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CREDIBILITY AND INFORMATION IN SECURITIES MARKETS AFTER REGULATION FD

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I. INTRODUCTION

Regulation FD,[1] the Securities and Exchange Commission's (SEC) new rules that prevent companies from selectively disclosing information to analysts, reflects the agency's broad concern for fairness among traders.[2] The Regulation's ultimate success will depend as much on a second factor—whether it adversely affects the total set of information available to market participants. This Article focuses on Regulation FD's likely effects on the availability and reliability of information and the resulting informativeness of market prices.[3] In particular, this Article discusses issues related to the amount of information issuers disclose, the amount of research analysts conduct, and the reliability of the combination of information provided by those two functions. These new rules redefine the information space within which issuers and analysts act, potentially tilting the information market to rely more on analysts and less on issuers.

The Regulation responds to the longstanding practice of many companies to reveal some information about themselves to the market, not in a government disclosure form, but by telling selected analysts or shareholders.[4] Those companies now face an all or nothing choice: they are not required to disclose any more information than before, but if they tell someone, they must tell everyone. The Regulation requires that a company[5] disclosing nonpublic information about itself to market professionals or shareholders

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1. 17 C.F.R. § 240.100 (2000).

2. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,715, 51,716 (Aug. 15, 2000) (codified at 17 C.F.R. pts. 240, 243, 249) [hereinafter Final Release]. In the Release, the agency identifies "FD" as standing for "Fair disclosure." *Id*. at 51,716.

3. Informativeness of market prices refers to the extent to which information is impounded in prices.

4. *See, e.g.*, Jeff D. Opdyke & Emily Nelson, *Conference Call Crunch: New SEC Rule Turns Analysts' Rite Into a Hectic Affair*, WALL ST. J., Oct. 31, 2000, at C1.

5. An individual acting on the company's behalf also cannot disclose information. 17 C.F.R. § 243.100(a) (2001).

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likely to trade on the information must simultaneously disclose the information to the public at large.[6]

II. INFORMATION REACHING THE SECURITIES MARKETS

In proposing Regulation FD, the SEC began with the observation: "Information is the lifeblood of our securities markets."[7] While proscribing one set of information transfers, the agency sought to avoid reducing the overall amount of information available to investors.[8] The total set of information available to investors is a complex combination of a company's disclosures about itself, information produced by information intermediaries, and the information investors generate for themselves or infer from market prices. This Article focuses on information specific to a company as opposed to information relevant to the entire market.

A. Company Disclosure

What a company discloses about itself reflects both its economic incentives to reveal information and what the government requires it to disclose. The basic story about a firm's incentive to disclose is well known. As Frank Easterbrook and Daniel Fischel describe the firm's dilemma, "If the firm simply asked for money without disclosing the project and managers involved . . . it would get nothing. Investors would assume the worst, because, they would reason that if the firm had anything good to say for itself, it would do so."[9] Thus, firms disclose more information to sell shares at a higher price.[10] They use verification and certification devices to distinguish themselves from other firms that might otherwise try to mimic their behavior without the results that support such action.

Beginning in 1933, federal law added a strong dose of government-mandated disclosure to the information set otherwise available because of the

6. *Id*. If the disclosure is unintentional, the same disclosure must be made promptly to the public. *Id*. § 243.100(a)(2). "Promptly" means within twenty-four hours or prior to the commencement of the next day's trading on the New York Stock Exchange. *Id*. § 243.101(d) (2000). The Regulation also defines the acceptable means of public disclosure. *Id*. §§ 243.100, 243.101(c),(e) (2000).

7. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,591 (proposed Dec. 20, 1999) (codified at 17 C.F.R. pts. 240, 243, 249) [hereinafter Proposing Release].

8. *See* Harvey J. Goldschmid, Luncheon Address to the American Law Institute (May 16, 2000) ("The trick for the SEC was to end selective disclosure, if possible, without producing counterproductive effects, without stopping the flow of information to analysts, shareholders, and others.").

9. Frank Easterbrook & Daniel Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 683 (1984).

10. *Id.*

market participants' economic incentives.[11] The motivations for such legislation[12] is not central to this discussion.[13] The result is that the information set coming from companies includes various financial numbers and other data in a variety of forms required by statute, together with substantial additional information provided by companies about themselves or by outsiders about those companies.

B. Information From Noncompany Sources

A healthy securities market requires more information than companies normally provide about themselves. Other actors possess or pursue a variety of information about a company that can inform the securities marketplace. These sources include: (1) information from one's own work; (2) information sought from others; and (3) information from prices.

1. Information From One's Own Work

Information about a particular company ends up in the possession of various market participants without any specific action on their part to seek the information. Employees and other insiders at the company, customers, suppliers, and competitors, each learn material information about the company in the course of dealing with it. In addition, government or private regulators may obtain material information.[14]

2. Information Sought From Others

Many players in the markets regularly pursue information about a company beyond that which may be provided by the company itself. Some private investors find it worthwhile to seek additional information. Analysts and other similar information providers make it their business to develop information to trade on themselves or to sell to others. In addition, the financial media are a source of useful information.

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11. *See, e.g.*, Securities Act of 1933, 15 U.S.C. §§ 77a *et seq*. (2000); Securities Exchange Act of 1934, 15 U.S.C. § 78a *et seq*. (2000).

12. Legislative motives could include the fact that: managers' incentives to disclose may not be completely aligned with their companies; there may be an oversupply of some information and verification; or the fact that some firms were trying to raise costs of their competitors.

13. For a discussion of the justification for a mandatory disclosure system, see generally John C. Coffee, Jr., *Market Failures and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 720-23 (1984).

14. Consider for example, the information about tires on sport utility vehicles that came into the hands of lawyers and government safety regulators prior to widespread public disclosure of those tire problems.

