limited and mixed."[451] In addition, if Regulation FD leads to a less efficient market, that too could reduce market participation and liquidity.[452]

The SEC's third interest, the possibility of the misuse of information,[453] with respect to analysts can be addressed by the marketplace. Analysts are only valuable to the degree that they provide accurate information.

---

[447] Larry E. Ribstein, *Federalism and Insider Trading*, 6 SUP. CT. ECON. REV. 123, 163-66 (1998).

[448] *Id.* at 164.

[449] *See* Stephen M. Bainbridge, *Insider Trading*, in 3 ENCYCLOPEDIA OF LAW AND ECONOMICS 786 (Boudewijn Bouckaert & Gerrit DeGeest eds., 1998) *available at* http://encyclo.findlaw.com/5650book.pdf; *see also* Donald C. Langevoort, *Taming the Animal Spirits of the Stock Market: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 166 (2002) (noting that "the long-standing increase in retail investor participation in the U.S. markets at a time when selective disclosure was a notorious practice indicates" that withdrawal is unlikely).

[450] *See* Stanislav Dolgopolov, *Insider Trading and the Bid-Ask Spread: A Critical Evaluation of Adverse Selection in Market Making*, 33 CAP. U. L. REV. 83, 108-09 (2004).

[451] Krawiec, *supra* note 425, at 469; *see also* Dolgopolow, *supra* note 450, at 105 n.108 (2004) (citing studies that contradict adverse selection model).

[452] *See, e.g.*, Arya et al., *supra* note 15, at 11; Mathew, *supra* note 203, at 18 (finding that "implementation of [Regulation FD] has not been without its increase in trading costs to small investors" and has resulted in reduced liquidity). Jim Hsieh and colleagues provide additional evidence of the potentially perverse impact of Regulation FD. They compared the informational value of insider trades with analyst recommendations, and found that in the 2000-2003 period buys by insiders were even more profitable and thus reflected greater nonpublic information than in the 1994-1999 period. Jim Hsieh et al., *How Informative Are Analyst Recommendations and Insider Trades?*, AFA 2006 Boston Meetings Paper, 20-21 (2005), http://ssrn.com/abstract=687584; *see also* Mark Hulbert, *The Analysts vs. the Insiders*, N.Y. TIMES, Sept. 25, 2005, at C3.

[453] Management may be misusing information in other ways. Professor Jagolinzer found evidence suggesting that management with Rule 10b5-1 plans "profit from information-based trade." Alan D. Jagolinzer, An Analysis of Insiders' Information-based Trade within the SEC Rule 10b5-1 Safe Harbor 2 (Jan. 6, 2005), *available at* http://ssrn.com/abstract=541502. One explanation for this is that insiders alter the timing or quality of company disclosures to earn extra market returns. *Id.* at 3.

As one court put it, "the analyst's reputation and livelihood depend solely on the analyst's ability to be correct."[454] Over time, generally efficient U.S. markets will reveal these inaccurate analysts, and the market should discount their forecasts.[455] Accurate and unbiased analysts should thus defeat "bribed" and "slanted" analysts.[456] Cutting somewhat against the efficient market argument, however, but also cutting against the utility of Regulation FD, it appears that Regulation FD's existence has failed to stop companies' attempts to influence analysts.[457] Clearly, there are other sources of bias among analysts besides selective disclosure.

The argument that the SEC has an interest in preventing management from rewarding particular investors is more compelling because the market response is less obvious and there are no clear benefits to the company or the market.[458] Investors have no easy way of knowing whether management rewards a particular group of investors. Furthermore, the possibility of collusion between bribed investors and management is not trivial.[459] The market response to this problem might simply be for investors to demand a higher return from those companies with a greater degree of concentration of ownership.[460] This response

---

[454] *In re* VeriFone Sec. Litig., 784 F. Supp. 1471, 1481 (N.D. Cal. 1992); *cf.* Harrison Hong & Jeffrey D. Kubik, *Analyzing the Analysts: Career Concerns and Biased Earnings Forecasts*, 58 J. FIN. 313 (2003), *available at* http://www.ruf.rice.edu/~jgsfss/Hong.pdf (finding that favorable career outcomes are linked to past accurate forecasts).

