[Fordham Journal of Corporate & Financial Law](https://ir.lawnet.fordham.edu/jcfl)

Volume 22 | Issue 1 Article 2

2017

Private Investor Meetings in Public Firms: The Case for Increasing Transparency

Martin Bengtzen
University of Oxford

Recommended Citation

Martin Bengtzen, Private Investor Meetings in Public Firms: The Case for Increasing Transparency, 22 FORDHAM J. CORP. & FIN. L. 33 (2017).

PRIVATE INVESTOR MEETINGS IN PUBLIC FIRMS: THE CASE FOR INCREASING TRANSPARENCY

Martin Bengtzen[*]

ABSTRACT

While developments in the law of insider trading usually attract significant scholarly interest, far less attention has been paid to the design and effects of the Securities and Exchange Commission's complementary Regulation Fair Disclosure. Yet, this Article argues that the SEC's current quandaries relating to insider trading enforcement are largely self-inflicted and could have been avoided if it had better aligned its Reg. FD with the Supreme Court's insider trading jurisprudence.

Introduced sixteen years ago to prevent senior officers of public firms from leaking material information to preferred investors and financial analysts, Reg. FD was designed to function as a backstop for undesirable favoritism that insider trading law, as developed by the Supreme Court, could not reach—in particular, the situation where a corporate manager divulges valuable information to a preferred investor not for any obvious personal benefit (which would trigger insider trading law) but for the ostensible benefit of the firm.

This Article analyzes Reg. FD through the lens of private investor meetings—personal conversations between corporate managers and investors they select—to find that Reg. FD should not be expected to deter selective disclosure. The regulation was disjointed from the

---

* DPhil Candidate, Faculty of Law, University of Oxford and the Oxford-Man Institute of Quantitative Finance. I would like to thank Jennifer Arlen, Dan Awrey, Paul Davies, Luca Enriques, Merritt Fox, Stavros Gadinis, Edward Greene, Charles Nathan, Giovanna Nicodano, Andrew Tuch, Kristin van Zwieten, and especially John Armour, for helpful comments and discussions. This Article has also benefited from the opportunity to present earlier drafts at workshops at Columbia Law School, the University of Oxford, the Sapienza University of Rome, and the Oxford-Man Institute of Quantitative Finance, and from helpful and careful review by the editors of this Journal. I appreciate financial support from the Torsten Söderberg Foundation. All views and errors are my own.

outset and professional market participants rationally appear to have taken advantage of its permissive design to obtain preferential access to inside information. For example, through one recently introduced service offering, "corporate access," selected investors spend billions of dollars on private access to corporate managers in return for the opportunity to lawfully trade on valuable information before it is released to the public.

This Article argues that the design of Reg. FD causes undesirable effects and that the SEC should redraft the regulation to follow the Supreme Court's classification of corporate information as firm property. The SEC could then regulate selective disclosures as transactions in this property that require public disclosure, similar to how insiders must report their personal transactions in firm stock. By increasing transparency to inform investors of selective disclosure events, concerns recently expressed by the SEC and the Department of Justice relating to insider trading enforcement could be alleviated and their requests for Supreme Court intervention in insider trading law reconsidered.

TABLE OF CONTENTS

INTRODUCTION

What are the consequences if a senior manager of a public firm selectively discloses valuable non-public information ("NPI") about the firm (such as details of its next quarterly report) to curry favor with an investor who trades on the information and makes a substantial profit? In theory, they may both be in breach of the insider trading prohibition and the manager may have violated Regulation Fair Disclosure ("Reg. FD"). In practice, however, this Article argues, the development of the federal common law of insider trading, the flawed design of Reg. FD, the enforcement policy and practices of the Securities and Exchange Commission ("SEC"), and the preference and ability of both corporate managers and investors to keep such selective disclosures out of the view of the public and the regulator combine to allow such conduct to occur with impunity. As a result, selective disclosure provides an attractive method for extraction of private benefits from public firms to the detriment of investors without preferential access.

As an example of how managers may be able to distribute such valuable information, consider the recent Second Circuit decision in *United States v. Newman*: an investor relations manager at Dell (at the time, a large public firm) selectively provided non-public information about its upcoming quarterly results that earned two investors trading profits of $62 million. The Second Circuit held that this activity did not constitute unlawful insider trading and the SEC did not even allege a Reg. FD violation.[1] Yet, the receipt of $62 million worth of information from a corporate manager would be a meaningful event for any investor and the potential availability of such awards could sway investors' decisions on parallel matters where they can influence the manager's position—such as when they vote on executive pay or in director elections.

This Article argues that the current regime, which affords corporate managers significant discretion over the allocation of corporate information, requires increased transparency to prevent abuse. As there is no current comprehensive treatment of the regulation and practices of private investor meetings, Part I begins by establishing what is publicly known about these highly private activities and describes the function of private investor meetings from the perspectives of firms and investors. Managers of large public firms participate in hundreds of private meetings per year, more than half of which are with hedge funds.[2] Notably, managers have significant discretion over their firms' disclosure choices and are often able to choose whether to disclose information publicly or selectively. This means that managers can decide whether to make such information a public good or a private good—a trade-off between increasing informational efficiency in the market for the firm's stock and providing their selected recipients with a valuable trading advantage.

Part II analyzes how federal securities regulation fails to deter undesirable selective disclosures. First, it examines when selective disclosure may violate the prohibition on insider trading by "tipping." In its still leading 1983 decision in *Dirks v. SEC*, the Supreme Court held that selective disclosure of material NPI is not prohibited unless the insider receives a personal benefit from the disclosure.[3] Without a personal benefit, neither the insider who discloses valuable information nor the outsider who trades on it will violate the insider trading framework. Against this permissive regulatory backdrop, the 1990s saw

1. United States v. Newman, 773 F.3d 438 (2d Cir. 2014).
2. Steve Johnson, *Hedge Funds Have Greater Access*, FIN. TIMES (London), June 3, 2013, at 2.
3. Dirks v. SEC, 463 U.S. 646 (1983).

an increasing number of press and research reports documenting how public firms used selective disclosure of material NPI to curry favor with selected sell-side financial analysts, which drew the regulator's attention to this issue. In considering its options, the SEC decided against attempting to extend insider trading law to selective disclosures where the "personal benefit" accrued to the firm instead of to one of its insiders, as the threat of such litigation would deter corporate communications. Rather than subsuming such selective disclosures under the insider trading framework, the SEC opted to introduce Reg. FD to deter them. So as not to discourage corporate managers from speaking to investors, however, the SEC drafted Reg. FD as a pure disclosure obligation, prohibiting intentional private disclosures without simultaneous disclosure to the market, while explicitly stipulating that failure to comply with the new regulation would not give rise to anti-fraud liability under the securities laws.

This Article offers a detailed analysis of Reg. FD, which requires that when firms intentionally disclose material NPI, they do so through broad public means and not through private channels. It finds that both the original design of the regulation and subsequent judicial developments cause it to fail to restrict many disclosures considered undesirable and have instead created an apparently unforeseen yet strong demand for private meetings with corporate managers. There are several reasons for this: first, as Reg. FD only applies to issuers, selective disclosure recipients are free to trade immediately after receiving private information, before other investors receive the information. Importantly, recipients can trade even if the information is material under the securities laws and even if the information was intentionally disclosed selectively to them. Consequently, Reg. FD cannot curb demand, only supply. Second, the SEC has explicitly acknowledged that, when managers evaluate whether a piece of information is material for purposes of establishing if it can be intentionally disclosed in private, it will apply a more lenient recklessness standard for disclosures made in unrehearsed private discussions than for prepared written statements. More disclosures can therefore be labeled unintentional under Reg. FD if they take place within private meetings than in other settings, which means that they do not violate the regulation as long as they are eventually disclosed to the public—a construction which should increase both supply and demand for such private conversations. Third, Reg. FD creates a window for recipients of selectively disclosed material information to trade on it. This is because issuers are allowed up to twenty-four hours from when they become aware of an unintentional private disclosure of material information to rectify it by publicly disclosing the same information, but the recipients can trade in the meantime. Fourth, the assessment of whether information disclosed in a private investor meeting is material is, as a practical matter, left to the disclosing insider. The regulation does not create any requirement or mechanism for oversight of the materiality determination, apart from possible SEC enforcement. This means that neither intentional nor unintentional disclosures of material information may ever be corrected and publicly disclosed. Fifth, Reg. FD does not require issuers to take any action to prevent recipients of mistaken disclosures of material information from trading. Issuers may even allow recipients to trade on such information, since they do not violate Reg. FD as long as they disclose the information to the public within the stipulated window. Sixth, where an issuer has mistakenly disclosed material information in private, Reg. FD only requires disclosure of the *information* to all investors. The regulation critically fails to provide any mechanism to inform shareholders or the regulator that a selective disclosure *event* has occurred; a design which makes it impossible to assess how frequently managers disclose material information in private and whether they repeatedly select the same beneficiaries for such disclosures. Reg. FD thus fails to curb opportunistic supply.

