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## Governing the Corporate Insiders: Improving Regulation Fair Disclosure With More Robust Guidance and Stronger Penalties for Individual Executives

Christopher Ippoliti

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# GOVERNING THE CORPORATE INSIDERS: IMPROVING REGULATION FAIR DISCLOSURE WITH MORE ROBUST GUIDANCE AND STRONGER PENALTIES FOR INDIVIDUAL EXECUTIVES

CHRISTOPHER IPPOLITI\*

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## I. INTRODUCTION

This article will first discuss the history of Regulation Fair Disclosure (Regulation FD), the problems it was intended to remedy, the scope of the regulation, and acceptable methods of disclosing material information in compliance with the rule.<sup>1</sup> Part III will then examine specific further guidance and two investigative reports issued by the United States Securities and Exchange Commission (SEC) impacting Regulation FD disclosures.<sup>2</sup> In Part IV, this article sets forth a comprehensive analysis of all the specific enforcement actions pursued by the SEC and the penalties assessed against publicly traded companies and individuals for Regulation FD violations.<sup>3</sup> Part V will evaluate the effectiveness of the rule and discuss whether any modifications may be warranted to clarify the disclosure requirements and enforce the rule to afford more protection to investors.<sup>4</sup>

## II. THE HISTORY OF REGULATION FAIR DISCLOSURE AND ACCEPTABLE METHODS FOR COMPLIANCE WITH THE SAME

The Securities Exchange Act operates to prevent pools and manipulations in the securities of your companies. It sets up standards for providing certain minimum information in the solicitation of proxies. Equally important, it recognizes that officers, directors[,] and dominant stockholders are fiduciaries and should not trade on inside information; and accordingly it penalizes certain purchases and sales.<sup>5</sup>

Thereafter, the Securities and Exchange Commission was created in 1934 with the following express purposes to: (1) protect investors; (2) maintain fair, orderly, and efficient markets; and (3) facilitate capital formation.<sup>6</sup> As part of the SEC's mission to protect investors, and to combat insider trading, "[o]n August 15, 2000, the SEC adopted Regulation FD to address the selective disclosure of information by publicly traded companies and other issuers."<sup>7</sup> However, discriminatory disclosure of forecast data by corporate management was previously

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<sup>1</sup> See *infra* Part II and accompanying notes 6–33.

<sup>2</sup> See *infra* Part III and accompanying notes 34–76.

<sup>3</sup> See *infra* Part IV and accompanying notes 77–180.

<sup>4</sup> See *infra* Part V and accompanying notes 181–255.

<sup>5</sup> William O. Douglas, Chairman, Sec. and Exch. Comm'n, Address at a Dinner given by the Society for the Advancement of Management for the Delegates of the International Management Congress (Sept. 21, 1938), available at [www.sechistorical.org/collection/papers/1930/1938\\_0921\\_DouglasManagement.pdf](http://www.sechistorical.org/collection/papers/1930/1938_0921_DouglasManagement.pdf) (last visited Dec. 12, 2013).

<sup>6</sup> *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last visited Oct. 3, 2013).

<sup>7</sup> *Fair Disclosure, Regulation FD*, SEC, <http://www.sec.gov/answers/regfd.htm> (last visited Oct. 3, 2013).

acknowledged many decades earlier, as follows:

At the same time as many companies announced their projections publicly, a number of others communicated their expectations to a select few:

Favored analysts might be advised of current budget data either directly or by letting them know that their estimates were “in the ball park.” Through a variety of such devices, many corporations sought to be sure that “market” estimates of their earnings were not far off the mark while still not taking any public position on the projected results. While the overwhelming majority of such efforts were done in good faith, the end result was lack of knowledge as to what forecasts were those of management as opposed to those of analysts working independently. In a few cases there was evidence of selective disclosure to institutional investors interested in the stock and unfair use of such insider information.<sup>8</sup>

To address this problem, Regulation FD “provides that when an issuer, or person acting on its behalf, discloses material[,] nonpublic information to certain enumerated persons (in general, securities market professionals and holders of the issuer’s securities who may trade on the basis of the information), it must make public disclosure of that information.”<sup>9</sup> Additionally, Regulation FD, like insider trading regulations, is a matter of corporate governance, because it affects the relationship between corporate directors and officers, among other insiders, and the corporation’s shareholders, on the other.<sup>10</sup> Moreover, Regulation FD is justified because disclosures of material information uphold the SEC’s mission in two ways—by protecting investors and maintaining fair markets.

#### A. *Potential Issues Remedied by the Adoption of Regulation FD*

The first major aspect Regulation FD intended to address was the fact issuers were disclosing important, nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors, or both, before making full disclosure of the same information to the general public.<sup>11</sup> This type of selective disclosure has been characterized as an “unerodable[,]

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<sup>8</sup> John C. Burton, *FORECASTS: A Changing View from the Securities and Exchange Commission*, available at [www.sechistorical.org/collection/papers/1970/1973\\_0402\\_Burton\\_Forecasts.pdf](http://www.sechistorical.org/collection/papers/1970/1973_0402_Burton_Forecasts.pdf) (last visited Dec. 12, 2013).

<sup>9</sup> Selective Disclosure and Insider Trading, Release Nos. 33-7881, 34-43154, IC-24599, 65 Fed. Reg. 51,716, 51,716 (Aug. 15, 2000) [hereinafter Regulation FD Adopting Release], available at <http://www.gpo.gov/fdsys/pkg/FR-2000-08-24/pdf/00-21156.pdf>; see 17 C.F.R. § 243.100(a) (2012).

<sup>10</sup> Joan M. Heminway, *Rock, Paper, Scissors: Choosing the Right Vehicle for Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP. & FIN. L. 225, 238 (2005).

<sup>11</sup> Regulation FD Adopting Release, *supra* note 10, at 51,717.

informational advantage.”<sup>12</sup> Although it is important to label this appropriately as a wrongful advantage, it is consistent with earlier forms of abuse in the trading markets:

[T]he “Pecora Hearings”[] uncovered a wealth of material about manipulation, insider trading, [and] breaches of fiduciary duty by the controlling persons of corporations and other strategically situated people who profited handsomely out of the financial distress of the companies that they dominated. It showed how these persons sold the stocks of their own companies short, concealed material information, and engaged in other malpractices.<sup>13</sup>

Consequently, those in possession of this nonpublic information were able to use this advantage to make a profit or avoid a loss at the expense of those investors kept in the dark.<sup>14</sup> At its heart, preventing the use of nonpublic information by industry insiders is a matter of fairness to all investors, especially retail investors. Nonetheless, the second major issue Regulation FD was designed to tackle concerned another threat to the integrity of the markets—the potential for corporate management to treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors.<sup>15</sup>

Substantively, Regulation FD requires, when an issuer makes an intentional disclosure of material, nonpublic information to a person covered by the regulation, it must do so in a manner that provides general public disclosure, rather than through a selective disclosure.<sup>16</sup> For a selective disclosure that is non-intentional, the issuer must publicly disclose the information promptly after it knows, or is reckless in not knowing, the information selectively disclosed was both material and nonpublic.<sup>17</sup> Absent a specified exclusion, selective disclosure may not be made to the following persons: (1) broker-dealers and their associated persons; (2) investment advisers, certain institutional investment managers, and their associated persons; and (3) investment companies, hedge funds, and affiliated persons.<sup>18</sup> This list was expanded with the passage of the Dodd-Frank Wall Street Reform and

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<sup>12</sup> United States v. O’Hagan, 521 U.S. 642, 658 (1997) (citing Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 356 (1979)); see also H.R. REP. NO. 100-910, at 8 (1988) (“The investing public has a legitimate expectation that the prices of actively traded securities reflect publicly available information about the issuer of such securities. . . . [T]he small investor will be—and has been—reluctant to invest in the market if he feels it is rigged against him.”).

<sup>13</sup> Bernard Wexler, *History of the Securities and Exchange Commission*, (Aug. 3, 1975), [www.sechistorical.org/collection/papers/1970/1975\\_0101\\_Wexler\\_History\\_SEC.pdf](http://www.sechistorical.org/collection/papers/1970/1975_0101_Wexler_History_SEC.pdf).

<sup>14</sup> Regulation FD Adopting Release, *supra* note 10, at 51,717.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 51,716, 51,719.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 51,721.

Consumer Protection Act, which eliminated the exemption for credit rating agencies.<sup>19</sup>

*B. The Scope of Regulation FD and Examples of Material Information*

The regulation applies to disclosures of “material, nonpublic” information about the issuer or its securities.<sup>20</sup> Relying on prior case law, Regulation FD’s Adopting Release explains information is defined as material if “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision.<sup>21</sup> To satisfy the materiality requirement, there must be a substantial likelihood a fact “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”<sup>22</sup> Instead of articulating a bright-line rule to determine materiality, the Adopting Release sets forth seven items it recommends should be reviewed carefully to determine whether they are material: (1) earnings information; (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract); (4) changes in control or management; (5) change in auditors; (6) a default or calling of securities, changes to the rights of security holders, and public or private sales of additional securities; and (7) bankruptcies.<sup>23</sup>

*C. Acceptable Methods for Disclosure of Material Information*

Regardless of the type of material information, a company may make the required disclosure by filing a form 8-K containing the information with the SEC, or by another method intended to reach the public on a broad, non-exclusionary basis, such as a press release.<sup>24</sup> Moreover, the Adopting Release reflects issuers should have flexibility to select among methods, or a combination of methods, to communicate directly with the market.<sup>25</sup>

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<sup>19</sup> *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act—Accomplishments*, SEC, <http://www.sec.gov/spotlight/dodd-frank/accomplishments.shtml#credit> (last visited Nov. 6, 2013).

<sup>20</sup> Regulation FD Adopting Release, *supra* note 10, at 51,722.

<sup>21</sup> *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *see Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988).

<sup>22</sup> *TSC Indus., Inc.*, 426 U.S. at 449.

<sup>23</sup> Richard Walker, Dir., Div. of Enforcement, Sec. and Exch. Comm’n, Speech by SEC Staff: Regulation FD—An Enforcement Perspective (Nov. 1, 2000), *available at* <http://www.sec.gov/news/speech/spch415.htm>; *see also* Regulation FD Adopting Release, *supra* note 10, at 51,721.

<sup>24</sup> *Fact Sheet: Regulation Fair Disclosure and New Insider Trading Rules*, SEC (Aug. 10, 2000), <http://www.sec.gov/news/extra/seldsfct.htm>.

<sup>25</sup> Regulation FD Adopting Release, *supra* note 10, at 51,716–17, 51,724.

Acceptable methods of public disclosure to comply with Regulation FD include press releases distributed through a widely circulated news or wire service, or announcements made through press conferences or conference calls, which interested members of the public may attend or listen to either in person, by telephonic transmission, or by other electronic transmission, including use of the Internet.<sup>26</sup> In particular, the Adopting Release discusses an example of a planned disclosure of an earnings release that would satisfy Regulation FD if a company took the following steps: (1) it issued a press release distributing the information; (2) provided notice of a conference call to discuss the information; and (3) gave the public the opportunity to listen to the call or view it electronically.<sup>27</sup> In defining the outer contours of a compliant selective disclosure, the SEC cautioned against using a press release that is not carried by a major business wire service.<sup>28</sup> Additionally, it advised issuers not to deviate from their usual practices if doing so would not result in an effective, broad, non-exclusionary disclosure of the information.<sup>29</sup>

#### *D. No Private Liability for Regulation FD Violations*

In an effort to avoid the potential for a “chilling effect” on issuer communications, the SEC decided violations of Regulation FD would not violate the general antifraud rule—Rule 10b-5.<sup>30</sup> As a result, an issuer’s failure to make a required public disclosure of material information is restricted to violations of Regulation FD and Section 13(a) of the Exchange Act.<sup>31</sup> Consequently, private plaintiffs may not use violations of Regulation FD as a basis for a lawsuit and only the SEC may enforce the regulation.<sup>32</sup> This decision to limit the scope of liability appears to have been a concession to large brokerage firms opposing the rule.<sup>33</sup> While a concession may have been necessary to initially effectuate the rule, the time is ripe to reconsider whether its reach should be expanded.

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<sup>26</sup> *Id.* at 51,716, 51,723–24.

<sup>27</sup> *Id.* at 51,716, 51,724.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Written Statement Of the U.S. Securities And Exchange Commission Concerning Regulation FD (“Fair Disclosure”) Before the Subcomm. on Capital Mkts., Ins. and Gov’t Sponsored Enter. Comm. on Fin. Servs., 107th Cong. (2001) (written statement of the SEC), available at <http://www.sec.gov/news/testimony/051701wssec.htm>; see also 17 C.F.R. § 243.102 (2014).*

<sup>31</sup> Regulation FD Adopting Release, *supra* note 10, at 51,726.