[455] *See* Wang, *supra* note 55, at 883 n.72; *see also* Langevoort, *supra* note 449, at 152 ("If investors are smart enough to anticipate the biases or the flaws [of analysts' reports], they will discount or ignore the recommendations."); Qi Chen et al., *Investor Learning About Analyst Predictive Ability*, 39 J. ACCOUNTING & ECON. 3, 4 (2005) (listing studies that have found that "investors attach higher weights to forecasts or stock recommendations issued by superior analysts," and also finding that investors put more weight on accuracy of analysts' recent forecasts).

[456] Ribstein, *supra* note 16.

[457] *See* Thompson & King, *supra* note 380, at 629; *see, e.g.*, Gretchen Morgenson, *You'll Never Do Research in This Town Again*, N.Y. TIMES, Jul. 31, 2005, at C3 (stating that "there may be another explanation for analysts' unreasoned optimism: fear of retaliation from the companies they follow"). Analysts may also have conflicting interests due to their employment.

[458] Management presumably is prepared to reward particular investors as a quid pro quo for those investors supporting management.

[459] *See* Choi, *supra* note 152, at 559-64.

[460] *See* Laura Nyantung Beny, *Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence*, 7 AM. L. & ECON. REV. 144, 146 (2005). Companies with a greater concentration of ownership would then have a higher cost of capital. If this were truly a problem, however, they could address this higher cost by publicly committing not to selectively disclose information.

rests on the theory that the more widely dispersed share ownership is, the less likely that bribery (or incentivizing) is taking place.[461] After all, corporate management has fewer reasons to bribe smaller investors. Of course, investors may also respond by trading less frequently, since an investor can only be on the wrong side of a trade to a better-informed investor if she trades.[462]

It is also worth noting that the SEC did not provide much justification for the belief that selective disclosure is a major cause of the problems that Regulation FD purports to solve.[463] Rather, the SEC merely adverted to some media reports suggesting that the practice of selective disclosure occurred and the perceptions of SEC employees regarding this practice.[464] The SEC appears to have ignored evidence suggesting that any problem with selective disclosure was decreasing, in that more companies were holding their conference calls publicly.[465]

Under *Central Hudson*, the SEC must also show that Regulation FD is "not more extensive than is necessary to serve [its] interests."[466] If, however, "the Government could achieve its interests in a manner that does not restrict speech, or that restricts less speech, the Government *must* do so."[467] Under strict scrutiny, the SEC must show narrow tailoring. As Professor Eugene Volokh describes, a law is not narrowly tailored if it is not the least restrictive alternative, meaning "if there are less speech-restrictive means available that would serve the interest essentially as well as would the speech restriction."[468] A law also is not narrowly tailored if it is underinclusive, meaning that it "fails to restrict a significant amount of speech that harms the government interest to about the same degree as does the restricted speech."[469]

---

[461] *See id.* at 147-48, 161-62 (listing reasons why insider trading might be linked to ownership concentration and finding empirical support).

[462] *See* Georgakopoulos, *supra* note 36, at 36.

[463] The government bears the burden of proof under both standards of review. *See, e.g.*, Thompson v. W. States Med. Ctr., 535 U.S. 357, 372 (2002) (citations omitted).

[464] Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,717 (Aug. 24, 2000). The SEC even acknowledged that the media reports did not indicate necessarily that selective disclosure had occurred.

[465] *Id.* at 51,717-18.

[466] Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 566 (1980).

[467] *Thompson*, 535 U.S. at 371 (citations omitted) (emphasis added).

[468] Volokh, *supra* note 416, at 2422 (citations omitted). He also explains how the least restrictive alternative can include whether the law actually promotes the interest and whether the law is overinclusive. *Id.* at 2423.

[469] *Id.* at 2424 (citations omitted).