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3. Information Provided by Price

Beyond the specific information sources just described, price itself is a source of information that may complement or substitute for those sources. For some traders in an efficient market, information from prices may be a sufficient base of information to justify securities trades.[15]

Indeed, each of the sources listed here is necessarily affected by the others. For each source, and for different users of the same source, differing search and verification costs exist that will determine the intensity of its use. If a company decreases the amount of information it releases, or price becomes less informative, market participants might well look to these other sources to make up the difference, depending on the costs and benefits of each. Ronald Gilson and Reinier Kraakman claim the cost of information is the core concept that shapes the role that analysts and other participants play in an information system and in contributing to an efficient market.[16] Acquisition costs, processing or deciphering costs, and verification costs are the central mechanisms in determining how quickly market prices incorporate new information.[17]

C. The Role of Analysts and Selective Disclosure

The Supreme Court concluded in *Dirks v. SEC*[18] that analysts are "necessary to the preservation of a healthy market."[19] The Court's opinion in *Dirks* quoted with approval the SEC's recognition of the role of analysts: "[T]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information and thus the analysts' work redounds to the benefit of all investors."[20]

Analysts play a crucial role in the process by which the market incorporates information into the price of securities.[21] They sometimes

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15. Ronald Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 572-77 (1984) (discussing trade decoding and price decoding).

16. Gilson & Kraakman, *supra* note 15, at 568-71.

17. *Id*. Gilson & Kraakman identify acquisition costs as the cost of production or acquiring the information from someone else; processing includes the human costs of evaluating information, a skill that often requires professional training; and verification reflects the need to determine the quality of information.

18. 463 U.S. 646 (1983).

19. Dirks v. Securities and Exchange Commission, 463 U.S. 646, 658 (1983).

20. *Id*. at 658 n.17 (citing 21 SEC Docket 1401, 1406 (1981)).

21. *See, e.g.*, Coffee, *supra* note 13, at 723-24 ("[M]ost accounts explaining the stock market's efficiency assign a substantial responsibility to the competition among analysts for securities information.").

contribute new information not otherwise available about the company and, at other times, analysts are the mechanisms by which publicly distributed information becomes incorporated into price.[22] They occupy an intermediate position within the universe of traders as measured by available information, typically possessing less information about a company than its insiders, but more information than noise traders.[23]

The traditional information market has included the company communicating directly to analysts without simultaneously communicating with the entire market, conduct that Regulation FD now seeks to eliminate.[24] In *Dirks*, the Supreme Court observed:

> [I]t is commonplace for analysts to 'ferret out and analyze information' and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It 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.[25]

The motivation for selective disclosure instead of disclosure to the entire market can be attributed to several purposes we discuss separately below. First, the nature of some information may create or contribute to the need for

22. *See* The Regulation of Securities Offerings, 63 Fed. Reg. 67,174, 67,217 (Dec. 4, 1998) (codified 17 C.F.R. pts. 200, 202, 210, 228-30, 232, 239, 240, 249) (discussing how analysts "digest information . . . put it all in context, and act as conduits in the flow of information by publishing reports explaining the effect of this to investors"). *See also* Sok Tae Kim et al., *Market Structure, Informed Trading and Analysts' Recommendations,* 32 J. FIN. & QUANTITATIVE ANALYSIS 507, 515 (1997) (finding that private information disseminated by analysts who initiate coverage with a buy recommendation is reflected in stock prices in less than 15 minutes). *See generally* Randall S. Thomas & James F. Cotter, *Measuring Securities Market Efficiency in the Regulatory Setting,* 63 LAW & CONTEMP. PROBS. 105 (2000) (discussing the level of analysts following that will impact a firm's price).

23. *See generally* Gilson & Kraakman, *supra* note 15, at 568-88 (describing four general forms of market efficiency mechanisms proposed by financial economists: universally informed trading, professionally informed trading, derivatively informed trading, and uninformed trading).

24. Final Release, 65 Fed. Reg. at 51,716.

> The regulation provides that when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer's securities who may well trade on the basis of the information), it must make public disclosure of that information.

Id.

25. *Dirks*, 463 U.S. at 658-59 (internal citation omitted).

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selective disclosure. Second, use of selective disclosure may produce a benefit to the company. Third, selective disclosure may produce a private benefit.

1. Selective Disclosure Because of the Nature of the Information

A common analogy used to describe the positive contribution of analysts in the information market refers to a mosaic.[26] Analysts retrieve bits of otherwise immaterial information and, in doing so, come to see a mosaic not readily visible to others. Most would describe a larger, more important role: "[M]any corporate managers have come to see the analyst community as an appropriate avenue for making minor, but material, disclosures to the market" where a press release is too "blunt [an] instrument."[27] There may be information that management cannot disclose in the market for competitive reasons, but such information can be communicated to the market via discussions with analysts and their subsequent trading. There may be information that will be misunderstood initially. Discussions with analysts can contribute to a more accurate interpretation and prevent market overreaction or excessive volatility. At the time of the implementation of Regulation FD, one analyst estimated that twenty-five percent of accuracy in analysts' earnings models has always come from companies through such selective disclosure.[28]

2. Selective Disclosure to Obtain a Company Benefit

Apart from whether the type of information requires selective disclosure, a company may find nevertheless that selective disclosure serves a company interest. The company could structure the information set and choose the recipients of the disclosure. Giving some analysts monopoly benefits as to particular information may be a necessary incentive to get analysts to follow the company, thereby providing liquidity and better pricing that will benefit shareholders as a group. The relationship provides economic benefits to both the analysts and the company. By gaining access to information not completely incorporated into market price, analysts could, over time, have a return that beats the market. In exchange, the company gets analysts who follow its stock, supply information that helps increase the accuracy of the

26. *See, e.g.*, Jeff D. Opdyke, *The Big Chill: Street Feels Effect of "Fair Disclosure" Rule*, WALL ST. J., Oct. 23, 2000, at C1.

27. Scott Rosen, *Regulation FD: The Inside Scoop*, INNOVATOR, (I/B/E/S Int'l) Dec. 2000, at 1.

28. Jeff D. Opdyke, *The Big Chill: Street Feels Effect of 'Fair Disclosure Rule*, WALL ST. J., Oct. 23, 2000, at C1 (quoting Matthew Berler, an analyst at Morgan, Stanley, Dean Witter & Co.).

share price, and reduce the mispricing risk facing investors. The activity likely makes the stock's price movement less volatile and provides additional liquidity in the stock's trading.[29]

3. Selective Disclosure to Obtain a Private Benefit

Opportunistic managers may engage in selective disclosure, not necessarily to benefit the company, but to benefit themselves. For example, the insider could receive a suitcase full of money in exchange for the information. Such conduct would easily violate current insider trading prohibitions and does not appear to be the motivation for Regulation FD. However, parallel, harder to detect trade-offs could support the Regulation. For example, managers might selectively disclose information to facilitate acquisitions of a block of stocks by friendly hands that might help protect management from a takeover.[30]