<sup>32</sup> *Id.*

<sup>33</sup> LAURA S. UNGER, SEC, SPECIAL STUDY: REGULATION FAIR DISCLOSURE REVISITED, COMMISSIONER LAURA S. UNGER (Dec. 2001), *available at* <http://www.sec.gov/news/studies/regfdstudy.htm>.



### III. FURTHER GUIDANCE AND INVESTIGATIVE REPORTS ADDRESSING REGULATION FD DISCLOSURES

#### A. *SEC Interpretations (October 2000–June 2001)*

In response to telephone inquiries, the SEC's Division of Corporation Finance produced a document entitled "Manual of Publicly Available Telephone Interpretations" that sets forth interpretations of Regulation FD, and appropriate updates with further examples, on October 2000, December 2000, and May 2001.<sup>34</sup> The interpretations consist of eighteen questions and answers designed to elucidate specific situations where Regulation FD may trigger public reporting requirements.<sup>35</sup> Interestingly, the manual states Regulation FD is *not* intended to replace the practice of using a press release to disseminate earnings information in advance of a conference call or webcast at which earnings information will be discussed.<sup>36</sup> Instead, the SEC confirmed its endorsement of the practice where a conference call or webcast is preceded by a press release containing earnings information.<sup>37</sup> Although the SEC focused on earnings information because it is probably the category most affected by selective disclosures, the interpretation implies this practice applies to all of the categories previously identified as containing material information. By this period in time, the use of other forms of technology, especially the Internet and the World Wide Web, had not yet proliferated, so it is not surprising the interpretations do not provide additional guidance regarding the dissemination of earnings information or other relevant categories of information.

#### B. *Motorola, Inc., Investigative Report (November 25, 2002)*

As a result of an enforcement investigation, the SEC issued a Section 21(a) report<sup>38</sup> as to "whether Motorola, Inc. (Motorola) violated the federal securities laws when one of its senior officials selectively disclosed information about the company's quarterly sales and orders during private telephone calls with sell-side

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<sup>34</sup> *Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations Fourth Supplement (Includes Interpretations Issued May 2001, December 2000, and October 2000)*, SEC, (June 8, 2001) [hereinafter *Manual of Publicly Available Telephone Interpretations*], available at <http://www.sec.gov/interps/telephone/phonesupplement4.htm>.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> The SEC uses a Section 21(a) report as a vehicle to signal how it views a particular problematic area or set of practices and to provide notice that going forward it will consider similar conduct to be fair game for enforcement action. Broc Romanek, *A Section 21(a) Report History Lesson: SEC Issues New One Cautioning Rating Agencies*, THECORPORATECOUNSEL.NET (Sept. 1, 2010), <http://www.thecorporatecounsel.net/Blog/2010/09/nyse-regulation-transfers-its-regulatory.html>.

analysts in March 2001.”<sup>39</sup>

In a February 23, 2001, press release and a public conference call, Motorola’s President and Chief Operating Officer stated sales and orders were experiencing “significant weakness,” and Motorola was likely to miss its earnings estimates of twelve cents per share for the first quarter and have an operating loss for the quarter if the order pattern continued.<sup>40</sup>

After the conference call, Motorola’s Director of Investor Relations (IR Director) concluded the analysts had not understood how disappointing the results were for the quarter.<sup>41</sup> Additionally, because the word “significant” was unspecific, the IR Director wanted to clarify this for selected analysts and relied on Motorola’s in-house counsel for guidance.<sup>42</sup> In this regard, Motorola’s in-house counsel specifically advised the IR Director:

[H]e could contact selected analysts, reiterate the information previously disclosed on February 23, 2001[,] and provide quantitative definitions for certain qualitative terms that were used in the February 23rd announcements. Counsel based this legal advice on the conclusion that providing a quantitative definition for the term “significant” was not material. Moreover, counsel also concluded that Motorola’s particular definition of the word “significant” was public for Regulation FD purposes.<sup>43</sup>

Thereafter, the IR Director telephoned every one of the analysts and told them the prior use of the term “significant” meant a “25% or more” decline. However, in spite of this follow-up action, Motorola elected not to issue a new press release or otherwise make any timely public disclosure of this additional information.<sup>44</sup>

The SEC determined the information selectively disclosed by Motorola was clearly material because there was a substantial likelihood a reasonable investor would consider it important if Motorola’s sales were down by 25% or more for the quarter.<sup>45</sup> The report also pointed out 25% was an exact quantitative figure that should have been disclosed to the public.<sup>46</sup> Accordingly, Motorola’s in-house counsel should have understood there were multiple potential interpretations investors could have attached to the term “significant,” and it could have meant

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<sup>39</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Motorola, Inc., Exchange Act Release No. 46898, 2002 WL 31650174 (Nov. 25, 2002), *available at* <http://www.sec.gov/litigation/investreport/34-46898.htm>.

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

sales were down 50% or more. Moreover, the SEC also warned issuers to be particularly cautious in private conversations with analysts, especially when discussing earnings.<sup>47</sup> Additionally, concerning the supplementation of prior public disclosures, the SEC stated its position as follows: “We are particularly troubled that in this case, after Motorola knew that even securities professionals had failed to understand the message Motorola purportedly was trying to convey, the company chose to contact selected analysts only, rather than make broad public disclosure.”<sup>48</sup>

This precise admonition was noteworthy because the SEC had made it clear in the June 2001 interpretation Regulation FD does *not* create a duty to update.<sup>49</sup> Nevertheless, because the IR Director relied on Motorola’s in-house counsel in good faith, the SEC decided not to pursue enforcement on this occasion.<sup>50</sup> However, the Section 21(a) report cautions an issuer should not rely upon a good faith consultation with counsel in the future if this situation arises.<sup>51</sup> In particular, communicating with counsel will not relieve an individual or a company from liability for disclosing information a person “knows, or is reckless in not knowing, is material and nonpublic.”<sup>52</sup>

The Section 21(a) report on Motorola’s conduct is important because it affirms prior guidance made available by the SEC—issuers and their corporate counsel must be careful when disclosing material, nonpublic information to analysts regarding earnings. In this case, Motorola could have avoided scrutiny if it opted to take one of the following courses of action: (1) it could have issued a press release and filed an 8-K to clarify the term “significant” meant sales would be down by 25% or more, with a conference call and webcast, or either, to discuss this with the public and answer questions about this issue; or (2) because Regulation FD does not impose a duty to update, Motorola could have chosen not to comment on what it previously meant by “significant” and waited until the filing of the next quarterly earnings report to release the actual results.<sup>53</sup> Nevertheless, the first option is arguably the better choice because it proactively addresses the issue and, therefore, should prevent any future allegations of a Regulation FD and Section 13(a) violation.

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<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> Manual of Publicly Available Telephone Interpretations, *supra* note 34.

<sup>50</sup> Report of Investigation Pursuant to Section 21(a): Motorola, Inc., *supra* note 39.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> Of course, an Exchange Act filing other than a Form 8-K, such as a Form 10-Q or proxy statement may provide another satisfactory alternative that would suffice if the company takes care to bring the disclosure to the attention of readers of the document, does not bury the information, and does not make the disclosure in a piecemeal fashion throughout the filing. *Regulation FD*, SEC (last updated Jun. 4, 2010) <http://www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm>.

As we will later see in Part IV, since the situation arose with Motorola, other issuers clearly received and understood the SEC's message because there have since been no occasions where any companies or their executives have attempted to defend an alleged Regulation FD and Section 13(a) violation by contending they relied on the advice of counsel in good faith.

*C. Interpretive Guidance on the Use of Company Web Sites (2008)*

By August 1, 2008, the SEC determined it was necessary to publish additional guidance on Regulation FD.<sup>54</sup> In fact, the release requires companies to embrace the use of technology by numerous means, including the use of websites, satisfying Exchange Act disclosures by filing them online with the Electronic Data Gathering, Analysis, and Retrieval system (EDGAR) or making them available on an issuer's website, and posting interactive data files on company websites.<sup>55</sup> This represented a significant advance in the SEC's attitude towards the Internet, both embracing and mandating the use of technology for public issuers. As an important part of this, the guidance also makes clear it is necessary to determine whether the information presented on company websites implicates Regulation FD:

In evaluating whether information is "public" for purposes of the applicability of Regulation FD to subsequent discussions or disclosure, companies must consider whether and when: [(1)] a company web site is a recognized channel of distribution; [(2)] posting of information on a company web site disseminates the information in a manner making it available to the securities marketplace in general; and, [(3)] there has been a reasonable waiting period for investors and the market to react to the posted information.<sup>56</sup>

The release identifies factors that can be used to assess the first two elements to determine whether a company's website is a recognized channel of distribution and whether the information posted on its website is "accessible" and, therefore, "disseminated," as follows:

Does the company disclose its website address in its periodic reports and in press releases?

Does the company also disclose that it routinely posts important information on its website?

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<sup>54</sup> Commission Guidance on the Use of Company Web Sites, Exchange Act Release No. 58288, 2008 WL 4068202 (Aug. 7, 2008), available at <http://www.sec.gov/rules/interp/2008/34-58288.pdf>.

<sup>55</sup> *Id.*

<sup>56</sup> Kim McManus, Special Counsel, Div. of Corp. Fin., SEC, Speech by SEC Staff: Commission Guidance on the Use of Company Web Sites (Jul. 30, 2008), <http://www.sec.gov/news/speech/2008/spch073008km.htm>.

Has the company made investors and the markets aware it will post important information on the website?

Does the company have a pattern or practice of posting important information on its website?

Does the website lead investors and the market efficiently to company information?

Is the information prominently disclosed on the website? Is it presented in a readily accessible format?

Is the information on the website regularly accessed by the market and the media?<sup>57</sup>

Has a company taken other steps to make the information accessible by using push technology, RSS feeds, or by way of other distribution channels?

Is the company's website current and accurate?

Does the company use other methods in addition to its website to disseminate information? If so, are these methods the ones predominantly used to disseminate information?<sup>58</sup>

For the third element, evaluating what constitutes a reasonable waiting period depends on the facts and circumstances of dissemination, including:

The size and market following of the company; how frequently investor information on the company website is accessed; what steps the company has taken to notify investors and the market that its website is a key source of important information about the company;

Whether the company has actively taken steps to disseminate the information or made it available on the website; and,

The nature and complexity of the information.<sup>59</sup>

The guidance also states for some companies in certain circumstances, it may be sufficient to disclose information using a website so a subsequent selective disclosure would not trigger Regulation FD.<sup>60</sup> This is acceptable when the website

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<sup>57</sup> *Id.* Here, a distinction is drawn between smaller companies with less of a market following and large, more established companies, with a recommendation for the former to take "more" affirmative steps to ensure investors know information has been posted on the company's website. *Id.*

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

posting is “reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”<sup>61</sup> And, because intentional disclosures must be made simultaneously, companies must ensure their websites are capable of complying with this timing requirement.<sup>62</sup> As an example, the guidance suggests a posting on a blog, by or on behalf of the company, would be treated the same as any other posting on a company’s website.<sup>63</sup> Furthermore, the company would have to consider the factors to ensure the blog posting could be considered “public” before proceeding.

Because the 2008 Guidance sets forth a sizeable number of parameters for online disclosures, it is worthwhile to point out the SEC continued to embrace the general “facts and circumstances” test to determine whether an issuer’s method of making a particular disclosure was reasonable.

*D. Section 21(a) Report on Reed Hastings and Netflix, Inc. (April 2, 2013)*

On July 3, 2012, just before 11:00 a.m. Eastern Standard Time, Reed Hastings, the Chief Executive Officer for Netflix, Inc., (Netflix) used his personal Facebook account to announce:

Netflix had streamed 1 billion hours of content in the month of June. Neither Hastings nor Netflix had previously used Hastings’s personal Facebook page to announce company metrics, and Netflix had not previously informed shareholders that Hastings’s Facebook page would be used to disclose information about Netflix. The post was not accompanied by a press release, a post on Netflix’s own web site or Facebook page, or a Form 8-K.<sup>64</sup>

On December 6, 2012, Netflix disclosed in a filing with the SEC, on December 5, 2012, Netflix and its Chief Executive Officer Reed Hastings each received a “Wells Notice” from the staff of the SEC indicating its intent to recommend to the SEC it should institute a cease and desist proceeding and/or bring a civil injunctive action against Netflix and Mr. Hastings for violations of Regulation FD and Section 13(a).<sup>65</sup>

In spite of its initial pursuit of an enforcement action, the SEC later reversed

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<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Exchange Act Release No. 69279 (Apr. 2, 2013), *available at* <http://ftp.sec.gov/litigation/investreport/34-69279.htm>.

