Commission has previously determined that the establishment of Regulation 1.59, as well as subsequent amendments to the regulation, have not created significant economic impact for affected entities or persons.[10]

The Commission does not believe that the proposed amendments would have a significant economic impact on SROs or employees, governing board members and committee members. The proposed amendments merely clarify the existing rule. The obligations and prohibitions which would be established by the proposed amendments are essentially the same obligations and prohibitions that are created by SRO rules promulgated pursuant to existing Regulation 1.59.

Therefore, the Chairman, on behalf of the Commission, hereby certifies, pursuant to Section 3(a) of the RFA,[11] that the proposed rulemaking, if adopted, would not have a significant economic impact on a substantial number of small entities.

B. Agency Information Activities: Proposed Collection; Comment Request

The Paperwork Reduction Act of 1980 (''PRA'')[12] imposes certain requirements on federal agencies (including the Commission) in connection with their conducting or sponsoring any collection of information as defined by the PRA. The Commission believes the proposed amendments to Regulation 1.59 would not impose a paperwork burden on self-regulatory organizations.

Copies of the information collection submission to the Office of Management and Budget are available from Stacy Dean Yochum, Clearance Officer, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581. Telephone: (202) 418–5157.

List of Subjects in 17 CFR Part 1

Commodity futures, Contract markets, Clearing organizations, Members of contract markets.

In consideration of the foregoing, and based on the authority contained in the Commodity Exchange Act and, in particular, Sections 3, 4b, 5, 5a, 6, 6b, 8, 8a, 9, 17, and 23(b) thereof, 7 U.S.C. 5, 6b, 7, 7a, 8, 13a, 12, 12a, 13, 21 and 26(b), the Commission hereby proposes to amend Title 17, Chapter I, Part 1 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 continues to read as follows:

Authority: 7 U.S.C. 2, 2a, 4, 4a, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 7, 7a, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 19, 21, 23, and 24, unless otherwise stated.

2. Section 1.59 would be amended as follows:

A. Paragraphs (a)(3) through (a)(8) are redesignated as paragraphs (a)(4) through (a)(9).

B. Paragraph (a)(2)is redesignated as paragraph (a)(3) and revised and new paragraph (a)(2) is added;

C. Paragraph (b)(1) introductory text and paragraph (b(1)(i) are revised to read as follows:

§ 1.59 Activities of self-regulatory organization employees and governing members who possess material, non-public information.

(a) *Definitions.* For purposes of this section:

* * * * *

(2) *Governing board member* means a member, or functional equivalent thereof, of the board of governors of a self-regulatory organization.

(3) *Employee* means any person hired or otherwise employed on a salaried or contract basis by a self-regulatory organization, but does not include any governing board member compensated by the exchange solely for governing board activities.

* * * * *

(b) Employees of self-regulatory organizations: Self-regulatory organization rules.

(1) Each self-regulatory organization must maintain in effect rules which have been submitted to the Commission pursuant to section 5a(a)(12)(A) of the Act and Commission regulation 1.41 (or, pursuant to section 17(j) of the Act in the case of a registered futures association) that, at a minimum, prohibit:

(i) Employees of the self-regulatory organization:

(A) From trading, directly or indirectly, in any commodity interest traded on or cleared by the employing contract market or clearing organization;

(B) From trading, directly or indirectly, in any related commodity interest;

(C) From trading, directly or indirectly, in any commodity interest traded on or cleared by contract markets or clearing organizations other than the employing self-regulatory organization where the employee has access to material, nonpublic information concerning such commodity interest; and

(D) From trading, directly or indirectly, in any commodity interest traded on or cleared by a linked exchange where the employee has access to material, nonpublic information concerning such commodity interest; and

* * * * *

Issued in Washington, DC on December 15, 1999, by the Commission.

Jean A. Webb,

Secretary of the Commission.

[FR Doc. 99–33305 Filed 12–27–99; 8:45 am]

BILLING CODE 6351–01–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 240, 243, and 249

[Release Nos. 33–7787, 34–42259, IC–24209, File No. S7–31–99]

RIN 3235–AH82

Selective Disclosure and Insider Trading

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

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

DATES: Public comments are due on or before March 29, 2000.

ADDRESSES: Please send three copies of your comment letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 5th Street, NW, Washington, DC 20549–0609. Comments can also be sent electronically to the following e-mail address: rule-comments@sec.gov. Your comment letter should refer to File No. S7–31–99. If e-mail is used, include this file number on the subject line. Anyone can inspect and copy the comment letters in the Commission's Public Reference Room at 450 5th St., NW,

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[10] *See* 47 FR 18618 (Apr. 30, 1982); 50 FR 24533 (June 11, 1985); 51 FR 44866 (Dec. 12, 1986); 52 FR 32568 (Aug. 28, 1987); 52 FR 48974 (Dec. 29, 1987); 58 FR 44470 (Aug. 23, 1993); 58 FR 54966 (Oct. 25, 1993).

[11] 5 U.S.C. 605(b) (1994).

[12] 44 U.S.C. 3501 *et seq.* (1988).

Washington, DC 20549. Electronically submitted comments will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Richard A. Levine, Assistant General Counsel, Sharon Zamore, Senior Counsel, or Elizabeth Nowicki, Attorney, Office of the General Counsel, at (202) 942–0890.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (Commission) today is proposing for comment new rules: Regulation FD,[1] Rule 181 under the Securities Act,[2] Rule 10b5–1,[3] Rule 10b5–2,[4] and amendments to Forms 8–K[5] and 6–K.[6]

I. Executive Summary

Information is the lifeblood of our securities markets. Congress enacted the federal securities laws to promote fair and honest securities markets, and a critical purpose of these laws is to promote full and fair disclosure of important information by issuers of securities to the investing public. The Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), as implemented by Commission rules and regulations, provide for systems of mandatory disclosure of certain material information in securities offerings and in periodic reports.

The antifraud provisions of the federal securities laws also play a very important role in furthering full and fair disclosure. Among other things, the antifraud provisions prohibit insider trading, or the fraudulent misuse of material nonpublic information. Unlike the law underlying the issuer disclosure requirements, which generally has been developed through statutes and rules, the law of insider trading has largely been developed through a series of Commission and judicial decisions in civil and criminal enforcement cases involving fraud charges. As a result, a few areas of insider trading law have been marked by disagreement among the courts.

Today's proposals address several issues related to full and fair disclosure of information, and insider trading law. The proposed rules are the following:

• **Regulation FD** (Fair Disclosure), a new issuer disclosure rule, deals with the problem of issuers making selective disclosure of material nonpublic information to analysts, institutional investors, or others, but not to the public at large. Although analysts play an important role in gathering and analyzing information, and disseminating their analysis to investors, we do not believe that allowing issuers to disclose material information selectively to analysts is in the best interests of investors or the securities markets generally. Instead, to the maximum extent practicable, we believe that all investors should have access to an issuer's material disclosures at the same time. Regulation FD, therefore, would require that: (1) When an issuer intentionally discloses material information, it do so through public disclosure, not through selective disclosure; and (2) whenever an issuer learns that it has made a non-intentional material selective disclosure, the issuer make prompt public disclosure of that information.

• **Rule 10b5–1** addresses an important unsettled issue in insider trading law: whether the Commission must show in its insider trading cases that the defendant ''used'' the inside information in trading, or merely that the defendant traded while in ''knowing possession'' of the information. The Rule would state the general principle that insider trading liability arises when a person trades while ''aware'' of material nonpublic information, but also provides four exceptions to liability. In these four situations, where a trade resulted from a pre-existing plan, contract, or instruction that was made in good faith, it will be clear that the trader did not use the information he or she was aware of.

• **Rule 10b5–2** addresses another unsettled issue in current insider trading law: what types of family or other non-business relationships can give rise to liability under the misappropriation theory of insider trading. The Rule would set forth three non-exclusive bases for determining that a duty of trust or confidence was owed by a person receiving information: (1) When the person agreed to keep information confidential; (2) when the persons involved in the communication had a history, pattern, or practice of sharing confidences that resulted in a reasonable expectation of confidentiality; and (3) when the person who provided the information was a spouse, parent, child, or sibling of the person who received the information, unless it were shown affirmatively, based on the facts and circumstances of that family relationship, that there was no reasonable expectation of confidentiality.

II. Selective Disclosure: Regulation FD

A. Background

Full and fair disclosure of information by issuers of securities to the investing public is a cornerstone of the federal securities laws. In enacting the mandatory disclosure system of the Exchange Act, Congress sought to promote disclosure of ''honest, complete, and correct information''[7] to facilitate the operation of fair and efficient markets.[8]

Despite this well-recognized principle, the federal securities laws do not generally require an issuer to make public disclosure of all important corporate developments when they occur. Periodic reports (*e.g.,* Forms 10–K and 10–Q) call for disclosure of specified information on a regular basis, and domestic issuers are additionally required to report some types of events on a Form 8–K soon after they occur. However, in the absence of a specific duty to disclose, the federal securities laws do not require an issuer to publicly disclose all material events as soon as they occur. While we encourage prompt disclosure of material information as the best disclosure practice,[9] and self-regulatory organization (SRO) rules often require this,[10] issuers retain some control over the precise timing of many important corporate disclosures.

In practice, issuers also retain control over the audience and forum for some important disclosures. If a disclosure is made at a time when no Commission filing is immediately required, the issuer determines how and to whom to make its initial disclosure. As a result, issuers sometimes choose to disclose information selectively—*i.e.,* to a small group of analysts or institutional investors—before making broad public disclosure by a press release or Commission filing.

Many recent cases of selective disclosure have been reported in the media.[11] In some cases, selective

[1] 17 CFR 243.100 and 243.101.

[2] 17 CFR 230.181.

[3] 17 CFR 240.10b5–1.

[4] 17 CFR 240.10b5–2.

[5] 17 CFR 249.308.

[6] 17 CFR 249.306.

[7] S. Rep. No. 73–1455, at 68 (1934).

[8] ''The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about aq situation where the market price reflects as nearly as possible a just price. . . . [T]he hiding and secreting of important imformation obstructs the operation of the markets as indices of real value,'' H.R. Rep. No. 73–1383, at 11 (1934). *See also* S. Rep. No. 73–792, at 10–11, 19–20 (1934).

[9] *See* Timely Disclosure of Material Corporate Developments, Securities Act Release No. 5092 (Oct. 15, 1970) (35 FR 16733).

[10] *See, e.g.,* NYSE Listed Company Manual, para. 202.05 (Timely Disclosure of Material News Developments); NASD Rules 4310(c)(16), 4320(e)(14), and IM–4120–1 (Disclosure of Material Information).

[11] *See, e.g.,* Susan Pulliam and Gary McWilliams, *Compaq Is Criticized for How It Disclosed PC*

Continued

disclosures have been made in conference calls or meetings that are open only to analysts and/or institutional investors, and exclude other investors, members of the public, and the media. In other cases, company officials have made selective disclosures directly to individual analysts. Commonly, these situations involve advance notice of the issuer's upcoming quarterly earnings or sales figures—figures which, when announced, have a predictable and significant impact on the market price of the issuer's securities.

We are troubled by the many recent reports of selective disclosure and the potential impact of this practice on market integrity. As the Supreme Court has recently emphasized, promoting investor confidence in the fairness of our securities markets is an ''animating purpose'' of the Exchange Act.[12] Clearly, one critical component of that mission is protecting investors from the prospect that others in the market possess ''unerodable informational advantages'' [13] obtained through superior access to corporate insiders.

In our view, the current practice of selective disclosure poses a serious threat to investor confidence in the fairness and integrity of the securities markets. We have recognized that benefits may flow to the markets from the legitimate efforts of securities analysts to ''ferret out and analyze information'' [14] based on their superior diligence and acumen. But we do not believe that selective disclosure of material nonpublic information to analysts—or to others, such as selected investors—is beneficial to the securities markets. As a recent academic study indicated, selective 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.[15] Indeed, while issuer selective disclosure is not a new practice,[16] the impact of such selective disclosure appears to be much greater in today's more volatile, earnings-sensitive markets. Accordingly, we think that a continued practice of selective disclosure by issuers inevitably will lead to a loss of public confidence in the fairness of the markets.

Even apart from the issue of fundamental fairness to all investors, selective disclosure poses other real threats to the health and integrity of our securities markets. Corporate managers should be encouraged to make broad public disclosure of important information promptly. If, however, they are permitted to treat material information as a commodity that can be parceled out selectively, they may delay general public disclosure so that they can selectively disclose the information to curry favor or bolster credibility with particular analysts or institutional investors.[17]

Moreover, if selective disclosure were to go unchecked, opportunities for analyst conflicts of interests would flourish. We are greatly concerned by reports indicating a trend toward less independent research and analysis as a basis for analysts' advice, and a correspondingly greater dependence by analysts on access to corporate insiders to provide guidance and ''comfort'' for their earnings forecasts.[18] In this environment, analysts are likely to feel pressured to report favorably about particular issuers to avoid being ''cut * * * off from access to the flow of non-public information through future analyst conference phone calls'' or other means of selective disclosure.[19] This raises troubling questions about the degree to which analysts may be pressured to shade their analysis in

Troubles, Wall St. J., Mar. 2, 1999, at C1; Susan Pulliam, *Abercrombie & Fitch Ignites Controversy Over Possible Leak of Sluggish Sales Data,* Wall St. J., Oct. 14, 1999, at C1; Randall Smith, *Conference Calls to Big Investors Often Leave Little Guys Hung Up,* Wall St. J., June 21, 1995, at C1; George Anders and Robert Berner, *Webvan to Delay IPO in Response to SEC Concerns,* Wall St. J., Oct. 7, 1999, at C16 (disclosure to institutional investors in road-show presentations). In addition, a recent study of corporate disclosure practices by the National Investor Relations Institute reported that 26% of responding companies stated that they engaged in some types of selective disclosure practices. National Investor Relations Institute, *A Study of Corporate Disclosure Practices, Second measurement,* 18 (May 1998) (NIRI Corporate Disclosure Study).

[12] *United States* v. *O'Hagan,* 521 U.S. 642, 658 (1997).

[13] *Id.* (citing Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws,* 93 Harv. L. Rev. 322, 356 (1979)).

[14] *Raymond L. Dirks,* 47 S.E.C. 434, 441(1981). This concern about protecting the legitimate functions of securities analysts was a basis for the Supreme Court's decision in *Dirks* v. *SEC,* 463 U.S. 646 (1983), which addressed an analyst's liability under Rule 10b-5 insider trading law. *See also* 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). *But see* Donald C. Langevoort, *Investment Analysts and The Law of Insider Trading,* 76 Va. L. Rev. 1023, 1044 (1990) (stating that the argument favoring special treatment for analyst disclosures is ''substantially overstated''). We discuss the *Dirks* case in greater detail at *infra* pp. 12–13.

[15] *See* Richard Frankel, Marilyn Johnson, and Douglas J. Skinner, *An Empirical Examination of Conference Calls as a Voluntary Disclosure Medium,* 37 J. Acct. Res. 133 (Spring 1999). This study revealed that, during and immediately following teleconference calls between analysts and issuers, trading volume in the issuers' stock increased, average trade size increased, and stock price volatility increased. This led the researchers to conclude that material information is released during these selective disclosure periods, which is immediately filtered to a subset of large investors who are able to trade on the information before it is fully disseminated to the market.