D. The Economics of Selective Disclosure

Whatever the motivation, how should we balance the various factors that enter into a selective disclosure decision? In a current paper, Professor Stephen Choi suggests an "informational disparity" framework to balance four considerations: (1) the amount an analyst or other investor spends to obtain information, (2) the benefit to analysts from trading with an information advantage, (3) the loss suffered by the uninformed trader on the other side of such a transaction, and (4) the benefit to the company and the market generally from more accurate pricing.[31] Choi suggests that if managers are not behaving opportunistically, the company will internalize all

29. Opdyke, *supra* note 28, at C21 ("Companies played along because it helped them manage investor expectations and keep their stock prices from swinging violently."). *But see* Richard Frankel et al., *An Empirical Evaluation of Conference Calls as a Voluntary Disclosure Medium*, J. ACCT. RES., Apr. 1, 1999, at 133, *available at* 1999 WL 25035824, at *5 (noting that issuer conference calls are often followed with abnormal trading volume and greater price volatility).

30. *See* Stephen J. Choi, *Selective Disclosures in the Public Capital Markets*, 35 U.C. DAVIS L. REV. (forthcoming 2001) (suggesting selective disclosures may induce outside investors to construct a block, whose monitoring of management would benefit all shareholders). *See also* Andrei Shleifer & Robert W. Vishny, *Large Shareholders and Corporate Control*, 94 J. POL. ECON. 461, 462 (1986) (noting that large blockholders have greater incentives than small dispersed shareholders to monitor managers for agency problems). *See generally* Michael J. Barclay et al., The Block Pricing Puzzle (Jan. 2001) (unpublished manuscript, on file with author) (examining the difference in price between acquiring a large percentage of stock directly from the corporation in a private placement—priced at a nineteen percent discount—and acquiring the shares directly from another shareholder—an average eleven percent premium—as reflecting implicit compensation for helping entrench management from the market for corporate control).

31. *See* Choi, *supra* note 30, at 16.

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costs associated with the selective disclosure of information. Therefore, Choi argues that the decision to disclose information selectively should be left to the company rather than the government.[32]

> Where managers act in the best interest of shareholders, managers will employ a selective disclosure policy that best maximizes shareholder welfare, balancing the cost of information production, the benefit to the party receiving the selective disclosure, . . . the loss to [the company's] own uninformed shareholders, and finally the increase in accuracy in [the company's] stock price.[33]

If managers behave opportunistically, Choi recognizes a benefit of regulation.[34] However, he also asks, somewhat provocatively, if that is not a question left to state law under the current division of responsibility between federal and state governments, as evidenced by cases such as *Business Roundtable v. SEC*.[35]

If these "informational disparity" factors are measured in absolute terms, two factors are likely to be positive and two are likely to be negative, but a direct summation of the four likely will be incomplete. The company does not cares about the absolute gain and loss in parts 2 and 3, but does care about how much uninformed traders will reduce the price they initially pay for the shares because of fear that, later, they will be induced to trade with an analyst who has an information advantage due to selective disclosure. The company also cares about how much the analyst will do for the company because the analyst receives the benefit of the gain on any transaction while possessing an information advantage. The benefit of these two components collectively is likely to correspond to the fourth component, the additional amount investors will pay for the stock because of its reduced mispricing and greater liquidity. Further, any price reduction resulting from uninformed investors worrying about being on the wrong side of a trade in a selective disclosure situation may be small. As insider trading literature has developed, any loss results from the new information itself or the change in the information set.[36] Selective disclosure simply accelerates the time in which

32. *Id*. at 26.
33. *Id*.
34. *Id*. at 35.
35. *Id*. at 56 n.138. *See also* Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990) (striking down a SEC rule that went beyond disclosure to regulate the distribution of power among the various players in corporate governance).
36. *See* David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U.L. REV. 1449, 1452-54 (1989). *See also* HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 110 (1966) (claiming that trades based on significant inside information are rare).

traders realize that loss.[37] For a typical uninformed trader to reduce what they would initially pay for the stock, he or she would have to expect to lose money in trades with selectively informed analysts, but not expect to lose a similar amount in trading with more generally informed analysts after the information ultimately comes out.[38] Uninformed traders are not likely to be at the front of the que, in any event. Market makers, however, face the possibility of increased trading losses due to the presence of traders with an information advantage stemming from selective disclosure. To that extent, market makers will increase their bid-ask spread to compensate for these losses.[39] This will produce an adverse third-party effect if company management did not take this into account.

David Haddock and Jonathan Macey suggest that prohibition of insider trading increases the return of market professionals at the expense of insiders.[40] Insider trading regulation could be seen as preferring the first group over the second. For selective disclosure, the impact of the Regulation becomes a bit more nuanced and less visible. The ban helps market makers and larger market participants, who are likely to be early traders on information on a regular basis, rather than a smaller subset of analysts whose regular trading has helped make a deeper and more accurate market for a stock.

Another third party effect would occur if company management cared less about accurate pricing for its stock than society and the business community as a whole. Part of the impetus for Regulation FD was a fear that companies were misusing the central role given them in the prior information structure to control analysts.[41] Because companies could choose to whom they selectively disclosed, they would ignore analysts whose reports did not reflect a rosy view of the company's future.[42] Analysts, who wanted to maintain the flow of information that would enable them to achieve above-

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37. *See* Michael P. Dooley, *Comment From an Enforcement Perspective*, 50 CASE W. RES. L. REV. 319, 321 (1999) ("Insiders are incidental participants in a zero-sum game between outsiders that would go on without them.").

38. For analysis of Rule 10b-5's effects on various types of traders, see generally William K.S. Wang, *Trading on Material Nonpublic Information in Impersonal Securities Markets: Who is Harmed and Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL L. REV. 1217 (1981).

39. *See* G.J. BENSTON & R.L. HAGERMAN, BID-ASK SPREADS IN THE OTC MARKET (1974) (reporting a positive correlation between breadth of bid-ask spread and companies with greater unsystematic risk where chances of trading with a better informed insider would be greater).

40. David D. Haddock & Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, With an Application to Insider Trading Regulation*, 30 J.L. & ECON. 311, 327-30 (1987).

41. *See* Final Release, 65 Fed. Reg. 51,715, 51,716-17 (Aug. 15, 2000) (codified at 17 C.F.R. pts. 240, 243, 249).