The Article continues by reviewing all enforcement actions in relation to Reg. FD to estimate its deterrent effect. The SEC has taken action in thirteen cases, of which twelve resulted in negotiated settlements with low civil penalties, typically paid by the issuers. On the only occasion the SEC opted for court action over a negotiated settlement in relation to Reg. FD, its complaint was dismissed—a defeat which appears to have reduced enforcement activity while demonstrating that it is difficult to prove materiality in cases of subtle private disclosures. Furthermore, the SEC enforces Reg. FD so infrequently and imposes penalties of such a low magnitude that the regulation is unlikely to deter opportunistic selective disclosure in practice. In larger firms, managers may be able to confer billions of dollars' worth of valuable information on preferred investors while facing little risk of paying civil penalties, which are low even when imposed.

The Article then considers whether market participants may have taken advantage of these incoherencies to develop methods for profitable information trading that negate the purposes of the *Dirks* and

Reg. FD frameworks while superficially complying with them. *Dirks*' protection of recipients who do not provide a personal benefit to insiders was built on the recognition that such selectively disclosed information at some point would benefit investors at large through improved market pricing of securities. However, as *Dirks* does not require that any such benefit actually materialize in order for the selective disclosure to be permitted, professional investors increasingly demand information in private forums and trade on such information in ways that may not provide benefits to investors other than themselves. Similarly, while Reg. FD encourages firms that selectively disclose material information by mistake to publicly disclose it promptly, the SEC failed to recognize that this construction creates strong incentives among investors to pay for the necessary access to managers, in order to be the investors who receive such disclosures first.

The Article illustrates how the SEC's design and enforcement of Reg. FD appears to have led to the introduction of a new service offering—"corporate access"—that formalizes selective disclosure. Through this service, which has quickly become a billion-dollar industry, brokers charge professional investors to participate in private investor meetings with managers of public firms. The Article analyzes potential problems with corporate access, including the severe conflicts of interest it creates between firms and their brokers; how managers may leverage their participation in corporate access events to pressure brokers into providing favorable research; and how it creates potentially severe, but hidden, information asymmetries among investors.

Part II ends by noting that the potential deterrent effect on selective disclosure provided by the insider trading framework may have diminished following the Second Circuit's decision in *United States v. Newman*. While the appellate courts have historically found it relatively easy to establish a personal benefit under *Dirks*, *Newman* appears to take a stricter approach in requiring an objective and consequential exchange. If and where *Newman* is followed, the insider trading regime will be unavailable, and therefore, unable to create deterrence in more selective disclosure scenarios.

Part III analyzes how to better regulate selective disclosure in light of the Supreme Court's recognition that a firm's NPI is its property. Building on this classification, it establishes that the value of information as an asset of the firm consists of the ability to transact with uninformed investors in the market. The Article considers agency implications that follow from the lack of monitoring, finding that managers have significant ability to monetize their firms' information assets through selective disclosure without internal or external oversight. Reviewing the existing evidence of managers' opportunistic use of information, it notes how managers use selective disclosure to influence analysts' behavior and voluntary public disclosure to maximize their own option awards and personal trading benefits. The available evidence on selective disclosure supports the hypothesis that some managers selectively disclose valuable information to investors they know, who then trade profitably on such information and reciprocate by voting against other shareholders' proposals to limit executive pay.

Against this background, a closer analysis of the disclosure incentives of managers and investors finds that investors face a collective action problem when firms choose to provide information privately. The first manifestation of this problem is that investors who know that they are able to procure private meetings with senior corporate managers will prefer that information is selectively, rather than publicly, disclosed to increase their opportunities for profitable trading. This means that the group of investors that actually engages with corporate managers is unlikely to be interested in improving the quality of public disclosure for the benefit of shareholders as a collective. A second expression of this collective action problem is that investors with such private access may in fact prefer less, and less useful, public disclosure in order to increase their opportunities for profitable trading on private information. Similarly, managers may prefer less, and less useful, public disclosure in order to maximize the value of information under their control and their ability to allocate information selectively to preferred investors.

Part III ends by contrasting the different methods for deployment of firm information. To place selective disclosure regulation in context, other mechanisms by which firms may deploy their NPI to conduct information-based transactions are examined. The Article proposes a taxonomy of three private methods for deployment of NPI: insider trading, firm trading, and selective disclosure followed by recipient trading, as well as one public method: full disclosure to the market. Following an analysis of these different options for deployment of information, the Article argues that selective disclosure is a very attractive route for managers to monetize information since it is comparatively lightly regulated. While this may create attractive opportunities for firms to effectively raise equity by selectively disclosing NPI to investors who can trade profitably and provide reciprocal value to the firm, it also leaves firms vulnerable to managerial opportunism.

Part IV starts by proposing the obvious improvement to the current Reg. FD: firms that have selectively disclosed material NPI by mistake should be required to file a Form 8-K to inform investors about the mistake. From an oversight and deterrence perspective, investors at large need to be informed when firms make such serious mistakes, as these could result in the redistribution of large amounts of money to investors selected by corporate managers. It is also proposed that firms provide a narrative in their proxy statements, detailing the purposes and frequency of their private investor interactions to allow investors to assess how individual firms actually use NPI as property.

While this proposal would bring Reg. FD closer to what the SEC appears to have intended, there are several reasons why issuers still may not provide shareholders with enough information about selective disclosures to allow them to monitor effectively: managers may apply a materiality threshold that is too high and thus fail to inform the market of disclosures; there will be transactions in information that, while not material, is still valuable; and managers may opportunistically avoid disclosing Reg. FD events due to the low probability of enforcement. As these concerns cannot be effectively addressed within the current structure of Reg. FD, Part IV proceeds to argue that the SEC should recognize that its regulation is unnecessarily disjointed from the Supreme Court's classification of information as firm property and embrace the Court's approach to instead regulate selective disclosure as a transaction in such property. As selective disclosure transactions resemble equity raisings with a significant risk of conflicted managerial interest, a transaction reporting requirement should be introduced so that firms are required to publicly report all selective disclosure events as transactions. Under the new framework, firms would not be required to disclose the actual information that is the subject of private investor meetings but would have to provide general details about these private interactions, such as their dates, times, and counterparties. Such reporting would provide investors at large the opportunity to assess managers' use of valuable firm information and the risk of conflicted managerial interest.

The new framework would deter behavior that shareholders find undesirable while rewarding beneficial transactions in information. Similar to the requirement that insiders report their own trading in their firms' stock, the reporting of selective disclosure events would better enable investors and the SEC to assess the likelihood that an insider is using corporate information for personal gain. Enforcement of undesirable selective disclosure would thus be easier. This new approach would also have other beneficial effects. First, shifting the enforcement focus to transactions enables the SEC to verify that firms disclose their transactions accurately by requiring the typical counterparties to these transactions—professional investors and analysts—to also keep records of meetings, with penalties imposed for failures to do so. By enlisting the other party to these transactions, enforcement is more likely to be effective. Second, it allows for a new approach where firms are made answerable for their information transactions to their own shareholders.

The idea is simple: investors cannot be deceived if firms are fully transparent about their selective disclosure transactions, and with full transparency the SEC can shift its focus from undertaking complicated and expensive investigations into the details of private conversations, which at best result in miniscule penalties unlikely to produce deterrence, to ensuring that firms provide complete reporting of their selective disclosure transactions. This new framework could also improve the allocation of analyst resources, as it will be easier for them to find firms that are undersupplied by information traders. Importantly, the new framework would not curtail legitimate disclosure activities or require disclosure of the potentially sensitive details of private discussions, and would consequently not dissuade investors from taking part in private investor meetings. Investors would still be able to receive and trade on material NPI; the main difference is that other investors would be made aware of the extent of such activities in individual firms after the fact.

The Article ends by considering systemic implications of the regulation of private investor meetings. By definition, only active investors take part in private discussions with corporate managers, and they require private information in order to outperform passive investment options over time to justify their fees. Active investors may consequently prefer private disclosures and may find it worthwhile to compensate obliging managers via the firm. Without oversight mechanisms, such as the new reporting obligation proposed herein, there is a significant risk that selective disclosure of valuable information becomes a widespread phenomenon that systematically reallocates value from investors at large to active investors selected by corporate managers. A regulatory response is therefore required in order to prevent unnecessarily inflated amounts of resources being spent on providing, procuring, and monetizing private information exchanges between corporate managers and the investors they select.