It is worth re-emphasizing that the SEC's primary interests for Regulation FD are to preserve fairness and confidence in the market, but that Regulation FD targets speech itself and *not* the trading resulting from the speech.[470] The mere fact that some people have more information than others, however, is neither surprising nor objectionable. People may lose confidence in the markets when they believe others are taking advantage of information that they both do not have and cannot get (i.e., information derived by way of the trader's position and access, rather than skill and hard work). Taking advantage in this context, however, necessarily requires trading on the material, nonpublic information, either directly or based on an analysts' recommendation.[471] Otherwise, there is no advantage to be gained from receiving information unavailable to others. Selective disclosure is not the problem — if there is a problem, it is trading based on selective disclosure.[472] In simple campaign slogan terms, "it's the trading, stupid!"[473]

1. Regulation FD's Scope

Is Regulation FD the least restrictive alternative or no more extensive than necessary? Put differently, is Regulation FD so overinclusive that it restricts, burdens, or compels speech that is irrelevant to the SEC's purposes?[474] In addition, are there alternative approaches that would serve the SEC's purposes adequately but have less impact on a

[470] Even the SEC's third justification regarding the misuse of selective disclosure to reward or influence market professionals ultimately depends upon trading. The information has value only to the degree that it can be traded on by someone, whether it is the investors themselves or the analysts' clients.

[471] "Taking advantage" could also refer to refraining from trading in the particular stock or to trading in substitutes, but since Regulation FD allows the confidentiality carve out, which permits such action or inaction, this is not the SEC's concern. *See infra* notes 506-11 and accompanying text.

[472] The SEC effectively acknowledged this distinction. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 (Dec. 28, 1999) ("[S]elective disclosure has the immediate effect of enabling those privy to the information to make a quick profit (or quickly minimize losses) by trading before the information is disseminated to the public.").

[473] This is a paraphrase of Bill Clinton's informal campaign slogan in 1992. *See, e.g.*, Mark Gongloff, *Is It Still the Economy, Stupid?*, MONEY, Sept. 26, 2003, 1.

[474] FEC v. Nat'l. Conservative Political Action Comm., 470 U.S. 480, 500-01 (1985); First Nat'l Bank v. Bellotti, 435 U.S. 765, 794 (1978); Volokh, *supra* note 416, at 2422 n.32 (citing Simon & Schuster, Inc. v. Members of the N.Y. State Crime Victims Bd., 502 U.S. 105, 120-21 (1991)).

company's speech?[475]

a. Overinclusiveness

Regulation FD is over-inclusive in the sense that all of the material nonpublic information that it targets is assumed to result in the harm of trading. In fact, it captures speech that does not result in trading and thus may not result in harm.[476] Although subsequent trading is evidence of materiality, the SEC does not need to prove that any trading took place to find a violation of Regulation FD.

The SEC argues that Regulation FD is not overinclusive, since a recipient of information who does not intend to trade can agree to keep the information confidential (thereby creating a duty that would implicate the existing insider trading regime).[477] Why, asks the SEC, would a recipient who does not intend to trade on the information not agree to confidentiality?[478] Actually, even such a recipient will likely be unwilling to agree, "given the uncertain scope and duration of limitations on their freedom of action."[479] For example, it will not

---

[475] Sable Commc'ns v. FCC, 492 U.S. 115, 126 (1989); Fla. Star v. B.J.F., 491 U.S. 524, 538 (1989); Boos v. Barry, 485 U.S. 312, 329 (1988); Minneapolis Star & Tribune Co. v. Minn. Comm'r of Revenue, 460 U.S. 575, 586 (1983); Volokh, *supra* note 416, at 2423 n.33 (citing Rutan v. Republican Party, 497 U.S. 62, 74 (1990)); *see also* Thompson v. W. States Med. Ctr., 535 U.S. 357, 372 (2002) (listing non-speech related means that government could use to advance its interests). Volokh also adds that a regulation is not the least restrictive alternative if it does not advance the government's interest. Volokh, *supra* note 416, at 2422. Failing to advance the government's interest is also the third prong of *Central Hudson,* where "the regulation may not be sustained if it provides only ineffective or remote support." *See* Cent. Hudson Gas & Elec. Corp. v. Publ. Serv. Comm'n, 447 U.S. 557, 564-66 (1980). If Regulation FD actually reduces the quality or quantity of information getting to the market, thereby resulting in a less efficient and more volatile market, this would presumably reduce investor confidence in the market. The SEC accepted that Regulation FD may have a "chilling effect" on issuers' disclosure of information. Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,718 (Aug. 24, 2000). With respect to issuers using information as a bribe, since the pre-Regulation FD insider trading regime already prevented insiders from disclosing information for personal gain, selective disclosure is largely performed to benefit the company, which should result in an increase in the company's value. Investors would normally prefer this state of affairs.