42. *Id.*

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average returns, would avoid harsh criticism of existing management to curry the necessary favor to keep the preferred channel open.[43] While managers may want to avoid negative analysts' reports, they do seem to care about negative earnings surprises that occur when actual earnings disappoint the market. In the years leading up to Regulation FD, analysts' estimates appeared to be getting more accurate in predicting company earnings.[44] Negative earnings surprises decreased as a share of all variances from expected earnings, a result that probably occurred because companies guided analysts to avoid surprises.[45] Such a surprise is more likely to put a manager's job at risk, creating an individual incentive to disseminate information, but the information itself still benefits investors.[46] If this fear of negative earnings surprises operates to discipline management's channeling of selective disclosure, finding third party effects in selective disclosure may require developing a larger story about managers' ability to massage or manipulate earnings while still avoiding earnings surprises.

III. REGULATION FD'S EFFECT ON THE SUPPLY OF INFORMATION

Regulation FD shuts off one long-standing source of information entering the market place. In its initial proposal, the SEC emphasized full as well as fair disclosure.[47] In its final promulgating release, the SEC expressed repeated concern about "chilling" the supply of information available to the marketplace.[48] Several antidotes seem possible to any reduction in the supply of information that might be caused by the selective disclosure ban in the Regulation: Issuers may pick up the slack and disclose the same information to the market; analysts may work harder or other private users of information may increase their efforts to obtain information about a company. We explore these antidotes and discuss whether there are reliability concerns apart from the volume of information.

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43. *Id*. at 51,717.

44. Rosen, *supra* note 27, at 1.

45. *Id*. at 1, 6 (noting that companies roughly split in exceeding or falling below consensus earnings predictions of analysts). After 1993, negative surprises decreased to twenty percent of the total, while positive surprises accounted for more than sixty percent. *See id.*

46. Rosen, *supra* note 27, at 1, 6.

47. Proposing Release, 64 Fed. Reg. 72,590, 72,591 (proposed Dec. 20, 1999) (codified at 17 C.F.R. pts. 240, 243, 249).

48. Final Release, 65 Fed. Reg. at 51,718-19.

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A. Companies' Ability to Provide Information Previously Given Via Selective Disclosure

The Regulation does not prevent companies from publicly disclosing the information previously given to analysts. Indeed, the SEC hopes and anticipates an increase in public disclosure.[49] The final release estimates that there will be an additional 65,000 8-K filings per year, an average of five for each registered company.[50] Press releases and other means of satisfying the Regulation's mandate to prevent selective disclosures will likewise increase the amount of publicly available information compared to that available under the prior practice.

Perhaps the most visible evidence of increase in a company's public disclosure of information is the greater incidence of open conference calls—companies making use of modern telecommunications technology to open up analysts' meetings with top managers previously limited to a select few.[51] A National Investor Relations Institute (NIRI) survey of issuer practices reported a noticeable trend in this direction, even before the promulgation of Regulation FD,[52] and published reports over the last year suggest this trend has become very common. A post-FD NIRI survey indicated that about a quarter of companies provide more information to analysts and investors since FD went into effect, about one quarter provide less information, and about half said they provide the same amount of information.[53]

Companies continue to have the same economic incentives to ensure the release of sufficient accurate information about their company for the reasons stated in Part II of this Article. Thus, even if companies might prefer selective disclosure, once that channel is closed off, they still retain an incentive to release information through other channels, such as public filings or open conference calls. Disclosing positive news can lead to higher prices; disclosing negative news can avoid negative earning surprises that might adversely affect the company's stock. The SEC recounted one

49. *Id.* at 51,733.

50. *Id.* at 51,731-32.

51. *See* Jeff D. Opdyke & Emily Nelson, *Conference-Call Crunch: New SEC Rule Turn Analysts' Rite Into a Hectic Affair*, WALL ST. J., Oct. 31, 2000, at C1.

52. National Investor Relations Institute, A Study of Corporate Disclosure Practices 7-8 (May 1998).

53. National Investor Relations Institute, Corporate Disclosure Practices Survey (Feb. 26, 2001) (on file with author). *See also* 33 Sec. Reg. & L. Rep. (BNA) 335 (Mar. 5, 2001) (quoting NIRI CEO as stating, "Our survey suggests, however, that Regulation FD is largely working as the SEC envisioned to provide more equal access to information"). Until more specific data becomes available, it will be difficult to draw any detailed conclusions about the regulation's impact on the overall information set.

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commentator's observation that the marketplace simply would not allow issuers to cease communications with analysts and security holders.[54]

Are there reasons to think that companies will fall short of the amount of disclosure that characterized pre-FD, even if they do not "cease" communications? Certainly around the time the SEC adopted the Regulation and when it became effective, there were stories of companies who canceled meetings with analysts and reduced the amount of disclosed information.[55] What might explain less disclosure after the selective disclosure ban?

1. No Required Disclosure

As the SEC notes, the federal securities laws do not require disclosure of all material information.[56] Much of the information that a company previously disclosed selectively to analysts, and which a company is now considering whether to disclose, will not have to be immediately released. This is not to say that at some point in the future, the company may have to disclose the information in a quarterly or annual report or a proxy solicitation; but, for the moment, mandatory disclosure does not replace the function previously performed by selective disclosure.

2. Information Withheld for Fear of Liability

Regulation FD forbids selective disclosure, but the SEC made clear that noncompliance does not give rise to private liability for damages.[57] But even with that caveat, the Regulation states a prohibition on conduct that can bring SEC action and public opprobrium.[58] Thus, we can expect managers to pay more attention to what the Regulation prohibits managers from saying and not as much to what the silence of the Regulation may permit them to

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54. Final Release, 65 Fed. Reg. at 51,718.

55. *Mum's the Word in the Wake of Disclosure Rule*, WALL ST. J., Aug. 16, 2000, at C1 ("Some corporate managers are evading queries, even about topics they would have discussed in the past, fearful that answers might cross into forbidden territory."); Phyllis Plitch, *SEC Rules Prompt Merrill to Limit Analysts Access to Executives*, DOW JONES NEWSWIRES, Oct. 24, 2000 (reporting Merrill Lynch policy restricting analysts' access to insiders and quoting a Merrill Lynch corporate secretary, "In the real world, many more companies will put a muzzle on most of the employee population").