I. OVERVIEW OF PRIVATE INVESTOR MEETINGS

A. REGULATORY BACKGROUND: DISCLOSURE AND DISCRETION

Managers of public firms have broad discretion in deciding which investors to meet with,[4] the forums in which to meet them, and how much information to provide about the firm. On a day-to-day basis,[5] the limits of what managers may disclose in private meetings are defined by two sets of SEC rules: Form 8-K,[6] which mandates public disclosure of certain significant events listed therein, and Reg. FD,[7] which provides

4. While this Article tends to use the term "meetings," any form of personal private communication (such as phone calls) will, of course, have the same effect. Similarly, as noted in Section II.D.1, *infra*, the line between analysts and investors is increasingly porous so references herein to "investors" should be considered in a broad sense to include parties seeking NPI from the firm to improve the accuracy of their valuation of the firm's stock, whether for their own or their clients' trading. As for references herein to "managers," think of a CEO or a CFO, as they are the most popular insiders to speak to.
Furthermore, investors taking part in a private meeting are *ex ante* receiving time with management and may not know what, if any, specific information they will receive. However, it is inevitable that an investor will receive some information, even if it is only an assessment of managers' confidence or composure in answering the investor's questions. *See, e.g.*, Serena Ng & Anton Troianovski, *Investors Prize Face Time with Bosses*, WALL ST. J., Sept. 28, 2015, at A1 (describing private meetings where managers' tone, confidence, and refusal to elaborate on certain issues gave participating analysts and investors clues for profitable trading). This Article thus regards private investor meetings to contain some element of selective disclosure, since participating investors will receive NPI, while acknowledging that this NPI will be non-material in many cases.

5. That is to say, disregarding periodic financial reports (Forms 10-K and 10-Q), which must include all material information. *See* 17 C.F.R. § 240.12b-20; *see also* 15 U.S.C. § 7241 (2012).

6. 17 C.F.R. § 249.308 (2015). Such disclosure has to occur within four business days.

7. 17 C.F.R. §§ 243.100–103 (2015). The SEC proposed Reg. FD in 1999, *see* Selective Disclosure and Insider Trading, Securities Act Release No. 7787, Exchange Act Release No. 42,259, Investment Company Act Release No. 24,209, 64 Fed. Reg. 72,590 (proposed Dec. 28, 1999) [hereinafter Proposing Release], and adopted a revised version after a comment process, *see* Selective Disclosure and Insider Trading, Securities Act Release No. 7881, Exchange Act Release No. 43,154, Investment

that disclosure of material[8] NPI[9] to certain recipients[10] shall also be publicly disclosed at least simultaneously (in the case of intentional[11] selective disclosure) or promptly[12] (in the case of non-intentional selective disclosure).

Managers can consequently disclose information not covered by these regulatory frameworks on a voluntary basis. This means that managers in deciding whether, and if so, when and to whom to disclose such information are guided primarily by their fiduciary duties. However, fiduciary duties in state corporate law are not useful in addressing managers' opportunistic use of their discretion over their

---

Company Act Release No. 24,599, 65 Fed. Reg. 51,716 (Aug. 24, 2000), codified at 17 C.F.R. §§ 243.100–103 (2015) [hereinafter Adopting Release].

8. The materiality concept is discussed further below. *See infra* text accompanying notes 20–25.

9. Information is deemed non-public under the securities laws if it has not been disclosed in a manner that ensures its availability to the investing public and "without favoring any special person or group." Dirks v. SEC, 463 U.S. 646, 653 n.12 (1983) (quoting Faberge, Inc., Exchange Act Release No. 10,174, 45 S.E.C. 249 (May 25 1973). Information can, however, be deemed public if enough people have access to it so that it is nonetheless impounded into the stock price. United States v. Libera, 989 F.2d 596, 601 (2d Cir. 1993).

10. While the Proposing Release, *supra* note 7, covered disclosure to any person outside the issuer, the Adopting Release, *supra* note 7, was narrowed to only cover disclosure to certain recipients which include "securities market professionals [such as broker-dealers and investment managers] and to holders of the issuer's securities under circumstances in which it is reasonably foreseeable that the security holder will trade on the basis of the information."

11. Reg. FD states that "selective disclosure of material nonpublic information is 'intentional' when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic." 17 C.F.R. § 243.101(a) (2015).

12. 17 C.F.R. § 243.101(d) (2015) defines "promptly" to mean:

> as soon as reasonably practicable (but in no event after the later of twenty-four hours or the commencement of the next day's trading on the New York Stock Exchange) after a senior official of the issuer . . . learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and non-public.

firms' NPI due to a lack of transparency,[13] the protection afforded them by the business judgment rule,[14] and enforcement obstacles.[15]

As opportunistic use of NPI about a public firm materializes in the monetization of that information in the stock market, this lack of state law tools has functionally been bridged by the imposition of a federal duty of loyalty in the insider trading framework. The most important development of this duty for present purposes was the Supreme Court decision in *Dirks v. SEC*, which established that insiders breach their duty by disclosing information to an outsider only if they get a personal benefit in doing so.[16] In the absence of a personal benefit, there is no breach of the duty of loyalty, and no insider trading liability will arise for the insider tipper or the outsider tippee. The *Dirks* decision, and the Supreme Court's declaration in *United States v. O'Hagan* that a firm's confidential information was its property,[17] caused some managers to establish disclosure practices to monetize the firm's NPI for the benefit of the firm. The SEC considered this development undesirable as it occasionally created severe information asymmetries among investors. As a result, it adopted Reg. FD in 2000 with the intent to prohibit intentional selective disclosure of material information.[18]

There are, accordingly, two different concepts and purposes involved in selective disclosure regulation. In the insider trading

---

13. This lack of transparency is the topic of this Article. For analyses of why transparency is necessary to enforce duties, see Merritt B. Fox, *Required Disclosure and Corporate Governance*, 62 LAW & CONTEMP. PROBS. 113, 118-20 (1999) (explaining that disclosure obligations are necessary to ensure that managers abide by their fiduciary duties under corporate law, since managers would not be expected to voluntarily provide information that could signal a duty breach) and Reinier Kraakman, *Disclosure and Corporate Governance: An Overview Essay*, *in* REFORMING COMPANY AND TAKEOVER LAW IN EUROPE 95 (G. Ferrarini, K. Hopt & E. Wymeersch eds., 2004).

14. *See* Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 171 (2002) ("It is not easy to separate out deliberate deception from optimistic bias, which may make courts reluctant to police this area under the rubric of fiduciary responsibility.").

15. *See* Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589, 1623–24 (1999) (arguing that the police powers of the SEC make it a more efficient enforcer of insider trading laws than private shareholders; an argument that appears equally convincing for selective disclosure).

16. Dirks v. SEC, 463 U.S. 646 (1983).

17. United States v. O'Hagan, 521 U.S. 642, 654 (1997).

18. *See infra* Section II.B.

context, the Supreme Court has repeatedly reinforced the idea that the informational playing field among investors in public firms does not need to be level, which means that managers may provide selected investors with better quality information than others.[19] This is due to the grounding of the insider trading rules in the anti-fraud framework. The SEC then overlaid this principle with Reg. FD in order to reduce the resulting information asymmetries and maintain public confidence in the fairness of securities markets.

One key type of information that managers may disclose on a discretionary basis is NPI that is not deemed *material*.[20] Information is material under the securities laws if it would be "viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" about the firm.[21] Whether a particular piece of information is material needs to be determined through an inquiry of the facts in each individual case. For present purposes, the most important aspect of materiality is that this concept is not synchronous with information having *some* relevance to the valuation of a firm (and thus its stock); since it is an explicit part of the materiality test that the particular information needs to have *significantly* altered the total mix of information available, information with low value-relevance will not be deemed material. There is thus a judicially recognized gray zone in which information is value-relevant without reaching the threshold of materiality. In this zone, corporate managers can lawfully disclose

---

19. Basic Inc. v. Levinson, 485 U.S. 224, 240 n.18 (1988) (holding that the standard of materiality is not automatically reached simply because insiders or a "favored few" profited from trading on the information); Dirks v. SEC, 463 U.S. 646, 661–62 (1983) ("All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders."); Chiarella v. United States, 445 U.S. 222, 232 (1980) ("[N]ot every instance of financial unfairness constitutes fraudulent activity under § 10(b)").

20. This is a slight but for present purposes inconsequential simplification as Form 8-K does require certain events to be disclosed regardless of materiality, such as the resignation of a director.

21. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1970). This test was adopted for 10b-5 purposes in *Basic*, 485 U.S. at 232. In promulgating Reg. FD, the SEC also preferred to use this concept over establishing another test or list of items to be considered material. *See* Adopting Release, *supra* note 7, at 51,721.

valuable information to investors they select themselves without concern for insider trading rules or Reg. FD.[22]

As materiality needs to be assessed by a "probability/magnitude" approach,[23] so-called "soft" information (such as the firm's own forecasts) may also be so unreliable that it will not be considered material as a matter of law.[24] Furthermore, as materiality is determined by reference to the information available to the public, professional investors or analysts may lawfully combine selectively disclosed non-material NPI from a firm with their own private information to create material information under the so-called "mosaic theory" and use it for profitable trading without committing fraud under the securities laws.[25]

The concept of selective disclosure thus covers two very different activities. The first is where investors or analysts exercise skill in knowing which questions to ask managers, and elicit answers that, combined with their prior knowledge of the firm, produce value-relevant

---

22. *See* Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. PA. L. REV. 801, 809 (2014) (arguing that "insiders can profit legally by trading on many types of valuable, 'sub-material' information"); Reinier Kraakman, *The Legal Theory of Insider Trading Regulation in the United States*, *in* EUROPEAN INSIDER DEALING—LAW AND PRACTICE 39, 48 (Klaus J. Hopt & Eddy Wymeersch eds., 1991) (describing how insiders can lawfully conduct profitable trading); Donald Langevoort, *Rereading Cady, Roberts: The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319, 1335 (1999) ("Materiality is a fluid concept: [i]nsiders at almost all times have the advantage of superior insight and a sense of which way things are going even if they do not possess a fact that a court would call material and nonpublic."); *see also* ROBERT C. CLARK, CORPORATE LAW 507–08 (1986) ("A successful 10b-5 suit presupposes the insider had access to definite bits of information of fairly obvious importance. He knows of an ore discovery, a forthcoming merger, the disastrous results of the current quarter, a new product, or some other discrete chunk of nonpublic news. . . . [I]nsiders occasionally have insight into their companies' futures that is better than the market's because of continual exposure to numerous bits and pieces of information and opinion that come their way by virtue of their being in their official positions and that have value as a totality. This total picture is based in part on numerous small items that, individually considered, are not important enough to be labelled material . . .").