[16] The NIRI Corporate Disclosure Study indicates that a higher percentage of issuers engaged in possible selective disclosure practices in 1995 than in 1998. *See* NIRI Corporate Disclosure Study, *supra* note 11 at 18.

[17] *See SEC* v. *Phillip J. Stevens,* Litigation Release No. 12813 (Mar. 19, 1991).

[18] Fred Barbash, *Companies, Analysts A Little Too Cozy,* Wash. Post, Oct. 31, 1999, at H1 (''Companies coddle analysts to obtain the most favorable coverage, which is critical to their stock price. Analysts covet their access to companies, because special knowledge is the only thing they have to offer clients.''); Andrew Hill, *Let the buyer beware,* Fin. Times, Oct. 27, 1999, at 14 (''The death of the 'sell' note is perhaps the clearest signal that big securities houses are suppressing or toning down negative analysis of companies that are clients or potential clients. In a snapshot of 27,700 individual analyst reports, taken at the beginning of this month, First Call/Thomson Financial, the research company, found nearly 70 per cent recommended that investors buy the stock, and just under 1 per cent advised they should sell.''); Gretchen Morgenson, *The Earnings Waltz: Is the Music Stopping?,* N.Y. Times, Oct. 24, 1999, at 3 (''As quarterly earnings numbers became paramount, analysts grew more dependent upon company management for 'guidance' to the correct earnings forecast. The more help they received, the less work they did.''); Robert McGough, *One Analyst Anticipated IBM News,* Wall St. J., Oct. 22, 1999, at C1 (''Too often analysts rely on executives at the companies they cover to let them know what's going on in the business.''); Jonathan Weil, *In Stock Ratings, Many Analysts Say 'Sell' Is a Four-Letter Word,* Wall St. J., May 6, 1998, at T2 (attributing analysts' ''speak no evil'' motto to fact that ''most analysts don't want to risk offending corporate executives, who have been known to retaliate by restricting access to information or selecting competitors' corporate-finance departments to do lucrative investment-banking deals. So analysts issue watered-down critiques, and shareholders have to read between the lines for suggestions on when to get out of a stock.''); Jeffrey M. Landerman, *Who Can You Trust? Wall Street's Spin Game, Stock Analysts Often Have a Hidden Agenda,* Bus. Wk., Oct. 5, 1998, at 148 (referencing a recent survey of Wall Street research, sales, and trading practices in which nearly one-third of the 272 responding large U.S. companies said that in response to an analyst's sell recommendation they would '' 'reduce communications and reduce access' . . . . The great fear of the analyst when he or she goes calling on a company is to find the door shut.'').

[19] John C. Coffee, Jr., *Is Selective Disclosure Now Lawful?,* N.Y.L.J., July 31, 1997, at 5. Professor Coffee also argues that selective disclosure may impair market efficiency in one other respect. If market efficiency is measured by the width of bid/asked spreads, market makers will widen spreads to protect themselves if they fear that others possess and will exploit asymmetric informational advantages. *See also* Amitabh Dugar, Siva Nathan, *Analysts' Research Reports: Caveat Emptor,* 5 J. Investing 13 (1996) (''Analysts depend on corporate management for accurate and timely information about the companies they follow. It is no secret that companies wield restriction of access as a weapon against analysts who issue a negative research report on their stock. Retribution ranges from refusing the analyst's calls for information, to barring the analysts from mailings, conference calls, and meetings, and even threats of legal action and physical harm.'' (citations and footnote omitted)).

order to maintain their access to corporate management. We believe that these pressures would be reduced if issuers were clearly prohibited from selectively disclosing material information to favored analysts.

These concerns about selective disclosure are widely shared, as reflected both in stock exchange listing standards and in ''best practices'' guidelines of investor relations and analyst groups. The New York Stock Exchange Listed Company Manual and the NASD Rules both require listed issuers to disclose promptly ''to the public'' information about material developments.[20] The National Investor Relations Institute (NIRI) guidance in this area also states that an issuer ''should not disclose in selective situations—such as conference calls and analyst meetings—information that it is unwilling to make available for general public use.'' [21] Similarly, the Association of Investment Management and Research Standards of Practice Handbook states that if an analyst selectively receives disclosure of information that he deems material, ''the member must encourage the public dissemination of that information and abstain from making investment decisions on the basis of that information unless and until it is broadly disseminated to the marketplace.'' [22]

Finally, revolutions in communications and information technologies have made it much easier for issuers today to disseminate important information broadly and swiftly. A generation ago, issuers may have relied on conferences attended by a handful of interested parties, or news releases that led to delayed, indirect retransmission of information to the public. Lacking effective means to communicate directly to large numbers of investors, issuers may have relied on analysts to serve as information intermediaries. In the last few years, however, new, effective methods for mass communications have become widely available. Today, issuers can—and many do—use a variety of these new methods to communicate with the market, including: live transmissions of annual meetings and news conferences on the Internet or closed circuit television; listen-only telephone transmission of meetings and analyst conferences; and company websites.[23] With the availability of these new technologies, issuers can much more easily reach a wide investor audience with their disclosures, and do not need to rely on analysts as heavily as in the past to serve as information intermediaries.[24]

Nevertheless, issuers are continuing to engage in selective disclosures of material nonpublic information, perhaps due in part to the uncertainty in current law about when selective disclosures are prohibited. For at least the past 30 years, the issue of potential liability for selective disclosure has been addressed under the principles of fraud law, particularly the law of insider trading. Under early insider trading case law, which appeared to require that traders have equal access to corporate information,[25] selective disclosure of material information to securities analysts could lead to liability.[26]

This changed with the Supreme Court's decisions in *Chiarella* v. *United States* [27] *and Dirks* v. *SEC.*[28] *In Chiarella,* the Court rejected the ''parity of information'' approach, which considered trading to be fraudulent whenever the trader possessed material information not generally available. The Court instead held that there must be a breach of a fiduciary or other relationship of trust and confidence before the law imposes a duty to disclose information or refrain from trading.

In *Dirks,* the Supreme Court addressed the disclosure, or ''tipping,'' of material nonpublic information by an insider to an analyst.[29] The Court rejected the idea that a person is prohibited from trading whenever he knowingly receives material nonpublic information from an insider. Instead, it stated that a recipient of inside information is prohibited from trading only when the information has been made available to him ''*improperly*''—that is, in breach of the insider's fiduciary duty to shareholders. To determine whether a breach of duty occurred, ''courts [must] focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.'' [30]

After *Dirks,* there have been very few insider trading cases based on disclosure to, or trading by, securities analysts. In some situations, an insider's selective disclosure can be viewed as improper, because the disclosure was motivated by a desire for some type of personal benefit.[31] In other cases, however, the evidence to support the ''personal benefit'' argument under *Dirks* is less clear. As a result, many have viewed *Dirks* as affording considerable protection to insiders who make selective disclosures to analysts, and to the analysts (and their clients) who receive selectively disclosed information.[32]

Although the antifraud provisions of the securities laws do not require that all traders possess equal information when they trade, we believe that our disclosure rules should promote fair

[20] *See supra* note 10.

[21] National Investor Relations Institute, *Standards of Practice for Investor Relations,* 30 (Apr. 1998).

[22] Association for Investment Management and Research, *Standards of Practice Handbook, 232 (8th ed. 1999).*

[23] *See, e.g.,* National Investor Relations Institute, Executive Alert, *Investor Relations Officers Report Dramatic Change in Ways Companies Communicate With Key Audiences* (June 18, 1999); Lynn Cowan, *Internet Broadcast of Conference Calls Creates Buzz and Niche for Businesses,* Wall St. J., May, 24, 1999, at B9D.

[24] We also have greater flexibility and improved technology for widespread dissemination of information. The Commission's EDGAR system permits investors to access issuer information almost as soon as it is filed with us.

[25] *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833, 849 (2d Cir. 1968) (en banc), *cert. denied,* 394 U.S. 976 (1969.

[26] *See SEC* v. *Bausch & Lomb, Inc.,* 565 F.2d 8 (2d Cir. 1977). At the same time, however, issuers were encouraged to divulge tidbits of non-material information to analysts to help them piece together more informed opinions. *Id.* The courts reasoned that although giving analysts direct, nonpublic, material information was prohibited, the law should permit ''[a] skilled analyst with knowledge of [a] company and the industry [to] piece seemingly inconsequential data together with public information into a mosaic which reveals material non-public information.'' *Elkind* v. *Liggett & Myers, Inc.,* 635 F.2d 156, 165 (2d Cir. 1980). This theory is known as the ''mosaic theory.'' The resulting tension between prohibited material disclosures and acceptable non-material disclosures led one judge to compare the corporate official's encounter with an analyst to a ''fencing match conducted on a tightrope.'' *Bausch & Lomb,* 565 F.2d at 9.

[27] 445 U.S. 222 (1980).

[28] 463 U.S. 646 (1983).

[29] In *Dirks*, a securities analyst had been informed about a major fraud at Equity Funding of America by a former officer of the company. Although Dirks made an effort to make the fraud public, he also told his clients, enabling them to sell their Equity Funding securities and avoid losses when the fraud became publicly known. The Commission charged that Dirks was a ''tippee'' of the insider, and in turn tipped his clients.

[30] 463 U.S. at 663. On the facts of the case, the Court found that Dirks' source did not breach a duty in disclosing information to Dirks because he did not receive a personal benefit from the disclosure and was clearly motivated by a desire to expose the fraud. Because a tippee's duty is ''derivative'' from the duty of the tipper, and the insider source did not breach a duty, the Court held that Dirks did not violate Section 10(b) of the Exchange Act or Rule 10b-5.

[31] *SEC* v. *Phillip J. Stevens, supra* note 17 (allegation of personal benefit based on corporate official's desire to protect and enhance his reputation).

[32] *See, e.g.,* Paul P. Brountas Jr., *Note: Rule 10b–5 and Voluntary Corporate Disclosures to Securities Analysts,* 92 Colum. L. Rev. 1517, 1529 (1992).

treatment of large and small investors by, among other things, giving all investors timely access to the material information an issuer chooses to disclose. Therefore, we are today proposing new rules, which use a different legal approach, to address selective disclosure.

The approach we propose does not treat selective disclosure as a type of fraudulent conduct or revisit the insider trading issues addressed in *Dirks.* Rather, we propose to use our authority to require full and fair disclosure from issuers, primarily under Section 13(a) of the Exchange Act, as a basis for proposed Regulation FD. This Regulation is designed as an issuer disclosure rule, similar to existing Commission rules under Exchange Act Sections 13(a) and 15(d).[33] We believe this approach would further the full and fair public disclosure of material information, and thereby promote fair dealing in the securities of covered issuers.

B. Description of Proposed Regulation FD

Rule 101 of Regulation FD sets forth the basic rule regarding ''selective disclosure.'' Under this Rule, whenever:

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

(2) discloses material nonpublic information

(3) to any other person outside the issuer,

(4) the issuer must

(a) simultaneously (for intentional disclosures), or

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

(5) make public disclosure of that same information.

Several definitional and other provisions in the Regulation establish the scope and effect of the general rule. As a whole, the Regulation would require that whenever an issuer makes an intentional disclosure of material nonpublic information, it must do so in a manner that provides general public disclosure, rather than through a selective disclosure. In the case of an unintentional selective disclosure, the issuer must make full public disclosure promptly after it learns of the selective disclosure. Regulation FD does not mandate that issuers make public disclosure of all material developments when they occur. What it does require, however, is that when an issuer chooses to disclose material nonpublic information, it must do so broadly to the investing public, not selectively to a favored few.

[33] 15 U.S.C. 78m(a) and 78o(d).

The key provisions of the Regulation are discussed in greater detail below.

1. Disclosures by ''An Issuer or Person Acting on its Behalf''

Regulation FD applies to all issuers with securities registered pursuant to Section 12 of the Exchange Act, and those issuers required to file reports under Section 15(d) of the Exchange Act, including closed-end investment companies but not including other investment companies.[34] It would apply not only to a selective disclosure formally made in the name of the issuer, but also to a selective disclosure made by a ''person acting on behalf of an issuer.'' This term is defined by Rule 101(c) as any officer, director, employee, or agent of the issuer who discloses material nonpublic information while acting within the scope of his or her authority.

The definition of ''person acting on behalf of an issuer'' distinguishes between cases where a properly authorized employee or agent of the issuer makes a selective disclosure, and cases where an employee or agent discloses material nonpublic information for his or her own benefit—*i.e.*, provides a ''tip'' that would violate Rule 10b–5 if securities trading ensued. This distinction means that the issuer would not automatically be liable under Regulation FD (or be responsible for making simultaneous or prompt public disclosure) whenever one of its employees or agents improperly trades or tips.[35] The Rule also would not apply if an official disclosed information to another person who owed him or her a duty of trust or confidence—such as a medical professional. By focusing on employees and agents acting within the scope of their authority, the Rule would make an issuer responsible only for the disclosures of company officials, employees, or agents who are properly authorized or designated to speak to the media, the analyst community, and/or investors.

We request comment on this approach. Is the definition of ''person acting on behalf of an issuer'' appropriate? Should it be narrower—for example, limited to executive officers and directors, and persons acting on their behalf? Or should it be broader, to prevent evasion—for example, covering any person authorized to act on behalf of the issuer?

[34] *See* Proposed Rule 101(b).

[35] The proper response in this type of case is to hold the employee or agent responsible for illegal insider trading, not to force the issuer to make a public disclosure due to the misconduct of one of its employees or agents.

2. Disclosure of Material Nonpublic Information

Regulation FD addresses the selective disclosure of ''material nonpublic information.'' The Regulation does not define the term ''material,'' but instead relies on the same definition as is generally applicable under the federal securities laws: information is material if ''there is a substantial likelihood that a reasonable shareholder would consider it important'' in making an investment decision, or if it would have ''significantly altered the 'total mix' of information made available.'' [36]

We recognize that materiality judgments can be difficult. Corporate officials may therefore become more cautious in communicating with analysts or selected investors, or may feel compelled to consult with counsel more frequently about their ability to respond to questions from analysts and investors. We understand that these communications take many forms, including unrehearsed question-and-answer sessions, and responses to unsolicited inquiries. We are mindful of the potential burdens of requiring instant materiality judgments to be made by those put in the position of responding immediately to questions.

We believe that these concerns are significant but can be mitigated in several ways, many of which involve practices already in place at many issuers.[37] First, issuers can designate a limited number of persons who are authorized to make disclosures or field inquiries from analysts, investors, or the media. Second, issuers can make sure that some record is kept of the substance of private communications with analysts or selected investors—for example, by having more than one person present during these contacts or by recording conversations. Third, issuer personnel can decline to answer questions that raise issues of materiality until they have had an opportunity to consult with others. Fourth, issuer personnel can secure the agreement of analysts not to make use of certain information for a limited time until they have had the opportunity to review their notes of the conversation and engage in whatever consultation they deem necessary to reach a conclusion as to

[36] *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U.S. 438, 449 (1976); *see Basic v. Levinson,* 485 U.S. 224, 231 (1988); *see also* Securities Act Rule 405, 17 CFR 230.405; Exchange Act Rule 12b–2, 17 CFR 240.12b–2; Staff Accounting Bulletin No. 99 (Aug. 12, 1999) (64 FR 45150) (discussing materiality for purposes of financial statements).