[476] The SEC's third interest (preventing use of information as a bribe to bias analysts) is not implicated, since the same result is achieved by means of the carve out for confidentiality agreements.

[477] SEC Opposition, *supra* note 265, at 25.

[478] *Id.*

[479] Letter from Securities Industry Association to Jonathan Katz, Secretary, SEC, *supra* note 10 (stating that Securities Industry Association believes that institutional investors will only be willing to sign confidentiality agreements in "exceptionally unusual circumstances").

necessarily be clear when or how an issuer will plan to disclose the information publicly or, if the issuer uses a different combination of words or different body language,[480] whether enough of the information was disclosed.

A second reason Regulation FD is overinclusive is that under Rule 10b-5(1), which the SEC introduced concurrently with Regulation FD, trading "on the basis of" material nonpublic information now occurs whenever the trader is aware that she has material nonpublic information,[481] subject to a few limited exceptions.[482] A recipient's possession of the information is sufficient — use need not be shown.[483] Thus, a recipient who receives material nonpublic information tending to show that a security should be sold and then performs an independent analysis to reach the same conclusion[484] would be unable to sell simply by virtue of her possession of the nonpublic information. This is true even though she would make the same decision regardless of her

---

[480] *See supra* notes 119-26 and accompanying text.

[481] The rule reads in relevant part:

> (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.

17 C.F.R. § 240.10b5-1(b) (2005).

[482] Transactions involving pre-existing plans, contracts, or instructions that the trader entered into in good faith are excluded. *Id.* § 240.10b5-1(c). *See, e.g.*, Jonathan D. Glater, *Witness Tells of Early Talk of Plan to Sell Stewart Shares*, N.Y. TIMES, Feb. 24, 2004, at C1 (explaining importance in (in)famous Martha Stewart case of defendant's argument that she had previously issued instruction to sell Imclone stock if it fell below $60).

[483] Rule 10b5-1 forestalls the argument that even though the trader had material nonpublic information, she would have made the trade anyways. Put slightly differently, there is now no need to show but-for causation (i.e., but-for the trader's knowledge of the material nonpublic information, she would not have traded) or even that the material nonpublic information was a factor in the decision. The argument that use of the information was necessary had previously been accepted by the Ninth and Eleventh circuits. United States v. Smith, 155 F.3d 1051, 1069 (9th Cir. 1998), *cert. denied*, 525 U.S. 1071 (1999); SEC v. Adler, 137 F.3d 1325, 1337 (11th Cir. 1998). The SEC and academic commentators had often argued the opposite, usually on evidentiary grounds. *See, e.g.*, *Adler*, 137 F.3d at 1332-33 (stating SEC advocated that mere possession of information, regardless of use, was adequate to establish liability); DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT, AND PREVENTION § 3.123 (2005).

[484] Technically, it does not matter whether a recipient's independent analysis points in the same direction as the material nonpublic information she received. Either way, she is prohibited from both buying and selling, regardless of whether the material nonpublic information is positive or negative for the company's securities.

possession of the information. Likewise, if she hears negative rumors about the issuer in the marketplace, she still cannot trade because rumors are not as accurate as direct comments from the issuer, and thus, the information could still be considered nonpublic.[485]

Trading on inappropriately received information is the harm that Regulation FD really seeks to address. The selective disclosure of information, without trading, is not itself harmful. Given this, directly targeting speech rather than presumed undesirable trading is inevitably overinclusive, as not all speech will result in trading.

b. Other Approaches

If one believes that reducing insider trading serves the SEC's interests[486] and that this is not outweighed by the harm to other interests, are there alternative approaches that adequately serve the SEC's interests but place fewer restrictions on speech? "If the First Amendment means anything, it means that regulating speech must be a last, not first, resort."[487] For example, in *Riley*, the Supreme Court provided examples of more narrowly tailored rules than the "prophylactic, imprecise, and unduly burdensome rule the State" adopted.[488]

The key is that the perceived harm results not from selective disclosure per se, but from the trading that may result from such disclosure.[489] As the Supreme Court noted in *Dirks*, "[i]t is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information per se and its possession . . . ."[490] The SEC or Congress should instead focus on the alleged harm — trading — without implicating the First Amendment.[491]

---

[485] In both cases she possessed material nonpublic information, but may not have used it.