23. *See Basic*, 485 U.S. at 238–39.

24. *See* WILLIAM K. S. WANG & MARC I. STEINBERG, INSIDER TRADING 125–31 (3rd ed. 2010) (summarizing case law which illustrates that soft information will often, but not always, fail to reach the materiality threshold).

25. *See* Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 165 (2d Cir. 1980); SEC v. Bausch & Lomb Inc., 565 F.2d 8, 14 (2d Cir. 1977). The SEC endorsed the mosaic theory in promulgating Reg. FD while recognizing that financial analysts can provide an important function in reviewing corporate disclosures for value-relevant information. *See* Adopting Release, *supra* note 7, at 51,722.

information. Here, recipients of information build mosaics and receive the property right to use them for trading in the stock market. This is a valuable activity in the equity markets, allowing analysts to monitor firms incentivized by profitable trading. The second type is where the manager delivers information that is independently valuable or material. In these cases, any professional investor would be able to realize that the information can be used for profitable trading without additional work. This is what appears to have taken place in *Newman*,[26] where certain investors received advance notice of details in an upcoming quarterly report. This second type is the focus of this Article and can in turn be divided into two categories: a) an award of information for reciprocal value only to the firm, and b) an award that includes some benefits to the manager herself. As investors may consider selective disclosure events where the manager gets personal benefits or where the firm does not receive adequate compensation for its information undesirable, mechanisms for oversight over the second type of selective disclosure may be useful. However, as the difference between the two types of selective disclosure depends on the value-relevance of the information disclosed, the SEC faces obvious challenges in distinguishing examples of skillful mosaic construction from cases where selected investors are simply handed material information in private discussions.

B. DETAILS OF PRIVATE INVESTOR MEETINGS

As the practices of private investor meetings do not appear to have been analyzed in the legal literature,[27] this section describes the general attributes of such meetings by drawing on academic research in adjacent disciplines such as accounting and finance, and presents details of

26. The Second Circuit recognized in *Newman* that Dell used selective disclosure to build relationships with investors, and this fact contributed to its finding that the defendants could not be expected to infer an improper motive for such information being privately available to them. United States v. Newman, 773 F.3d 438, 454–55 (2d Cir. 2014).

27. The topic has generally not been analyzed much in the literature, likely because "informal contact between institutional investors and firms is by its nature private and difficult to quantify." Lucian A. Bebchuk & Michael S. Weisbach, *The State of Corporate Governance Research*, 23 REV. FIN. STUD. 939, 942 (2010). Some recent financial research on the topic is presented at the end of this subsection.

meeting and disclosure practices as described in investor relations publications and the financial press.

Private meetings or discussions between senior corporate managers and investors or analysts are generally referred to as an "investor relations" activity. The National Investor Relations Institute ("NIRI")[28] defines investor relations as "a strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation."[29] More simply, investor relations is described by industry literature as a corporate function for marketing the firm's stock.[30]

Analysts and active investors consistently rank private conversations with management as their preferred channel for sourcing information.[31] Firms equally regard private meetings as the most

---

28. Founded in 1969, NIRI characterizes itself as "the professional association of corporate officers and investor relations consultants responsible for communication among corporate management, shareholders, securities analysts and other financial community constituents." It presents itself as "[t]he largest professional investor relations association in the world, . . . [with] more than 3,300 members represent[ing] over 1,600 publicly held companies and $9 trillion in stock market capitalization." *See About NIRI*, NAT'L INV'R RELATIONS INST., http://www.niri.org/FunctionalMenu/About.aspx [https://perma.cc/94BQ-45X7]. NIRI has issued voluntary standards of practice relating to disclosure, conducts surveys on investor relations practices, and publishes the monthly magazine "IR Update," all cited herein.

29. NAT'L INV'R RELATIONS INST., 2014 ANNUAL REPORT 1 (2014), http://www.niri.org/about-niri/annual-report [https://perma.cc/SM9K-6FVP][hereinafter NIRI 2014 ANNUAL REPORT].

30. BRUCE W. MARCUS, COMPETING FOR CAPITAL – INVESTOR RELATIONS IN A DYNAMIC WORLD 12 (2005) (arguing that the role of investor relations is to convince investors that the firm's stock will be a better investment than other alternatives). See ANNE GUIMARD, INVESTOR RELATIONS – PRINCIPLES AND INTERNATIONAL BEST PRACTICES IN FINANCIAL COMMUNICATIONS 190 (2d ed. 2013) for a description of investor relations as a marketing function. Guimard was a NIRI board member as of its latest annual report. *See* NIRI 2014 ANNUAL REPORT, *supra* note 29.

31. In 1977, securities analysts regarded personal conversations with managers as the most valuable source of information. *See* REPORT OF THE ADVISORY COMMITTEE ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION 67–68 (1977). This still appears to be the case. *See* Lawrence D. Brown et al., *Inside the "Black Box" of Sell-Side Financial Analysts*, 53 J. ACCT. RES. 1, 10–13 (2015) (finding that sell-side analysts find communication with management more useful than their own research or firms' public reporting); Lawrence D. Brown, Andrew C. Call, Michael B. Clement & Nathan Y. Sharp, *The Activities of Buy-Side Analysts and the Determinants*

important communication channel with investors.[32] Private investor meetings are now so common that many professional investors require a meeting with the CEO before initiating a new investment,[33] and some investors decline to take part in meetings with firms unless they are on a "one-on-one" basis with senior management.[34] North American firms average 153 one-on-one investor meetings per year, with a senior manager taking part in 90 of them.[35] Naturally, there may be large discrepancies in meeting practices between firms depending on their individual circumstances and the policies their managers decide to adopt. For example, one well-known CEO reportedly avoids private investor meetings entirely to ensure that new information reaches all investors simultaneously,[36] while another CEO has estimated that such meetings take up 25% to 30% of his time.[37] General Electric participates in approximately 400 analyst and investor meetings annually, 70 of which are with senior managers.[38] The data presented here only covers

of Their Stock Recommendations, 62 J. ACCT. & ECON. 139, 147 (2016) (finding that buy-side analysts find sell-side analysts' provision of access to management more useful than their written reports, earnings forecasts or stock recommendations); *see also* GUIMARD, *supra* note 30, at 161 (arguing that one-on-one meetings are the preferred way of investor communication for both issuers and investors and labeling the practice "irreplaceable").

32. GUIMARD, *supra* note 30, at 161; NAT'L INV'R RELATIONS INST., ANALYST SPONSORED INVESTOR CONFERENCES SURVEY, 2013 REPORT, 14 (Jan. 10, 2014) (finding that "one-on-ones were the most valuable element of an analyst sponsored investor conference").

33. Leslie Kwoh, *Investors Demand CEO Face Time*, WALL ST. J., Nov. 28, 2012. One investor has stated that he would typically have two or three such meetings before "even contemplat[ing] an investment." For further examples, see Alex Jolliffe, *Corporate Access: The Investor View*, IR MAG., SUPPLEMENT: CORPORATE ACCESS: OPPORTUNITY KNOCKS, June 2012, at 12, and Ng & Troianovski, *supra* note 4.

34. GUIMARD, *supra* note 30, at 160.

35. *IR Events and Meetings*, IR MAG., Spring 2015, at 39 (presenting data by size of firms, showing that larger firms take part in more meetings; e.g., the largest firms take part in an average of 253 meetings per year, of which 116 are with a senior manager).

36. Richard Blackden, *Warren Buffett Tackles Tricky Issue of Succession*, SUNDAY TELEGRAPH (London), May 6, 2012, at 5. See Ng & Troianovski, *supra* note 4, for another example of a public firm that does not participate in private meetings.