[37] *See NIRI Corporate Disclosure Study, supra* note 11.

materiality;[38] then, if the issuer determines that public disclosure of the information is necessary, it can do so. Finally, and most importantly, as described in greater detail below, the Regulation recognizes that issuers may sometimes unintentionally make a selective disclosure of material nonpublic information, and it treats such unintentional disclosures differently from cases in which the issuer makes a planned selective disclosure.

We also believe that a heightened awareness of materiality issues may well have overall benefits to the disclosure process. Senior corporate officials who are responsible for dealing with analysts, investor relations, and disclosure issues already should be sensitive to materiality questions. When particularly difficult issues arise, responsible officials should seek the advice of counsel. Though it is likely that this Regulation will require corporate officials to consider more thoughtfully precisely what to disclose, it is unlikely, given the robust, active capital market, that the flow of information to the market will be significantly chilled.

Although materiality issues do not lend themselves to a bright-line test, we believe that the majority of cases are reasonably clear. At one end of the spectrum, we believe issuers should avoid giving guidance or express warnings to analysts or selected investors about important upcoming earnings or sales figures; such earnings or sales figures will frequently have a significant impact on the issuer's stock price. At the other end of the spectrum, more generalized background information is less likely to be material. We request comment on whether use of the procedures discussed above or similar procedures can significantly reduce the risk of ''chilling'' the flow of corporate information to the marketplace.

The Regulation also does not specifically define the term ''nonpublic.'' It is well established that information is nonpublic if it has not been disseminated in a manner making it available to investors generally.[39] In order to make information public, ''it must be disseminated in a manner calculated to reach the securities market place in general through recognized channels of distribution, and public investors must be afforded a reasonable waiting period to react to the information.''[40] The Regulation does specify means by which ''public disclosure'' is to be made.[41] We request comment on whether to rely on existing standards for the term ''nonpublic.'' Should we provide further guidance, or is the specific definition of ''public disclosure'' provided in Rule 101(e) sufficient?

3. Selective Disclosure ''To Any Other Person Outside the Issuer''

Rule 100(a) covers selective disclosures made to ''any person or persons outside the issuer.'' Therefore, the Rule would not apply to communications of confidential information by officials and employees of issuers to each other. Only selective disclosures to outsiders, such as analysts or selected investors, are covered by the Regulation.

To make clear the scope of the Regulation, paragraph (b) of Rule 100 expressly states that the Rule does not apply to disclosures of material information to persons who are bound by duties of trust or confidence not to disclose or use the information for trading. Paragraph (b) expressly refers to several types of persons whose misuse of the information would subject them to insider trading liability under Rule 10b–5: (1) ''temporary'' insiders of an issuer—*e.g.*, outside consultants, such as its attorneys, investment bankers, or accountants;[42] and (2) any other person who has expressly agreed to maintain the information in confidence, and whose misuse of the information for trading would thus be covered either under the ''temporary insider'' or ''misappropriation'' theory.[43]

This approach recognizes that issuers and their officials may properly share material nonpublic information with outsiders when those outsiders agree to keep the information confidential. This would permit issuers to discuss confidential strategies or plans with outsiders, as necessary for business purposes, without need to make public disclosure under this Rule. For example, issuers could share material nonpublic information with other parties to a business combination transaction or with a purchaser in a private placement without having to make public disclosure if the party receiving the information agrees to hold the information in confidence. Similarly, if it served an issuer's corporate interests to make disclosure of material information to selected analysts—for example, to give the analysts sufficient time to analyze complex information before its public release, or to solicit analysts' views on a business strategy under consideration—it could do so, provided that the recipients of the information expressly agreed not to use the information and to keep it confidential prior to public disclosure. Such a confidentiality agreement would also include an agreement not to trade on the nonpublic information.

We request comment on whether the proposed Regulation covers the appropriate categories of persons. Should other types of persons be enumerated in Rule 100(b) as proper recipients of material nonpublic information? By permitting disclosures to outsiders who agree to confidentiality requirements, does the Regulation adequately permit issuers to engage in legitimate business communications with customers or suppliers, potential co-venturers, and others? Would purchasers in private offering who receive material nonpublic information be willing to sign confidentiality agreements? How would this affect the resale market for private offerings and the flow of information in these transactions? Would the proposals reduce liquidity in the 144A market? How should the Regulation account for practices in this market? Should we require that confidentiality agreements take any specific form—i.e., be written—or include certain required provisions?

4. Timing of Public Disclosure Required by Regulation FD

An important provision of Regulation FD is that the timing of required public disclosure differs depending on whether the issuer has made an ''intentional'' or a ''non-intentional'' selective disclosure.

When an issuer makes an ''intentional'' disclosure of material nonpublic information, Rule 100(a)(1) requires the issuer to publicly disclose the same information simultaneously. In effect, this requirement for simultaneous disclosure means that issuers cannot engage in an intentional selective disclosure consistent with the terms of Regulation FD.

Under the definition provided in Rule 101(a), a selective disclosure is

[38] If a person receives material nonpublic information subject to such a confidentiality agreement, the use or disclosure of the information for securities trading purposes will lead to insider trading liability under Rule 10b–5.

[39] *See, e.g., Texas Gulf Sulphur,* 401 F.2d at 854; *In re Investors Management Co.,* 44 S.E.C. 633, 643 (1971).

[40] *Faberge, Inc.,* 45 S.E.C. 249, 255 (1973). Thus, for purposes of insider trading law, insiders must wait a ''reasonable'' time before trading. What constitutes a reasonable time prior to trading depends on the circumstances of the dissemination. *Id., citing Texas Gulf Sulphur,* 401 F.2d at 854.

[41] *See, infra* Section II.B.5.

[42] ''Classical'' insiders—an issuer's officers, directors, or employees—are of course also subject to duties of trust and confidence and to Rule 10b–5 insider trading liability if they trade or tip.

[43] *United States* v. *O'Hagan,* 521 U.S. 642 (1997); *Dirks,* 463 U.S. at 655 n.14.

''intentional'' when the individual making the disclosure either knew prior to making the disclosure, or was reckless in not knowing, that he or she would be communicating information that was material and nonpublic. This definition would cover, for example, situations where an issuer official determined to hold a conference call or meeting that excluded the public, or selectively contacted a particular analyst or investor, to disclose material nonpublic information. The individual making the disclosure must know (or be reckless in not knowing) that the information he or she is going to disclose is both material and nonpublic. Thus, for example, a communication would not be ''intentional'' under this Rule if it was disclosed inadvertently through an honest slip of the tongue, or because the individual mistakenly (but not in reckless disregard of the truth) believed that the information had already been made public.

Under Rule 100(a)(2), when this type of ''non-intentional'' disclosure of material nonpublic information occurs, the issuer is required to make public disclosure promptly. In this situation, because the disclosure was unplanned, the Rule does not require simultaneous public disclosure. Instead, the Rule requires ''prompt'' public disclosure, with ''promptly'' defined to mean ''as soon as reasonably practicable'' (but no later than 24 hours) after a senior official of the issuer knows (or is reckless in not knowing) of the non-intentional disclosure.[44] ''Senior official'' is defined as any executive officer of the issuer, any director of the issuer, any investor relations officer or public relations officer, or any employee possessing equivalent functions.[45]

By creating a separate requirement for ''prompt'' public disclosure in the case of a non-intentional selective disclosure, the Rule recognizes that corporate officers may sometimes make mistakes without the intent to selectively disclose material nonpublic information. When mistakes are made, absent intent or recklessness, we do not believe that the issuer should be held in violation of Regulation FD for not having made simultaneous public disclosure.[46]

If, however, an inadvertent selective disclosure of material information occurs, the issuer must take prompt ''corrective'' action when it knows (or is reckless in not knowing) that the disclosure of material information has occurred. The requirement to take corrective action arises when a senior official of the issuer (as defined above) becomes aware of the selective disclosure.[47] When that occurs, the issuer is required to act ''as soon as reasonably practicable'' to make full public disclosure of the information that has been selectively disclosed.[48]

We request comment on the distinction between ''intentional'' and ''non-intentional'' disclosures for purposes of the timing of public disclosure. Does the proposed definition of ''intentional'' disclosure draw the appropriate distinction? Does the definition of ''promptly'' provide an appropriate time period for the required public disclosure? Should the time period be shorter (*e.g.*, same trading day); or longer (*e.g.*, next business/trading day or 48 hours later)? Is the definition of senior official appropriate, or should it be narrower (*e.g.*, executive officers only) or broader (*e.g.*, all employees)?

5. Definition of ''Public Disclosure''

Rule 101(e) defines the type of ''public disclosure'' that will satisfy the requirements of the Regulation. This definition provides issuers with considerable flexibility in determining how to make the required public disclosure.

In general, the Rule states that issuers can comply with the ''public disclosure'' requirement by filing a Form 8–K with the Commission containing the information (or, in the case of foreign private issuers, by filing a Form 6–K).[49] We are proposing to add a new Item 10 to Form 8–K for disclosures made under Regulation FD. Should we permit issuers to make Regulation FD disclosures on existing Item 5 of Form 8–K as an alternative to proposed new Item 10? Item 5 is not confined to material disclosures; accordingly, if a registrant used Item 5 it would not acknowledge that the information disclosed was necessarily material. Is this a preferable approach?

As alternatives to making a Commission filing, the Rule permits an issuer to choose other methods of public disclosure. Under Rule 101(e)(2), an issuer will be exempt from the filing requirement if it uses one of the following alternative methods of public disclosure:

• First, an issuer could make public disclosure by disseminating a press release containing the information through a widely circulated news or wire service. Under current practice and SRO rules, corporate issuers typically provide press releases to services such as Dow Jones, Bloomberg, Business Wire, PR Newswire, or Reuters. Any of these services would continue to be a satisfactory means of making public disclosure.

• Second, an issuer could make public disclosure by disseminating information through any other method of disclosure that is reasonably designed to provide broad public access, and does not exclude access to members of the public—such as announcement at a press conference to which the public is granted access (for example, by personal attendance or by telephonic or electronic transmission). In order to afford broad public access, an issuer must provide notice of the disclosure in a form that is reasonably available to investors.

As noted above, current technology provides various means that issuers can use to transmit announcements and press conferences to the public. The Rule would not require use of any particular technological means, but would give issuers their choice of any method that did not limit public access to announcements and conferences.

An additional method for issuer dissemination of material information is posting the information on the issuer's website.[50] We encourage issuers who maintain websites to post information

[44] Proposed rule 101(d)(1). Although requirements for ''prompt'' disclosure exist elsewhere in the securities laws—*e.g.*, the requirement that amendments to Schedules 13D be filed ''promptly''—Proposed Rule 101(d)(1) defines ''prompt'' disclosure for purposes of Regulation FD. This definition is not meant to apply in any other contexts.

[45] *See* Proposed Rule 1010(d)(2). For closed-end investment companies that are subject to Regulation FD, the term ''senior official'' would also cover directors, officers, and employees of the fund's investment adviser.

[46] Of course, a pattern of ''mistaken'' selective disclosures would make less credible the claim that any particular disclosure was not intentional.

[47] For example, a senior official may become aware of his mistake when he sees a significant change in the market price and/or trading volume of his company's securities. Alternatively, a senior official might learn that a lower-level employee mistakenly disclosed material information, because an analyst or investor who received the information called the officer to confirm the information.

[48] Proposed Rule 101(d)(1) states that the required public disclosure must be made no later than 24 hours after the issuer or a senior official of the issuer knows (or is reckless in not knowing) of the selective disclosure. The 24-hour period takes into account the issuer's potential difficulty in making the disclosure any sooner because of the need to marshal all the information necessary, and reach the appropriate personnel. In other cased, however, the issuer may well be able to make public disclosure before the maximum allowable 24-hour disclosure period. In such cases, the requirement to disclose ''as soon as reasonably practicable'' means that the issuer should act sooner than 24 hours later.

[49] Proposed Rule 101(e)(1).

[50] *See NIRI Corporate Disclosure Study, supra* note 11, at 9, 21 (finding that 82% of responding issuers used their websites to post disclosures of quarterly finanical results).

on their websites whenever they make public disclosure through one of the means described above. However, the proposed Rule would not consider a website posting by itself to be a sufficient means of public disclosure.[51] Will this limitation make issuers less willing to post information on their websites?

We request comment on the proposal's approach for making public disclosure. We acknowledge that filings on EDGAR may only be made during specified hours, and only on business days of the Commission. In the case of filings permitted to be made in paper (as in the case of foreign private issuers), there are similar constraints because of our filing desk hours. Therefore, when an issuer is required to make public disclosure within 24 hours, the timing of a weekend or holiday may mean that EDGAR filing is not an available method of public disclosure. Issuers would therefore have to use one of the other methods. We solicit comment on whether this approach is workable, or whether we should alter the timing requirements of the Rule so that filing is always an available method. How else can we promote issuer flexibility and investor access?

We are also considering whether to require a delayed filing of a Form 8–K (within two business days) when an issuer chooses one of the other methods of making public disclosure. This would ensure that the information is part of the Commission's public files. Should we adopt this alternative approach? If so, is two business days the appropriate time period, or should it be shorter (*e.g.*, one business day) or longer (*e.g.*, five business days)?

Are the current technologies that we discuss available to all issuers? Are they prohibitively costly? Would they provide all investors with sufficient access? Are there other methods of public disclosure that might be as effective as a press release or an open press conference? Should these methods be specified in the Rule? Would an open press conference alone provide adequate dissemination of information in all circumstances (*e.g.*, for smaller companies with less media or analyst coverage)? Should we require that information be posted on an issuer's website, if it has one, in addition to the other methods of publicizing the information?

6. Issuers Covered by the Regulation

Regulation FD would apply to all issuers with securities registered under Section 12 of the Exchange Act, and all issuers required to file reports under Section 15(d) of the Exchange Act, including closed-end investment companies but not including other investment companies. Are there any categories of issuers that should not be included? Should we have different and/or modified rules for small business issuers? If so, what modifications are warranted?

We are proposing to apply Regulation FD to foreign private issuers that are subject to the reporting requirements of the Exchange Act, although these foreign issuers would be permitted to make filings under the Regulation on Form 6–K rather than Form 8–K.[52] The vast majority of these issuers have subjected themselves to such reporting requirements by their election to access U.S. markets. Most of the issuers have a class of securities listed on the New York or American Stock Exchanges, or are admitted to trading on the Nasdaq Stock Market. The listing standards of these markets make no distinction between domestic and foreign issuers in requiring timely disclosure of material information.[53]

The content and timing of submissions on Form 6–K currently are based on a foreign private issuer's disclosure obligations and practices in its home jurisdiction and in any other jurisdiction where its securities are listed. We recognize that this Rule proposes for the first time to add a substantive disclosure requirement to Form 6–K, thereby changing the fundamental character of the form. We understand that some foreign issuers may view Regulation FD as requiring a change in what they consider to be normal communications with major shareholders, analysts, the press, labor unions, and other constituencies. In many cases, the disclosure requirements of Regulation FD also will impose a translation requirement on the information disclosed to the public and/or filed on Form 6–K. On the other hand, the benefits of the proposal to shareholders in all markets, not just the U.S. capital markets, may warrant the additional steps required of foreign issuers.