56. Final Release, 65 Fed. Reg. at 51,731-32.

57. Final Release, 65 Fed. Reg. at 51,718. *But see* Michael G. Lange & Chauncey D. Steele IV, The Probable Effects of Regulation FD on Private Securities Litigation 5-6 (Mar. 9, 2001) (unpublished manuscript, on file with author). ("[J]ust because the SEC says that a Reg[ulation] FD violation will not be "deemed" a violation . . . does not make it so. Courts ultimately determine the scope of § 10(b) liability, not the agency.").

58. *See* Proposing Release, 64 Fed. Reg. 72,590, 72,591 (proposed Dec. 20, 1999) (codified at 17 C.F.R. pts. 240, 243, 249) ("If an issuer fails to comply with Regulation FD however, it will be subject to an SEC enforcement action.").

affirmatively take the initiative to communicate. It does not seem surprising to expect that the net result will be less information, not more. The disclosure contemplated by the rule, moreover, does bring a new set of costs inherent in filing an 8-K or otherwise making sufficient public disclosure,[59] a cost that can lead managers to err on the side of being silent.

The impact on individual managers may differ from the impact on the company, an asymmetry that may contribute to nondisclosure. Saying something to analysts that you should not have said creates consequences that may be visited directly on an individual manager for failing to meet federal regulations.[60] The benefit of that same statement would accrue to the company with less benefit to an individual manager. Thus, individual managers' cost-benefit analysis would encourage less communication.

3. Information for Which Disclosure Destroys its Value

Certain information cannot be revealed without also revealing a company's proprietary information, a process that would adversely affect the company. Some information that is positive to a company cannot be revealed without destroying some or all of its benefit to the company, in part by exposing it to competitors who can use that information for their own benefits.[61] Companies face difficult choices in choosing between credible disclosure or destroying the value of the information.[62] Companies previously invested in a network of company-analyst relationships in which the companies had the primary incentive for developing a reputation of reliability over time. In such a setting, companies could effectively communicate the effect of the information without exposing it to misuse by competitors. In the alternative system, where the legal rules give analysts the greater incentive to develop reputation and certification abilities, information will be less able to be passed to the market without destroying much of its value.

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59. *See* Final Release, 65 Fed. Reg. at 51,732 (estimating that Regulation FD would cost issuers, on average, five additional burden hours for each Form 8-K filing).

60. *See* 17 C.F.R. § 243.100(a) (2001) (including "any person acting on [the issuer's] behalf"); 17 C.F.R. § 230.405(c) (2001) (defining the term "person acting on behalf of an issuer").

61. Daniel R. Fischel, *Insider Trading and Investment Analysts: An Economic Analysis of* Dirks v. Securities and Exchange Commission, 13 HOFSTRA L. REV. 127, 142 (1984).

62. For example, in *SEC v. Texas Gulf Sulphur Co.*, disclosure would have interfered with the company's acquisition of property. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (holding that purchasing stock without disclosing information about the company's ore strike was a violation of Rule 10b-5).

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4. *Information That Cannot Be Easily Interpreted*

The market easily misinterprets information of a specialized nature or information that requires connection to other information not readily available in order to fully understand its significance. A company's call to a knowledgeable analyst has sometimes pointed professionally informed traders in the correct direction.[63] The 1998 NIRI study revealing an increase in webcast conference calls and a decline in individual calls to analysts supports such a use, showing the individual calls that remained often follow the press release.[64]

B. Analysts Working Harder

Even if companies reduce the amount of information they make available after Regulation FD, the total amount of information available to investors will not decline if analysts change what they do or if private investors otherwise seek out and obtain additional information. Given the same economic incentives discussed in the Part II of this paper, analysts can make money via trading when they discover information not yet incorporated into the price of a security. Indeed, if companies generally provide less information, the potential for gains from searching for information may well increase. However, the actual return on such information may be harder to predict. Analysts must now work harder to discover information previously obtained directly from the issuer. As a result, analysts' costs will increase without a corresponding increase in benefit. This disparity became visible in the early days of Regulation FD, where webcast conference calls became more hectic and time-consuming for analysts, containing much noise that analysts do not find particularly relevant, and providing less opportunity to pursue a line of inquiry that would truly interest the analysts.[65] If returns do not change and costs go up, the expectation is that analysts will redirect their

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63. *See* Opdyke, *supra* note 28, at C1, C21.

> Because most forest companies operate in a variety of separate wood, paper and pulp segments . . . . [leading to] low predictability of earnings, companies . . . historically have tried "to help analysts understand the inputs they use in their models" . . . . [the analyst] would methodically walk through the critical suppositions, gauging the executives' comfort with his numbers. At the end of the exercise, "you've narrowed in on a tight [earnings] range" . . . . He would check in frequently "for little updates to find out how things are going, where any changes are taking place, so we have a continuous picture of what to expect."

64. National Investor Relations Institute, *supra* note 52, at 7, 27.

65. Jeff D. Opdyke & Emily Nelson, *Conference-Call Crunch: New SEC Rule Turn Analysts' Rite Into a Hectic Affair*, WALL ST. J., Oct. 31, 2000, at C1 (describing analysts' difficulties with overlapping conference calls that are lengthier and require analysts to listen to more questions that are not directly relevant to their analysis).

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resources to follow fewer stocks; it is likely that smaller stocks will bear the brunt of the decrease and will end up with less liquidity.[66]

The SEC has paid considerable attention to the distorting effect on analysts' buy-sell recommendations because of their need to curry favor with company's insiders who have the ability to disperse wealth via selective disclosure.[67] Freed of this distortion, the expectation is that analysts will be more honest in their evaluation, providing tough and honest criticisms of managers.[68] Buy recommendations have traditionally been the overwhelming majority of analysts buy-sell recommendations, with one recent study showing that sell recommendations comprised only two percent of the total.[69] To the extent that the need to curry favor is removed, the SEC would expect the number of sell recommendations to increase.[70] The difficulty is figuring out whether there are confounding variables that may explain this result. Many analysts have long had conflicting incentives due to their employment at firms that have large investment banking businesses that depend on the decisions of some of the same executives to whom it was previously necessary to curry favor to gain selective disclosure.[71] This pressure has not disappeared. There are also cognitive reasons why the buy recommendations outweigh the sell recommendations and those, too, will continue.