<sup>65</sup> Michael J. De La Merced, *S.E.C. Warns Netflix Over a Post on Facebook*, N.Y. TIMES, Dec. 6, 2012, [http://dealbook.nytimes.com/2012/12/06/s-e-c-weighs-suit-against-netflix-over-improper-disclosure/?\\_r=0](http://dealbook.nytimes.com/2012/12/06/s-e-c-weighs-suit-against-netflix-over-improper-disclosure/?_r=0).

course and decided to issue a Section 21(a) report to address the situation.<sup>66</sup> The SEC explained it wanted to address this particular situation and to also shed light on its position regarding the use of social media for disclosures.<sup>67</sup> Here, Hastings' Facebook post was:

[P]icked up by a technology-focused blog about an hour later, around 12:00 p.m. Eastern time, and by a handful of news outlets within two hours. Approximately an hour after the post, Netflix sent it to several reporters[] but did not disseminate it to the broader mailing list normally used for corporate press releases. After the markets closed early at 1:00 p.m., several articles in the mainstream financial press picked up the story.<sup>68</sup>

One of the problems arising from this posting was Netflix's stock continued a rise that began when the market opened on July 3, increasing from \$70.45 at the time of Hastings' Facebook post to \$81.72 at the close of the following trading day.<sup>69</sup> Another was Hasting publicly stated "we [Netflix] don't currently use Facebook and other social media to get material information to investors; we usually get that information out in our extensive investor letters, press releases[,] and SEC filings."<sup>70</sup>

As part of the Section 21(a) report, the SEC stated the disclosure of material, nonpublic information on the personal social media site of an individual corporate officer, without advance notice to investors the site may be used for this purpose, is unlikely to qualify as a method "reasonably designed to provide broad, non-exclusionary distribution of the information to the public" within the meaning of Regulation FD.<sup>71</sup> This is true even if the individual has a large number of subscribers, friends, or other social media contacts, such that the information is likely to reach a broader audience over time.<sup>72</sup> Personal social media sites of individuals employed by a public company would not ordinarily be assumed to be channels through which the company would disclose material corporate information.<sup>73</sup> In sum, the SEC's report cautioned others from engaging in this behavior going forward.

Besides the Hastings Facebook post, the SEC also communicated its

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<sup>66</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, *supra* note 64.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

expectation a company must take steps to alert the market about which forms of communication a company intends to use for the dissemination of material, non-public information, including the social media channels.<sup>74</sup> Providing appropriate notice to investors of the specific channels a company will use for the dissemination of material, nonpublic information is a sensible and expedient solution.<sup>75</sup> Similarly, disclosures on corporate web sites identifying the specific social media channels a company intends to use for the dissemination of material, nonpublic information would theoretically furnish investors and the markets the opportunity to take the steps necessary to be in a position to receive important disclosures by subscribing, joining, registering, or reviewing a particular channel.<sup>76</sup>

#### IV. ANALYSIS OF SPECIFIC ENFORCEMENT ACTIONS AND PENALTIES

##### A. *A Comprehensive Summary of All Existing Enforcement Actions*

Prior to the adoption of Regulation FD, the comments provided to the proposal ranged from complaints about the rule having a potential “chilling” effect on communications because it would make determining materiality too risky, with corporate executives becoming less inclined to discuss important information.<sup>77</sup> On the other hand, people argued against information overload that might result and impede the dissemination and absorption of the information in a meaningful way.<sup>78</sup> To address some of these concerns, Richard H. Walker, the Director for the SEC’s Division of Enforcement, stated it would be looking for two types of violations: (1) egregious violations involving the intentional or reckless disclosure of information that is unquestionably material; and, (2) cases against those who deliberately attempt to game the system either by speaking in code, or stepping over the line again and again, thus diminishing the credibility of a claim their disclosures were non-intentional.<sup>79</sup>

In reviewing the enforcement actions filed by the SEC, we will see Mr. Walker’s prediction was accurate. His comment captures the essential intent of

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<sup>74</sup> *Id.*

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> Laura S. Unger, Commissioner, Sec. and Exch. Comm’n, Speech by SEC Commissioner: Rethinking Disclosure in the Information Age: Can There Be Too Much of a Good Thing? (Jun. 26, 2000), available at <http://www.sec.gov/news/speech/spch387.htm>.

<sup>78</sup> Laura S. Unger, Commissioner, Sec. and Exch. Comm’n, Speech by SEC Commissioner: Securities Law and the Internet (Jul. 28, 2000), available at <http://www.sec.gov/news/speech/spch395.htm>.

<sup>79</sup> Richard H. Walker, Director, Division of Enforcement, Sec. and Exch. Comm’n, Speech by SEC Staff: Regulation FD—An Enforcement Perspective (Nov. 1, 2000), available at <http://www.sec.gov/news/speech/spch415.htm>.



## Regulation FD:

Despite the securities industry's outcry against Regulation FD and the flood of alarmist client letters from law firms, Regulation FD was not intended to be revolutionary, though it was clearly drafted to change behavior and to end practices that were universally regarded as unfair.<sup>80</sup>

Notwithstanding this, it took over two years after Regulation FD was enacted before the SEC brought its first enforcement actions on November 25, 2002.<sup>81</sup> Because there have only been thirteen enforcement actions brought by the SEC, the following represents an exhaustive treatment of the cases.

1. *In the Matter of Raytheon Co. and Franklyn A. Caine (November 25, 2002)*

Here, the SEC instituted an administrative proceeding because Franklyn A. Caine, Raytheon's Chief Executive Officer, allegedly selectively disclosed quarterly and semi-annual earnings guidance to sell-side equity analysts.<sup>82</sup> The company's sales force also sent e-mails to institutional customers about negative earnings information without simultaneously disclosing the same information to the public.<sup>83</sup>

In response, the SEC issued a cease and desist order to Raytheon and Caine from committing or causing any violations and any future violations of Section 13(a) of the Exchange Act or Regulation FD.<sup>84</sup> No monetary penalties were assessed, although Commissioner Campos dissented on this basis.<sup>85</sup>

2. *In Re Secure Computing Corp. and John McNulty (November 25, 2002)*

In early March 2002, Secure Computing Corporation, a Silicon Valley software company, and its Chief Executive Officer . . . John McNulty, [allegedly] disclosed material[,] non-public information about a significant contract to two portfolio managers at two institutional advisers in violation of Regulation FD . . . . Following the disclosures, Secure announced the contract to the public in a press release issued after the close of the stock markets. However, investors who sold

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<sup>80</sup> *Id.*

<sup>81</sup> SEC News Digest, Issue 2002-227, SEC, (Nov. 25, 2002), <https://www.sec.gov/news/digest/11-25.txt>.

<sup>82</sup> Raytheon Co., Exchange Act Release No. 46897, 2002 WL 31643026 (Nov. 25, 2002).

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

Secure's stock prior to the Company's press release were denied information that may have affected their investment decisions.<sup>86</sup>

The SEC issued a cease and desist order to Secure Computing Corp. and McNulty "from committing or causing any violations and any future violations of Section 13(a) of the Exchange Act or Regulation FD."<sup>87</sup> No monetary penalties were assessed, although Commissioner Campos dissented on this basis.<sup>88</sup>

3. *Securities and Exchange Commission v. Siebel Systems, Inc.*  
(November 25, 2002)

[O]n November 5, 2001, the company's Chief Executive Officer [allegedly] disclosed material, nonpublic information to the attendees of an invitation-only technology conference in California. At the conference, the company's CEO made positive comments about the company's business that were based on material, nonpublic information and that contrasted with negative statements that he had made about the company's business in a public conference call three weeks earlier. The public did not have access to the technology conference and was unable to benefit from the information that was disclosed at the conference. Immediately following the disclosures, certain attendees at the conference purchased the company's stock or communicated the disclosures to others who purchased the stock. On the day of the conference, the company's stock price closed approximately 20% higher than the prior day's close[,] and the trading volume was more than twice the average daily volume.<sup>89</sup>

The SEC determined the company violated Section 13(a) of the Exchange Act and Regulation FD, and the company consented to pay a \$250,000 civil penalty.<sup>90</sup>

4. *Securities and Exchange Commission v. Schering-Plough Corp.*  
(September 9, 2003)

The SEC charged, during the week of September 30, 2002, Schering's Chairman and CEO, Kogan, and senior vice president of investor relations met privately in Boston with analysts and portfolio managers of four institutional investors.<sup>91</sup> Three of these were Schering's largest investors.<sup>92</sup> "[A]t each of these

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<sup>86</sup> Secure Computing Corp., Exchange Act Release No. 46895, 2002 WL 31643024 (Nov. 25, 2002).

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> Siebel Sys., Inc., Litigation Release No. 17860, 2002 WL 31643062 (Nov. 25, 2002).

<sup>90</sup> *Id.*

<sup>91</sup> Schering-Plough Corp., Litigation Release No. 18330, 2003 WL 22082154 (Sept. 9, 2003); *see also* Schering-Plough Corp., Exchange Act Release No. 48461, 2003 WL 22082153 (Sept. 9, 2003).

meetings, through a combination of spoken language, tone, emphasis, and demeanor, Kogan allegedly disclosed negative and material, nonpublic information regarding Schering's earnings prospects, including that analysts' earnings estimates for Schering's 2002 third-quarter were too high, and that Schering's earnings in 2003 would significantly decline.<sup>93</sup> According to the SEC, "immediately after the meetings, analysts at Fidelity and Putnam downgraded their ratings on Schering, and portfolio managers at those firms and at Wellington heavily sold Schering stock."<sup>94</sup> Fidelity and Putnam each sold more than 10 million shares of Schering stock over a three-day period following the meetings, accounting for more than 30 percent of the overall market for that period.<sup>95</sup> The price of Schering's stock declined during this period by more than 17 percent, from \$21.32 to \$17.64 per share, on approximately four times normal volume.<sup>96</sup>

On October 3, 2002, in the midst of this sell-off, Kogan held a previously scheduled private meeting with approximately 25 analysts and portfolio managers at Schering's New Jersey headquarters, during which he said, among other things, Schering's 2003 earnings would be "terrible."<sup>97</sup> Later that evening, Schering issued a press release providing earnings guidance for 2002 and 2003 that was materially below analysts' consensus estimates and, with regard to the full 2002 fiscal year, materially below the company's own prior earnings guidance.<sup>98</sup>

To settle the matter, Schering agreed to pay a \$1,000,000 penalty, Kogan agreed to pay a \$50,000 penalty, and both parties agreed to entry of the SEC's cease and desist order.<sup>99</sup>

5. *Securities and Exchange Commission v. Siebel Systems, Inc., Kenneth A. Goldman, and Mark D. Hanson (June 29, 2004)*

Approximately six months after the November 25, 2002, cease and desist order was issued, Kenneth A. Goldman allegedly disclosed material, nonpublic information during two private events he attended with Mark D. Hanson in New York on April 30, 2003, a "one-on-one" meeting with an institutional investor and an invitation-only dinner hosted by Morgan Stanley.<sup>100</sup> The SEC charged, at both the meeting and the dinner, Goldman made positive comments about the company's

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<sup>92</sup> Schering-Plough Corp., Exchange Act Release No. 48461, 2003 WL 22082153 (Sept. 9, 2003).

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> Siebel Systems, Inc., Litigation Release No. 18766, 2004 WL 1462251 (Jun. 29, 2004).

business activity levels and transaction pipeline that materially contrasted with negative public statements Siebel made about its business in the preceding several weeks.<sup>101</sup> According to the complaint, based on Goldman's comments in the April 30 meeting, an institutional investor converted its 108,200 share short position in Siebel stock into a 114,200 share long position—a net change of 222,400 shares.<sup>102</sup> On May 1, 2003, the day following the private meetings, the company's stock price closed approximately 8% higher than the prior day's close, and the trading volume was nearly twice the average daily volume for the preceding year.<sup>103</sup>

The defendants moved to dismiss the complaint, which alleged Mr. Goldman made four nonpublic, material disclosures violating Regulation FD: (1) there were some five million dollar deals in the company's pipeline for the second quarter of 2003; (2) new deals were coming into the sales pipeline; (3) the company's sales pipeline was "growing" or "building;" and (4) the company's sales or business activity levels were "good" or "better."<sup>104</sup> The United States District Court for the Southern District of New York dismissed the SEC's complaint because it determined none of the four statements qualified as material or non-public information.<sup>105</sup> The court decided the information was public because Mr. Goldman conveyed essentially the same information previously disclosed by Mr. Siebel on an earnings call.<sup>106</sup> In terms of materiality, the court acknowledged stock movement is a relevant factor in determining materiality and concluded as follows: "the mere fact that analysts might have considered Mr. Goldman's private statements significant is not, standing alone, a basis to infer that Regulation FD was violated."<sup>107</sup> Even though the court dismissed the SEC's complaint because it believed the statements were too general, it stated the following: "the challenged communication need not be an expressed verbal or written statement. Tacit communications, such as a wink, nod, or a thumbs up or down gesture, may give rise to a Regulation FD violation."<sup>108</sup>

The SEC elected not to appeal the court's ruling. To date this is the only time Regulation FD was challenged in court and also the only occasion where the SEC did not prevail.