Regulation FD permits issuers to use other means for publicly disseminating non-intentional selective disclosures as alternatives to Forms 8–K or 6–K. Under current Form 6–K requirements, however, foreign private issuers are required to submit a Form 6–K containing any material information that is disseminated publicly, promptly after the dissemination. As proposed, foreign private issuers would not have to file a Form 6–K if they use one of the alternative means of disclosure permitted by Regulation FD.

We note that Forms 6–K are not currently required to be filed on EDGAR, which may impede investor access to information. Does this limitation make the requirement to file on Form 6–K less useful? If so, how should we address this issue?

We request comment on the proposed coverage of Regulation FD. Would it be appropriate to exempt all foreign private issuers from compliance with Regulation FD? If so, what would be the basis for this exemption and how would we address the impact on U.S. investors of having different requirements for selective disclosures by U.S. issuers and foreign private issuers? Would it be more appropriate to limit the application of Regulation FD to only certain foreign private issuers, such as those issuers with equity securities listed on a registered national securities exchange or the Nasdaq Stock Market National Market System, or foreign private issuers whose number of U.S. shareholders or volume of trading in our capital markets exceeds certain levels? If so, what levels should trigger the application of Regulation FD? Are there other ways the proposal could be modified to reduce the burden on foreign private issuers? Should foreign and domestic issuers be treated similarly with respect to the application of Section 18 to Regulation FD disclosure?

We are proposing to apply Regulation FD to closed-end investment companies, but not other types of investment companies. Investment companies that are continually offering their securities to the public already are required to update their prospectuses to disclose material changes subsequent to the effective date of the registration statement or any post-effective amendment, and are not permitted to sell, redeem, or repurchase their securities except at a price based on their securities' net asset value. While we believe that Regulation FD would offer little additional protection to investors in these types of investment companies and therefore they should be excluded from its coverage, these considerations do not apply in the case of closed-end investment companies.

[51] Despite the rapid expansion of Internet access, a significant number of households do not have access. Moreover, simply putting information on a website does not alert investors that it is available.

[52] As is the case currently, Form 6–K used to mkae Regulation FD disclosure would not be deemed to be ''filed'' for purposes of Section 18 of the Exchange Act or subject to liability under that section.

[53] *See supra* note 10.

We are thus proposing to include closed-end investment companies within the requirements of Regulation FD.

At present, no form used by registered closed-end investment companies is equivalent to Form 8–K. In order to provide closed-end investment companies with the same disclosure options under Regulation FD available to operating companies, we propose to permit registered closed-end investment companies to file on Form 8–K for the sole purpose of making the public disclosure required by Regulation FD. The Commission does not intend by this rule proposal to otherwise require registered investment companies to file on Form 8–K.[54]

We request comment on whether any investment companies should be covered by Regulation FD, and if so, which types of investment companies should be covered. Commenters should address whether there are specific types of information relating to investment companies that could be the subject of problematic selective disclosure (*e.g.,* the impending departure of a portfolio manager who is primarily responsible for day-to-day management of the fund, or information relating to the fund's portfolio investments). We also request comment on whether it is appropriate for closed-end investment companies to file on Form 8–K for purposes of making disclosure under Regulation FD, and whether there should be a separate Item 11 for closed-end investment companies making disclosure on Form 8–K, so that members of the public can easily distinguish filings by closed-end investment companies from those of operating companies. Commenters that oppose the use of Form 8–K by closed-end investment companies should discuss other methods for obtaining equivalent disclosure from those companies.

7. Liability Issues and Securities Act Implications

Regulation FD is an issuer disclosure rule that is designed to create duties only under Sections 13(a) and 15(d) of the Exchange Act and Section 30 of the Investment Company Act. It is not an antifraud rule, and unlike other Section 13(a) and 15(d) reporting requirements, it is not intended to create duties under Section 10(b) of the Exchange Act or any other provision of the federal securities laws. As a result, no private liability will arise from an issuer's failure to file or make public disclosure.[55]

If an issuer fails to comply with Regulation FD, however, it will be subject to an SEC enforcement action.[56] We could bring an administrative action seeking a cease and desist order, or a civil action seeking an injunction and/or civil money penalties.[57] In appropriate cases, we could also bring an enforcement action against the individual(s) at the issuer responsible for the violation, either as ''a cause of'' the violation in a cease and desist proceeding,[58] or as an aider and abetter of the violation in an injunctive action.[59]

In addition, Regulation FD does not affect or undermine any existing bases of liability under Rule 10b–5. Thus, for example, liability for ''tipping'' under Rule 10b–5 may still exist if a selective disclosure is made in circumstances that meet the *Dirks* ''personal benefit'' test.[60] In addition, an issuer's failure to make a public disclosure still may give rise to liability under a ''duty to correct'' or ''duty to update'' theory in certain circumstances.[61] And in other cases, an issuer's contacts with analysts may lead to liability under the ''entanglement'' or ''adoption'' theories.[62]

Moreover, if an issuer's filing or public disclosure made under Regulation FD contained false or misleading information, or omitted material information, the issuer could incur liability for those misstatements or omissions. Rule 10b–5 would apply to any materially false or misleading statements made to the public, and if an issuer had filed a Form 8–K containing false or misleading information, Section 18 of the Exchange Act[63] would apply as well. If a Form 8–K filed under Regulation FD was required to be incorporated into an issuer's registration statement, it would be subject to liability under Section 11 of the Securities Act.[64] If the public disclosure is not filed on a Form 8–K, it may nevertheless be subject to Section 11 liability if the information is otherwise required to be included in a registration statement subject to Section 11.

As noted above, Regulation FD applies only to issuers that have securities registered under Section 12 of the Exchange Act or that are required to file reports under Section 15(d) of that Act. Accordingly, the Regulation would not apply during an issuer's initial public offering (IPO) of its securities prior to effectiveness of the registration statement.[65]

The proposed Regulation would, however, apply to disclosures made by reporting issuers while they have pending registration statements for securities offerings. For example, the Regulation would apply to statements made in a ''roadshow'' for a reporting issuer's offering. In that situation, if an issuer made oral selective disclosure of material information, Regulation FD would require the issuer also to make public disclosure of the same information. This would be a departure from current distinctions in the Securities Act between oral and written communications around the time of an offering.[66]

The required public disclosure could also be considered an ''offer'' of the securities for purposes of Section 5 of

[54] Business development companies (''BDCs''), a category of closed-end investment companies not required to register under the Investment Company Act, are already required to file reports on Form 8–K. Under this proposal, BDCs would continue to be subject to Form 8–K filing obligations, including those imposed by Regulation FD.

[55] Courts have held that there is no implied private right of action under Section 13(a) of the Exchange Act. *Lamb* v. *Phillip Morris, Inc.*, 915 F.2d 1024 (6th Cir. 1990), *cert. denied*, 498 U.S. 1086 (1991); *J.S. Service Center Corp.* v. *General Electric Technical Services Co.*, 937 F. Supp. 216 (S.D.N.Y. 1996).

[56] In addition, eligibility to file on a number of ''short-form'' Securities Act registration statements requires, in part, that the registrant be timely in filing its Exchange Act reports. The obligation to be timely in these filings includes the filing of a required Form 8–K. As such, any required Form 8–K filing under proposed Item 10 would have to be made in a timely manner for the registrant to be eligible to file such a short-form registration statement. If, under today's proposals, the registrant would not be required to file under Item 10 of Form 8–K because it uses an alternative means of public dissemination, the failure to file an Item 10 Form 8–K would not affect that registrant's form eligibility.

[57] Regulation FD does not expressly require insurers to adopt policies and procedures to avoid violations, but we expect that most issuers will consider implementing appropriate disclosure policies to guard against selective disclosure. We are aware that many, if not most, issuers already have policies and procedures regarding disclosure practices, the dissemination of material information, and the question of which issuer personnel are authorized to speak to analysts, the media, or investors. The existence of this type of policy, and the issuer's general adherence to it, may often be relevant to determining the issuer's intent with regard to a selective disclosure.

[58] Section 21C of the Exchange Act, 15 U.S.C. 78u–3.

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

[60] *See SEC* v. *Phillip J. Stevens, supra* note 17.

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

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

[63] 15 U.S.C. 78r.

[64] 15 U.S.C. 77k. This proposal is not intended to change existing liability for forms incorporated by reference.

[65] After the registration statement for the IPO becomes effective, however, and the issuer becomes subject to Section 15(d) of the Exchange Act, it would be subject to Regulation FD.

[66] Our staff is currently engaged in a more comprehensive review of the regulatory issues raised by ''roadshows.''

that Act,[67] and when made by writing or broadcast could be considered a ''prospectus'' for purposes of section 2(a)(10) of the Act.[68] This creates the possibility that an issuer may violate sections 5(c) or 5(b)(1) of the Securities Act by making the public disclosures required by Regulation FD.

To permit an issuer that has already filed a registration statement to make the required public disclosure without violating section 5(b)(1) of the Securities Act, we are proposing new Rule 181 under the Securities Act. Under this Rule, any public disclosure required by Rule 100(a) of Regulation FD would not be required to satisfy the requirements of section 10 of the Securities Act[69] for a prospectus, as long as the disclosure was made in compliance with Regulation FD. We request comment on whether this Rule should apply only to non-intentional disclosures. Should we place other conditions on the use of this Rule—for example, requiring the material information to be included in the registration statement at the time it is declared effective?

A more difficult situation arises when a reporting company is planning an offering, but has not yet filed a registration statement. A company may find itself in the position of being required by Regulation FD to disclose to the public information which could constitute an ''offer'' of its securities prior to the filing of a registration statement, contrary to section 5(c). While companies are not supposed to make offers to anyone prior to filing a registration statement, an inadvertent disclosure of material nonpublic information to one person could result in an obligation to disclose information to the public, thus resulting in offers being made to many persons. If the company complies with the Regulation FD requirement in that situation, its disclosure would violate section 5(c), and subject it to liability under section 12(a)(1) if it proceeds with its offering. The public disclosure also could constitute a general solicitation and therefore preclude the company from undertaking a private exempt offering.

If the Commission were to adopt an exemption from section 5(c) for Regulation FD-required disclosure, however, companies could abuse that exemption to make public communications that hype an offering before filing a registration statement with the Commission. In that event, the balanced full disclosure, against which to test the hyping information, would not be available. The protections of section 5 could thus be eroded. While we have published proposals that, if adopted, would allow offers to be made prior to the filing of a registration statement in some offerings, those proposals did not extend to offerings by unseasoned companies to less sophisticated investors.[70] We proposed to retain the pre-filing prohibition on offers in those cases because of the continued need for this aspect of investor protection.

We request comment on whether we should also adopt an exemption from liability under section 5(c) of the Securities Act for communications made before the filing of a registration statement. If we do so, should the exemption apply only to non-intentional disclosures? Do the same reasons for providing a section 5(b)(1) exemption also apply to section 5(c), either for all issuers, or for offerings made by very large issuers or to more sophisticated investors? Or could a section 5(c) exemption provide issuers with such freedom to make public disclosures prior to filing a registration statement that issuers could engage in the hyping of an offering that Section 5(c) is designed to prevent?

With respect to the interplay between Regulation FD and the Securities Act, we request comment on the proposed approach described above. Should the Regulation also apply to issuers engaged in IPOs? Alternatively, given the liability questions under the Securities Act for these disclosures and the pending proposals in the Securities Act Reform release, should the Regulation not cover communications made as part of securities offerings under the Securities Act?

In our recent release on business combinations,[71] we adopted non-exclusive exemptions under the Securities Act, proxy rules, and tender offer rules that permit communications with respect to business combinations[72] for an unrestricted length of time without a cooling-off period between the end of communications and the filing of definitive disclosure documents. Those communication exemptions apply regardless of materiality, so long as the conditions to the exemption are satisfied. All written communications must be filed on the date of first use. Those communications must contain a prominent legend advising investors to read the registration, proxy, or tender offer statement, as applicable, when it becomes available. Under those rules, oral statements are not required to be reduced to writing and filed.

Proposed Regulation FD would impose requirements on material communications, written and oral, that are in addition to the filing and legend requirements of the new business combination rules. Any material information disclosed to the public, whether oral or written, would be required to be publicly disseminated by filing, press conference, news release, or otherwise.[73] Issuers may use confidentiality agreements to protect communications in the context of business combinations or other transactions which the issuers expressly mean to reserve from public disclosure. Early discussions among parties negotiating a transaction that are subject to confidentiality agreements among the parties and are kept confidential generally would not be subject to disclosure requirements of Regulation FD or the communications exemptions. Similarly, discussions between a party to a transaction and a security holder regarding a possible ''lock-up'' or other agreement generally would not be subject to these requirements so long as a confidentiality agreement is in effect.

Under current practice, parties negotiating a transaction do not always enter a confidentiality agreement, so Regulation FD may effect a change to current practice. Does this provide a practicable solution for parties seeking to negotiate transactions or to discuss ''lock-ups''?

III. Insider Trading Issues

The prohibitions against insider trading in our securities laws play an essential role in maintaining the fairness, health, and integrity of our markets. We have long recognized that the fundamental unfairness of insider trading harms not only individual investors, but also the very foundations of our markets, by undermining investor confidence in the integrity of the markets. Congress, by enacting two separate laws providing enhanced

[67] 15 U.S.C. 77e.

[68] 15 U.S.C. 77b(a)(10).

[69] 15 U.S.C. 77j.

[70] The Regulation of Securities Offerings, Securities Act Release No. 7606A (Nov. 13, 1998) (63 FR 67174). As discussed below, we also have adopted rules that allow offers in the business combination context to be made before filing a registration statement.

[71] Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 7760 (Oct. 22, 1999) (64 FR 61408) (effective date Jan. 24, 2000).

[72] The proxy rule amendments are not limited to communications concerning business combinations.

[73] Written information must be disseminated by filing in order to satisfy the communication exemptions. A news release or other means of dissemination would not meet the requirements of the business combination rules.

penalties for insider trading,[74] has expressed its strong support for our insider trading enforcement program. And the Supreme Court in *United States* v. *O'Hagan* has recently endorsed a key component of insider trading law, the ''misappropriation'' theory, as consistent with ''an animating purpose'' of the federal securities laws: ''to insure honest securities markets and thereby promote investor confidence.'' [75]

Neither we nor Congress have expressly defined insider trading in a statute or rule. Instead, insider trading law has developed on a case-by-case basis under the antifraud provisions of the federal securities laws, primarily Section 10(b) of the Exchange Act and Rule 10b–5. As a result, from time to time there have been issues on which various courts have disagreed. With the Supreme Court's *O'Hagan* decision, the fundamental issues in insider trading law are now settled. Today's proposals address two issues on which disagreement remains.