C. Reliability of Information

Even if the incentives discussed above operate to ensure that the amount of information produced by companies or analysts together is as much as was produced before Regulation FD, the total impact on the market would not be beneficial if the information in the new system is less reliable than before. A loss in reliability could result in several places after Regulation FD.

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66. Final Release, 65 Fed. Reg. 51,715, 51,732-33 (Aug. 15, 2000) (codified at 17 C.F.R. pts. 240, 243, 249).

67. *Id.* at 51,716-17.

68. *Id.*

69. Robert McGough, *Call It Courage: Bold Analysts Buck the Trend on Sell Ratings*, WALL ST. J., Jan. 2, 2001, at C1 (reporting that only 2.1% of all analysts recommendations tracked by Thomson Financial/IBES in mid-December 2000 were classified as "sell" or "underperform" in contrast to 31.2% "strong buys" and 39.6% "buys"). *See also* Gretchen Morgenson, *How Did So Many Get It So Wrong*, N.Y. TIMES, Dec. 31, 2000, at C1 (reporting that, of 8000 analysts' recommendations covering companies in the S & P 500 Index, only 29 are "sells," less than one-half of one percent).

70. Final Release, 65 Fed. Reg. at 51,731 ("[I]t will allow analysts to express their honest opinions without fear of being denied access to valuable corporate information being provided to their competitors.").

71. Hsiou-wei Lin & Maureen F. McNichols, *Underwriting Relationships, Analysts Earnings Forecasts and Investment Recommendations*, 25 J. ACCT. & ECON. 101127, 101127 (1998) (reporting data indicating that lead and co-underwriter analysts' growth forecasts and recommendations are significantly more favorable than those made by unaffiliated analysts).

For much firm-specific information, the company will be the best and cheapest source of information. To the extent that the company is not able to pass on information that it did prior to Regulation FD, there will be additional costs and greater uncertainty in getting the information to the market as well as a greater likelihood of overproduction of information.[72]

Even if the company conveys information to others, reliability can decrease if the recipient is less able to interact with the speaker and thus judge the sensitivity of the message. An analyst sitting across a table or having an opportunity to talk with a company representative will receive a different message than one who is only one of hundreds or more in a conference call transmitted via the Internet.

The relationship between companies and analysts is a repeat play game in which the crucial point of intersection is not discrete, easily digestible information, but a complex, ongoing relationship in which getting an accurate picture of today's new information requires prior investment in reputations and credibility.[73] Under the pre-FD approach, companies had the primary incentives to develop an information system with the analyst. Because companies controlled the selective information, they could decide which analysts received it. As the SEC release identified, this control gave companies the opportunity to emphasize nonefficiency reasons for distributing the information.[74] Nevertheless, companies also had the greatest incentive to release information in a way that maximized firm income.[75]

By forbidding selective disclosure, the SEC encourages development of an alternative system in which analysts have the greater incentive to develop reputations about information not contained in mandatory disclosure documents. What is the basis for assuming that analysts will do better than issuers? A recent paper by Zohar Goshen and Gideon Parchomovskey makes a broader claim that analysts can outperform insiders in providing efficiency and liquidity to the market.[76] They argue analysts have an advantage as to firm-specific information as well as general market information.[77] Relying on this argument, Goshen and Parchomovskey note the positive externalities

72. Robert McGough & Cassell Bryan-Low, *Analysts' Earnings Estimates are Diverging, and SEC Disclosure May Be the Reason*, WALL ST. J., Nov. 2, 2000, at C2 (reporting BulldogResearch study that analysts' estimates for the third quarter of 2000 became more dispersed than in the second quarter).

73. *Id.*

74. Final Release, 65 Fed. Reg. at 51,716-17.

75. *Id.*

76. Zohar Goshen & Gideon Parchomovsky, *On Insider Trading, Markets and 'Negative' Property Rights in Information*, 87 VA. L. REV. (forthcoming 2001).

77. *Id*. at 28-30.

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that result from creating an information market that would accompany a greater dependence on analysts in our information system.[78]

IV. Reasons For Regulation FD Beyond Its Impact on the Amount of Available Information

The SEC's argument for a ban on selectively disclosed information does not depend on avoiding any decrease in the amount of available information. Even if an adverse effect on information were conceded, the SEC rests the Regulation on: (1) possible adverse economic consequences that may accrue even with more information and (2) on societal harms from selective disclosure that may not be measured in economic terms.[79]

A. Economic Harm

The economic costs that the new Regulation would remove or reduce, even if the selective disclosure ban produces less overall information, draw on well-developed arguments in the long-running debate over regulation of insider trading.[80] In efficiency terms, it is an adverse selection problem. Investors may be reluctant to trade with those who know more than they do. "We agree with the common sense view—expressed by both the Supreme Court and the Congress—that investors will lose confidence in a market they believe is unfairly rigged against them."[81] Either investors will leave the market, which will decrease liquidity, or they will require a greater return to take the risk of dealing with those who have superior information. For example, market makers might increase the bid-ask spread, or there may be an increase in volatility and, perhaps, the costs of capital. To the extent that management internalizes these costs,[82] any economic impact may be negated.

These arguments about selective disclosure are the same as those traditionally made as to insider trading. As with insider trading, it is difficult to measure when someone has left the market. Overall, the U.S. securities markets continue to experience widespread investor confidence.[83]

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78. *Id.*

79. *See* Final Release, 65 Fed. Reg. at 51,716.

80. *Compare, e.g.*, Dennis W. Carlton & Daniel R. Fisckel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983), *with* James D. Cox, *Insider Trading and Contracting: A Critical Response to the "Chicago Schools,"* 1986 DUKE L.J. 628.