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<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> Sec. and Exch. Comm'n v. Siebel Sys., Inc., 384 F. Supp. 2d 694, 701 (S.D.N.Y. 2005).

<sup>105</sup> *Id.* at 704–05.

<sup>106</sup> *Id.* at 705.

<sup>107</sup> *Id.* at 707.

<sup>108</sup> Regulation FD Adopting Release, *supra* note 10.

6. *In the Matter of Senetek PLC (September 16, 2004)*

This matter involved Senetek's violation of Section 13(a) of the Exchange Act and Regulation FD on two separate occasions in 2002.<sup>109</sup> Prior to December 2001, there were no analysts who were actively providing research information about Senetek to the marketplace.<sup>110</sup> To increase its visibility with investors, Senetek entered into an agreement with a research firm in December 2001 (Firm A).<sup>111</sup> As part of this agreement, Senetek paid a monthly fee to the research firm, which, in exchange, agreed to publish research reports about the company.<sup>112</sup> In March 2002, Senetek entered into an agreement with a firm (Firm B) pursuant to which Firm B agreed to render financial advisory services to Senetek in consideration for the payment of a monthly fee and other compensation.<sup>113</sup> On May 28, 2002, an analyst engaged by Firm B sent an initial draft of a research report to Senetek's CEO for his review.<sup>114</sup> This draft report contained, among other information, projected earnings for Senetek's fiscal year ending December 31, 2002.<sup>115</sup>

On June 6, 2002, Senetek's CFO, at the direction of the CEO, sent Firm B an e-mail containing nonpublic information about the company's projected revenues and earnings for the 2002 fiscal year.<sup>116</sup> The CFO's projections were materially lower than the projections contained in the draft report.<sup>117</sup> Senetek did not simultaneously or promptly release these projections to the public.<sup>118</sup> A similar violation also occurred when Firm A published its final report on Senetek on September 30, 2002.<sup>119</sup> Based on the nonpublic data provided by Senetek's CEO, Firm A had lowered the revenues and earnings projections in its final report from those contained in the draft report provided to Senetek on September 10, 2002.<sup>120</sup>

The SEC brought an administrative action against the company, it consented to a cease and desist order, and no monetary penalties were assessed.<sup>121</sup>

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<sup>109</sup> Senetek PLC, Exchange Act Release No. 50400, R2004 WL 2076191 (Sept. 16, 2004).

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*

<sup>121</sup> *Id.*

7. *Securities and Exchange Commission v. Flowserve Corp. and C. Scott Greer (March 24, 2005)*

C. Scott Greer was Flowserve's Chairman, President, and Chief Executive Officer and Michael Conley was the Director of Investor Relations.<sup>122</sup> On November 19, 2002, forty-two days before the end of Flowserve's fiscal year, Greer, along with Conley, met privately in Irving, Texas, with analysts from four investment and brokerage firms.<sup>123</sup> At that meeting, the attendees discussed Flowserve's business, including recent acquisitions, debt covenants, and free cash flow.<sup>124</sup> At one point, one of the analysts asked about the company's earnings guidance for the year.<sup>125</sup> Neither Conley nor Greer gave the response required by the company's policy earnings guidance was effective at the date given and would not be updated until the company publicly announced updated guidance.<sup>126</sup> Conley did not caution Greer before Greer answered the analyst's questions.<sup>127</sup> In fact, Conley remained altogether silent.<sup>128</sup> Instead, in response to the question, Greer reaffirmed the previous guidance, which had been issued on October 22, 2002, and provided additional material, nonpublic information.<sup>129</sup> Having heard the exchange between Greer and the analyst, again Conley was silent and did nothing to explain Greer's statements.<sup>130</sup> Conley also failed to reiterate the company policy as to earnings guidance.<sup>131</sup>

On November 20, 2002, an analyst who attended the meeting issued a report to the investment firm's subscribers stating Flowserve reaffirmed its earnings guidance.<sup>132</sup> The report was electronically distributed to subscribers of Thomson's First Call.<sup>133</sup> The next day, on November 21, Flowserve's closing stock price was approximately 6% higher than the closing price the day before.<sup>134</sup> In addition, the trading volume of Flowserve's stock increased by 75%.<sup>135</sup> After the market closed on November 21, Flowserve furnished a Form 8-K admitting it had "reaffirmed its

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<sup>122</sup> Flowserve Corp., Litigation Release No. 19154, 2005 WL 677813 (Mar. 24, 2005).

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

full year 2002 estimated earnings per share.”<sup>136</sup>

The SEC filed a civil action against Flowserve and Greer for violating Regulation FD and Section 13(a) and a separate administrative action against Flowserve, Greer, and Conley.<sup>137</sup> As part of the civil action, Greer agreed to pay \$50,000, and Flowserve agreed to pay \$350,000 as penalties; in the administrative action, Flowserve, Greer, and Conley consented to a cease and desist order.<sup>138</sup>

8. *Securities and Exchange Commission v. Chandramowli Srinivasan*  
(September 25, 2007)

In 1995, Electronic Data Systems, Inc. (EDS) acquired A.T. Kearney, Inc. (ATK), a management consulting firm with operations in 37 countries (ATK).<sup>139</sup> After announcing on September 18, 2002, its earnings and cash flow would fall far short of prior guidance, EDS's share price fell over 50 %, causing the trigger provisions in all of EDS's remaining derivatives contracts to go into effect.<sup>140</sup> Although all of the derivatives contracts were required by their terms to be settled by year-end in the ordinary course of business, the financial institution demanded EDS immediately settle the outstanding transactions.<sup>141</sup> The settlement occurred on September 20, 2002, and cost EDS over \$225 million.<sup>142</sup> EDS personnel disclosed the \$225 million payment to settle the derivatives contracts to securities analysts on September 19, 2002, and September 23, 2002.<sup>143</sup> The SEC determined it was material to EDS at that time.<sup>144</sup> However, EDS did not disclose publicly until September 24, 2002, it had closed out its position in these obligations through the issuance of commercial paper and did not publicly disclose the \$225 million cost of the settlement until November 14, 2002.<sup>145</sup>

As a result of determining EDS violated Regulation FD and Section 13(a) of the Exchange Act, EDS agreed to pay \$490,902 as a penalty, and Srinivasan was also ordered to pay \$70,000 as a penalty.<sup>146</sup>

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<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

<sup>139</sup> Srinivasan, Litigation Release No. 20296, 2007 WL 2778650 (Sept. 25, 2007).

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

9. *Securities and Exchange Commission v. Christopher A. Black*  
(September 24, 2009)

Christopher Black was a senior vice president and the CFO of American Commercial Lines, Inc. (ACL) from February 2005 until April 2008.<sup>147</sup> After ACL conducted an initial public offering of its stock in October 2005, the company designated Black and its Chief Executive Officer as the company's investor relations contacts.<sup>148</sup>

The SEC's complaint alleged Black, without informing anyone at ACL, selectively disclosed material, nonpublic information regarding ACL's second quarter 2007 earnings forecast to a limited number of analysts without simultaneously making that information available to the public.<sup>149</sup> More specifically, the complaint alleged, on Monday, June 11, 2007, ACL issued a press release projecting second quarter earnings in line with ACL's first quarter earnings of approximately \$.20 per share.<sup>150</sup> The complaint further alleged on Saturday, June 16, 2007, Black sent an e-mail from his home to the eight sell-side analysts who covered the company stating ACL's earnings per share for the second quarter would "likely be in the neighborhood of about a dime below that of the first quarter," effectively cutting in half ACL's second quarter earnings guidance.<sup>151</sup> The complaint also charged Black's selective disclosure and resulting analysts' reports triggered a significant drop in ACL's stock price.<sup>152</sup> Lastly, the complaint alleged, on Monday, June 18, the first trading day after Black's e-mail to analysts, ACL's stock price dropped 9.7% on unusually heavy volume.<sup>153</sup>

Thereafter, Black consented to the entry of a final judgment requiring him to pay a \$25,000 penalty.<sup>154</sup> ACL was not charged with an enforcement action because of its extensive cooperation and the fact Black acted alone.<sup>155</sup>

10. *Securities and Exchange Commission v. Presstek, Inc., and*  
*Edward J. Marino (March 9, 2010)*

The SEC's complaint alleged, on September 28, 2006, while acting on behalf of Presstek, Marino selectively disclosed material, nonpublic information regarding

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<sup>147</sup> Black, Litigation Release No. 21222, 2009 WL 3047574 (Sept. 24, 2009).

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> *Id.*



Presstek's financial performance during the third quarter of 2006 to a partner of a registered investment adviser.<sup>156</sup> According to the complaint, within minutes of receiving the information from Marino, the partner decided to sell all of the shares of Presstek stock managed by the investment adviser.<sup>157</sup> The complaint alleged Presstek violated Section 13(a) of the Exchange Act and Regulation FD when it did not simultaneously disclose to the public the information provided by Marino to the partner, and Marino aided and abetted those violations.<sup>158</sup>

On March 9, 2010, Presstek agreed to pay a \$400,000 civil penalty, and, by May 15, 2012, Marino agreed to pay a \$50,000 civil penalty.<sup>159</sup>

*11. Securities and Exchange Commission v. Office Depot, Inc. (Oct. 21, 2010)*

The SEC's complaint allege[d] that Office Depot's CEO, in an attempt to get analysts to lower their estimates, proposed to the company's CFO that the company talk to the analysts and refer them to recent public announcements by two comparable companies about their financial results being impacted by the slowing economy. The CEO further suggested that Office Depot point out on its calls what the company had said in prior public conference calls in April and May 2007. The CFO then assisted Office Depot's investor relations personnel in preparing talking points for the calls.

According to the SEC's complaint, the CEO and CFO were not present during the calls but were aware of the analysts' declining estimates while the company made the calls.<sup>160</sup> They encouraged the calls to be completed. Office Depot continued to make the calls despite the CFO being notified of some analysts' concerns about the lack of public disclosure among other things. Six days after the calls began, Office Depot filed a Form 8-K announcing that its sales and earnings would be negatively impacted due to a continued soft economy. Before that Form 8-K was filed, Office Depot's share price had significantly dropped on increased trading volume.

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Office Depot agreed to settle the SEC's charges without admitting or denying the allegations, and [to] pay a \$1 million penalty. Office Depot also consented to the entry of an administrative order in a separate

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<sup>156</sup> Presstek, Inc., Litigation Release No. 21443, 2010 WL 784231 (Mar. 9, 2010).

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> Presstek, Inc., Litigation Release No. 22369, 2012 WL 1894212 (Mar. 9, 2010).

<sup>160</sup> Odland, Exchange Act Release No. 63153, 2010 WL 4134968, (Oct. 21, 2013); McKay, Exchange Act Release No. 63154, 2010 WL 4134969 (Oct. 21, 2010).

proceeding requiring it to cease and desist from committing or causing any violations and any future violations.<sup>161</sup>

Both the CEO, Stephen A. Odland, and the CFO, Patricia McKay, in separate administrative proceedings, agreed to a cease and desist order and to each pay a \$50,000 penalty.<sup>162</sup>

12. *Securities and Exchange Commission v. David Ronald Allen, et al.*  
(November 22, 2011)

The SEC's Complaint alleged defendants David Ronald Allen, the co-founder and former CFO, and William F. Burbank IV, the former CEO and President of China Voice Holding Corporation., acting on behalf of the corporation, disclosed material, nonpublic information to Gerald Patera, a major shareholder, and others without making simultaneous disclosure of that information to the public.<sup>163</sup> Moreover, China Voice did not inform its investors of developments affecting its financial situation, but it did update Patera about this privately in an e-mail on December 17, 2009.<sup>164</sup> Further, other investors did not receive the same information until a press release was circulated on April 8, 2010.<sup>165</sup>

As a result:

Burbank agreed to entry of a Final Judgment permanently enjoining him from violating Section 17(a) of the Securities Act of 1933, 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder and from aiding and abetting violations of Section 13(a) of the Exchange Act and Regulation FD . . . . The Final Judgment . . . also order[ed] Burbank to pay \$60,333 in disgorgement and prejudgment interest and a civil penalty of \$60,000. In addition, Burbank [was] barred [for] . . . ten years from serving as an officer or director of a public company and from participating in an offering of a penny stock.<sup>166</sup>

Allen agreed to entry of a final judgment permanently enjoining him from violating Sections 5 and 17(a) of the Securities Act of 1933, 10(b) and 15(a) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder and from aiding and abetting violations of

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<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

<sup>163</sup> Allen, Litigation Release No. 22165, 2011 WL 10902926 (Nov. 22, 2011) (referencing Complaint at 13–17, 22–23, Sec. and Exch. Comm'n v. Allen, No. 3:11-CV-882-0 (N.D. Tex. 2011)).