A. Rule 10b5–1: Trading ''On the Basis of'' Material Nonpublic Information

1. Background

One unsettled issue in insider trading has been what, if any, causal connection must be shown between the trader's possession of inside information and his or her trading. In enforcement cases, we have argued that a trader may be liable for trading while in ''knowing possession'' of the information. The contrary view is that a trader will not be liable unless it is shown that he or she ''used'' the information for trading.

Until recent years, there has been little case law discussing this issue. Although the Supreme Court has variously described an insider's violations as involving trading ''on'' [76] or ''on the basis of'' [77] material nonpublic information, it has not addressed the use/possession issue. Three recent court of appeals cases address the issue, but have reached different results.

The three court of appeals cases recognize the practical difficulty of divorcing a trader's knowing possession, or awareness, of inside information from its ''use'' in a trade. In *United States* v. *Teicher*,[78] the Second Circuit suggested that ''knowing possession'' is sufficient to trigger insider trading liability, for precisely this reason.[79] In *SEC* v. *Adler*, the Eleventh Circuit held that ''use'' was the ultimate issue, but that proof of ''possession'' provides a ''strong inference'' of ''use'' that suffices to make out a *prima facie* case.[80] In *United States* v. *Smith*, the Ninth Circuit required that ''use'' be proven in a criminal case.[81]

The *Adler* court suggested that we could adopt a new rule or amend existing Rule 10b–5 to adopt a presumption approach or to provide for liability for trading while in ''knowing possession'' of material nonpublic information.[82] In view of the differing opinions expressed in the three cases discussed above, we agree that it would be useful to define the scope of Rule 10b–5, as it applies to the use/possession issue.

In our view, the goals of insider trading prohibitions—protecting investors and the integrity of securities markets—are best accomplished by a standard closer to the ''knowing possession'' standard. Whenever a person purchases or sells a security while aware of material nonpublic information that has been improperly obtained, that person has the type of unfair informational advantage over other participants in the market that insider trading law is designed to prevent.[83] As a practical matter, in most situations it is highly doubtful that a person who knows inside information relevant to the value of a security can completely disregard that knowledge when making the decision to purchase or sell that security. In the words of the Second Circuit, ''material information can not lay idle in the human brain.'' [84] Indeed, even if the trader could put forth purported reasons for trading other than awareness of the inside information, other traders in the market place would clearly perceive him or her to possess an unfair advantage.

On the other hand, we recognize that an absolute standard based on knowing possession, or awareness, could be overbroad in some respects. Sometimes a person may reach a decision to make a particular trade without any awareness of material nonpublic information, but then come into possession of such information before the trade actually takes place. A rigid ''knowing possession'' standard would lead to liability in that case. We believe, however, that for many cases of this type, a reasonable standard would not make such trading automatically illegal.

The *Adler* case attempted to balance these considerations by means of a ''use'' test with a strong inference of use from ''possession.'' We propose a somewhat different approach today: A general rule based on ''awareness'' of the material nonpublic information, with several carefully enumerated exceptions. We believe our proposed Rule would lead to the same outcome as *Adler* in almost all insider trading cases, but will provide greater clarity and certainty than a presumption or ''strong inference'' approach. Our proposed approach will better enable insiders and issuers to conduct themselves in accordance with the law.

2. Proposed Rule 10b5–1

Proposed Rule 10b5–1 is designed to address only the use/possession issue in insider trading cases under Rule 10b–5.

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

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

[76] *See Dirks*, 463 U.S. at 654.

[77] *See O'Hagan*, 521 U.S. at 651–52.

[78] 987 F.2d 112 (2d Cir), *cert. denied*, 510 U.S. 976 (1993).

[79] *Teicher* was a criminal case premised on the misappropriation theory of insider trading. The court reasoned, in *dicta*, that the simplicity of a ''knowing possession'' standard recognizes the informational advantage that a trader with inside information has over other traders. ''Unlike a loaded weapon which may stand ready but unused, material information can not lay idle in the human brain.'' *Id.* at 120.

[80] 137 F.3d 1325 (11th Cir. 1998). *Adler* was a civil action under ''classical'' insider trading theory. The court stated that trading while ''in possession of'' the material nonpublic information gives rise to a ''strong inference'' that the defendant ''used'' the information in trading, thereby allowing the Commission to establish a *prima facie* case based on possession of the information. The court reasoned that this inference addresses the Commission's proof difficulties by allowing the Commission to make out a *prima facie* case without establishing direct proof of a causal connection between possession of the information and its use. *Id.* at 1337–38. The defendant, however, has the opportunity to rebut this inference by introducing evidence to establish that the information was not used in making the trade. It is left to the fact finder to weigh the evidence to determine whether the information was used. *Id.* at 1337.

[81] 155 F.3d 1051 (9th Cir. 1998), *cert. denied*, 119 S. Ct. 804 (1999). *Smith* was a criminal case under ''classical'' insider trading theory. The court expressed no view on whether the *Adler* presumption could be permitted in a civil enforcement case. *Id.* at 1069 & n.27.

[82] ''We note that if experience shows that this approach unduly frustrates the SEC's enforcement efforts, the SEC could promulgate a rule adopting the knowing possession standard, as the SEC has done in the context of tender offers * * * or a rule adopting a presumption approach in which proof that an insider traded while in possession of material nonpublic information would shift the burden of persuasion on the use issue to the insider.'' *Adler*, 137 F.3d at 1337 n.33 (citation omitted).

[83] Under the classical theory, there is an additional argument why trading in ''possession'' of inside information is fraudulent. A ''classical'' insider has a fiduciary duty to the corporation's shareholders. The insider violates this duty, and thereby commits fraud, if he or she trades in the company's securities while in possession of inside information without disclosing the information to the other party. The insider violates this duty regardless of whether he or she ''uses'' the insider information. *See* Brief of the Securities and Exchange Commission at 22–24, *SEC* v. *Soroosh* (9th Cir. 1998) (No. 98–35006); Brief of the Securities and Exchange Commission at 18, *SEC* v. *Adler* (11th Cir. 1997) (No. 96–6084).

[84] *Teicher*, 987 F.2d at 120.

As the Preliminary Note states, the Rule does not modify or address any other aspect of insider trading law, which has been established by case law under Rule 10b–5.

Paragraph (a) sets forth the general prohibition of insider trading contained in existing case law. Under existing law, it is illegal to trade a security ''on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.'' [85] This language incorporates all theories of insider trading liability under the case law—classical insider trading, temporary insider theory, tippee liability, and trading by someone who misappropriated the inside information.[86]

Paragraph (b) defines trading ''on the basis of'' material nonpublic information. A trade is on the basis of material nonpublic information if the trader ''was aware of'' the information when he or she made the purchase or sale. Thus, the general rule is that ''awareness'' of the inside information inevitably leads to use of the information, and provides a sufficient basis for liability.

Paragraph (c) provides specific affirmative defenses against liability. A purchase or sale is not ''on the basis of'' information when a person can establish that one of four exclusive situations is true. These four defenses cover situations in which a person can show that the information he or she possessed was not a factor in the trading decision.

First, an affirmative defense is available if, before becoming aware of material nonpublic information, a person had entered into ''a binding contract'' to trade ''in the amount'' and ''at the price'' and on the date at which he or she ultimately traded.[87] This defense permits persons to carry out pre-existing contracts to purchase or sell a specified number (or dollar amount) of shares of a particular security at a specified price (or at the market price), as long as the person was not aware of material nonpublic information when he or she entered into the contract.[88]

Second, an affirmative defense is similarly available if, before becoming aware of material nonpublic information, a person ''had provided instructions to another person to execute'' a trade for the instructing person's account, ''in the amount, at the price, and on the date'' at which that trade was ultimately executed.[89] This defense would apply, for example, to an insider who instructs his or her broker to execute a plan to sell stock in accordance with Rule 144 at the expiration of a required holding period. If the insider provides the instructions without awareness of any material nonpublic information, the Rule would permit him or her to complete the previously instructed sales plan even if he or she later became aware of inside information.

Third, the Rule provides an affirmative defense if, before becoming aware of material nonpublic information, a person ''[h]ad adopted, and had previously adhered to, a written plan specifying purchases or sales of the security in the amounts, and at the prices, and on the dates at which the person purchased or sold the security.'' [90] This provision is designed to apply in the case of an insider who wishes to establish a regular, pre-established program of buying or selling his or her company's securities. If the plan is established before the insider is aware of material nonpublic information, and provides for specified trades at specified times, the insider will be permitted to engage in those trades even if he or she later becomes aware of material nonpublic information. As discussed below, plans of this type must be entered into in good faith, and not as part of a plan or scheme to evade insider trading prohibitions.[91]

Fourth, the Rule provides an affirmative defense for purchases or sales that result from a written plan for trading securities that is designed to track or correspond to a market index, market segment, or group of securities.[92] This defense would permit trading by an index fund, for example, where the fund's trading strategy was pre-established by the fund or its manager, even if the manager later became aware of material nonpublic information regarding one of the securities in the index. The defense would be available if the plan was sufficiently circumscribed to prevent trading decisions from being affected by the manager's later awareness of material nonpublic information.

The Rule provides one important limitation on the availability of all of the affirmative defenses. Paragraph (c)(1)(ii) states that a defense would be available only if a contract, plan, or instruction to trade relied on for a defense was entered into in good faith, and not as part of a plan or scheme to evade the prohibitions of this Rule. If a person changes a previous contract, plan, or instruction in any respect after becoming aware of material nonpublic information, he or she will lose any defense against liability. Thus, for example, if an insider enters into a contract or plan to sell 1,000 shares of his or her company's stock without being aware of material nonpublic information, then learns negative material nonpublic information and doubles his or her planned sale to 2,000 shares, he or she will lose the defense for the entire sale of 2,000 shares. Similarly, if the insider accelerates the timing of a planned sale in order to complete it before the release of negative corporate news that he or she has recently learned, he or she will have no defense for the transaction.

[85] Proposed Rule 10b5–1(a).

[86] *See United States* v. *O'Hagan*, 521 U.S. 642 (1997); *Dirks* v. *SEC*, 463 U.S. 646 (1983); *Chiarella* v. *United States*, 445 U.S. 222 (1980). In *O'Hagan*, the Supreme Court recognized that under the misappropriation theory of insider trading liability, the fraud is consummated when the defendant, without proper disclosure to the source, ''uses the information to purchase or sell securities.'' Proposed Rule 10b5–1 is consistent with this view in that it provides for no liability when a trader can meet one of the stated defenses in paragraph (c) demonstrating lack of use.

[87] Proposed para. (c)(1)(i)(A).

[88] Proposed para. (c)(1)(iii) defines the terms ''[i]n the amount(s)'' and ''[a]t the price(s)'' for purposes of all of paragraph (c)(1)(i)'s affirmative defenses. These definitions are designed to ensure that a contract, plan, or instruction is sufficiently defined to foreclose the use of any inside information of which the person later becomes aware. A trade specified ''in an amount'' must specify either the number of securities to be traded or the total monetary proceeds to be realized from or spent on the securities to be traded. Thus, a person could plan a sale of, for example, either 1,000 shares or $10,000 worth of stock; however, the person could not plan a trade within a range—for example, a sale of between 1,000 and 2,000 shares. The term ''at the price(s)'' includes a purchase or sale at the market price for a particular date. Therefore, persons would not be required to commit to trading at a particular price, but could merely contract, plan, or provide instructions to trade at the market price on the date of the trade.

Under the Rule, a defense would not be available for a contract, plan, or instruction to trade that used a limit order. By using a limit order, the person would not firmly be committing to make a trade, because if the market price at the relevant date exceeded the limit order price, the trade would not be made. We request comment on whether this restriction on the use of limit orders is necessary.

[89] Proposed para. (c)(1)(i)(B).

[90] Proposed para. (c)(1)(i)(C).

[91] This exception does not cover trading for a person's account through a ''blind trust.'' We have not included any express defenses for blind trust trading, because we do not believe this trading creates difficulties under existing insider trading law. When a person places securities in a blind trust, by definition he or she does not make the decisions to purchase or sell securities in that account. Therefore, those trading decisions (which are made by the trustee of the blind trust) should not be attributed to the person for purposes of potential insider trading liability.

[92] Proposed para. (c)(1)(i)(D).

Paragraph (c)(1)(ii) also specifies that a person will lose any defense for a trade if he or she enters into or alters a ''corresponding or hedging transaction or position'' with respect to the planned securities trade. This requirement is designed to prevent persons from devising schemes to exploit inside information by setting up pre-existing hedged trading programs, and then canceling execution of the unfavorable side of the hedge, while permitting execution of the favorable transaction. By altering the corresponding position, the insider would lose any defense for the transaction that he or she permitted to be executed.[93]

The Rule provides an additional, separate affirmative defense designed solely for entities that trade.[94] This defense is derived from the defense against liability currently provided in Exchange Act Rule 14e-3(b)[95] regarding insider trading in a tender offer situation. To meet this defense, an entity must demonstrate two things: first, that the individual(s) making the decision on behalf of the entity was not aware of the inside information; and second, that the entity had implemented reasonable policies and procedures (*e.g.*, informational barriers, restricted lists) to prevent insider trading.

3. Request for Comments

We request comments on all aspects of proposed Rule 10b5–1. Is the approach we propose—a general standard of ''awareness'' of the information, with specific affirmative defenses—the appropriate one? Are the proposed affirmative defenses appropriate? Should we provide additional defenses to liability, and if so, what should they be? Are the provisions defining the ''amount'' and ''price'' of pre-planned trades specific enough to permit plans to be made? Should we require written plans or instructions in all cases? Should we require that contracts, instructions, or trading plans be approved by counsel?

We also request comment on whether the defense for institutional traders is appropriate and adequate. Has this provision worked effectively for entities subject to Rule 14e-3? Is there any reason the same type of provision would not be adequate for this Rule?

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

1. Background

In *United States* v. *O'Hagan*, the Supreme Court upheld the misappropriation theory of insider trading.[96] Under that theory, a person commits fraud in violation of Section 10(b) of the Exchange Act and Rule 10b-5 by misappropriating material nonpublic information for securities trading purposes, in breach of a duty of loyalty and confidence.

Certain types of business relationships by themselves provide the duty of trust or confidence necessary in a misappropriation theory case. In *O'Hagan*, for example, the attorney-client relationship established the duty of confidence. In other cases, the agency relationship inherent in an employer-employee relationship provides the duty.[97] It is not as settled, however, under what circumstances certain non-business relationships, such as family and personal relationships, may provide the duty of trust or confidence required under the misappropriation theory.

Two courts have considered this issue in criminal cases: *United States* v. *Chestman*[98] and *United States* v. *Reed*.[99] Although *Chestman* and *Reed* took into account common law notions of fiduciary and confidential relationships, they both took a relatively narrow view of when a duty of confidence exists in the context of criminal liability for insider trading.