[486] One must also believe that the interest is not adequately served by the SEC's existing narrowly tailored regulation against insider trading, Rule 10b-5.

[487] Thompson v. W. States Med. Ctr., 535 U.S. 357, 373 (2002) (applying *Central Hudson*).

[488] Riley v. Nat'l Fed'n of the Blind, 487 U.S. 781, 800 (1987).

[489] Rule 10b-5 already targets other kinds of insider trading. *See supra* notes 38-47 and accompanying text.

[490] Dirks v. SEC, 463 U.S. 646, 662-63 (1983) (citations omitted).

[491] For those who respond with the dubious assertion that attacking the speech is easier than attacking the trading, it is worth remembering that, at least in the equal protection context, administrative efficiency is not an acceptable state compelling interest. *See* City of Richmond v. J.A. Croson Co., 488 U.S. 469, 508 (1989); *see also* Police Dep't of Chicago v. Mosley, 408 U.S. 92, 102 n.9 (1972). ("small administrative convenience" in First Amendment case is not compelling interest).

One possible alternative is for the SEC to introduce a fraud-based regulation clarifying the "personal benefit" test of *Dirks*. For example, Harvey Goldschmid, SEC General Counsel, when the Proposing Release was issued, believed that the SEC could lawfully extend the *Dirks* benefit test to apply to trading that resulted from disclosures benefiting the issuer.[492] Trading that resulted from selective disclosure would then become a part of the Rule 10b-5 insider trading regime. Goldschmid, however, did not support this approach, because "the fraud stigma, private action, and treble-damage disgorgement, would be available to plaintiffs and could have had a large chilling effect on communication."[493] Although a case-based extension might suffer from this result, a rule-based extension could modify the availability of remedies to plaintiffs.

If the SEC's interests are as important as it argues, an even better approach is for Congress to legislate against the trading resulting from selective disclosure.[494] Although the SEC may lack the authority to target the type of trading at issue, Congress clearly does not. For example, in *Lowe*, Justice White's concurrence noted that "there is no suggestion that the application of the antifraud provisions of the [Investment Advisers] Act . . . would present serious First Amendment difficulties."[495] Similarly there is no suggestion that Congress cannot regulate the trading of securities by broadening the definition of impermissible insider trading,[496] even if Congressional restrictions on possibly unrelated speech would be prohibited by the First Amendment.

Alternatively the SEC might simply encourage firms to commit to and explain their own selective disclosure policies.[497] As Professor Choi

---

[492] *Panel Discussion: The SEC's Regulation FD*, 6 FORDHAM J. CORP. & FIN. L. 273, 279 (2001) (remarks of Harvey J. Goldschmid). The Supreme Court's suggestions in *Riley* for less restrictive alternatives than compelling speech included the vigorous enforcement of antifraud laws. *Riley*, 487 U.S. at 800.

[493] *Panel Discussion: The SEC's Regulation FD*, *supra* note 492, at 279.

[494] Congress does not necessarily have to be the body that takes action. *See* Ribstein, *supra* note 447, at 154-66 (arguing persuasively in favor of leaving much of regulation of insider trading to states rather than to Congress). Alternatively, control of trading could be assigned to the issuers. *See* Ayres & Choi, *supra* note 384 at 370-402.

[495] Lowe v. SEC, 472 U.S. 181, 225 (1985) (citations omitted).

[496] Australia's insider trading regime serves as an example. Subject to a few limited exceptions, Australia prohibits almost everyone from trading who possesses information that is not generally available. Corporations Act, 2001, § 1043A (Austl.).