<sup>164</sup> Complaint at 13–17, 22–23, Sec. and Exch. Comm'n v. Allen, No. 3:11-CV-882-0 (N.D. Tex. 2011).

<sup>165</sup> *Id.* at 23.

<sup>166</sup> Allen, Litigation Release No. 22165, 2011 WL 10902926, *supra* note 163.

Section 13(a) of the Exchange Act and Regulation FD . . . . The final judgment, entered on December 2, also ordered Allen and his company, Winterstone Financial Ltd., to pay \$225,468 in disgorgement and prejudgment interest and for Allen to pay a civil penalty of \$212,821. In addition, Allen was barred permanently from serving as an officer or director of a public company and from participating in an offering of a penny stock.<sup>167</sup>

*13. In the Matter of Lawrence D. Polizzotto (September 6, 2013)*

Mr. Polizzotto was the former head of investor relations for First Solar, Inc., (First Solar)<sup>168</sup>:

In June 2011, First Solar received conditional commitments from the [Department of Energy] for loan guarantees of approximately \$4.5 billion relating to three separate First Solar projects . . . . The loan guarantees were important to First Solar because they would allow the company to receive guaranteed low-cost financing from the federal government. [But,] . . . the loans were conditioned upon First Solar meeting several requirements prior to September 30, 2011, the last day on which the DOE could make the loan guarantees.

. . . .

On September 13, 2011, . . . First Solar's CEO publicly expressed confidence that the company would receive all three loan guarantees.

. . . [However, o]n September 15, 2011, Polizzotto and several other executives learned that the DOE had decided not to provide a loan guarantee [for one of the projects]. [As a result,] . . . Polizzotto and one of First Solar's in-house lawyers, began discussing how and when the company should disclose the loss of the . . . loan guarantee.<sup>169</sup>

Although it was decided First Solar should address the loss in a formal press release, on September 21, 2011, Polizzotto moved forward and delivered "talking points" about the loss to more than thirty analysts and investors.<sup>170</sup> In this conversation, Polizzotto stated there was a low probability the company would receive the guarantee.<sup>171</sup> "[I]n certain discussions, Polizzotto went further than [t]his and told at least one analyst and one institutional investor that if they wanted to be conservative, they should assume First Solar would not receive the . . . loan

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<sup>167</sup> Allen, Litigation Release No. 22178, 2011 WL 10915506 (Dec. 5, 2011).

<sup>168</sup> Polizzotto, Exchange Act Release No. 70337, 2013 WL 4773958 (Sept. 6, 2013).

<sup>169</sup> *Id.* at 2–3.

<sup>170</sup> *Id.* at 4.

<sup>171</sup> *Id.*

guarantee.”<sup>172</sup> First Solar’s management learned of this selective disclosure later that evening and issued a press release about the loss the next morning, prior to the opening of the market.<sup>173</sup> “The company’s stock opened that morning at \$68.95, down 6%.”<sup>174</sup>

Polizzotto agreed to settle the charges and pay a \$50,000 penalty<sup>175</sup>:

The SEC decided not to bring an enforcement action against First Solar due to the company’s extraordinary cooperation with the investigation among several other factors.<sup>176</sup> Prior to Polizzotto’s selective disclosure on September 21, First Solar cultivated an environment of compliance through the use of a disclosure committee that focused on compliance with Regulation FD . . . .<sup>177</sup> First Solar quickly self-reported the misconduct to the SEC.<sup>178</sup> Concurrent with the SEC’s investigation, First Solar [also] undertook remedial measures to address the improper conduct . . . . [by providing] additional Regulation FD training for employees responsible for public disclosure.<sup>179</sup>

Additionally, First Solar reported in its 10-Q filed with the SEC, after completing the internal investigation, the company appointed a new Vice President of Investor Relations.<sup>180</sup>

## V. AN EVALUATION OF THE EFFECTIVENESS OF REGULATION FD AND PROPOSALS TO STRENGTHEN THE RULE: DISCLOSURES, PENALTIES, AND CORPORATE COMPLIANCE

### A. *The SEC’s Self-Assessment of Regulation FD in Practice*

In analyzing the early impact of Regulation FD seven months after it went into effect, Commissioner Paul R. Carey opined the rule was working “amazingly well” and clarified it should not supplant stock exchange rules requiring issuers to disclose certain material information, such as earnings information, in a press

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<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.* at 5.

<sup>176</sup> *SEC Charges Former Vice President of Investor Relations with Violating Fair Disclosure Rules*, SEC (Sept. 6, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539799034#Um6h8hDoYzo>.

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> First Solar, Inc., Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, (Form 10-Q) (Nov. 1, 2013).

release.<sup>181</sup> Nevertheless, Commissioner Laura S. Unger was more critical,<sup>182</sup> releasing a study in December 2001 calling for more guidance on materiality, increased flexibility for using technology to satisfy Regulation FD, and a recommendation the SEC should analyze the concerns of issuers.<sup>183</sup> Thereafter, the SEC received complaints after the first batch of four Regulation FD cases were settled.<sup>184</sup> The criticism involved the differences in penalties among the settled actions, which purportedly sent a confusing message to the business and legal communities.<sup>185</sup> In response, in February 2003, the SEC proposed issuing further guidance to clarify the rule.<sup>186</sup> For many years, however, additional clarification and revisions to the rule were not forthcoming. In fact, Regulation FD received only modest attention for several years after the *Siebel II* defeat in federal court. This is apparent given only two such cases were pursued between *Siebel II* and the 2008 financial crisis.<sup>187</sup>

### B. Common Themes of the Enforcement Actions: Breadth and Scope

More than thirteen years have passed since Regulation FD was enacted. To date, the SEC has pursued thirteen enforcement actions and issued two Section 21(a) investigative reports.<sup>188</sup> Of the enforcement actions, all but one of them resulted in either a cease and desist order or a civil monetary penalty for the company and its executives.<sup>189</sup>

Consistent with the categories of potentially material information identified in the Adopting Release, an overwhelming number of Regulation FD violations concern the selective disclosure of earnings information to advisers, analysts, and institutional investors.<sup>190</sup> Notable exceptions to this include the acquisition of a significant contract in the matter styled as *In Re Secure Computing* and a payment made to settle derivatives contracts in the *Srinivasan* matter. The fact the selective

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<sup>181</sup> Paul R. Carey, Comm'r, Sec. and Exch. Comm'n, Testimony Concerning Regulation Fair Disclosure (May 17, 2001), available at <http://www.sec.gov/news/testimony/051701tsprc.htm>.

<sup>182</sup> See Laura S. Unger, Comm'r, Sec. and Exch. Comm'n, Speech by the SEC Commissioner: Fallout from Regulation FD: Has the SEC Finally Cut the Tightrope?, (Oct. 27, 2000), available at <http://www.sec.gov/news/speech/spch421.htm>.

<sup>183</sup> UNGER, *supra* note 33.

<sup>184</sup> Paul S. Atkins, Comm'r, Sec. and Exch. Comm'n, Speech by the SEC Commissioner, Remarks at "The SEC Speaks in 2003" (Feb. 28, 2003), available at <http://www.sec.gov/news/speech/spch022803psa.htm>.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

<sup>187</sup> See *supra* Part IV and accompanying notes 77–180.

<sup>188</sup> See *supra* Part IV and accompanying notes 77–180.

<sup>189</sup> Sec. and Exch. Comm'n v. Siebel Sys., Inc., 384 F. Supp. 2d 694, 701 (S.D.N.Y. 2005).

<sup>190</sup> See *supra* Part IV and accompanying notes 77–180.

disclosure of earnings information to outside parties has occurred, and continues to happen, on a regular basis since August 2000 reveals the passage of Regulation FD was a positive event because it is protecting investors. Because protecting investors is viewed as the main aspect of the SEC's tri-partite mission,<sup>191</sup> Regulation FD appears to be generally functioning as it was intended. By extension, arguments raised before its passage Regulation FD would "chill" communications of issuers now appear to be unfounded. Instead, most issuers and analysts appear to have changed their behavior. This is evident given the analysts raising concerns about the lack of public disclosure in the *Office Depot* case. Accordingly, Regulation FD should be viewed as a regulatory success story.

In terms of breadth, the absence of other Regulation FD violations across the remaining categories tends to suggest either there are no longer any such infractions, or this information is being disclosed selectively but is evading the SEC's detection. While the former is implausible, given the increase in the number of enforcement actions filed by the SEC in recent years, another possible explanation is Regulation FD violations have received lesser priority in light of the 2008 financial crisis; this is a strong possibility given the SEC presently devotes an entire webpage showcasing its pursuit of misconduct that led to or arose from the financial crisis.<sup>192</sup> Besides this, the SEC has also devoted considerable resources to investigating Ponzi schemes after Bernie Madoff's confession, and the Office of the Inspector General issued its lengthy report about the SEC's failure to uncover the scheme.<sup>193</sup> With these two major issues catapulting to the top of the SEC's agenda for the past several years, Regulation FD violations have likely received lesser attention based on the agency's conscious shift in policy and due to its focus on the Dodd-Frank Act and the Jumpstart Our Business Startups (JOBS) Act.<sup>194</sup>

Another alternative explanation for the small quantity of enforcement actions involving Regulation FD violations is the line between insider trading and selective disclosures may be blurry. This was acknowledged in the Adopting Release when the SEC stated the following: "investors in many instances equate the practice of

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<sup>191</sup> *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC (June 10, 2013), available at <http://www.sec.gov/about/whatwedo.shtml#VGPNBofKPY>.

<sup>192</sup> *SEC Enforcement Actions Addressing Misconduct that Led to or Arose from the Financial Crisis*, SEC, <http://www.sec.gov/spotlight/enf-actions-fc.shtml> (last visited Nov. 5, 2013).

<sup>193</sup> *SEC Charges Bernard L. Madoff for Multi-Billion Dollar Ponzi Scheme*, SEC (Dec. 11, 2008), available at <http://www.sec.gov/news/press/2008/2008-293.htm>; SEC OFFICE OF INVESTIGATIONS, INVESTIGATION OF FAILURE OF THE SEC TO UNCOVER BERNARD MADOFF'S PONZI SCHEME (Public Version 2009), available at [www.sec.gov/news/studies/2009/oig-509.pdf](http://www.sec.gov/news/studies/2009/oig-509.pdf).

<sup>194</sup> "On April 5, 2012, the Jumpstart Our Business Startups (JOBS) Act was signed into law by President Barack Obama. The Act requires the SEC to write rules and issue studies on capital formation, disclosure[,] and registration requirements." *Jumpstart Our Business Startups (JOBS) Act*, SEC, <http://www.sec.gov/spotlight/jobs-act.shtml> (last visited Nov. 14, 2013).

selective disclosure with insider trading.”<sup>195</sup> As an example, selective disclosure a company intends to file bankruptcy may be prosecuted if it is easily identified as an insider trading violation. This occurred in one notable case where a crude oil purchasing manager learned an oil company was experiencing liquidity issues, and he secretly traded on this non-public information several days before the company publicly announced it was considering bankruptcy.<sup>196</sup> In this instance, the public perception of the SEC’s enforcement may also come into play as the concept of “insider trading” is well appreciated by the public and has been glamorized by the media.<sup>197</sup> Stated differently, insider-trading cases likely have considerably more mainstream appeal than cases involving Regulation FD violations.

### C. *How Different Investors Are Likely Impacted by Selective Disclosures*

Concerning the goal of protecting investors against selective disclosures, it may be worthwhile to consider the different types of investors who are likely to be impacted by this issue. Historically, the SEC has thought of itself as the “average” investor’s advocate.<sup>198</sup> As explained by Professor Langevoort, this has been commonly understood to mean individual investors and households, as opposed to institutional investors.<sup>199</sup> In taking this definition a bit further, Mr. Cartwright, the former General Counsel of the SEC, distinguishes between retail investors who invest primarily through mutual funds, which he refers to as “intermediated retail investors” and those who own stocks directly, styled as “unintermediated retail investors.”<sup>200</sup>

Regarding institutional investors, it is difficult to envision any potential problems they would face in the event an issuer commits a violation from selective disclosure. This is evident for a number of reasons. First, a review of the enforcement actions to date demonstrates institutional investors have been the ones benefiting from selective disclosures by issuers. This is because they have been able to take advantage of the information by moving stock prices dramatically after discovering the information. Examples of this are present in all but one of the enforcement actions, the only notable exception being the second case the SEC

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<sup>195</sup> Regulation FD Adopting Release, *supra* note 10, at 51,731 (citing the Letters of Pieter Bergshoeff and Barbara Black).