In *Reed*, the court did not find a father-son relationship sufficient in itself to provide the required duty of confidence. But it stated that if family members have a prior history of sharing confidences, such that one family member has a reasonable expectation that the other will keep those confidences, there may be a sufficient relationship of trust and confidence. The final determination is left to the fact finder.[100]

In *Chestman*, a narrow majority of the Second Circuit *en banc*, while not overruling *Reed*, took a more restrictive view.[101] The *Chestman* majority held that marriage alone does not suffice to create a fiduciary relationship.[102] It stated that in the absence of an ''express agreement of confidentiality,'' or a ''pre-existing fiduciary-like relationship between the parties'' to a family relationship, there is not a sufficient basis for establishing the necessary duty to support a fraud conviction under the misappropriation theory.[103]

Chestman makes clear that its narrow approach, in contrast to the ''elastic'' definition of confidential relations employed by courts of equity in the civil context, was influenced by the criminal context of the case before it.[104] In our view, however, the *Chestman* majority's approach does not fully recognize the degree to which parties to close family and personal relationships have reasonable and legitimate expectations of confidentiality in their communications.[105] For this reason, we believe the *Chestman* majority view does not sufficiently protect investors and the securities markets from the misappropriation and resulting misuse of inside information.

We have investigated and prosecuted a large number of insider trading cases that involved trading by friends or family members of insiders. In many of these cases, the evidence supports the claim that the insider intended to give the information to the friend or family member for trading.[106] The evidence in

[93] As a general matter, the Rule requires that any written plan specifying trading at a particular time must be made in good faith. Similarly, paragraph (c)(1)(i)(C) requires that a person have ''previously adhered to'' the written plan, as a means of demonstrating its bona fides.

[94] Proposed para. (c)(2).

[95] 17 CFR 240.14e–3(b).

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

[97] *See e.g., United States* v. *Carpenter*, 791 F.2d 1024, 1028 (2d Cir. 1986), *aff'd*, 484 U.S. 19 (1987); *SEC v. Materia*, 745 F.2d 197, 203 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *United States* v. *Newman*, 664 F.2d 12, 15 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729, *cert. denied*, 464 U.S. 863 (1983).

[98] 947 F.2d 551 (2d Cir. 1991), *cert. denied*, 503 U.S. 1004 (1992).

[99] 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 447 (2d Cir. 1985).

[100] *Reed*, 601 F. Supp. at 717–18.

[101] Although the facts alleged in *Reed* were that the father and son had a prior history of sharing business confidences, 601 F. Supp. at 690 n.6, the *Reed* court's analysis states, without limitation to business confidences, that ''[t]he repeated disclosure of secrets by the parties or by one party to the other'' or a ''pre-existing confidential relationship'' could be sufficient to establish a duty of trust and confidence. *Id.* at 717–18. The *Chestman* majority, however, limited *Reed's* holding in a criminal context to its facts—that the repeated sharing of business confidences between family members could be the basis of a finding of a relationship of trust and confidence, the functional equivalent of a fiduciary relationship. *Chestman*, 947 F.2d. at 569.

[102] *Id. at 568.*

[103] *Id.* at 571

[104] *Chestman* recognized that although concern about the ''rule of lenity'' did not permit the use of ''an elastic and expedient definition of confidential relations'' in criminal cases, such an approach may be useful in the civil context. *Id.* at 570 *See also O'Hagan*, 521 U.S. at 679 (concurring and dissenting opinion of Scalia, J.) (noting applicability of ''principle of lenity'' in criminal insider trading prosecution, and potential distinction between criminal and civil construction of Rule 10b–5).

[105] *Cf. Chestman*, 947 F.2d at 580 (concurring and dissenting opinion of Winter, J.) (calling majority's view ''unrealistic'' in that ''it expects family members to behave like strangers to each other''). Nor does *Chestman* consider the recognition of a fiduciary duty between family members as a matter of common law or statutory enactments.

[106] *See, e.g., SEC v. Michelle Nguyen, et al.*, Litigation Release No. 16199 (June 29, 1999); *SEC*

such cases supports liability under a classical tipper-tippee theory.[107]

In other circumstances, however, the evidence does not support the view that the disclosing insider intended or expected that the recipient of the inside information would trade. Instead, the evidence indicates that the insider confided the material nonpublic information to the friend or relation with the reasonable expectation that the recipient of the information would maintain the confidence. In those situations, a classical tipper-tippee theory of liability would probably not be available under the *Dirks* analysis. The misappropriation theory of liability would fit the facts better, because the trader breached a duty of confidentiality to the disclosing insider when he or she traded on the basis of the inside information. However, misappropriation liability is very difficult to establish in these situations under the restrictive analysis of *Chestman*, because *Chestman* appears to require either an express agreement of confidentiality, or a pre-existing fiduciary-like relationship that included the prior sharing of business confidences. Stated differently, under *Chestman*, it is not sufficient that the disclosing insider had a reasonable expectation of confidentiality based on his or her prior relationship with the trader.

Chestman thus leads to the following anomalous result. A family member who receives a ''tip'' (within the meaning of *Dirks*) and then trades violates Rule 10b–5. A family member who trades in breach of an express promise of confidentiality also violates Rule 10b–5. A family member who trades in breach of a reasonable and legitimate expectation of confidentiality, however, does not necessarily violate Rule 10b–5.

We think that this anomalous result harms investor confidence in the integrity and fairness of the nation's securities markets. The family member's trading has the same impact on the market and investor confidence in the third example as it does in the first two examples. In all three examples the trader's informational advantage ''stems from contrivance, not luck,'' and the informational disadvantage to other investors ''cannot be overcome with research or skill.'' [108] We believe that permitting the trader in the third example to trade legally is inconsistent with investors' expectations about what types of informational advantages can be properly exploited. Moreover, this result provides all trading family members—including those in the classical tipper-tippee example—with a roadmap for concocting a story that could provide a lawful explanation for the trading. Finally, the need to distinguish between the three types of cases may require an unduly intrusive examination of the details of particular family relationships.

Accordingly, we believe that there is good reason for the broader approach we propose today for determining when family or personal relationships create ''duties of trust or confidence'' under the misappropriation theory. Our proposed approach is not designed to interfere with particular family or personal relationships; rather, our goal is to protect investors and the fairness and integrity of the nation's securities markets against improper trading on the basis of inside information.

2. Proposed Rule 10b5–2

Proposed Rule 10b5–2 sets forth a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for purposes of the ''misappropriation'' theory of insider trading under Section 10(b) of the Exchange Act and Rule 10b–5 thereunder. As stated in the Preliminary Note to the Rule, the law of insider trading is otherwise defined by judicial opinions interpreting Rule 10b–5, and this Rule is not intended to address or modify the scope of insider trading law in any other respect.

Paragraph (a) states that the Rule applies to any cases based on the misappropriation theory of insider trading, whether involving trading or tipping. Paragraph (b) enumerates a non-exclusive list of circumstances under which a ''duty of trust or confidence'' shall exist.[109]

a. *Agreement Between the Parties.* First, whenever a person agrees to maintain information in confidence, a duty of trust or confidence exists.[110] This reflects the common-sense notion, acknowledged in *Reed* and *Chestman*, that reasonable expectations of confidentiality, and corresponding duties, can be created by an agreement between two parties. Although sometimes, most commonly in a business context, the parties will sign an express, written confidentiality agreement, the Rule does not require either a written or an express confidentiality agreement. This approach recognizes the fact that in everyday personal interactions, individuals frequently rely on reasonable, implicit understandings of confidentiality. In some situations, it may not be realistic or socially acceptable to insist that a close friend or relative execute a signed confidentiality agreement, or expressly consent to an oral agreement.

b. *Relationships With a History, Pattern, or Practice of Sharing Confidences*. Second, the Rule provides that a duty of trust or confidence exists when two people have a ''history, pattern, or practice of sharing confidences, such that the person communicating the material nonpublic information has a reasonable expectation that the other person would maintain its confidentiality.'' [111] This part of the Rule does not use a bright line test that enumerates specific relationships, but instead sets forth a ''facts and circumstances'' analysis derived from *Reed*. This standard recognizes that in some circumstances a past pattern of conduct between two parties will lead to a legitimate, reasonable expectation of confidentiality on the part of the confiding person. This analysis does not require that the history, pattern, or practice of sharing confidences include the sharing of business confidences for there to be a duty of trust or confidence for purposes of misappropriation liability. However, evidence about the type of confidences shared in the past might be relevant to determining the reasonableness of the expectation of confidentiality.

We request comments on the approach proposed in paragraph (b)(2). Does the requirement of a prior ''history, pattern, or practice'' of sharing confidences provide a sufficiently well-defined standard? Should other factors be relevant to the analysis as well?

c. *Enumerated Family Relationships.* Third, paragraph (b)(3) sets forth a bright line liability rule for certain enumerated close family relationships,

v. Bharat Kotecha, et al. Litigation Release No. 16151 (May 18, 1999); *SEC v. Hahn Truong, et al.*, Litigation Release No. 16080 (Mar. 9, 1999); *SEC v. Eugene Dines, et al.*, Litigation Release No. 13900 (Dec. 10, 1993); *SEC v. Steven L. Glauberman, et al.*, Litigation Release No. 12574 (Aug. 9, 1990).

[107] *See Dirks*, 463 U.S. at 664 (noting that tipping liability can exist ''when an insider makes a gift of confidential information to a trading relative or friend'').

[108] *O'Hagan*, 521 U.S. at 658–59.

[109] Proposed para. (b) does not enumerate relationships that existing case law already recognizes as providing a clear basis for misappropriation liability: for example, lawyer-client, *O'Hagan*; employee-employer, *Carpenter*; pshchiatrist-patient, *United States v. Willis*, 737 F. Supp. 269 (S.D.N.Y. 1990), *appeal dismissed*, 778 F. Supp. 205 (S.D.N.Y. 1991). As the *O'Hagan* case demonstrates, an individual working at a professional firm may be liable for misappropriating information about a particular matter even if he or she is not personally working on that matter.

[110] Proposed para. (b)(1).

[111] Proposed para. (b)(2).

but allows for an affirmative defense. Spousal, parent-child,[112] and sibling relationships would be sufficient in themselves as a basis for misappropriation theory liability. Our enforcement experience demonstrates that these are the relationships in which family members most commonly share information with a legitimate expectation of trust or confidentiality.[113] These also are normally the types of close familial relationships in which the parties have a history, pattern, or practice of sharing confidences that would lead to a reasonable expectation of confidentiality.

Paragraph (b)(3) permits the person receiving or obtaining the information to assert an affirmative defense by demonstrating that under the facts and circumstances of that particular family relationship, no duty of trust or confidence existed. To demonstrate this, the person must establish that the disclosing family member did not have a reasonable expectation of confidentiality because the parties had neither: (a) a history, pattern, or practice of sharing confidences; nor (b) an agreement or understanding to maintain the confidentiality of the information. If the person receiving or obtaining the information can satisfy the requirements of the affirmative defense set forth in paragraph (b)(3), he or she would not be liable under Rule 10b5–2.

Paragraph (b)(3) does not reach non-traditional relationships (*e.g.*, domestic partners) or more extended family relationships. However, paragraphs (b)(1) and (b)(2) could reach these relationships, depending on the factual context of the relationship. We request comment on whether this is an appropriate distinction.

Are the family relationships enumerated in paragraph (b)(3) the proper ones to cover, or is the list too narrow or too broad? Should the list of enumerated relationships be limited to family members residing in the same household? Should it expressly encompass step-parents and step-children? Should it expressly encompass non-traditional relationships, and if so, which ones? Should it include additional family relationships, such as the list of family relationships covered in our Section 16 rules?

3. *Request for Comments.* We request comment on all aspects of Proposed Rule 10b5–2. For non-enumerated relationships, does paragraph (b)(2) focus on the proper factors for determining whether a reasonable expectation of confidentiality exists? Is the approach of paragraph (b)(3)—a per se rule with an affirmative defense for certain enumerated family relationships—the most suitable one, or should a different standard be employed?

IV. General Request for Comments

We invite you to submit comments on proposed Regulation FD, Rule 10b5–1, and/or Rule 10b5–2. If you have empirical data relevant to proposed Regulation FD, Rule 10b5–1, or Rule 10b5–2, please include it with your comments. Please submit three copies of your comment letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. You may also submit comments electronically to the following e-mail address: rule-comments@sec.gov. Refer to File No. S7–31–99. If you are commenting by e-mail, include this file number on the subject line. We will make comments available for public inspection and copying in the Commission's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549. In addition, we will post electronically submitted comment letters on our Internet Website (http://www.sec.gov).

V. Paperwork Reduction Act

Certain provisions of Regulation FD, and the related amendments to Form 8–K and Form 6–K under the Exchange Act, contain ''collections of information'' requirements within the meaning of the Paperwork Reduction Act of 1995,[114] and the Commission has submitted the proposal to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

Form 8–K (OMB Control No. 3235–0060) [115] was adopted pursuant to Sections 13, 15, and 23 of the Exchange Act. Form 8–K prescribes information, such as material events or corporate changes, that a registrant must disclose. Form 6–K (OMB Control No. 3235–0116)[116] was adopted pursuant to sections 13 and 15 of the Exchange Act. Form 6–K prescribes information that foreign private issuers subject to the reporting requirements of the Exchange Act must disclose. The Commission is also proposing to create a new information collection entitled ''Reg. FD—Other Disclosure Materials.'' This information collection will encompass press releases, webcasts, announcements, conference calls, etc. that are conducted pursuant to Regulation FD, which is proposed pursuant to sections 13, 15, 23, and 36 of the Exchange Act, and that are not filed under cover of Form 8–K or Form 6–K.

The Commission currently estimates that Form 8–K results in a total annual compliance burden of 140,500 hours. The burden was calculated by multiplying the estimated number of Form 8–K filings annually (approximately 28,100) by the estimated average number of hours each entity spends completing the form (approximately 5 hours). The Commission based the number of entities that would complete and file each of the forms on the actual number of filers during the 1999 fiscal year. The staff estimated the average number of hours each entity spends completing each of the forms by contacting a number of law firms and other persons regularly involved in completing the forms.

The Commission currently estimates that Form 6–K results in a total annual compliance burden of 91,848 hours and $515,000 non-labor burden costs. This was calculated by multiplying the estimated number of Form 6–K filings annually (approximately 11,481) by the estimated average number of hours each entity spends completing the form (approximately 8 hours) and adding the non-labor burden costs. The Commission based the number of entities that would complete and file each of the forms on the actual number of filers during the 1999 fiscal year. The staff estimated the average number of hours each entity spends completing each of the forms by contacting a number of law firms and other persons regularly involved in completing the forms.

We believe that the proposed Regulation is necessary to provide for fairer and more effective disclosure of issuer information to all investors and thereby bolster investor confidence in

[112] We do not intend to limit this to minor children. Our enforcement cases in this area typically involve communications between parents and adult sons or daughters.

[113] *See e.g., SEC* v. *Judy Hockett, et al.* Litigation Release No. 15377 (May 30, 1997) (spouse); *SEC* v. *Linda Lou Taylor, et al.*, Litigation Release No. 14775 (Jan. 4, 1996) (spouse); *SEC* v. *Robert J. Young, et al.* Litigation Release No. 14661 (Sept. 29, 1995) (brother); *SEC* v. *Jonathan J. Sheinberg, et al.*, Litigation Release No. 13465 (Dec. 10, 1992) (son-father); *SEC* v. *Thomas C. Reed, et al.*, Litigation Release No. 9537 (Dec. 23, 1981) (son-father).