[497] *See* Choi, *supra* note 152, at 574-78 (explaining advantages of firms committing to selective disclosure policies). Choi also suggests a shift from the existing system of periodic disclosure to current or continuous disclosure. *Id.* at 569-74. Such a shift may have fewer First Amendment implications. *See supra* note 26 (discussing First Amendment

explained, especially at the time of an initial public offering, firm owners have an incentive to maximize the value of their company and are therefore likely to choose a wealth-maximizing policy,[498] which should address liquidity concerns. In addition, it is hard for an investor to perceive unfairness when warned in advance of how a company will use its information.

2. Underinclusive

In addition to being overinclusive, Regulation FD is startlingly underinclusive in relation to its purpose of promoting fairness and investor confidence.[499] The following situations are likely untouched by Regulation FD (and the existing insider trading regime). Each scenario could result in those with access to inside information taking advantage of such information, thus potentially impairing investor confidence if one accepts the SEC's logic.

Part I.A.1 described how the adopted version of Regulation FD does not apply to all issuers.[500] Selective disclosures by foreign private issuers and foreign governments are not covered.[501] Professor Merritt Fox argues persuasively that if the trading from selective disclosure is appropriately considered unfair, then Regulation FD should also apply

---

concerns of periodic reporting). The SEC first accepted this principle of current disclosure in 1980, but it never acted on it. *See* Stephen E. Bochner & Samir Bukhari, *The Duty to Update and Disclosure Reform: The Impact of Regulation FD and Current Disclosure Initiatives*, 7 STAN. J.L. BUS & FIN. 225, 240-46 (2002); Dale Arthur Oesterle, *The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Companies: "Are We There Yet?,"* 20 CARDOZO L. REV. 135, 148-49 (1998).

[498] *See* Choi, *supra* note 152, at 574.

[499] This is an inevitable result of the narrowing of the scope of Regulation FD that took place between its proposal and adoption. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,718-19 (Aug. 24, 2000) (describing narrowing revisions). Underinclusiveness is less relevant for the *Central Hudson* test.

[500] Of course, Regulation FD also does not apply to all types of material nonpublic information, such as information received from lower level employees who do not regularly speak with analysts. It also does not apply to information transmitted in the ordinary course of business to vendors or suppliers or to information transmitted to other groups, such as the media or business partners. Concededly the recipients of information in these circumstances may not trade much, or in some circumstances, trading might be reached by the misappropriation theory accepted in *O'Hagan*. Regulation FD also does not apply to information conveyed to potential investors who are not yet holders of an issuer's securities regardless of how likely it is that they will trade.

[501] *See supra* text accompanying notes 56-58 for information on the importance of foreign issuers.

to foreign issuers.[502]

Furthermore, Regulation FD does not apply to some situations where trading is likely. The SEC chose not to apply Regulation FD to issuers in most Securities Act offerings. Since material nonpublic information is commonly given orally at road shows that may well be invitation-only,[503] this is exactly the type of so-called "unfairness" that should be addressed. Similarly, underwriters with an information advantage are permitted to buy or sell shares to stabilize the price after an initial public offering.[504]

Regulation FD also does not apply to the negligent issuer. It is not clear that there is any less unfairness or perceived unfairness when the supranormal returns of trading with inside information result from an issuer's negligence rather than recklessness.[505] Put differently, an outsider on the unprofitable side of a trade is unlikely to care about the subtle distinctions in the issuer's agent's mental state.

In addition, Regulation FD does not prevent refraining from trading.[506] An investor can refrain from trading or the analyst can refrain from changing their recommendations due to material nonpublic information he or she receives, if the parties agree to a confidentiality agreement.[507]

---

[502] Fox, *supra* note 55, at 668-69.

[503] *See* Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 730-31 (2005) (noting that individual investors are generally excluded from some types of road shows and that they generally have less information). Google's recent follow-on offering may also illustrate this point. Google's share price had risen sharply after the announcement of the offering, resulting in speculation that the road shows, closed to the general public, were revealing new market-moving information. *See* Saul Hansell, *Investors Rush to Buy Another $4.2 Billion in Google Stock*, N.Y. TIMES, Sept. 15, 2005, at C1.