37. Kwoh, *supra* note 33.

38. Ng & Troianovski, *supra* note 4.

physical meetings, however, so the figures would be higher if telephone calls, which may be similar in content and purpose, were included.[39]

Recent empirical studies indicate that private access to management can be valuable. Investors with access to invitation-only investor conferences that provide private meetings can earn significant trading profits through regular attendance.[40] In a similar vein, brokers who host investor conferences have been found to issue more accurate earnings forecasts on participating firms than non-hosting brokers (who are typically not invited), and their recommendations generate abnormal returns, indicating that greater access to management is a contributing factor to an analyst's informational advantage.[41] An analysis of all private meetings between senior management and investors of a NYSE-listed firm found that hedge funds with access to such meetings made more informed trading decisions.[42] As these studies review the actions of investment professionals, they should be interpreted carefully without inferring that anyone given access to management could conduct profitable trades. These studies do, however, indicate that NPI can be used for profitable trading by professional investors with access to private events.

Interestingly, more than half of US firms' investor meetings are with hedge funds, even though they hold only 6% of the equity market.[43]

---

39. It is very difficult to establish the amount of private interactions firms have with analysts and investors. Soltes reviewed records of all interactions between one large-cap NYSE-traded firm and sell-side analysts over a year, and found that only 21% of interactions were publicly observable, for example, where the firm's participation in investor conferences was disclosed. *See* Eugene Soltes, *Private Interaction Between Firm Management and Sell-Side Analysts*, 52 J. ACCT. RES. 245, 247 (2014).

40. Brian J. Bushee, Michael J. Jung & Gregory S. Miller, *Do Investors Benefit from Selective Access to Management?* 33 (Wharton School, Working Paper, 2013), http://ssrn.com/abstract=1880149 [https://perma.cc/BFT4-NY49] (finding that informed trading increased during private meetings held as part of investor conferences, and such trading could earn investors a three-day trading profit of 0.4%-0.6% per conference).

41. T. Clifton Green, Russell Jame, Stanimir Markov & Musa Subasi, *Access to Management and the Informativeness of Analyst Research*, 114 J. FIN. ECON. 239 (2014).

42. David Solomon & Eugene Soltes, *What Are We Meeting For? The Consequences of Private Meetings with Investors*, 58 J.L. & ECON. 325 (2015) (noting that their results, which indicate that hedge funds conduct more profitable trades than other investors who meet privately with management, could support both a theory that they are better at interpreting information and a theory that they are receiving different information).

43. Johnson, *supra* note 2.

For example, the records of the NYSE-listed firm mentioned above showed that the four investors it had the most private meetings with were all hedge funds, and the most active hedge fund met the firm once per quarter, on average.[44] The prevalence of hedge funds as meeting participants and their ability to make more profitable trades following private meetings than other investors[45] raise questions of how firms choose investors for selective disclosure and why private meetings are a worthwhile activity. Put differently, when Dell disclosed information worth $62 million to selected investors,[46] what did it get in return? This will be explored next.

C. The Function of Private Investor Meetings

1. From the Perspective of Firms

NIRI describes the importance of private investor meetings as follows, which emphasizes that the focus of such meetings is to provide investors with information they cannot otherwise obtain:

> One-on-one meetings with individuals or groups are a common and indispensable way to disseminate information about a company and to answer legitimate requests for a discussion of long-term strategies, as well as to provide detailed information. One-on-one meetings help to increase transparency, build goodwill, and make a company more approachable in the eyes of the investment community.[47]

This description succinctly illustrates that firms may use selective disclosure of new information as a unique disclosure method in order to bond with investors. Other benefits of private meetings presented in the investor relations literature similarly allude to the use of NPI as a corporate resource. Private meetings may be used to convince investors

---

44. Solomon & Soltes, *supra* note 42, at 335–36 (finding that the investor that met most frequently with the firm took part in twenty-two meetings during a time period covering twenty-two quarters).

45. *Id.* at 349–50.

46. See Section II.E, *infra*, for a further discussion of this case, which was briefly outlined on pp. 35-36.

47. NAT'L INV'R RELATIONS INST., STANDARDS OF PRACTICE FOR INVESTOR RELATIONS – DISCLOSURE 53 (2014).

to buy the firm's stock.[48] They may also help build shareholder loyalty to increase the likelihood of participation in future securities offerings, assistance if the firm encounters a crisis, or support for potential future strategic shifts or large acquisitions.[49] Such meetings also allow for investor feedback and may provide an informal venue for managers to test ideas.[50] Reasons for conducting private meetings particularly with hedge funds may include generating greater liquidity,[51] increasing volatility, and decreasing uncertainty associated with market rumors.[52]

In general, firm benefits of private meetings appear to be provided in the form of intangible value that is difficult to quantify.

2. From the Perspective of Participating Investors

A main function of private meetings with senior management is, of course, to enable investors and analysts to find value-relevant NPI that can be used for profitable trading. Perceived advantages to investors of private meetings compared to other disclosure methods include the opportunity to ask more searching questions and receive more detailed

---

48. GUIMARD, *supra* note 30, at 97 (explaining that it is important to have investors willing to buy stock when existing shareholders sell); *id.* at 165 (suggesting that "[d]ecisions about whether to send the CEO or IRO to meet with a portfolio manager should be based . . . on the likelihood that the meeting will lead to the purchase of stock in the company"); *see also* United States v. Newman, 773 F.3d 438, 455 (2d Cir. 2014) ("[The Head of Investor Relations at Dell] selectively disclosed confidential quarterly financial information . . . to establish relationships with financial firms who might be in a position to buy Dell's stock."); MARCUS, *supra* note 30, at 91 (arguing that the purpose of private meetings is to increase investors' understanding of the firm and convince them to buy the firm's stock).

49. GUIMARD, *supra* note 30, at 162 (stating the importance of regular meetings with investors); *id.* at 181 (stating that "[f]aithful shareholders are more likely to participate in a capital increase . . . or to help withstand a crisis"); MARCUS, *supra* note 30, at 107 (noting that some investors are willing to "provide some support in difficult times"); Kwoh, *supra* note 33 (quoting a CEO describing the purpose of private meetings as "selling the management team" and showing accountability).

50. MARCUS, *supra* note 30, at 107.

51. One representative of a hedge fund argued that issuers should participate in private meetings with hedge funds since they provide liquidity. *See* Matt Brusch, *What Investors Want from IROs*, IR UPDATE, Oct. 2010, at 18.

52. GUIMARD, *supra* note 30, at 102 (suggesting "[h]igher volatility" and "remov[ing] uncertainty in the stock conveyed by market rumors" as reasons for meeting with hedge funds, but not explaining why increased volatility would be beneficial or why private meetings may be a preferable method for managing rumors).

answers than would otherwise be possible, as well as the opportunity to challenge managers more than would be appropriate in a public forum.[53] Analysts use meetings to verify facts, find new information, and familiarize themselves with corporate managers.[54] Topics of discussion are often forward-looking and include industry competition and the managers' strategy.[55] Analysts also attempt to confirm their earnings projections, for example, by gaining management's feedback on whether their forecasts are "*in the ball park*."[56]

Functionally, investors can engage in three conceptually distinct types of activities to reduce uncertainty about the pricing of a security: they can seek to acquire new information, verify already available information, or analyze available information.[57] Investors use private meetings with management to reduce uncertainty about securities pricing by asking questions both to acquire new information and to verify existing information. Acquisition of new information could consist of asking for more details on items that already have been subject to some disclosure[58] or, as in *Newman*, attempting to learn of information in advance of its imminent public disclosure.[59] Verification of information could consist of attempts to have management confirm whether previous forward-looking statements are still valid because such

53. *See* GUIMARD, *supra* note 30, at 162 (suggesting that corporate managers meeting with hedge fund managers may have an experience similar to "being held in custody in an interrogation room"); MARCUS, *supra* note 30, at 107–08 (noting that professional portfolio managers have an urgent and intensive demand for substantial information and ask highly technical questions); Kwoh, *supra* note 33 (quoting a CEO of a public firm who notes that "investors probe him for confidential information . . . 'all the time'").

54. MARCUS, *supra* note 30, at 96.

55. *Id.*

56. *Id.* at 106. For a real-world example, see *United States v. Newman*, 773 F.3d 438, 454–55 (2d Cir. 2014), where investor relations personnel provided testimony that analysts regularly received information from firms "in order to check assumptions in their models in advance of earnings announcements" and the investor relations departments in question "routinely 'leaked' earnings data in advance of quarterly earnings."

57. Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 564–65 (1984).

58. For example, in Soltes, *supra* note 39, at 257, 43% of all analyst interactions occurred within seventy-two hours of public news releases by the firm.

59. *Newman*, 773 F.3d at 454–55.

information would be more reliable if confirmed by a person with the ability to influence it.

The costs associated with undertaking each of these activities will determine the availability of the information resulting from them.[60] Information costs of private investor meetings may include compensating intermediaries who arrange conferences and salaries for professional analysts who know the most valuable questions to ask corporate managers and have the skill to analyze their answers. These costs are consequently relatively high, meaning that comparatively few investors will take part in private investor meetings and have access to such information. Verification of information relating to a firm without its cooperation is expensive, however, so procuring a private meeting with management may still be the most cost-effective method of doing so.[61] Furthermore, acquiring new information directly from senior managers may remove the need for further verification as they are often the best possible source.

