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**SEC ADOPTS NEW RULES ON
SELECTIVE DISCLOSURE AND INSIDER TRADING**

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On August 10, 2000, the Securities and Exchange Commission adopted new rules addressing the disclosure and use of material, non-public corporate information and insider trading. [Regulation FD, Rule 10b5-1, and Rule 10b5-2]. These rules could have a significant impact on the manner in which corporations and corporate representatives disclose and securities analysts and investors obtain and use corporate information. Corporate executives need to be mindful of the new regulations both (a) when discussing company affairs with analysts and institutional shareholders, as well as with other persons whom the SEC deems to have a confidential relationship with the company or the executive and (b) when making personal investment decisions. The new rules also require the company to address questions regarding what information is in fact material and non-public in a new context.

1. Regulation FD

A. What does the regulation provide?

Generally, Regulation FD (FD stands for “fair disclosure”) prohibits issuers of securities or their representatives from disclosing material, nonpublic information to analysts and certain other categories of persons before disclosing the same information to the general public. The SEC has termed this practice “selective disclosure” and has long considered it improper. Selective disclosure prohibited under Regulation FD now triggers a duty to disclose publicly any material information selectively disclosed. Regulation FD also subjects the violators to enforcement remedies.

Regulation FD does not, however, prohibit all selective disclosures of material, non-public information. Rather, the SEC limited the impact of Regulation FD in three important ways:

1. Whether Regulation FD applies to a selective disclosure depends on who makes the disclosure. The regulation applies to disclosures made by the issuer itself and senior officials of the issuer. The Regulation also applies to those who regularly communicate with securities market professionals and/or

securities holders on the issuer's behalf. Disclosures made by lower-level employees, or those who are not designated to speak on the issuer's behalf, are not covered by Regulation FD and thus do not trigger Regulation FD's public disclosure obligations.

2. Regulation FD's applicability also depends on the identity of the recipient of a selective disclosure. The Regulation applies only to disclosures made to securities market professionals, such as analysts, institutional investors and broker-dealers, and to owners of the issuer's securities who might trade on the basis of the information. The Regulation was not intended to reach communications in the ordinary course of the company's business, e.g., to suppliers. According to the SEC release announcing the Regulation's adoption, it does not apply to disclosures to representatives of the news media. Issuers may continue to selectively disclose information in confidence to attorneys, accountants, or investment bankers, or to anyone who expressly agrees to maintain the information in confidence. Selective disclosures to credit rating agencies are also exempt, so long as the disclosure is made for the purpose of developing a credit rating and the issuer's credit ratings are publicly available.

3. Regulation FD does not apply to disclosures made in connection with most offerings registered under the Securities Act of 1933.

B. When must the public disclosure triggered under Regulation FD be made?

Regulation FD requires simultaneous disclosure of material information to analysts or institutional shareholders and the public alike. The Regulation permits a brief period for corrective public disclosure when the issuer's selective disclosure was unintentional. A selective disclosure is intentional when the person making the disclosure knows, or is reckless in not knowing, that the information communicated is both material and nonpublic. A disclosure is unintentional when the person making the disclosure has no reason to know that the information is material or nonpublic. The definition of "material" is discussed briefly in Section F below.

When an issuer unintentionally makes a selective disclosure to a person covered by Regulation FD - an analyst, for example - it must publicly disclose the information as soon as possible, but in no event later than 24 hours or the beginning of the next day's trading, whichever is later. There is no safe harbor corrective period for intentional selective disclosure. However, immediate corrective action may help prevent an enforcement proceeding or lessen the penalty.

C. What constitutes public disclosure for Regulation FD purposes?

Regulation FD gives issuers two options for publicly disclosing information. First, an issuer can satisfy its disclosure obligation by filing a Form 8-K (a form used to report

extraordinary corporate events to investors) with the SEC. If the issuer chooses not to file a Form 8-K, it may disclose the information by any means reasonably designed to provide broad, non-exclusionary distribution of the information to the public.

Apart from an 8-K, Regulation FD does not specifically identify any method of disclosure that will automatically constitute “public” disclosure. Press releases, public conference calls or press conferences will probably constitute public disclosure. Merely posting information on the corporation’s website, however, will not.

Issuers are free to use any combination of disclosure methods, and using a variety of acceptable methods is probably the best practice.

D. What is the penalty for violating Regulation FD?

Failure to make a public disclosure required by Regulation FD is not deemed a violation of the anti-fraud provisions of the federal securities laws. Thus, a violation of Regulation FD cannot of and by itself be the subject of a shareholder lawsuit. The Commission retains full authority to police Regulation FD, and violations can lead to substantial fines, cease and desist orders or injunctions against the issuer. Moreover, if a selective disclosure meets the elements of traditional insider trading prohibitions against “tipping” (i.e., if the person making the disclosure expects to receive personal benefit from making the disclosure), the person making the disclosure can be subject to liability for insider trading under the antifraud rules.

E. Complying with Regulation FD.

Most of the principles underlying Regulation FD are long established. What is new is the SEC’s emphasis on policing selective disclosure, and Regulation FD’s provisions facilitate that enforcement effort. Issuers will no longer have the same latitude in their discussions with analysts and institutional shareholders as before.

Issuers can ensure compliance with Regulation FD by making a practice of simultaneously publicly disclosing, in the manner required by the Regulation, all material information they communicate with market professionals or securities holders who might trade on the basis of the information. Compliance can be achieved by permitting public access to conference calls with analysts or preparing press releases that carefully track disclosures scripted for analysts and that are published simultaneously with the call. Such programmed disclosure, however, is not always practical or possible, especially in one-on-one communications with analysts and shareholders.