<sup>196</sup> Navarro, Litigation Release No. 21469, 2010 WL 1244003 (Mar. 31, 2010).

<sup>197</sup> *Is Hollywood Glamorizing Insider Trading?* (Fox Business News broadcast Apr. 29, 2013), <http://video.foxbusiness.com/v/2338551338001/>. Former SEC Chair and Commissioner Harvey Pitt debated this topic on a Fox Business News segment. *Id.*

<sup>198</sup> Donald C. Langevoort, *The SEC, Retail Investors, and the Institutionalization of the Securities Markets*, 95 VA. L. REV. 1025, 1025 (2009).

<sup>199</sup> *Id.*

<sup>200</sup> Brian G. Cartwright, *Whither the SEC Now?*, 95 VA. L. REV. 1085, 1089 (2009). An example of an “intermediated” investor is one who invests through an intermediary, such as a broker-dealer. *Id.*

pursued against Siebel Systems, Inc.<sup>201</sup> Second, institutional investors are dominant market players as evidenced by their overwhelming ownership in the aggregate of 73% of the outstanding equity in the 1,000 largest corporations.<sup>202</sup> With a vast, diverse ownership of the majority of large issuers, they exert considerable control and power over the financial markets. Third, institutional investors have been characterized as quasi-insiders or outsiders depending on their ownership stake and long-term trading behavior.<sup>203</sup> Fourth, with their direct access to analyst reports, institutional investors are likely to have much more access to truly valuable information than a retail investor. Given these foregoing advantages, institutional investors are highly likely to be able to quickly capitalize on material, public disclosures made in compliance with Regulation FD whether the disclosure is done via traditional channels using a press release and an 8-K, through an issuer's website, via social media, or a combination of methods.

For intermediated retail investors, there is likely to be a negligible impact if they invest in a diversified portfolio. Many of these investors, electing to invest in the market through mutual funds, reduce their risk and enhance their protection by engaging investment advisers and broker-dealers to execute their transactions. Additionally, even these investors who regularly buy and sell stock will on average be benefited as much as harmed by fraud. Consequently, a Regulation FD violation that occurs for one of this investor's portfolio is likely to have little to no meaningful impact on the overall portfolio.

However, selective disclosures are likely to have a much more significant impact on unintermediated investors. If material information is disclosed selectively to analysts, hedge funds, institutional investors, or other third parties who promptly and profitably exploit the information, this constitutes an unerodable, informational advantage.<sup>204</sup> When the insiders gain such an advantage, which should also be viewed as information asymmetry, this increases the probability of market manipulation. While a retail investor may potentially benefit from a volatile price movement if he or she has a long position on the stock and the insiders drive the price up, investors without such an edge are much more likely to incur losses. Besides this, if the insiders acquire an edge shortly before an earnings event, they will probably accumulate large positions in one direction to capitalize on the anticipated movement. Knowing a company will likely fail to meet earnings

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<sup>201</sup> See *supra* Part IV and accompanying notes 77–180.

<sup>202</sup> Luis A. Aguilar, Comm'r, Sec. and Exch. Comm'n, Institutional Investors: Power and Responsibility (Apr. 19, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171515808#.UoE5Z-JeIzo>.

<sup>203</sup> Joseph D. Piotroski & Darren T. Roulstone, *The Influence of Analysts, Institutional Investors and Insiders on the Incorporation of Market, Industry and Firm-Specific Information into Stock Prices*, 79 THE ACC. REV. 1119, n. 4 (2004).

<sup>204</sup> *United States v. O'Hagan*, 521 U.S. 642, 659 (1997).



expectations, or that an issuer will exceed the analysts' consensus on estimates, raises the possibility an unintermediated investor will suffer large losses. While any investor must realize the risk an earnings event is likely to trigger volatility in the price of an equity, an unintermediated investor should not be subjected to strong directional price swings due to an unlevel playing field. Furthermore, unintermediated investors who are burned by those who wrongfully take advantage of selective disclosures are probably less inclined to trust the market and invest in stocks if they believe the game is rigged by Wall Street.

*D. Is the 2008 Guidance Due for Amendments and/or Clarification to Improve Disclosures of Material Information for Investors?*

In the 2008 Guidance, the SEC stated, as a potential example of satisfying Regulation FD, a posting on a blog, by or on behalf of the company, would be treated the same as any other posting on a company's website.<sup>205</sup> However, the illustrative example is potentially problematic in a number of ways. Does it contemplate a blog will necessarily be on the company's website? The language is unclear in this regard, and it is certainly possible a blog may instead appear on a third-party website. If so, and a blog posting is on a third-party's website, it is questionable whether the investing public would receive reasonable notice of this. As part of this inquiry, it is also possible hyper-linking to a third-party website may result in the adoption and/or entanglement theories.<sup>206</sup> While there have been no documented instances where a company's material information was disclosed on a third-party's website, this is within the realm of possibilities. When, rather than if, this happens, whether the resulting disclosure is reasonable will depend on the facts and circumstances. In this instance, an issuer would be well advised to ensure there is simultaneous disclosure of the information if it is done intentionally, or promptly if it was inadvertent, to prevent a Regulation FD violation.

Similarly, assuming a company has "investor relations" or "finances" pages on its website, disclosure of material information outside of these pages could be problematic. Even institutional investors would be hard pressed to locate information if a blog, post, or announcement turns up on a random web page that has seemingly little to do with investor relations or a company's finances. If

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<sup>205</sup> Commission Guidance on the Use of Company Websites, Release No. 34-58288, 73 Fed. Reg. 45862 (Aug. 7, 2008), available at <http://www.sec.gov/rules/interp/2008/34-58288.pdf>.

<sup>206</sup> The SEC addressed this as follows: "In the case of hyperlinked information, liability under the 'entanglement' theory would depend upon a company's level of pre-publication involvement in the preparation of the information. In contrast, liability under the 'adoption' theory would depend upon whether, after its publication, a company, explicitly or implicitly endorses or approves the hyperlinked information." See SEC Interpretation: Use of Electronic Media, SEC Interpretive Letter Release No. 33-7856, 34-42728, 65 Fed. Reg. 25843-01 (May 4, 2000), available at <http://www.sec.gov/rules/interp/34-42728.htm>.

something like this happened, it would run contrary to the goal of transparency of disclosures for investors. Specifically, it would also present an unreasonable hurdle for the average investor to be forced to spend time searching the website, the site map, and other areas outside of an investor relations page to locate the information. Because of this, it is uncertain whether a company's blog on its own website or on a third-party website constitutes broad, non-exclusionary distribution. Moreover, if the goal is to protect investors by providing a disclosure-based regime, then information should be disclosed in a consistent manner.<sup>207</sup> As such, in light of the foregoing potential questions and issues, the SEC's guidance has the potential to become more robust if additional details would be supplied. While flexibility for issuers is an admirable goal, the SEC has regularly supplied examples of questions and answers to deal with hypothetical scenarios.<sup>208</sup> Accordingly, the time may be ripe for some additional clarification on these issues. While the Financial Industry Regulating Authority (FINRA) published guidance on "Social Media Web Sites" in January 2010, the SEC has not issued any further interpretative guidance to resolve some of these concerns.<sup>209</sup>

While the explosive popularity of social media and technology shows no signs of losing momentum as of late 2013, a major concern is the fragmentation of information—if investors are required to search for disclosures of material information in multiple places, there is a risk that retail investors will be left behind. This is particularly true if a retail investor is attempting to keep up with sell-side equity analysts whose daily professional existence revolves around closely following one or two major equities in one sector of the economy. Former SEC Commissioner, Laura Unger, anticipated the noise, or fragmentation, issue prior to the enactment of Regulation FD.<sup>210</sup> In particular, she voiced her concern about investors struggling to tell the difference between high quality information being disclosed online and "noise."<sup>211</sup> With social media in play and companies free to choose among many different methods for disclosure, it remains to be seen how long issuers will continue to use traditional methods. While most companies may likely continue to rely on press releases and the filing of an accompanying 8-K to fully satisfy Regulation FD instead of posting information solely on their

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<sup>207</sup> *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last visited Nov. 11, 2013) ("Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.").

<sup>208</sup> Manual of Publicly Available Telephone Interpretations, *supra* note 34.

<sup>209</sup> *Guidance on Blogs and Social Networking Web Sites*, FINRA (Jan. 2010), <http://www.finra.org/Industry/Regulation/Notices/2010/P120760>.

<sup>210</sup> Laura S. Unger, Comm'r, Sec. and Exch. Comm'n, Speech by the SEC Commissioner: Rethinking Information about Issuers in the Age of the Internet, (Feb. 18, 1999), *available at* <http://www.sec.gov/news/speech/speecharchive/1999/spch258.htm>.

<sup>211</sup> *Id.*

company's website, this raises an important issue—if a company posts on its website instead of the traditional approach, there may be a potential delay for the information to reach investors. Also, such a posting may not reach the news media as quickly as if a press release were issued and distributed by the major news wires. Stated differently, this could create a new burden on investors in the sense they would become obligated to search and discover information posted on multiple company websites instead of relying on major news sources like Bloomberg Television and CNBC. However, one can easily imagine a potential rebuttal to this problem of investors scrambling for information by supporters of the semi-strong version of the Efficient Capital Market Hypothesis.<sup>212</sup> Supporters of this are likely to argue whether the SEC's mandate for issuers to use technology to make material disclosures results in more hurdles for retail investors to obtain information is immaterial because the current price of any equity will arguably include all of the known, available information. The problem with this position, however, is unintermediated investors who have a small portfolio of stocks are more likely to be left in the dust if this happens than intermediated investors holding on to mutual funds.

In light of the foregoing concerns, only nine published comments were submitted in response to the 2008 release.<sup>213</sup> Only one of the comments, which was submitted by the CFA Institute Centre for Financial Market Integrity (CFA), requested guidance with more certainty.<sup>214</sup> The CFA's comment objected to the proposal to allow posting on a company website alone because it would allow a company to avoid making an 8-K filing by using this alternative approach.<sup>215</sup> Moreover, the CFA argues the SEC should reject the "facts and circumstances" approach because it creates a risk investors will not receive certain information they are entitled to receive under Regulation FD. Although the CFA's point is a bit vague in this regard because it fails to provide any specific factual examples, the CFA asserts clearly a "public filing" requirement should not be circumvented with information solely appearing on a company website.<sup>216</sup> Instead, the CFA proposes a combination of methods similar to what the SEC found acceptable in the past, in which a company issues a press release and posts the information on its website

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<sup>212</sup> STEPHEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION: CASES AND ANALYSIS* 33, (3rd ed. 2012) ("Under the semi-strong hypothesis, the stock market price of an actively traded company's stock will reflect all relevant *publicly* available information.").

<sup>213</sup> Comments on Interpretive Release: Commission Guidance on the Use of Company Web Sites, SEC, <http://www.sec.gov/comments/s7-23-08/s72308.shtml> (last visited Oct. 16, 2013).

<sup>214</sup> Letter from Kurt N. Schacht, Chief Fin. Advisor, CFA Inst. Ctr. for Fin. Mkt. Integrity, to Florence E. Harmon, Acting Sec'y, Sec. & Exch. Comm'n (Dec. 1, 2008), *available* at <http://www.sec.gov/comments/s7-23-08/s72308-9.pdf>.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

instead of filing an 8-K with the press release.<sup>217</sup> In this manner, the CFA's position is sound: it permits companies to use their websites to post information, and the dissemination will be broad enough to reach the masses with a press release. Because this is largely consistent with the current practice, issuers will not see an increase in costs either, and may enjoy a cost savings by not having to prepare and file an 8-K.

The SEC has previously rejected the approach advanced by the CFA, and it has done so with good reasons—to promote flexibility, to encourage the use of technology, and to promote disclosure through a combination of methods. Taking this into consideration, it is easy for issuers to meet their disclosure obligations under the facts and circumstances approach, and it probably results in less time spent enforcing violations than if a “bright line” rule were in place. Moreover, issuers are free to choose, based on their judgment and the SEC's guidance, whether they should use a sliding scale for disclosure of items based on whether they are less material or more material. For ones of greater significance, the traditional route may be preferable. Items of smaller concern may be better suited for disclosure via social media or through a combination of methods. Disclosing whether a company reached a certain metric, such as streaming one billion hours of content like Netflix did, falls into more of a gray area, unless the company previously announced its intent to use a particular social media site.