81. Final Release, 65 Fed. Reg. at 51,731.

82. For ways in which management can internalize the costs, see *supra* note 33 and accompanying text.

83. *See, e.g.*, Stephen M. Bainbridge, *Insider Trading*, *in* 3 ENCYCLOPEDIA OF LAW AND ECONOMICS 786 (Boudewijn Bouckaert & Gerrit DeGeest eds., 1998) (noting that stock market

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B. Evil

The argument against selective disclosure is not confined to economic terms. In fact, the noneconomic aspects may dominate the argument. Certainly, the language of the proposals suggests the fairness arguments that provided the basis for the SEC's early action against insider trading. Former SEC Chairman Arthur Levitt termed selective disclosure "a stain" on our market,[84] and former SEC general counsel Harvey Goldschmid presented selective disclosure as "an evil."[85] Those phrasings of the problem hearken back to the early days in the development of federal insider trading law, when the focus was on broad principles of fairness. Such comments also seem to have more in common with Justice Harry Blackmun's dissent in *Dirks* than with the Supreme Court's majority opinion in that case—the most notable legal source prior to Regulation FD in framing the discussion about analysts' conduct. In *Dirks*, the Court overturned an insider-trading claim against analyst Raymond Dirks using laudatory language about the importance of the analyst's role.[86] Justice Blackmun dissented and specifically rejected the Court's justification that the benefit to shareholders exceeded the harm.[87] In Blackmun's view, the benefit to society as a whole from additional information did not justify losses to individual shareholders.[88] Blackmun suggested an analyst's role in exposing fraud but trading on that information was analogous to misprision of a felony and emphasized the analyst's ethical obligation to report the information, but not to make any profit.[89] The majority opinion on the other hand, acknowledged the beneficial effect on information provided by the analyst,[90] and defined fraud as the breach of a fiduciary duty of a particular person, not the effect of

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performance after highly publicized insider trading scandals undercuts the market integrity argument).

84. Arthur Levitt, Speech Before the Economic Club of New York, Oct. 19, 1999, *at* http://www.sec.gov/news/sppech/speecharchives/1999/spch304.htm (last visited Apr. 13, 2001).

85. Goldschmid, *supra* note 8, at 38.

86. *Id*. at 658-59 (describing market analysts as "necessary to the preservation of a healthy market").

87. 463 U.S. at 677 (Blackmun, J., dissenting) (characterizing the majority's rationale by paraphrasing "in other words, [because] the end justifies the means").

88. *Id*. Dirks, an analyst, was approached by Secrist, an insider who knew that a firm's current management was engaged in fraud. *Id*. at 649. Dirks investigated the fraud allegations and shared his conclusions with clients and friends. *Id.* Eventually, Dirks' investigation prompted California state authorities to investigate the fraud. *Id*. However, many of the company's stockholders lost money when the company's stock price fell. *Id.*

89. *Id*. at 677-78.

90. *Id.* at 658 n.18 ("[U]ntil the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' effort, the fraud might well have gone undetected longer.") (citation omitted).

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harm to a trader from an imbalance in information.[91] The SEC's final release emphasized the effect on shareholders,[92] as opposed to the wrongful actions of a defendant in breach of a fiduciary duty, in the same way as the pre-*Chiarella* federal courts[93] and Justice Blackmun's dissent in *Dirks* emphasized the effect on shareholders.[94]

Insider trading law has moved back in the direction of its early roots and the focus there on fairness.[95] In *United States v. O'Hagan*,[96] the Supreme Court accepted a broad reading of duty that would extend the reach of insider trading obligations.[97] The SEC, in promulgating Regulation FD based on fairness principles, fits within this developing trend.

C. Is Selective Disclosure the Same as Insider Trading?

The SEC places Regulation FD squarely within the space of the long-standing debate about insider trading. The final release's explanation for the need for the regulation begins with an explicit tie to insider trading and the loss of investor confidence.[98]

Given the strong link to insider trading, and to parts of the history of the insider trading debate, it is worth examining the closeness of the connection. Think about the universe of all relevant information not known to the market and ask: what subset of the group possessing such information could trade without incurring insider trading liability? Classic insider trading doctrine blocks trading by officers and others who have a fiduciary duty to the company, for whose shares the information is material.[99] Legal theory in the

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91. *Id.* at 657 ("Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading . . . .").

92. Final Release, 65 Fed. Reg. at 51,716 (noting that analysts and "market insiders" made money from selectively disclosed information at the expense of shareholders "kept in the dark.").

93. *See, e.g.*, Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

94. *See Dirks*, 461 U.S. at 674 (Blackmun, J., dissenting) ("It makes no difference to the shareholder whether the corporate insider gained or intended to gain personally from the transaction; the shareholder still has lost because of the insider's misuse of nonpublic information.").

95. *See* Stephen Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1648 (1999) (characterizing *O'Hagan* as an "arguable revival of the long-discredited equal access theory of liability"). *See generally* Elliott J. Weiss, United States v. O'Hagan*: Pragmatism Returns to the Law of Insider Trading*, 23 J. CORP. L. 395 (1998).

96. 521 U.S. 642 (1997).

97. *Id.* at 661-66.

98. Final Release, 65 Fed. Reg. 51,715, 51,716 (Aug. 15, 2000) (codified at 17 C.F.R. pts. 240, 243, 249) (quoting United States v. O'Hagan, 521 U.S. 642, 658 (1997)).

99. *See O'Hagan*, 521 U.S. at 660-61 (describing the *Chiarella* case). *See also Texas Gulf Sulphur Co.*, 401 F.2d at 848.

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1970s and 1980s extended that duty in two ways to individuals who received information from such insiders. If the information was given wrongfully or "tipped"—as measured by a personal benefit received by the tipper—and the tippee knew the transfer was wrongful, the recipient inherited the insider's duty not to trade.[100] Alternatively, if the information was conveyed rightfully with the expectation that it would be kept confidential, as when a corporation brings a lawyer or investment banker into its confidence in order to do a deal, then there, too, the recipient inherits the duty not to trade.[101] In 1997, *O'Hagan* confirmed the extension of duty to include a fourth group: recipients who gain the information not from the insider under the circumstances just described, but in breach of a fiduciary relationship owed to someone other than the corporation whose shares were being traded.[102] That same case upheld the extension of liability to a fifth group under Rule 14e-3: anyone who receives material information in connection with a tender offer.[103]

The *Dirks* case, like *Chiarella* decided by the court three years before, explicitly rejected the lower court reasoning that had framed insider trading and disclosure theory as focusing on equality of information and the effect on investors.[104] The Supreme Court rejected drawing the line based on mere possession of information and required some wrongful conduct.[105] An analyst like Dirks, who got information from an insider without an expectation of confidence–or by breach of an insider's duty—would be among those who are free to trade.[106] This rests both on the absence of a wrongful purpose by the insider and also on the positive role analysts play in providing useful information to the market.[107]