[504] *See* Thompson & King, *supra* note 380, at 636 (citing Regulation M, 17 C.F.R. § 242.104 (2000)).

[505] *See* Krawiec, *supra* note 425, at 479.

[506] *See generally* Jesse M. Fried, *Insider Abstention*, 113 YALE L.J. 455 (2003). Professor Fried has argued that contrary to the conventional view, the ability to refrain from trading does not actually allow the insider to earn higher trading profits than a comparably situated public shareholder. Fried's argument, however, depends on insiders being unable to trade in favorable situations (i.e., when they have information indicating that the trade would be profitable), which is not necessarily accurate. *See* Choi, *supra* note 152, at 567-68; SEC Telephone Interpretation 15 (May 2001) (stating that insider may terminate plan while in possession of material nonpublic information), *available at* http://www.sec.gov/interps/telephone/phonesupplement4.htm. It also ignores the possibility that management may alter the timing or quality of disclosure in order to earn extra market returns through Rule 10b5-1 plans. *See* Jagolinzer, *supra* note 453, at 3.

[507] That refraining from trading can be profitable recently made front page news. The *Wall Street Journal*, reporting on Google's initial public offering, noted how at the last minute as the offering price was being cut, seven of Google's directors lowered the number of shares they or their institutions planned to sell. (The remaining two directors had not

For example, say the investor who is subject to a confidentiality agreement and planned to sell their stock learns positive material nonpublic information. Although they cannot buy more stock, they no longer decide to sell.[508]

Regulation FD also does not prevent trading in substitutes.[509] Substitutes may be "the stock of that firm's rivals, suppliers, customers, or the manufacturers of complementary products."[510] A prominent example of this was SBC's takeover of AT&T in early 2005. Even before the parties announced the takeover, the shares of MCI, the only comparable company to AT&T, increased.[511] Investors believed, not unreasonably, that, given the consolidation in the industry MCI, would also become a takeover target. Investors, subject to a confidentiality agreement and with advance notice of the SBC/AT&T transaction, could trade and profit on that information simply by buying MCI stock.

In addition to the above situations, Regulation FD also appears underinclusive when looking specifically at the SEC's third interest of preventing corruption of issuer or analyst.[512] First, even with a confidentiality agreement, material nonpublic information may still have value for an analyst or investor and thus still be useful as a bribe. As noted above, for the investor, refraining from trading or trading in

---

planned any sales.) In the 13 months since the IPO, Google stock has increased 256%. The directors "were in a privileged position to guess the stock's future trajectory," including perhaps information about the company's "spectacular" third quarter that other investors would not have known about. *See* Kevin J. Delaney, *Google IPO Revisited: Insiders Got Choice Other Sellers Didn't*, WALL ST. J., Sept. 16, 2005, at A1.

[508] Professor Choi notes how the investor and management may collude. Choi, *supra* note 152, at 568. The investor indicates to management their trading intentions, which if likely to be profitable, are greeted with silence, but if likely to be unprofitable, are greeted with the selective disclosure of information. In the former case he has not derived any information advantage from selective disclosure, and in the latter case he must refrain from continuing with his unprofitable trade. *Id.*

[509] More technically, Regulation FD would appear only to prevent trading in substitutes if the confidentiality agreement between the company and the enumerated person so specified.

[510] *See* Ian Ayres & Joe Bankman, *Substitutes for Insider Trading*, 54 STAN. L. REV. 235, 235 (2001); *see also* Choi, *supra* note 152, at 566.

[511] *See* Ken Belson, *MCI Widely Seen as Target of Next Round of Courtship*, N.Y. TIMES, Jan. 29, 2005, at C2 (noting that AT&T's attempt to sell itself is "worst-kept secret"); *SBC Talks With AT&T Could See Dollars 16bn Deal*, FIN. TIMES, Jan. 28, 2005, at 30.