[114] 44 U.S.C. 3501 *et seq.*

[115] 17 CFR 249.308.

[116] 17 CFR 249.306.

the securities markets. Under the proposed Regulation, issuers would be required to simultaneously (or, in some instances, promptly), upon first disclosure of material, nonpublic information, publicly disclose the information broadly. The disclosure could be made by filing a Form 8–K or Form 6–K with the Commission, disseminating a press release to a widely circulated news or wire service, or disseminating the information through any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude any members of the public from access.

We estimate that, on average, completing and filing a Form 8–K under proposed Regulation FD would require the same amount of time currently spent by entities completing the Form—approximately 5 hours. We estimate that, on average, completing and filing a Form 6–K under proposed Regulation FD would require the same amount of time spent completing Form 6–K—approximately 8 hours. As noted, however, under the proposed Regulation, companies are exempt from the requirement to file a Form 6–K or Form 8–K if they disseminate a press release to a widely circulated news or wire service or disseminate the information through any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude any members of the public from access. We estimate that other methods of disclosure, such as press releases and press conferences, will require no more than the preparation time of Form 8–K—less than 5 burden hours.

We anticipate that, under Regulation FD, companies will make five [117] disclosures per year.[118] Since there are approximately 14,000 companies affected by this Regulation, we estimate that there will be 70,000 additional disclosures per year under Regulation FD. Based on a burden hour estimate of five hours, we anticipate that companies will incur 350,000 additional burden hours under Regulation FD.[119]

Compliance with the disclosure requirements is mandatory. There would be no mandatory retention period for the information disclosed, and responses to the disclosure requirements will not be kept confidential.

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to: (i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609, with reference to File No. S7–31–99. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–31–99, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VI. Cost-Benefit Analysis

A. Regulation FD: Selective Disclosure

Proposed Regulation FD would require that when an issuer intentionally discloses material nonpublic information to any person outside the issuer, it must simultaneously make public disclosure, and when it unintentionally discloses material nonpublic information, it must promptly make public disclosure.

Proposed Regulation FD is intended to produce several important benefits to investors and the securities markets as a whole. First, Regulation FD will inhibit current practices of selective disclosure, which damage investor confidence in the fairness and integrity of the markets. One recent study indicates that analysts and institutional investors immediately use information received in conference calls to trade.[120] Traders on the other side of these transactions, who are excluded from the conference calls, do not have the same information as the more informed analysts and selected investors. Numerous individual investors have complained about this practice. By addressing selective disclosure of material information, the proposed Regulation will foster fairer disclosure of information to all investors, and thereby increase investor confidence in market integrity.

By enhancing investor confidence in the markets, we believe the proposed Regulation will encourage continued widespread investor participation in our markets, which will enhance market efficiency and liquidity, and foster more effective capital raising.

Second, we believe that issuers may also benefit from more open and fair disclosure practices. One study concluded that companies that more liberally disclose information have a larger analyst following, a narrower consensus in earnings estimates, and a low stock price volatility, which likely leads to a lower cost of equity capital.[121] Proposed Regulation FD would encourage these beneficial disclosure practices.

Third, the proposed Regulation likely will also provide benefits to securities analysts and others in the market for information. This Regulation will place all analysts on equal competitive footing with respect to access to material information. As well, this Regulation will allow analysts to express their honest opinions without fear of being denied access to valuable corporate

[117] In many cases, information disclosed under Regulation FD would be information that an issuer was ultimately going to disclose to the public. Under Regulation FD, that issuer likely will not make any more public disclosure than it otherwise would, but it may make the disclosure sooner and now would be required to file or disseminate that information in a manner reasonably designed to provide broad public access to the information and which does not exclude any members of the public from access.

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

[119] Although eight burden hours are incurred by issuers filing a Form 6–K, we assume that, since issuers have the option of how to make disclosure under Regulation FD, they will make disclosure under the least burdensome option. Therefore, our burden number for estimation purposes is five burden hours.

[120] *See supra* Section II.A. and note 15.

[121] *See* National Investor Relations Institute, *Standards of Practice for Investor Relations,* 7 (1st ed. Apr. 1998) (citing Russell Lundholm and Mark Lang, ''The Benefits of More Forthcoming Disclosure Practices,'' University of Michigan School of Business Administration, Ann Arbor, MI, 1994).

information.[122] Analysts will continue to be able to use and benefit from superior diligence or acumen, without facing the prospect that other analysts will have a competitive edge based solely on better access to corporate insiders.

We do not currently have sufficient information to quantify these or other benefits. We therefore request your comments, including supporting data, on the benefits of the Regulation.

The proposed Regulation would impose some costs on issuers. First, there will be some additional cost to publicly disclose material nonpublic information on a non-selective basis. This proposal gives issuers three options for making public disclosure. The issuer can: (1) File a Form 8–K[123] or Form 6–K;[124] (2) disseminate a press release containing the material nonpublic information through a widely circulated news or wire service; or (3) disseminate the information through any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude any members of the public from access (*e.g.*, teleconference, web-conference).

Because the Regulation does not require issuers to disclose material information (just to make any disclosure on a non-selective basis), we cannot predict with certainty how many issuers will actually make disclosures under this Regulation. For purposes of the Paperwork Reduction Act, however, we estimate that issuers will make five[125] public disclosures under Regulation FD per year.[126] Since there are approximately 14,000 issuers affected by this Regulation, we estimate that the total number of disclosures under Regulation FD per year will be 70,000.

If an issuer files a Form 8–K, we estimate that the issuer would incur, on average, five burden hours per filing. This estimate is based on current burden hour estimates under the Paperwork Reduction Act for filing a Form 8–K and the staff's experience with such filings. We believe that approximately 75% of the burden hours are expended by the company's internal professional staff, and the remaining 25% by outside counsel. Assuming a cost of $85/hour for in-house professional staff and $125/hour for outside counsel, we believe the total cost is $475 per filing.

If an issuer files a Form 6–K, we estimate that the issuer would incur, on average, eight burden hours per filing and other miscellaneous costs of $45 per filing. This estimate is based on estimates under the Paperwork Reduction Act for filing a Form 6–K and the staff's experience with such filings. We believe that approximately 75% of the burden hours are expended by the issuer's internal professional staff, and the remaining 25% by outside counsel. Assuming a cost of $85/hour for in-house professional staff and $125/hour for outside counsel, we believe the total cost is $805 per filing.

We have no hard data on which to base estimates of the costs of other disclosure options. However, we anticipate that other methods of disclosure, such as press releases, may require less preparation time than a Form 8–K. If the costs of the other methods of disclosure are less than the cost of filing the Form 8–K, we presume issuers will choose the other methods of public disclosure. Issuers may, however, choose to use methods of dissemination with higher out-of-pocket costs, presumably because they believe these methods provide additional benefits to the issuer or investor.

Given that we estimate that there will be 70,000 disclosures under Regulation FD per year at a cost of approximately $475 per disclosure,[127] we estimate that the total paperwork burden of preparing the information for disclosure per year will be approximately $33,250,000.

We request your comments, including supporting data, on our estimates of the costs of each disclosure option, the number of times a company will make a disclosure in a year, and which method companies are likely to use.

The proposed Regulation may also lead to some increased costs for issuers resulting from new or enhanced systems and procedures for disclosure practices. We believe that many, if not most, issuers already have internal procedures for communicating with the public; for many issuers, therefore, new procedures to prevent selective disclosures will not be needed. There might be a cost to these issuers, however, for enhancing and strengthening existing procedures to ensure that nonpublic material information is not inadvertently disclosed and for disclosing inadvertently released materials promptly. We do not have data to quantify the cost of enhancing and strengthening existing internal monitoring procedures, and we seek your comments and supporting data on these costs.

We are sensitive to the concern that the proposed Regulation might "chill" corporate disclosures to analysts, investors, and the media. Issuers may speak less often out of fear of a post hoc assessment that disclosed information was material. If the Regulation has such a chilling effect, there would be a cost to overall market efficiency. However, there are numerous practices that issuers may employ to continue to communicate freely with analysts and investors, while becoming more careful in how they disclose information. Moreover, the Regulation only covers the selective disclosure of material nonpublic information; the level of "soft" or non-material information available to the market need not decrease. As well, we believe issuers have strong reasons to continue releasing information, given the market demand for information and a company's desire to promote its products and services. Further, we note that, in light of existing SRO rules and disclosure practice guidance provided by organizations such as NIRI, many issuers are currently conducting their disclosure practices in a manner consistent with the proposed Regulation. In light of these factors, we request your comments on the effect the proposed Regulation will have on information flow. Please support your comments and conclusions with data.

Today's proposal is designed to create duties only under Sections 13(a) and 15(d) of the Exchange Act, and the Regulation does not create new duties under Section 10(b) of the Exchange Act. We nevertheless request comments on liability exposure, including the underlying case law if applicable, and we request your estimates of any costs that may result from increased risk of liability.

Are there other costs we have not identified? Please supply data to help us estimate the cost.

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

Proposed Rule 10b5–1 would define when a sale or purchase of a security

[122] *See supra* Section 11.A and notes 18 & 19.

[123] 17 CFR 249.308.

[124] 17 CFR 249.306.

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

[126] In many cases, information disclosed under Regulation FD would be information that an issuer was ultimately going to disclose to the public. Under Regulation FD, that issuer is not going to make any more public disclosure than it otherwise would, but it may make the disclosure sooner and now would be required to file or disseminate that information in a manner reasonably designed to provide broad public access to the information and does not exclude any members of the public from access.

[127] While, as discussed, the staff estimates that filing a Form 6–K costs slightly more than filing a Form 8–K, fewer than 1,000 issuers filed Forms 6–K in fiscal 1999. Therefore, for estimation purposes, we are not accounting for this slightly higher cost in estimating the cost of other disclosure options.

occurred ''on the basis of'' material nonpublic information. Under the proposed Rule, a person trades ''on the basis of'' material nonpublic information if the person making the purchase or sale was aware of the material nonpublic information at the time of the purchase or sale. However, the proposed Rule provides affirmative defenses to liability when a trade resulted from a pre-existing plan, contract, or instruction that was made in good faith.

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

The Rule does not require any particular documentation or recordkeeping by insiders, although it would, in some cases, require a person to document a particular plan, contract, or instruction for trading if he or she wished to establish an affirmative defense that his or her trading was not ''on the basis of'' material nonpublic information. We therefore do not attribute any costs to this aspect of the proposed Rule. We seek comments and data on any costs that this Rule would impose.

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

Proposed Rule 10b5–2 would enumerate three non-exclusive bases for determining when a person receiving information was subject to a duty ''of trust or confidence'' for purposes of the misappropriation theory of insider trading. Two principal benefits are likely to result from this Rule. First, the Rule will provide greater clarity and certainty to the law on the question of when a family relationship will create a duty of trust or confidence. Second, the Rule will address an anomaly in current law under which a family member receiving material nonpublic information may exploit it without violating the prohibition against insider trading. By addressing this potential gap in the law, the Rule would enhance investor confidence in the integrity of the market. We do not attribute any costs to this aspect of the proposed Rule. We seek comments and data on any costs that this Rule would impose.

VII. Consideration of the Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[128] the Commission is requesting information regarding the potential impact of the proposals on the economy on an annual basis. Commenters should provide empirical data to support their views.

Section 23(a) of the Exchange Act[129] requires the Commission, when adopting rules under the Exchange Act, to consider the anti-competitive effects of any rule it adopts. Because we do not believe the rules would affect companies differently, we do not believe that the proposals would have any anti-competitive effects. We request comment on any anti-competitive effects of the proposals.

In addition, section 3(f) of the Exchange Act[130] requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. We believe that the proposals would bolster investor confidence in the securities markets by improving both the actual and perceived equity of the information available to investors from all companies. Accordingly, the proposals should promote capital formation and market efficiency. We anticipate no impact on competition. We request comment on these matters.

VIII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with 5 U.S.C. 603. It relates to proposed new Regulation FD, Rule 10b5–1, and Rule 10b5–2 under the Exchange Act, as amended. The proposed Regulation and Rules address the selective disclosure of material information and clarify two unsettled issues under current insider trading law.

[128] Pub. L. No. 104–121, tit. II, 110 Stat. 857.

[129] 15 U.S.C. 78w(a).

[130] 15 U.S.C. 78c(f).

A. Reasons for the Proposed Action

The proposed Rules address three separate issues. Regulation FD addresses the problem of issuers making selective disclosure of material nonpublic information to analysts or particular investors before making disclosure to the investing public. Rules 10b5–1 and 10b5–2 address two unsettled issues in insider trading case law: (1) whether the Commission needs to show that a defendant ''used'' material nonpublic information in an insider trading case, or merely that the defendant traded while in ''knowing possession'' of the information; and (2) when a family or other non-business relationship can give rise to liability under the misappropriation theory of insider trading. By addressing these issues, the proposals will enhance investor confidence in the fairness and integrity of the securities markets.

B. Objectives

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

Proposed Rule 10b5–1 would resolve the unsettled case law on whether the Commission must prove that a defendant ''used'' or traded while in ''knowing possession'' of material nonpublic information in order to prove insider trading liability. The proposal would provide a general rule that liability arises when a person trades while ''aware'' of material nonpublic information. It provides four defenses against liability, in cases where a trade resulted from a pre-existing plan, contract, or instruction that was made in good faith. It also provides a defense against liability for trading by entities, including small entities, when the individual making the trade was not aware of the information, and the entity had implemented reasonable procedures to prevent insider trading. We believe this proposed Rule would clarify an important issue in insider trading law, and thereby enhance investor confidence in market integrity.

Proposed Rule 10b5–2 would define when a non-business relationship, such as a family or personal relationship, may provide the duty of trust and confidence required under the misappropriation theory of insider trading. This issue currently is also unsettled in the case law. Moreover, we believe that the main case on the issue, which arose in a criminal prosecution, does not fully recognize the degree to which parties to close family and personal relationships have reasonable and legitimate expectations of confidentiality in their communications, and leads to anomalous results in certain situations. Accordingly, the proposed Rule defines the scope of ''duties of trust and confidence'' for purposes of the misappropriation theory in a manner that more appropriately serves the purposes of insider trading law. Proposed Rule 10b5–2 will have no direct effect on small entities.