#### *E. Additional Issues Presented By Disclosures Using Social Media*

One problematic issue identified by the SEC's 21(a) report is Reed Hastings' Facebook friends included, among others, equity research analysts associated with registered broker-dealers.<sup>218</sup> These analysts would have been the first to receive the disclosure and capitalize on the information for trading. This is precisely what Regulation FD was intended to remedy and punish—the disclosure of information that provides insiders, such as analysts, with an “unerodable[,] informational advantage.” It is also a sign of an unlevel playing field between the institutional and retail investors. And, because there was a significant jump in the price of Netflix's stock in the period after the Hastings post and into the next trading session, it appears reasonable to conclude the “smart money” profited enormously because of this.<sup>219</sup> While this may not have presented a problem for institutional investors and long term retail investors who had bought the stock before the

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<sup>217</sup> *Id.*

<sup>218</sup> Joe Patrice, *SEC's Netflix Probe Is No Blockbuster*, ABOVE THE LAW (Dec. 12, 2012, 6:10 PM), <http://abovethelaw.com/tag/reed-hastings/>.

<sup>219</sup> INVESTOPEDIA, <http://www.investopedia.com/terms/s/smart-money.asp> (last visited Oct. 23, 2013). “Smart money” is defined as follows: “Cash invested or wagered by those considered to be experienced, well-informed, ‘in-the-know’ or all three.” *Id.*

Hastings Facebook post, it probably had a significant impact on any investors who would have shorted the stock, or purchased put options, between the issuance of the post and the close of the trading session. As an example, shorting 1,000 shares of the stock between \$70.45 and the closing price of \$72.04 on July 3, 2012, at an average price of \$71.25 would have resulted in loss of at least \$3,000.<sup>220</sup> Because Netflix's price rocketed upwards on July 5, 2012, covering a short position at the high of the day, \$82.90, would have netted a loss around \$11,650. Of course, a hedge fund or an institutional investor who received early notice of the Facebook post would likely have taken the other side of the trade and profited substantially.

A second issue concerns the distinction that can be drawn between registering and subscribing to social media. For Twitter,<sup>221</sup> any person can view the tweets, whether they are registered or unregistered.<sup>222</sup> However, for Facebook, you must be a Facebook member to view postings. This raises the question of whether an issuer can realistically achieve broad, non-exclusionary disclosure of information for a "members only" website and its postings. Arguably, it is comparatively more difficult to achieve a broad, non-exclusionary disclosure if membership is required. Regardless, this did not stop Netflix from contending the opposite—a post reaching over 200,000 Facebook members was broad enough to reach the market and a sufficient amount of investors.<sup>223</sup> While the 21(a) report did not squarely address this, it is an interesting issue and murky enough to provoke a lively debate. For issuers who would prefer to avoid a public debate and SEC scrutiny going forward on topics like this, it may be safer for compliance purposes to use a combination of methods using sites that do not have a members-only requirement.

The third potential problem is the proliferation of multiple social media channels may also make it harder for individual investors to track a group of their investments. While an issuer may utilize a combination of methods to communicate directly with the market, there is a potential problem when the number of media channels reaches a certain level. For example, Netflix itself has a "Social Media Disclosure" page on its website with hyperlinks to six separate sites: (1) The Netflix Investor Relations YouTube Page; (2) The Netflix Blog; (3) The Netflix Tech Blog; (4) The Netflix Facebook Page; (5) The Netflix Twitter Feed;

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<sup>220</sup> See *Netflix, Inc. Historical Stock Prices*, NASDAQ, <http://www.nasdaq.com/symbol/nflx/historical> (last visited Oct. 23, 2013). The closing price on July 5, 2012, was \$81.72. *Id.*

<sup>221</sup> "Twitter is a social-networking blog site that allows users to send status updates, or 'tweets,' from cell phones, instant messaging services[,] and Facebook in less than 140 characters." Mallory Simon, *Student 'Tweeters' His Way Out of Egyptian Jail*, CNN (updated Apr. 25, 2008, 2:03 PM), <http://www.cnn.com/2008/TECH/04/25/twitter.buck/index.html#cnnSTCText>.

<sup>222</sup> *Difference Between Twitter and Facebook*, DIFFERENCEBETWEEN.INFO, <http://www.differencebetween.info/difference-between-twitter-and-facebook> (last visited Oct. 21, 2013).

<sup>223</sup> Steven M. Davidoff, *In Netflix Case, a Chance to Re-examine Old Rules*, N.Y. TIMES, Dec. 11, 2012, <http://dealbook.nytimes.com/2012/12/11/in-netflix-case-a-chance-for-the-s-e-c-to-re-examine-old-regulation/>.

and (6) Reed Hastings' Public Facebook Page.<sup>224</sup> While not every publicly traded company is likely to announce material financial information across six or more media channels, this possibly makes it more difficult in general for investors to receive the information and specifically to obtain it in a timely fashion. Also, if a company like Netflix uses all these distinct media channels for material disclosures, there is the strong chance the information will not be disclosed simultaneously. Therefore, this may present an imbalance where a follower of social media X receives an update at a specific time and trades on it immediately, while a follower of social media Y does not receive the news until a point later in time. And, whether this failure to achieve simultaneous market disclosure is a result of a technical glitch or market manipulation is irrelevant if an individual investor has no recourse and the only potential punishment an issuer faces is an enforcement action from the SEC.

Alternatively, as social media continues to progress, other services will inevitably be embraced and utilized by the public. The issue that will arise is when a social media site achieves enough prominence to be considered a public site. This will, of course, depend on the facts and circumstances. And, in terms of Regulation FD, does the use of the particular social media site provide broad, non-exclusionary distribution? Until it becomes readily apparent a site will provide enough distribution, issuers would be well advised to use a traditional approach or a combination of newer, yet more established ones to cover enough bases to prevent allegations of selective disclosure.

#### F. Penalties

If disclosure is the most laudable goal, then a focus on preventative maintenance and education should be a top priority for issuers, the top executives, and investor relations personnel. This includes C-Suite executives, whose "titles tend to start with the letter C, for chief, as in chief executive officer, chief operating officer, and chief information officer."<sup>225</sup> Issuers should ensure the C-Suite

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<sup>224</sup> Social Media Disclosure, NETFLIX, <http://ir.netflix.com/social-media-disclosure.cfm> (last visited Oct. 21, 2013). The page states the following:

Investors and others should note that we announce material financial information to our investors using this investors website, SEC filings, press releases, public conference calls[,] and webcasts. We also use social media to communicate with our subscribers and the public about our company, our services[,] and other issues. It is possible that the information we post on social media could be deemed to be material information. Therefore, we encourage investors, the media, and others interested in our company to review the information we post on the U.S. social media channels listed below. This list may be updated from time to time.

*Id.*

<sup>225</sup> *C-Suite*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/c-suite.asp> (last visited Nov. 6, 2013).

executives and investor relations personnel receive education and training to avoid selective disclosures from occurring inadvertently or intentionally. As part of this, the executives should receive specific policies and procedures with concrete examples designed to prevent selective disclosures. Presumably, such a compliance program is already in place for most large, well-seasoned issuers, but the larger companies have also been the ones liable for many of the recent violations, including Netflix and Office Depot. Nevertheless, the SEC's guidance and information concerning materiality could easily be boiled down to its constituent parts to assist with compliance efforts. Moreover, because the disclosure of earnings information has resulted in the most enforcement actions, this is a topic deserving special attention. Furthermore, an emphasis should be placed on company and individual penalties in the event a Regulation FD violation occurs.

In three of the thirteen enforcement actions, no penalties were imposed, although cease and desist orders were issued to deter against future violations.<sup>226</sup> In two cases, issuers were ordered to pay \$1,000,000 in fines,<sup>227</sup> but the highest penalty ever awarded against a corporate executive was \$50,000 for a "pure" Regulation FD violation without other charges of securities law violations.<sup>228</sup> In closely examining the Regulation FD violations, it is useful to consider whether the SEC is pursuing the correct parties. This is because many of the penalties being paid out are by corporations. The problem with this is it may unfairly harm the shareholders and result in a "double whammy" where the shareholder may already have been injured by the selective disclosure itself and a penalty may add insult to injury.

*1. Which Parties Should the SEC Pursue for Regulation FD Violations?*

The imposition of civil monetary penalties against a corporation is a relatively recent creation and raises concerns about the SEC's mission of investor protection.<sup>229</sup> In cases in which shareholders are the principal victims of the violations, the SEC, when appropriate, will seek penalties from the individual offenders acting for a corporate issuer.<sup>230</sup> In terms of the policy supporting penalties, the justification offered by the SEC is "variable-penalty provisions are appropriate to penalize and deter the broad range of conduct for which these

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<sup>226</sup> See *supra* Part IV and accompanying notes 77–180.

<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

<sup>229</sup> Statement of the Securities and Exchange Commission Concerning Financial Penalties (Jan. 4, 2006), <http://www.sec.gov/news/press/2006-4.htm>.

<sup>230</sup> *Id.*

penalties will be assessed.”<sup>231</sup>

The SEC may understandably have to make tough, discretionary choices when it comes to determining whether to pursue a corporation only, or also include its managers. This situation is likely to arise in a case where the evidence against individual executives is weak. As a result, the SEC may decide to pursue the corporate entity because it is easier and more favorable to do so. Another reason why the SEC may elect to pursue the issuer only is that an individual may be more likely to fight a matter through trial instead of settling if the executive has to pay for a settlement out-of-pocket instead of relying on the corporate reserves. Such an individual may be motivated to clear his or her name to attempt to avoid any long-term damage to his or her reputation. Additionally, the SEC’s decision may also come down to an allocation of resources; if pursuing individual executives is likely to consume more time and resources, then it may not be worthwhile to pursue them. As part of this evaluation, the SEC may not want to allocate resources pursuing large penalties against individual managers with negligible assets or name recognition, because pursuing the corporation may result in more publicity and a greater perception of deterring illegal conduct.<sup>232</sup>

However, in spite of all of the foregoing issues that may arise in pursuing individual executives, the ultimate problem is less deterrence may result if potential fraudsters are able to evade punishment for their actions. Instead, a much greater amount of deterrence will probably result if management realizes there is a strong possibility of serious, individual penalties that may result from Regulation FD violations. Shifting the focus to individual accountability is something at least one of the SEC’s Commissioners recently acknowledged is important for an effective enforcement program.<sup>233</sup> Commissioner Aguilar articulated it elegantly, as follows: “The fact remains that corporations and other business are led by men and women, who are ultimately responsible for their actions. When an entity is charged with a violation of the federal securities laws, it is clear that there are human beings who are responsible for the misconduct.”<sup>234</sup>

This approach to securities regulation has long-standing roots, receiving support from A.A. Berle, Jr., lawyer, diplomat, and member of President Roosevelt’s Brain Trust, who was the co-author, with Gardiner Means, of The

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<sup>231</sup> Memorandum of the Securities and Exchange Commission in Support of the Securities Law Enforcement Remedies Act of 1989, reprinted in H.R. No. 975, 101st Cong., at 7 (1989).

<sup>232</sup> Paul S. Atkins & Bradley J. Bondi, *Evaluating the Mission: A Critical Review of the History and Evolution of the SEC Enforcement Program*, 13 *FORDHAM J. CORP. & FIN. L.* 367, 401 (2008) [hereinafter Atkins].

<sup>233</sup> Luis Aguilar, Comm’r, Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws, Address Before the Securities Enforcement Forum 2012 (Oct. 18, 2012), available at <http://www.sec.gov/News/Speech/Detail/Speech/1365171491510#.UnqxyOLoYzp>.

<sup>234</sup> *Id.*



Modern Corporation and Private Property, a groundbreaking work in corporate governance.<sup>235</sup> He articulated his position in this manner:

There are only two ways yet known of protecting investors. One is flatly to prohibit certain kinds of corporate activity, trusting that you will catch in your net of prohibition the dodges through which investors' savings are usually lost or dissipated. That is not a good way; because the business processes of today are complex; conditions change overnight; honest corporate managements not only want but [also] thrive under a wide freedom of action. The other method is to give your corporation pretty wide latitude in what it does, within reasonable limits; and then make your directors and officers personally liable for any abuse of the machinery. In substance, you can say to people, [']Take all the power you want; but you, individually, are responsible for the use of the power[.] I think by a process of common law we are getting to this latter view; but whether we are or not, it is pretty clear that legislation will put us there before very long.<sup>236</sup>

Of course, the punishment should fit the crime in a manner consistent with the underlying action, and the SEC has issued specific criteria it uses to determine the extent of the misconduct and whether there are mitigating factors.<sup>237</sup> Although deterrence is important, careful scrutiny of the SEC's thirteen separate factors is necessary to ensure a minor violation does not result in a senior executive getting fired, losing all, or a substantial part of, his savings, being banned from serving as an officer or a director, and suffering considerable harm to his reputation.<sup>238</sup> Along these lines, as part of a stronger compliance program, it would be desirable to educate would-be fraudsters to these possible punishments as part of a worst case scenario for the most egregious violations. Consequently, while Regulation FD sought to prevent selective disclosures to analysts, placing the focus on responsible executives instead of just pursuing corporations for quick settlements may represent the next paradigm shift that results in less misconduct. Symbolically, it also fits in with the SEC's recent policy shift towards taking more cases to trial, which presents, in the words of Chair Mary Jo White, "an open forum for public

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<sup>235</sup> Draft on Administration of Corporations by Adolph A. Berle, Jr., (1931) (on file with Franklin Delano Roosevelt Presidential Library), available at [http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1930/1931\\_1231\\_CorporationBerleT.pdf](http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/1930/1931_1231_CorporationBerleT.pdf).