[512] There is also a tension between the fiduciary's property rights in information approach exemplified by *O'Hagan* and the approach in Regulation FD that prevents a company from using its information for its own benefit. *See* Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,592 (Dec. 28, 1999) (stating that proposal is intended to address issuers who "treat material information as a commodity"). *See generally* Ribstein, *supra* note 16.

substitutes is still possible. The analyst, likewise, has the opportunity to refrain from changing her report or to alter reports for related companies. In addition, the information (especially when combined with selective disclosures from other issuers) may allow better general predictions about the state of the economy or an industry sector. Second, since an issuer can comply with Regulation FD by simultaneously making an EDGAR filing that has the same date as the date of disclosure to favored market professionals or investors, these favored parties can still act on the information before it becomes readily available to the market.[513]

Despite its underinclusiveness, Regulation FD may actually be more "unfair" to the individual investor than the previous status quo because the investor is "punished" twice. For example, someone buying stock in an issuer while a market professional's clients are selling based on the issuer's selective disclosure of material nonpublic information may feel aggrieved for two reasons. First, the perception that the market professional's clients had an unearned information advantage may exist. Second, the issuer may then have to pay a fine for violating Regulation FD (thereby further reducing the value of the investor's investment), while those who profited from the information, such as those to whom the analyst recommended the sale of the issuer's stock, face no sanction whatsoever.

Even assuming that the SEC's interests are substantial or compelling, Regulation FD appears both fatally underinclusive and overinclusive at the same time. There are also other less restrictive alternatives. The courts should not uphold the SEC's choice to regulate speech rather than actual securities trading, which is the source of the perceived underlying harm.

CONCLUSION

More than seventy years ago, when Congress enacted the Securities Act and the Exchange Act, the First Amendment had not yet been extended to protect commercial speech or the speech of corporations.[514] Similarly, the First Amendment had not yet been deployed to invalidate laws compelling speech.[515] Recently, however, in the wake of decisions

---

[513] *See* Fisch & Sale, *supra* note 14, at 1092 n.367 (explaining how this process appears to be in compliance with Regulation FD).

[514] *See supra* notes 290-93 and accompanying text.

[515] The first compelled speech case was *West Virginia State Board of Education v. Barnette,*

such as *44 Liquormart, Lorillard,* and *United Foods* government regulations restricting and compelling speech by corporations have received a heightened intermediate scrutiny, even when the speech constituted mere commercial advertising.[516]

The SEC, however, "a juggernaut among regulatory agencies,"[517] ignored this trend and chose to implement a new regulation, Regulation FD, that solely targeted speech. Unlike nearly all other securities regulations, Regulation FD does not require harmful conduct or even a reasonable likelihood of harmful conduct.[518] In similar but distinct fashion, Regulation FD operates as a burden on private speech to private parties, again without requiring a showing of harm or likelihood of harm.[519]

Perhaps the most astonishing aspect of Regulation FD is that the SEC had other constitutional alternatives. It could have instead targeted directly the conduct it perceived as harmful, trading securities on the basis of inappropriately received information, as it had with its antifraud Rule 10b-5. The SEC could have also sought additional power from Congress to prevent the suspect trading activities.[520] Regulating the trading of securities, unlike regulating speech, raises no constitutional issues.

Regulation FD raises a substantial constitutional question. Has the SEC, in targeting truthful, valuable speech, finally gone too far?[521] This Article argues that it has and that the courts should reach the same conclusion.

---

319 U.S. 624 (1943).

[516] *See supra* notes 309-17, 368-75 and accompanying text.

[517] Joseph McLauglin, *The SEC's Coming Regulatory Retreat, in* SECURITIES LAW & THE INTERNET: DOING BUSINESS IN A RAPIDLY CHANGING MARKETPLACE 185, 187 (PLI Corp. Law & Practice Course Handbook Series No. B0-00S, 1999).

[518] *See supra* note 470-73 and accompanying text.

[519] *See supra* notes 379-87 and accompanying text.

[520] *See supra* notes 494-96 and accompanying text.

[521] *See* Wash. Legal Found. v. Friedman, 13 F. Supp. 2d 51, 67 (D.D.C. 1998) (finding that "FDA exaggerates its overall place in the universe" in connection with striking down on First Amendment grounds restrictions on encouraging off-label prescription of drugs).