Not all investors are interested in acquiring NPI. Liquidity traders buy or sell stocks depending on whether they have a surplus or shortage of liquid funds for consumption without conducting any research, and passive investors may invest in funds that simply track an index and charge minimal management fees. Investors who demand NPI are sometimes referred to as "information traders"[62] or "active investors," a group which includes mutual funds and hedge funds.[63] These investors believe that they can outperform a passive index investment by investing based on their own information collection and analysis, and that the returns from their superior skill will outweigh the costs of this activity. They attend private meetings to unearth information, to refine their estimated intrinsic value of a security, and trade when their estimation varies from the market price. The investment performance of active

60. Gilson & Kraakman, *supra* note 57, at 594-95 (describing the different types of information costs).

61. This could involve paying an intermediary for arranging a meeting via "corporate access." *See infra* Section I.D.

62. *See, e.g.*, Fischer Black, *Noise*, 41 J. FIN. 529 (1986) (contrasting different types of traders).

63. "Buy-side" institutions such as mutual funds and hedge funds employ their own financial analysts. They may also receive information from "sell-side" financial analysts employed by brokers. "Active investors" is an umbrella term and only a subset of such investors seek to acquire NPI in private investor meetings—it is that subset which this Article references with the term.

investors is typically evaluated against a benchmark. Active investors demand NPI—and therefore, private meetings with corporate managers—as it helps them outperform such benchmarks.

To deduce the appropriate price of a security, an active investor must estimate many variables. For example, the discounted cash flow model commonly used for equity valuation forecasts a firm's future cash flows by applying growth and profitability estimates (soft information) to its historical accounting figures (hard information). Factors relating to the firm, its industry, and the economy all need to be considered to forecast revenue growth for the firm's products or divisions, and costs need to be estimated to determine how future revenue will translate into profitability. The financing structure must also be projected to estimate the residual cash flows available to shareholders.

All forward-looking data points in a valuation model are estimates and therefore subject to uncertainty. Given the uncertainty that surrounds many of the required inputs to equity valuation, we can portray an active investor's expectation of the price of an individual share that will prevail at some date in the future (and, thereby, the potential return on investment) as a probability distribution. The dispersion around the mean expected share price will reflect the risk the investor attributes to the expected return on the firm's shares as a result of the uncertainties in the valuation inputs.[64] We can further think of value-relevant information as data that has the ability to change the return distribution.[65] Production, purchase, or discovery of new hard or soft information can consequently change an investor's share price probability distribution.

By reducing uncertainty about valuation estimates, investors can refine their assessments of the risk-return profile of a security. If an investor acquires information that reduces "upside risk" (or the probability of a positive deviation from the mean), the expected value becomes lower and the investor may be more inclined to sell the security. If the acquired information instead reduces "downside risk,"

64. Risk is used in this context as a measure not only of downside deviations from the expected mean, but also upside deviations. ZVI BODIE, ALEX KANE & ALAN J. MARCUS, INVESTMENTS 129 (10th ed. 2014).

65. This depiction of information is inspired by Jack Hirshleifer, *Where Are We in the Theory of Information?*, 63 AM. ECON. REV. 31 (1973). *See also* Gilson & Kraakman, *supra* note 57, at 561.

the expected value increases and the investor may be more disposed to buy the security. If risk is reduced symmetrically (equally on the downside and the upside, with the same mean after the information acquisition), the investment offers more return per unit of risk, which will make it more attractive.[66] Thus, any change in the risk profile of a security can have value to active investors, and new information about a security will have value if it changes the risk profile.

3. From the Perspective of Non-Participating Investors

Investors who do not participate in private meetings may still benefit from them. If they are shareholders, they can share in the benefits accruing to the firm as set out in Section I.C.1. There are two further potential benefits that may lie more on the shareholder level than on the firm level: increased market efficiency and improved monitoring of management.[67] These two factors were recognized as beneficial in *Dirks* where the Supreme Court acknowledged that financial analysts who meet privately with management to question them may "ferret out" information for the benefit of all investors.[68]

a. Market Efficiency Benefits?

A security is typically described as trading in an efficient capital market if the price of the security always reflects all available information.[69] Efficiency is usually considered in relation to three different types of information. Developed equity markets are generally considered to be efficient in relation to two such types: historical price information (weak form efficiency) and other publicly available

---

66. Eugene F. Fama & Arthur B. Laffer, *Information and Capital Markets*, 44 J. BUS. 289, 290 (1971). Of course, for an optimally diversified investor a reduction in the idiosyncratic risk of one security which she already holds may not be of value, but for an active investor attending a private meeting with management in order to decide whether to take or change a position in a security, such a reduction of risk could be of interest.

67. These benefits were not noted in the investor relations literature in Section I.C.1, *supra*, so they do not appear to be the focus of firms themselves.

68. Dirks v. SEC, 463 U.S. 646, 658–59 (1983) (quoting Dirks, Exchange Act Release No. 17,480, 21 SEC Docket 1401, at *6 (Jan. 22, 1981)).

69. Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

information (semi-strong efficiency). As these types of information will be instantly incorporated into prices, they do not offer opportunities for profitable trading.[70] Markets do not, however, typically impound information available only to a small number of people into prices (that is to say, markets do not exhibit strong form efficiency), meaning that such information may offer profitable trading opportunities.[71] The absence of strong form efficiency thus provides an initial explanation for professional investors' demand for NPI.

In considering the market efficiency requirement that prices fully reflect "available" information, Gilson and Kraakman noted how the three levels of market efficiency relate to different information sets that become reflected in the price following distinct processes.[72] Arranging the three levels on a continuum from weak to strong market efficiency, they argued that market efficiency should be viewed as a relative concept, with relative efficiency as a measure of how quickly prices reflect new information.[73] Relative efficiency then increases as the group of initial recipients of information becomes broader.[74] If information is initially distributed broadly, it will be expected to be reflected in price quickly and the market will exhibit high relative efficiency with regards to that information. Conversely, if information is initially distributed to only a few recipients, it will be expected to take longer to become reflected in price and the market would therefore be described as having lower relative efficiency in respect of such information. While this applies to all relevant information about a security, the focus here is on disclosures by firms themselves.

Non-mandated disclosures take many different forms. Examples of methods in which firms disclose information to investors include one-on-one meetings and private telephone conversations, small-group meetings with investors, non-public roadshow presentations, analyst and

---

70. *Id.*; Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. FIN. 1575, 1607 (1991).

71. Fama, *supra* note 69, at 409-13.

72. Gilson & Kraakman, *supra* note 57, at 558–60.

73. *Id.* at 560.

74. While such a continuum of information distribution makes intuitive sense, a "market may be efficient [with regards to a piece of information] if 'sufficient numbers' of investors have ready access" to it. *See* Fama, *supra* note 69, at 388; Gilson & Kraakman, *supra* note 57, at 569.

investor days, and press releases.[75] If we apply the concept of relative efficiency to illustrative corporate disclosure methods, we may represent it along the lines of Figure 1.

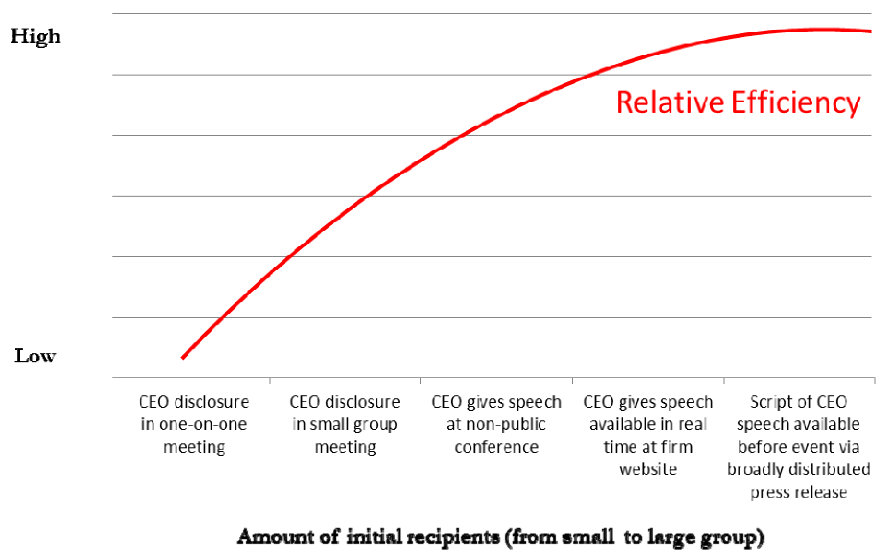

Figure 1. Relative Efficiency of Different Corporate Disclosure Methods

While Figure 1 should not be viewed as a *quantitative* representation of how prices adapt to new information disclosed via different methods, the *qualitative* intuition should be broadly correct. Information selectively disclosed to one investor will take longer to become reflected in price than broadly disseminated information since investors with private information seek to maximize their personal gain. Knowing that other traders are able to observe their trading activity, traders with selectively disclosed information will attempt to make decoding as difficult as possible by trading slowly in order to conceal their informational advantage and disguise themselves as liquidity traders.[76] The more successfully such information recipients convince other traders that they are uninformed, the larger their potential profit

75. A useful overview of how firms interact with investors via these (and other) methods from the perspective of an investor relations professional is presented in GUIMARD, *supra* note 30, at 143–87.