<sup>236</sup> *Id.*

<sup>237</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions, Exchange Act Release No. 1470, 2001 WL 1301408 (Oct. 23, 2001), available at <http://www.sec.gov/litigation/investreport/34-44969.htm> [hereinafter Relationship of Cooperation].

<sup>238</sup> Atkins, *supra* note 232, at 401–02. There is also the possibility of facing criminal charges from a separate action, if one is pursued by the Department of Justice, along with possible incarceration. See *supra* note 192.

accountability.”<sup>239</sup>

Overall, whether it is the corporation itself and possibly a handful of executives facing an allegation of a Regulation FD violation, the end result is the shareholders are probably the ones to suffer the most. This is because the investigation and ensuing litigation that results from a potential violation distracts management from the business, drains corporate resources, and harms the corporation’s reputation.<sup>240</sup> This negative chain of events is exacerbated when a corporation pays the penalty, which further adds to shareholder injury.<sup>241</sup> Accordingly, the next section proposes increasing the penalties against individual executives who violate Regulation FD, with part of the goal being to protect shareholders from being penalized when this occurs.

## 2. *Penalties Should Be Enhanced to Increase Deterrence of Regulation FD Violations*

There are several ways in which deterrence can be increased for C-Suite executives, which is important because people, not corporate entities, are the ones engaging in wrongdoing. First, Congress should raise the current \$50,000 limit considerably higher on individual executive penalties for Regulation FD violations.<sup>242</sup> The main reason for increasing the limit is a maximum penalty of \$50,000 lacks any real teeth, let alone sharp teeth that genuinely enforce the rule. This is particularly the case for executives earning tens of millions of dollars annually, where a \$50,000 fine is less than a slap on the wrist.<sup>243</sup> For example, in 2010, when Stephen A. Odland, the former CEO of Office Depot, settled his enforcement action and paid a \$50,000 penalty, he made over \$15.2 million.<sup>244</sup> Facing such a small penalty, it is highly unlikely a C-Suite executive such as Odland is ever deterred from wrongfully disclosing material, non-public information to industry insiders, to the detriment of retail investors. With such a small potential maximum fine, it begs the question of whether the sharing of selective information is even on the radar of executives like this. To send a strong

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<sup>239</sup> Mary Jo White, Chair, Sec. and Exch. Comm’n, The Importance of Trials to the Law and Public Accountability, Address at the 5th Annual Judge Thomas A. Flannery Lecture (Nov. 14, 2013), available at <http://www.sec.gov/News/Speech/Detail/Speech/1370540374908#.Uopf9o0eDiU>.

<sup>240</sup> Atkins, *supra* note 232, at 400.

<sup>241</sup> *Id.*

<sup>242</sup> Section 21(d)(3)(B)(ii) of the U.S. Securities Exchange Act of 1934 authorizes a \$50,000 penalty for a natural person committing “second tier” violations. Securities Exchange Act of 1934, Pub. L. No. 112–58 (Aug. 10, 2012).

<sup>243</sup> Steven M. Davidoff, *A Vote Goes Against Outsize Executive Pay, but it’s Hardly a Blow*, N.Y. TIMES, Nov. 5, 2013, [http://dealbook.nytimes.com/2013/11/05/a-vote-goes-against-outsize-executive-pay-but-its-hardly-a-blow/?\\_r=0](http://dealbook.nytimes.com/2013/11/05/a-vote-goes-against-outsize-executive-pay-but-its-hardly-a-blow/?_r=0).

<sup>244</sup> *Steve Odland*, FORBES, <http://www.forbes.com/profile/steve-odland/> (last visited Nov. 18, 2013).

message to discourage this behavior, the current rule should be amended and strengthened to impose penalties based on the facts and circumstances of the wrongdoing, which is consistent with the existing general framework for penalties.<sup>245</sup> Although Congress took a step in the right direction with the introduction of a bill styled as the “Stronger Enforcement of Civil Penalties Act of 2012,”<sup>246</sup> known colloquially as the SEC Penalties Act, which would increase the limits on penalties, the bill will likely die in committee. For egregious, willful misconduct, which shows deliberate indifference or unadorned venality, the penalties should be exponentially higher to establish a meaningful correlation to the worst selective disclosures.<sup>247</sup>

Second, there are other means that even publicly traded corporations can employ to encourage a real change that prevents these disclosures. On the front end, an issuer who is mindful of this situation could rewrite the employment agreement when it hires new C-Suite executives to include a provision requiring the settlement of an SEC enforcement action for a Regulation FD violation results in an automatic waiver of an annual bonus, stock options, or a golden parachute severance provision. This would increase the odds an executive would refrain from selective disclosures when something like stock options are on the line. For someone like Reed Hastings, the CEO of Netflix, this is particularly significant because 75% of his salary for 2012 and half of his pay for 2013 will consist of compensation through stock options.<sup>248</sup> And, for Mr. Hastings, because Netflix’s stock has risen 300% in 2013, the stock options represent a staggering amount of money.<sup>249</sup> Thus, the loss of stock options or possibly other compensation could serve as the carrot-and-stick approach to discouraging selective disclosures.

Third, the rules restricting the pursuit of Regulation FD violations could be loosened to include private shareholder litigation. If limiting the scope of liability was done only to ensure passage of Regulation FD by appeasing large brokerage firms, then the time is ripe to revisit a modification to the rule.<sup>250</sup> This is even more apparent given Regulation FD was passed in an era that was anti-regulatory,

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<sup>245</sup> Statement of the Securities and Exchange Commission Concerning Financial Penalties, *supra* note 229.

<sup>246</sup> Stronger Enforcement of Civil Penalties Act of 2013, S. 286, 113th Cong. (2013) (reflecting the bill’s assignment to a congressional committee on February 12, 2013, with a three percent chance of getting by the committee and a zero probability estimate it will ever be passed), *available at* <https://www.govtrack.us/congress/bills/113/s286>.

<sup>247</sup> Relationship of Cooperation, *supra* note 237.

<sup>248</sup> Drew Fitzgerald, *Netflix to Boost CEO Reed Hastings’s Pay in 2013*, WALL ST. J., Dec. 28, 2012, <http://blogs.wsj.com/marketbeat/2012/12/28/netflix-to-boost-ceo-reed-hastings-pay-in-2013/>.

<sup>249</sup> Jeff Bercovici, *Netflix CEO Reed Hastings Tries to Let Some Air Out of the Bubble on Earnings Call*, FORBES (Oct. 21, 2013, 6:45 PM), <http://www.forbes.com/sites/jeffbercovici/2013/10/21/netflix-ceo-reed-hastings-tries-to-let-some-air-out-of-the-bubble-on-earnings-call/>.

<sup>250</sup> UNGER, *supra* note 33.

especially now the pendulum has swung in the other direction with the Dodd-Frank Wall Street Reform and Consumer Protection Act, which was passed to reshape the United States regulatory system in a number of areas, including but not limited to: consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency.<sup>251</sup> If private lawsuits are permitted, shareholders could still remain protected if the costs of the lawsuit are borne by the responsible executives. Shareholders would be protected if the corporation pays the penalty for an individual executive.

Fourth, in conjunction with the earlier suggestion to modify an executive's employment agreement, another potential alternative would be including a provision that ensures the employer is not required to indemnify the rogue manager if there is a settlement reached with the SEC concerning Regulation FD violations.<sup>252</sup> While the typical C-Suite agreement may already contain a provision prohibiting indemnification for willful misconduct, this would take it a step further to avoid the potential for disputes between executives and corporations as to whether the conduct is willful or not. Regardless, the net result would be to place the burden squarely on the shoulders of the executive to pay for the defense of any investigation and legal costs, not the corporation. It would also provide standing for the corporation to seek declaratory relief that it is not obligated to pay for an executive's legal fees. Overall, the net effect of this would be to protect the shareholders and actually provide them with some form of restitution in the event of misconduct.

### 3. *The Future of Regulation FD*

One of the most positive aspects to emerge from the SEC enforcement actions is the cultural shift in the industry, which has taken place since the regulation was enacted. Specifically, the Office Depot case reveals even the analysts were concerned about the C-Suite executives failing to make public disclosures of the negative earnings information. This information is significant because it tends to show Regulation FD is working at a broad level, which includes other parties in the industry beyond issuers and their top brass.

Along the same lines, a potential new concern for issuers is whistleblowers. "The SEC's whistleblower program went into effect on July 21, 2010, when

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<sup>251</sup> See *supra* note 192; see generally Viral V. Acharya, Thomas Cooley, Matthew Richardson, & Ingo Walter, *Manufacturing Tail Risk: A Perspective on the Financial Crisis of 2007-2009*, 4 FOUND. & TRENDS IN FIN. 249 (2010), available at [http://pages.stern.nyu.edu/~sternfin/vacharya/public\\_html/tail\\_risk.pdf](http://pages.stern.nyu.edu/~sternfin/vacharya/public_html/tail_risk.pdf).

<sup>252</sup> Chester S. Spatt, Chief Economist, Sec. and Exch. Comm'n, Speech by SEC Staff: "Penalties and Sanctions for Securities Fraud": Remarks Before the American Economic Association (Jan. 6, 2007), available at <http://www.sec.gov/news/speech/2007/spch010607css.htm>.

President Obama signed the ‘Dodd-Frank Wall Street Reform and Consumer Protection Act’ into law.”<sup>253</sup> “The Commission is authorized by Congress to provide monetary awards to eligible individuals who come forward with high-quality original information that leads to a Commission enforcement action in which over \$1,000,000 in sanctions is ordered.”<sup>254</sup> By the same token, deferred prosecution agreements (DPAs) may have a similar effect of encouraging cooperation from individuals and companies to provide the SEC with information about misconduct and even assist with a subsequent investigation.<sup>255</sup> Regardless of the technique utilized by the SEC to ferret out instances of misconduct, with increasing penalties in recent years for violations of Regulation FD, it is not difficult to envision third parties seeking to take advantage of a whistleblower reward if an issuer selectively discloses material, non-public information. Alternatively, a management insider with knowledge of a selective disclosure but no active participation in the misconduct may be able to escape liability using a DPA. Ideally, if these possibilities of whistleblower rewards and DPAs make issuers at the top level uncomfortable with sharing information selectively, then this should also deter possible violations.

## VI. CONCLUSION

Regulation FD serves an important function in ensuring proper compliance with the U.S. securities laws, especially when it comes to discouraging selective disclosures and preventing insider trading. This protects retail investors and creates a level playing field. If unrodable, informational advantages do result, then the focus of future enforcement actions may best be directed to combat the wrongdoing by the responsible individuals. Flowing from this idea, innocent shareholders should not have to suffer if the company itself did not engage in wrongful conduct. This article is intended to begin a list of possible amendments to improve and strengthen the rule, through improving disclosures and also in the context of individual versus corporate penalties. With executive compensation being an important topic, the SEC should be receptive to considering new possibilities to enhance monetary penalties against executives who willfully violate the rule. With enhanced compliance programs in place and regular training, we may see less Regulation FD violations. This is particularly evident if C-Suite executives face

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<sup>253</sup> *Frequently Asked Questions*, SEC, <http://www.sec.gov/about/offices/owb/owb-faq.shtml> (last visited Nov. 13, 2013).

<sup>254</sup> *Welcome to the Office of the Whistleblower*, SEC, <http://www.sec.gov/whistleblower> (last visited Nov. 13, 2013).

<sup>255</sup> *SEC Announces First Deferred Prosecution Agreement with Individual*, SEC (Nov. 12, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540345373#.UopvxI0eC6U>.

much stiffer penalties, including the loss of stock options and legal fees paid by the issuer. The net result of augmenting the penalties should be to deter future violations and inspire confidence and trust in the market.