Furthermore, Regulation FD requires judgment calls regarding what is “material.” Close monitoring and coordination regarding what has been previously disclosed both in public SEC filings and press releases, is also essential in determining what is new information that must be publicly disclosed. In the future, issuers must be very careful in communicating with the persons covered by Regulation FD. Issuers should not address or comment on matters beyond the scope of prior public disclosures unless they are willing to

make simultaneous disclosure of such new or expanded information to the general public. While it is permissible in discussions with analysts to add detail consistent with what has already been disclosed in public SEC filings, an issuer must take care not to cast its existing public disclosures in a significantly different light if simultaneous public disclosure is not possible.

It is also now more important than ever to concentrate the authority to speak for the corporation in as few persons as possible. Companies should formally designate and publish the list of persons authorized to speak on their behalf. Before communicating with persons covered by Regulation FD, corporate spokespersons should be familiar with the contents of recent SEC filings, should be briefed on the issuer's prior press releases and other informal public disclosures, and should have an understanding as to whether new information is material and whether the company is willing to publicly disclose such information.

F. What is “material” information?

Generally, information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to buy or sell a security. Materiality, however, is not judged in isolation. To be material, information must significantly alter the total mix of information available to investors. Thus, disclosure can be viewed as immaterial and harmless in light of information already within the public domain. As a theoretical matter, material information should be reflected in the price of this issuer's stock. As a practical matter, market response to disclosures is very difficult to predict.

Issuers must decide whether particular items of information are material on a case-by-case basis, based on familiarity with the market's current picture of the company and the performance of its stock, along with a working knowledge of the applicable legal principles. In particular, the SEC has emphasized in several recent statements that materiality judgments should not be based on a general quantitative rule of thumb or threshold (such as a percentage of revenue or assets), but rather must include consideration of all the specific facts and circumstance to determine whether the information would be important to investors. Issuers should consult with legal counsel when there is uncertainty as to whether a matter is material or nonpublic, as well as questions regarding the company's duties of disclosure.

2. Rule 10b5-1

Prior to the adoption of Rule 10b5-1, courts were unable to agree on whether a trader had to actually “use” inside information, or whether trading while in mere possession of inside information was required for a violation of the insider trading laws. Rule 10b5-1 attempts to settle this uncertainty. Under the new rule, a person is liable for insider trading if he or she is “aware” of material, nonpublic information when making a purchase or sale. Thus, a person who is aware of material, nonpublic information about a particular issuer must either disclose that information or abstain from trading in the issuer's securities,

whether or not the person makes some identifiable, intentional “use” of the information in trading.

There are three limited exceptions to the rule. A trader, who is aware of material, nonpublic information at the time a trade is completed will not violate 10b5-1 if, before becoming aware of the information, he or she had:

- (1) entered into a contract for the purchase or sale of securities, or
- (2) instructed another person to buy or sell securities for his or her account, or
- (3) adopted a written plan for selling securities.

These exceptions are subject to a number of further technical requirements, and a person who becomes aware of material, nonpublic information about an issuer should consult legal counsel before trading in that issuer’s securities.

Of course, this rule applies not only to information concerning one’s employer when trading in the employer’s stock, but also information about customers, suppliers, acquisition candidates or even competitors if obtained confidentially from or through the employer when trading in securities of such companies.

3. Rule 10b5-2

Courts developed the “misappropriation” theory of insider trading, under which persons can be liable for insider trading if they trade on the basis of information misappropriated from a source to whom they owe a duty of trust or confidence. While it is clear that many employer/employee and other business and professional relationships impose duties of trust or confidence for purposes of the misappropriation theory, the precise boundaries of the rule have remained unsettled.

In new Rule 10b5-2, the Commission identified three additional specific relationships that, in its view, impose a duty of trust or confidence, and can therefore serve as the basis for insider trading liability under the misappropriation theory:

1. A person acquires a duty of trust or confidence whenever he or she specifically agrees to maintain information in confidence, whether in writing or otherwise. An oral promise not to disclose information thus acquires regulatory significance. Violation of such an agreement can lead to liability.
2. If two people have a history or pattern of sharing confidences, and the person communicating non-public information expects that the communication will be kept confidential, the recipient has acquired a duty of confidence under the misappropriation theory.

3. Information learned from a spouse, parent, child, or sibling imposes a duty of trust or confidence under most circumstances.

A person who acquires material, nonpublic information in any of these three circumstances must abstain from trading and must not disclose it to others who might trade on the basis of it. Violations expose both the “tipper” and the “tippee” to the full range of remedies at the SEC’s disposal, including penalties of three times the gain realized or loss averted by the trader. Intentional violations can be punished through criminal prosecution, heavy fines and imprisonment.

For more information on these developments, the securities law aspects of corporate communications or other securities and corporate litigation issues, contact the authors, John Bielema (404-572-4504; jbielema@pgfm.com), David Meadows (404-572-4564; dmeadows@pgfm.com); other members of the Securities and Corporate Litigation Practice Group, Tom Richey, Chair (404-572-6663; trichey@pgfm.com); Bill Speer (404-572-6722; bspeer@pgfm.com), Eliot Robinson (404-572-6785; erobinso@pgfm.com), or other Corporate Finance Practice Group members; or your regular contact at Powell, Goldstein, Frazer & Murphy LLP.

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