76. XAVIER VIVES, INFORMATION AND LEARNING IN MARKETS 339–47 (2008).

will be and the less information will be impounded into the price of the security.

Without cooperation from the selective disclosure recipient, other investors must resort to the less efficient processes of "price decoding" or "trade decoding" to attempt to decipher the value of the recipient's NPI.[77] However, neither type of decoding informs the outsider as to whether the observed trading is based on new information (such as NPI from the issuer), mistaken belief, or for liquidity reasons. It is therefore unlikely that decoding would offer many, if any, opportunities for market participants to learn of information disclosed to an investor in a private meeting.[78] Research confirms that when information traders are able to choose when and how to trade, they can prevent decoding.[79]

The difficulty in decoding does not mean that informed trading will never have any impact on share prices. Factors affecting the incorporation of information into prices may be sketched out by considering an individual investor's preferences in a practical case. Consider a stylized version of *Newman*,[80] where one or more investors receive advance information about the contents of a firm's quarterly report.[81] From the perspective of an investor, we can outline five factors that will influence how she chooses to trade and consequently the extent to which prices will reflect the information.

---

77. Gilson & Kraakman, *supra* note 57, at 573. "Trade decoding occurs whenever uninformed traders glean trading information by directly observing the transactions of informed traders," for instance, by studying transactions subject to reporting requirements. *Id.* Price decoding occurs when an outsider observes a price change and concludes that another trader in the market possesses new information. *Id.*

78. For early statements to this effect, see *id.* at 572–79, 629–34, and Donald C. Langevoort, *Investment Analysts and the Law of Insider Trading*, 76 VA. L. REV. 1023, 1038 (1990).

79. *See, e.g.*, Pierre Collin-Dufresne & Vyacheslav Fos, *Do Prices Reveal the Presence of Informed Trading?*, 70 J. FIN. 1555 (2015) (finding that "when informed traders can select when and how to trade, standard measures of adverse selection may fail to capture the presence of informed trading"); *see also* Lauren Cohen, Christopher Malloy & Lukasz Pomorski, *Decoding Inside Information*, 67 J. FIN. 1009 (2012) (insider trades not decoded until publicized).

80. *See generally* United States v. Newman, 773 F.3d 438 (2d Cir. 2014).

81. "[I]llegal trading usually concerns 'bombshell' information that companies are forced to disclose publicly in the near term." WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 681 (4th ed. 2012).

First, as already determined, the size of the group of initial recipients will matter. If several traders have the same information (for instance, by attending the same conference presentation), the information may be impounded into prices more quickly than if only one investor receives it. This results because the recipients may not be able to coordinate and instead have to compete to capture the gains.[82] Second, the amount of time before the quarterly report becomes public is important. If the recipient has a week to trade, she can trade more slowly, whereas if the information will become public in a few hours, the recipient may opt for a more aggressive strategy that results in more information leakage.[83] Third, the recipient's investment constraints will be relevant. The recipient may have limits for the percentage of a firm's shares she can hold, be subject to constraints on short-selling or borrowing, or may have limited funds available to invest. Fourth, the amount of other trading in the market will impact the trading strategy and information revelation. The more liquid the market for the stock in question is, the easier it will be for an informed investor to trade without revealing its advantage.[84] Fifth, and importantly for the selective disclosure situation, the investor's desire to maintain a relationship with the firm will impact its trading strategy. The more aggressively the investor trades on privately obtained information, the higher is the likelihood that it will affect the stock price and make it apparent to the regulator that she has an informational advantage. Since the party that carries the most regulatory risk in such a situation is not the investor but the disclosing firm,[85] a privately informed investor needs to choose between two broad types of trading strategies: (i) trade aggressively with a higher risk of detection and a resulting increased risk that the relationship with the firm will be terminated due to a regulatory inquiry,

---

82. VIVES, *supra* note 76, at 339–47.

83. *Cf.* Robert J. Jackson, Jr., Wei Jiang & Joshua Mitts, *How Quickly Do Markets Learn? Private Information Dissemination in a Natural Experiment* 27 (Colum. Bus. Sch., Research Paper No. 15-6, 2015), http://ssrn.com/abstract=2544128 [https://perma.cc/J5NP-9EXR] (finding evidence suggesting that traders with private information trade strategically, depending on the expected length of their trading advantage).

84. *See* Collin-Dufresne & Fos, *supra* note 79 (finding that information traders increase trading with a rise in stock liquidity); ALLEN ET AL., *supra* note 81 (noting that informed trading may "fail entirely to move prices if the level of background 'noise trading' is sufficiently high").

85. The firm carries more risk since Reg. FD does not apply to the investor. *See infra* Part II.

or (ii) trade moderately, with a low risk of detection and a high likelihood of maintaining the relationship into the next period.

If the recipient finds herself in a situation where she is unable to trade, e.g., due to investment constraints, she may, of course, decide to share the information with another investor who is so able. It may indeed be useful for an information trader to establish informal reciprocal relationships with like-minded investors in order to benefit when other investors are similarly unable to trade.[86] Such secondary selective disclosure could have some positive impact on market efficiency, depending on how the secondary information recipients view the five factors outlined above.

The picture that emerges from this analysis is one where a selective disclosure recipient may rationally trade in a way that leaves information less than fully incorporated into prices. Indeed, in certain configurations of the five factors sketched out above, the information will never affect the stock price at all.

In conclusion, when information is distributed to only one investor, this recipient receives a valuable trading advantage. On the other side of the spectrum where information is disclosed broadly, relative market efficiency is high and recipients do not receive any trading advantages on average. In-between these end-points, the two effects will exhibit some progressive development. We can then illustrate the corporate manager's choice between disclosure methods as a trade-off between improving market efficiency and conferring value on recipients, as in Figure 2.

---

86. *Cf.* United States v. Newman, 773 F.3d 438, 443 (2d Cir. 2014) (describing how information was relayed between financial analysts at different buy-side institutions).

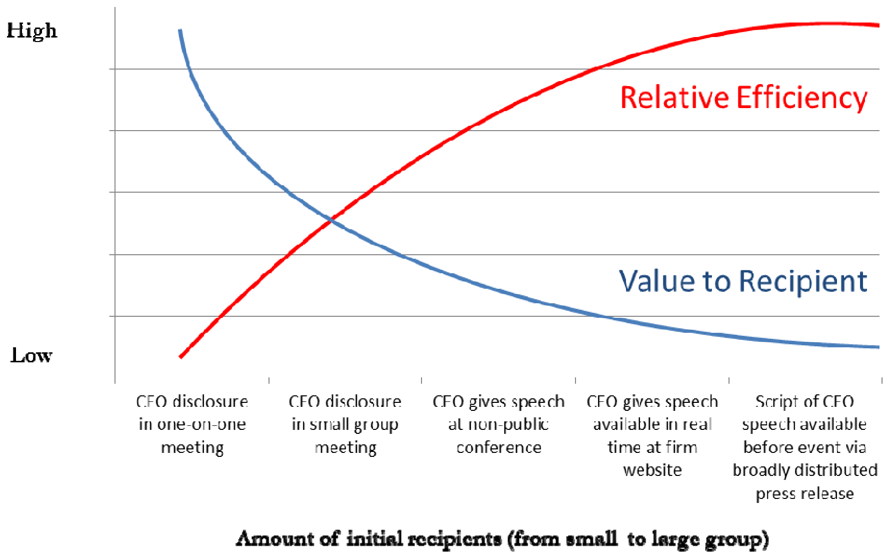

Figure 2. Trading Value to a Recipient of Different Corporate Disclosure Methods

Figure 2 shows that a public firm can either have secrecy or increased market efficiency with regards to a particular item of NPI, but not meaningful degrees of both at the same time. In sum, there appears to be little expected market efficiency benefit to investors as a group of the practice of selective disclosure, unless the firm selectively discloses the information to larger groups.

b. Monitoring Benefits?

If it is doubtful that private meetings with investors produce notable market efficiency benefits, such meetings may instead be beneficial to investors at large by providing a forum where professional investors can engage in monitoring and verification by questioning the public reporting presented by management and verified, in part, by the auditors. This is the "ferreting out" activity that the SEC and the Supreme Court agreed was beneficial in *Dirks*.[87] The social benefit of private investor meetings may then arise from their function of ensuring that managers' disclosure decisions are unbiased—with an *ex ante*

87. Dirks v. SEC, 463 U.S. 646, 658 (1983).

disciplining effect, as managers will be aware that they will need to justify their disclosure decisions to investment experts, and with an *ex post* effect of verifying the actual disclosures made.