Regulation FD does not seek to impose liability on analysts.[108] Those who engage in selective disclosure could face SEC action, but not private liability for damages.[109] Yet, the effect of Regulation FD is to redraw the line regarding what transfers of information are permissible. There is now a sixth category of recipients of information that the government frowns upon: any

100. *Dirks*, 463 U.S. at 660.
101. *Id.* at 655 n.14.
102. *O'Hagan*, 521 U.S. at 653, 659.
103. *Id*. at 675.
104. *See Dirks*, 463 U.S. at 657-58; Chiarella v. United States, 445 U.S. 222, 233 (1980).
105. *See Dirks*, 463 U.S. at 663-64.
106. *Id*. at 661-63.
107. *Id*. at 658-59, 662-64.
108. *See* 17 C.F.R. § 243.100(a) (2000) (imposing liability only on issuers or persons acting on behalf of an issuer); 17 C.F.R. § 243.101(c) (2000) (defining "person acting on behalf of an issuer").
109. Regulation FD, 17 C.F.R. § 243.102 (2000) ("No failure to make a public disclosure required solely by § 243.100 shall be deemed to be a violation of rule 10b-5 . . . .").

transfer of information from an insider to an analyst –even if no improper personal benefit is going to the tipper and, and even if no expectations of confidentiality exist for the recipient.[110] The *Dirks* Court did not want to include this category.[111] Within the space provided by *O'Hagan*, and in the guise of not establishing a liability rule, the SEC has reversed the legal consequences of the analyst's conduct discussed in *Dirks*.

The "evil" and "stain" element of selective disclosure to analysts is exemplified by Goldschmid's example of a CEO picking up the phone to tell two or three favored analysts: "The stock will be down badly next week" followed by trading by the favored analysts and their favored clients.[112] To come within existing insider trading liability, the SEC would have to prove that the CEO received a personal benefit or that the information was communicated for a confidential purpose to make the recipient a temporary insider.[113] The most egregious possibility is that the insider receives some disguised personal benefit, but it cannot be proven. In that sense, Regulation FD would be a way to penalize action long considered within the law's intended scope.[114] But that does not seem to be the principal focus of the Regulation. The CEO may have picked the particular analyst for company purposes, such as to create a sense of beholdenness so that their reports would be favorable to the company.[115] What Regulation FD does, then, is to insure that insiders, in the process of looking out for the company, do not create negative externalities for society by reducing the amount of negative information about their company.[116]

Of course, Regulation FD reaches further than these exact situations. It also precludes conversations such as those where the information cannot be revealed to the market credibly or where the analyst's specific knowledge would be helpful to shareholders as a group. The universe of company contact with analysts is difficult to separate between those that have an appearance of evil and those that are benign or even helpful. Even conduct at the worst end of this spectrum does not involve the personal gain that has

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110. *See* 17 C.F.R. § 243.100(a); Final Release, 65 Fed. Reg. at 51,716.

111. *Dirks*, 463 U.S. at 658-59, 662-64.

112. Goldschmid, *supra* note 8, at 38.

113. The SEC notes that it brought and settled one action on this theory. *See* Final Release, 65 Fed. Reg. at 51,716 n.7.

114. *See, e.g.*, *Dirks*, 463 U.S. at 663-64 (noting that an insider has an illegal intent to defraud and deceive shareholders when the insider receives some "pecuniary gain or reputational benefit" in exchange for inside information).

115. Final Release, 65 Fed. Reg. at 51,716-17.

116. *See* Final Release, 65 Fed. Reg. at 51,716-17 (noting that issuers sometimes place subtle pressures on analysts to report favorably).

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long been core to insider trading.[117]

Regulation FD is based on the widely shared view that the perception of fairness is an important foundation underlying the strength of American securities markets. It illustrates the expressive function of law. But arguments based on fairness bring their own set of challenges. Why are some informational advantages permitted but not others? As Professor Kim Krawiec has observed, "[I]nvestors are likely to feel that such transactions are unfair regardless of whether the unshared information was acquired through breach of a fiduciary duty, through theft, from a disclosure made to analysts in a closed session, or from information that, while public in theory, is simply beyond the reach of the average investor."[118] A rule based on unfairness is particularly difficult in a transnational setting, where notions of fairness vary across cultures. Regulation FD itself excludes foreign issuers, so that even within the same market of American investors, Regulation FD's broader definition of fairness is limited to domestic issuers only.[119] Fairness might help communicate the SEC's brand name as a protector of investors, but will not necessarily improve the overall benefit to investors if it sparks a backlash of less cooperation by those who resent an overbroad characterization of their conduct as evil.[120]

There are other areas where we continue to permit trading with an information advantage, for example, where underwriters enter the market after an initial public offering to "stabilize" the price.[121] Regularly the SEC and the courts have to trade fairness for efficiency, and favor benefits in the market for corporate control versus benefits in the market for shares. If Regulation FD were based on empirical evidence that the pejorative selective disclosure exceeded the helpful selective disclosure, the weight of evidence may well be in favor of the regulation's need. The fairness argument in the absence of such evidence, however, seems to reflect simply a sense of fairness that could support limits on any encroachment on equality of information.

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117. *See Dirks*, 463 U.S. at 663-64 (describing the illegality of revealing inside information for personal gain).

118. Kimberly D. Krawiec, *Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U.L. REV. 443, 479 (2001).

119. 17 C.F.R. § 101(b) (2000).

120. *See* Donald C. Langevoort, *The SEC's Pursuit of Managerial Accountability: A Study of Law and Strategic Behavior*, 79 WASH. U. L.Q. 449 (2001).

121. *See* Regulation M, 17 C.F.R. § 242.104 (2000). Another example is warehousing in connection with a tender offer which Rule 14e-3 would prohibit. In *O'Hagan*, the Supreme Court stated that "we leave for another day . . . the legitimacy of Rule 14e-3(a) as applied to warehousing." *O'Hagan*, 521 U.S. at 672 n.17.

V. CONCLUSION

Information about a company comes to the market in a variety of ways, including both the company itself and analysts. Regulation FD, debated against a backdrop of full and fair disclosure, prefers the latter to the former. The impact on full disclosure is uncertain, but more likely than not the new regime will mean somewhat less disclosure. Reasons outside of efficiency can tip the balance in favor of a ban. But by drawing a tight analogy to insider trading, the SEC has taken the last forty years of legal doctrine and stretched it to a factual circumstance that is less pejorative than any of the prior uses.

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