C. Legal Basis

We are proposing Regulation FD, Rule 181, the amendments to Forms 6–K and 8–K, Rule 10b5–1, and Rule 10b5–2 under the authority set forth in sections 10, 19(a) and 28 of the Securities Act,[131] sections 3, 9, 10, 13, 15, 23, and 36 of the Exchange Act,[132] and section 30 of the Investment Company Act.[133]

D. Small Entities Subject to the Proposed Regulation and Rules

Proposed Regulation FD would affect issuers and closed-end investment companies that are small entities.[134] As of July 31, 1999, the Commission estimated that there were approximately 830 issuers, other than investment companies, that may be considered small entities.[135] As of December 14, 1999, the Commission estimated that there are approximately 62 closed-end investment companies that may be considered small entities subject to Regulation FD.[136]

Proposed Rule 10b5–1 would apply to any small entities that engage in securities trading while aware of inside information and therefore are subject to existing insider trading prohibitions of Rule 10b–5. This could include issuers, broker-dealers,[137] investment advisers,[138] and investment companies. As of July 31, 1999, the Commission estimated that there were approximately 830 issuers, other than investment companies, that may be considered small entities. As of December 31, 1998, the Commission estimated that there were approximately 970 broker-dealers that may be considered small entities.[139] As of December 15, 1999, the Commission estimated that there were approximately 2,000 investment advisers that may be considered small entities.[140] As of December 14, 1999, the Commission estimated that there are approximately 227 investment companies that may be considered small entities. The Commission cannot estimate with certainty how many small entities engage in securities trading while aware of inside information.

E. Reporting, Recordkeeping, And Other Compliance Requirements

1. Regulation FD

When an issuer, large or small, discloses material nonpublic information, proposed Regulation FD would require it to do one of the following: (1) File a Form 8–K or, in the case of a foreign private issuer, a Form 6–K; (2) disseminate a press release containing the information through a widely circulated news or wire service; or (3) disseminate the information through any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude any members of the public from access (*i.e.,* a press conference to which the public is granted access such as by a teleconference or other electronic transmission).

The Regulation's ''public disclosure'' requirement would give small entity issuers flexibility in how to disseminate information (such as telephonic or Internet conference calls). This flexible performance element enables small entity issuers the freedom to select the method of public disclosure that best suits their business operations, and makes it unlikely that this ''public disclosure'' requirement would have a disproportionate affect on small entity issuers.

2. Rule 10b5–1

Proposed Rule 10b5–1 does not directly impose any recordkeeping or compliance requirements on any small entities. To the extent that an entity engaged in securities trading wished to rely on one of the defenses against liability provided in the Rule, it might be required to take certain steps. For example, to assert the affirmative defense in paragraph (c)(1)(i)(D) for trades that result from a written plan for trading securities designed to track or correspond to a market index, market segment, or group of securities, an entity, large or small, would have to maintain a written record of the trading plan. More generally, any entity, large or small, that sought to rely on the affirmative defense in paragraph (c)(2) for institutional traders would be required to comply with the specific provisions of that defense, including implementing reasonable policies and procedures to prevent insider trading. We believe that most entities to whom this defense would be relevant—*i.e.,* broker-dealers and investment advisers—already have the required procedures in place, because of existing statutory requirements.[141]

3. Rule 10b5–2

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

F. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap, or conflict with proposed Regulation FD, Rule 10b5–1, or Rule 10b5–2.

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[131] 15 U.S.C. 77j, 77s(a), and 77z–3.

[132] 15 U.S.C. 78c, 78i, 78j, 78m, 78o, 78w, and 78mm.

[133] 15 U.S.C. 80a–29.

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

[135] The Commission bases its estimate on information from the Insight database from Compustat, a division of Standard and Poors.

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

[137] Exchange Act Rule 0–10(c) defines a broker-dealer as a small entity if it had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared and it is not affiliated with any person (other than a natural person) that is not a small entity. 17 CFR 240.0–10(c).

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

[139] The Commission bases its estimate on information from FOCUS Reports.

[140] The Commission bases its estimate on information from the Commission's database of registration information.

[141] *See* Section 15(f) of the Exchange Act (15 U.S.C. 78o(f)); Section 204A of the Investment Advisers Act (15 U.S.C. 80b–4a).

G. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entity issuers. In connection with proposed Regulation FD and Rule 10b5–1 we considered the following alternatives: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (b) the clarification, consolidation, or simplification of compliance and reporting requirements under the Rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the Regulation or Rule, or any part thereof, for small entities.

With respect to proposed Regulation FD, we believe that different compliance or reporting requirements or timetables for small entities would interfere with achieving the primary goal of protecting investors. For the same reason, we believe that exempting small entities from coverage of proposed Regulation FD, in whole or part, is not appropriate. In addition, we have concluded preliminarily that it is not feasible to further clarify, consolidate, or simplify the proposed Regulation for small entities. We have used performance elements in proposed Regulation FD in two ways. Regulation FD does not require that an issuer satisfy its obligations in accordance with any specific design, but rather allows each issuer, including small entities, flexibility to select the method of compliance that is most efficient and appropriate for its business operations. First, each issuer can select what method(s) to use to avoid selective disclosure (*e.g.,* by designating which authorized official(s) will speak with analysts). Second, each issuer can choose what method(s) to use for ''public disclosure'' (*e.g.,* filing a Form 8–K, issuing a press release, holding a conference call transmitted telephonically or over the Internet, etc.). We do not believe different performance standards for small entities would be consistent with the purpose of the proposed Regulation.

With respect to proposed Rule 10b5–1, we believe that different compliance requirements for small entities would interfere with achieving the primary goal of protecting investors. For the same reason, we believe that exempting small entities from coverage of proposed Rule 10b5–1, in whole or part, is not appropriate. In addition, we have concluded that it is not feasible to further clarify, consolidate, or simplify the proposed Rule for small entities. First, the aspects of proposed Rule 10b5–1 that indirectly involve compliance requirements are affirmative defenses that are not required to comply with the proposed Rule. Second, we have used performance elements for the affirmative defenses based on an index trading plan or an institutional investor implementing proper informational barriers set forth in paragraphs (c)(1)(i)(D) and (c)(2) of proposed Rule 10b5–1. If an entity decides to assert either of these affirmative defenses, proposed Rule 10b5–1 does not require that it satisfy its obligations under either of the affirmative defenses in accordance with any specific design, but rather allows it flexibility to select which measure(s) it wants to put in place to satisfy the elements of each affirmative defense. We do not believe different performance standards for small entities would be consistent with the purpose of the proposed Rule.

H. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding: (i) The number of small entity issuers that may be affected by the proposed Regulation and Rules; (ii) the existence or nature of the potential impact of the proposed Regulation and/or Rules on small entity issuers discussed in the analysis; and (iii) how to quantify the impact of the proposed Regulation and Rules. Commentators are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed Regulation and/or Rules are adopted, and will be placed in the same public file as comments on the proposed Regulation and Rules themselves.

IX. Statutory Bases

We are proposing Regulation FD, Rule 181, the amendments to Forms 6–K and 8–K, Rule 10b5–1 and Rule 10b5–2 under the authority set forth in Sections 10, 19(a), and 28 of the Securities Act, Sections 3, 9, 10, 13, 15, 23, and 36 of the Exchange Act, and Section 30 of the Investment Company Act.

List of Subjects

17 CFR Part 230

Securities, Reporting and recordkeeping requirements, Investment companies.

17 CFR Part 240

Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 243 and 249

Securities, Reporting and recordkeeping requirements.

Text of Proposed Rules and Rule Amendments

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

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77f, 77g, 77h, 77j, 77r, 77s, 77sss, 78c, 78d, 78l, 78m, 78n, 78o, 78w, 78*ll*(d), 79t, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, unless otherwise noted.

* * * * *

2. Section 230.181 is added to read as follows:

§ 230.181 Public disclosures required under Regulation FD.

Notwithstanding Section 5(b)(1) of the Act (15 U.S.C. 77e(b)(1)), any public disclosure that constitutes a prospectus need not satisfy the requirements of Section 10 (15 U.S.C. 77j) of the Act if the prospectus is used only as required under Rule 100(a) of Regulation FD (17 CFR 243.100(a)) and the registrant otherwise complies with the requirements of Regulation FD.

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

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

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*(d), 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, and 80b–11, unless otherwise noted.

* * * * *

4. Section 240.10b5–1 is added after § 240l.10b–5 to read as follows:

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

Preliminary Note to § 240.10b5–1: This provision defines when a purchase or sale constitutes trading ''on the basis of'' material nonpublic information in insider trading cases brought under Section 10(b) of the Act and Rule 10b–5 thereunder. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b–5, and

Rule 10b5–1 does not address or modify the scope of insider trading law in any other respect.

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

(b) *Definition of ''on the basis of.''* Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is ''on the basis of'' material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.

(c) *Affirmative defenses*.

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

(A) Had entered into a binding contract to purchase or sell the security in the amount, at the price, and on the date which the person purchased or sold the security;

(B) Had provided instructions to another person to execute a purchase or sale of the security for the instructing person's account, in the amount, at the price, and on the date which that purchase or sale was executed;

(C) Had adopted, and had previously adhered to, a written plan specifying purchases or sales of the security in the amounts, and at the prices, and on the dates at which the person purchased or sold the security; or

(D) Had adopted, and had previously adhered to, a written plan for trading securities that is designed to track or correspond to a market index, market segment, or group of securities, and the amounts, prices, and timing of the purchases or sales actually made were the result of following the previously adopted plan.

(ii) The defenses provided in paragraph (c)(1)(i) of this section shall be available only when the contract, plan, or instruction to purchase or sell securities was entered into in good faith, and not as part of a plan or scheme to evade the prohibitions of this section. For example, if, after becoming aware of material nonpublic information, a person alters a previous contract, plan, or instruction to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale), or enters into or alters a corresponding or hedging transaction or position with respect to those securities, the person shall not be able to assert the contract, plan, or instruction as a defense to liability.

(iii) For purposes of paragraph (c), the following definitions shall apply:

(A) *In the amount(s).* A contract, plan, or instruction for a purchase or sale of securities in specified ''amount(s)'' must specify either the aggregate number of shares or other securities to be purchased or sold, or the aggregate dollar amount of securities to be purchased or sold.

(B) *At the price(s).* A contract, plan, or instruction for a purchase or sale of securities at specified ''price(s)'' includes one that specifies a purchase or sale at the market price for a particular date.

(2) In the case of a person other than a natural person, a purchase or sale of securities is not ''on the basis of'' material nonpublic information if the person demonstrates that:

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

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

5. Section 240.10b5–2 is added to read as follows:

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

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

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

(b) *Enumerated ''duties of trust or confidence.''* For purposes of this section, the circumstances under which a ''duty of trust or confidence'' exist shall include, among others, the following:

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

(2) Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the person communicating the material nonpublic information has a reasonable expectation that the other person would maintain its confidentiality; or

(3) Whenever a person receives or obtains material nonpublic information from the person's spouse, parent, child, or sibling; *provided*, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that the spouse, parent, child, or sibling that was the source of the information had no reasonable expectation that the person would keep the information confidential, because the parties had neither a history, pattern, or practice of sharing confidences, nor an agreement or understanding to maintain the confidentiality of the information.

6. Part 243 is added to read as follows:

PART 243—REGULATION FD

Sec.

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

§ 243.100 General rule regarding selective disclosure.

(a) Except as provided in paragraph (b) of this section, whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person or persons outside the issuer, the issuer shall:

(1) In the case of an intentional disclosure, make public disclosure of that information simultaneously; and

(2) In the case of non-intentional disclosure, make public disclosure of that information promptly.

(b) Paragraph (a) of this section shall not apply when a disclosure is made to a person who owes a duty of trust or confidence to the issuer (including, for example, an outside consultant such as an attorney, investment banker, or accountant) or to a person who has expressly agreed to maintain such information in confidence.

§ 243.101 Definitions.

For purposes of this Regulation FD (§ 243.101), the following definitions shall apply:

(a) *Intentional.* A selective disclosure of material nonpublic information is ''intentional'' when the individual making the disclosure either knew prior to the disclosure, or was reckless in not knowing, that he or she would be communicating information that was material and nonpublic.

(b) *Issuer.* Every issuer having securities registered pursuant to section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*), or which is required to file reports under Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), including closed-end investment companies (as defined in Section 5(a)(2) of the Investment Company Act of 1940) (15 U.S.C. 80a–5(a)(2)) but not including other investment companies, shall be subject to this Regulation.

(c) *Person acting on behalf of an issuer.* Any officer, director, employee, or agent of an issuer, who discloses material nonpublic information while acting within the scope of his or her authority, shall be considered to be a ''person acting on behalf of the issuer.'' An officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to the issuer shall not be considered to be acting on behalf of the issuer.

(d) *Promptly.*

(1) ''Promptly'' shall mean disclosure as soon as reasonably practicable (but in no event more than 24 hours) after a senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser) knows, or is reckless in not knowing, of the non-intentional disclosure.

(2) For purposes of paragraph (d)(1) of this section, a ''senior official'' means any director, any executive officer (as defined in § 240.3b–7 of this chapter), any investor relations or public relations officer, or any other person with similar functions.

(e) *Public disclosure.*

(1) Except as provided in paragraph (e)(2) of this section, an issuer shall make the ''public disclosure'' of information required by § 243.100(a) of this chapter by filing with the Commission a Form 8–K (17 CFR 249.308) disclosing that information, or if the issuer is a foreign private issuer it shall file a Form 6–K (17 CFR 249.306).

(2) An issuer shall be exempt from the requirement to file a Form 8–K or Form 6–K if it instead does one of the following:

(i) Disseminates a press release containing that information through a widely circulated news or wire service; or

(ii) Disseminates the information through any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude any members of the public from access, such as announcement at a press conference to which the public is granted access (*e.g.*, by personal attendance or by telephonic or other electronic transmission).

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

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

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

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

* * * * *

8. Form 6–K (referenced in § 249.306) is amended by revising the phrase ''and any other information which the registrant deems of material importance to securityholders'' in the second paragraph of General Instruction B to read ''information required to be publicly disclosed under Regulation FD (17 CFR 243.100) except information publicly disclosed in accordance with Rule 101(e)(2) of Regulation FD (17 CFR 243.101(e)(2)); and any other information which the registrant deems of material importance to securityholders''.

Note: Form 6–K does not and the amendments will not appear in the Code of Federal Regulations.

9. Section 249.308 is revised (Ed. Note remains unchanged) to read as follows:

§ 249.308 Form 8–K, for current reports.

This form shall be used for the current reports required by Rule 13a–11 or Rule 15d–11 (§ 240.13a–11 or § 240.15d–11 of this chapter) and for reports of material nonpublic information required to be disclosed by Regulation FD (§ 243.100 and § 243.101 of this chapter).

10. Form 8–K (referenced in § 249.308) is amended:

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

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

c. in General Instruction B.4., by revising the phrase ''other events of material importance pursuant to Item 5,'' to read ''other events of material importance pursuant to Item 5 and of reports pursuant to Item 10,'';

d. by adding a new Item 10 under ''Information To Be Included in the Report'' to read as follows:

Note: Form 8–K does not and the amendments will not appear in the Code of Federal Regulations.

Form 8–K

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General Instructions

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B. Events To Be Reported and Time for Filing of Reports

1. * * * A report on this form pursuant to Item 10 shall be filed in accordance with the requirements of Rule 100(a) of Regulation FD (17 CFR 243.100(a)).

* * * * *

Information to be Included in the Report

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Item 10. Regulation FD Disclosure.

Report under this item the material nonpublic information required to be disclosed by Regulation FD (17 CFR 243.100 and 243.101).

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By the Commission.

Dated: December 20, 1999.

Margaret H. McFarland,

Deputy Secretary.

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