However, the investors who take part in private meetings will not be inclined to share their findings broadly, as we have just seen that they profit more from private information. Additionally, the extent to which managers opt to subject themselves to such monitoring is entirely voluntary and unknown to shareholders. This may lead to a situation where honest managers subject themselves to monitoring by more skillful or diligent investors, whereas less honest managers—who *Dirks* itself took aim at—can choose not to subject themselves to investor monitoring or only meet with investors who are less skillful monitors.[88]

An argument that selective disclosure practices are beneficial may proceed by claiming that by leaving something (i.e., value-relevant information) on the table, active investors may be more attracted to meet with managers to monitor them for the benefit of all investors.[89] Whether this would work in practice would depend on the managers' skill and interest in choosing to meet participants who have the motivation to conduct monitoring and verification instead of those only looking to acquire the NPI.

D. Corporate Access as a Medium for Investor Meetings

As information about listed securities is more valuable the more privately it is received, the demand for selectively disclosed information and the willingness to pay for it is obvious. Active investors will prefer to receive information as privately as possible in order to have a larger window of exclusivity in which to profit from the NPI. Several factors may affect the amount an investor would be willing to pay for information, such as the statutory materiality threshold (above which the insider trading and Reg. FD frameworks may apply), the quality and

---

88. While one reason for managers choosing not to participate in investor meetings may be an unwillingness to be monitored in this way, another reason (as noted in Section I.B, *supra*) is to ensure that information reaches all investors simultaneously. There is consequently nothing inherently honest or dishonest about a firm's choice not to participate in investor meetings.

89. *Cf.* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003) (discussing costs and benefits of the presence of controlling shareholders).

usefulness of management's disclosures in previous meetings, the amount of uncertainty surrounding the firm's future (the more uncertainty, the more valuable the information may be), and perhaps also the perceived skill, knowledge or frankness of management. While, on the one hand, it is rational for investors to economize on information costs (for example, by pooling together in the employment of securities analysts and other experts to study and issue reports on firms to reduce verification costs),[90] information is, on the other hand, not valuable for trading purposes if everyone has access to it, which is why investors rationally demand NPI directly from managers.[91]

A recently introduced offering that caters to investors' demand for private information is "corporate access," an investor meeting arranging service now provided by all major investment banks.[92] As part of invitation-only conferences or non-deal roadshows, these intermediaries arrange private meetings where selected investors can meet with senior managers of public firms to ask questions and learn more about the firms than is available in the public domain.[93] In return, the participating investors route their trading based on the information they learn through the arranging banks' brokerage departments[94] and award them higher commissions depending on the quality of the information.[95] This method

---

90. Gilson & Kraakman, *supra* note 57, at 600.

91. Investors may, of course, find it economical to pool their resources in an investment fund that acquires NPI; the point here is that such a fund will need to trade against an uninformed trader in order to profit from its NPI.

92. John Brinkley, *Managing Face Time: What IROs Need to Know About Working with Corporate Access Providers*, IR UPDATE, Nov. 2012, at 14, 15.

93. Roadshows generally consist of both public and one-on-one meetings. *See* GUIMARD, *supra* note 30, at 165.

94. Brokers may be compensated for ancillary services such as providing access to meetings with senior corporate managers in accordance with the framework on so-called 'soft dollars' in section 28(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78bb(e) (2012). This is a safe harbor provision which protects investment managers from liability for breach of fiduciary duty solely on the basis that they paid more than the lowest commission in order to receive ''brokerage and research services'' from a broker-dealer. The SEC has explicitly included corporate access as a service which qualifies for this safe harbor. *See* Commission Guidance Regarding Client Commission Practices under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Release No. 54,165, 71 Fed. Reg. 41,978, 41,985–86 (July 24, 2006) ("Meetings with corporate executives to obtain oral reports on the performance of a company are eligible because reasoning or knowledge will be imparted at the meeting.").

95. T. Clifton Green et al., *Broker-Hosted Investor Conferences*, 58 J. ACCT. ECON. 142 (2014).

for charging participants based on the quality of information they receive, which allows intermediaries to withhold future corporate access from investors who do not pay, appears to present an apt solution to the problem of establishing a price for information.[96] The public firms themselves do not typically pay to participate in corporate access events.[97]

Corporate access is now a significant industry. A majority of public firms participate in one-on-one meetings arranged as part of analyst-sponsored investment conferences, attending an average of eight such

---

96. *See generally* Kenneth J. Arrow, *Economic Welfare and the Allocation of Resources for Invention*, *in* THE RATE AND DIRECTION OF INVENTIVE ACTIVITY 609, 615 (1962) (describing the "fundamental paradox" that the "value [of information] for the purchaser is not known until he has received the information, but then he has in effect acquired it without cost").

97. The head of corporate access at one large investment bank has described an ideal corporate access event as follows:

> Yahoo! says to me, 'UBS, we'd like you to host us on a road show. We're looking to find new shareholders. What do you think? 'And I say, 'Okay, I know there are some people who are interested in your stock in Chicago, so why don't we go to Chicago?'
>
> Yahoo! representatives come with us, they do a day of meetings, they do a group lunch in Chicago. They tell their story, they tell everyone why this new CEO is going to change things and why it's a great investment from here on out.
>
> A bunch of those investors say, 'You know, I think it is time to buy Yahoo! stock.' They will call up their UBS sales trader and say, 'You know what, we're thinking of buying Yahoo! Give us 10 million shares.'
>
> So we get a commission on that trade. Yahoo! is happy because it got a new shareholder, we're happy because we got some commissions off the back of it, and the investors are happy because they got to meet with management.

Brinkley, *supra* note 92 (also comparing corporate access to a free five-star concierge service); *see also* GUIMARD, *supra* note 30, at 163–64 (proposing criteria for evaluating corporate access services, mentioning that such services are "the least-costly solution for the issuer"); Brusch, *supra* note 51 (noting that intermediaries are "typically paid by commission").

events per year and meeting twenty-two investors per event.[98] Estimates suggest that institutional investors pay brokers over $1 billion per year for corporate access.[99] Individual meetings may be worth between $3500 and $20,000, the latter figure being the going rate for a meeting with a marquee CEO.[100] Some firms may use their participation in corporate access events as a form of payment to corporate access providers by participating in meetings with clients that are important to the intermediary even though the firm would not typically meet with such an investor.[101] This demonstrates awareness that managers' attendance is valuable to investors and thereby to the intermediaries.[102] Corporate access is considered further in Section II.D.2.

II. THE UNFULFILLED PROMISES OF REGULATION FD

Demand for NPI is understandably strong: we have seen that NPI disclosed in private meetings can be valuable and that investors pay significant sums for it. This part explores the design and effects of the applicable federal securities regulation in order to determine the regulatory perimeter for selective disclosure. It proceeds in a relatively, but not completely, chronological way in an attempt to describe how the

---

98. NAT'L INV'R RELATIONS INST., *supra* note 32, (finding that 98% of the 392 firms that replied had taken part in a one-on-one meeting in an analyst sponsored conference).

99. Referencing a 2010 study by Greenwich Associates, Brusch, *supra* note 51, found that "total U.S. equity commission payments allocated to sell-side research and related services represent approximately $6.4 billion. . . . [O]f this $6.4 billion, institutions used about 19 percent to reward brokers for facilitating access to corporate management teams and 14 percent to compensate sponsors of research conferences," for a total of $2.1 billion. Accordingly, institutions spent approximately 33% of equity commissions on access services on average, while the sub-group of hedge funds spent closer to 40%. *See also* Brad Allen, *How the Money Flows*, IR MAG., SUPPLEMENT: CORPORATE ACCESS: MEETING THE CHALLENGE, Dec. 2011 (referencing the same data with similar conclusions). A more recent annual spend figure on corporate access services may be $1.4 billion. *See* Ng & Troianovski, *supra* note 4.

100. Allen, *supra* note 99; Steve Johnson, *Fears Rise over Cash for Access*, FIN. TIMES (London), Mar. 4, 2013, at 1.

101. Brinkley, *supra* note 92, at 16.

102. *See* GUIMARD *supra* note 30, at 102 (noting generally that "management time is incredibly valuable"); NAT'L INV'R RELATIONS INST., *supra* note 32, at 15 (quoting a conference participant noting that attendance at a conference is "doing [the broker] a favor").

regulatory framework evolved and how analysts, investors, and corporate managers appear to have adapted.

A. THE SUPREME COURT DEVELOPS INSIDER "TIPPING" IN *DIRKS V. SEC*

The scope of permissible disclosures of NPI in private investor meetings is limited by two main sources of federal law and regulation: the prohibition on insider trading and the SEC's Reg. FD. The federal prohibition on insider trading is based on Section 10(b) of the Securities Exchange Act of 1934,[103] "a catch-all clause to prevent manipulative devices,"[104] and Rule 10b-5, which the SEC issued under that section.[105] Neither the statute nor the regulation provides much detail to establish the contours of a regulatory regime governing insider trading or tipping, which instead has developed through federal common law under two distinct theories. The classical theory targets insiders of the firm and holds that they are prohibited from trading the firm's shares based on material NPI due to a special "relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation."[106] This relationship gives rise to a duty to disclose the material information before (or abstain from) trading in order to "prevent[] a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed . . . stockholders."[107] The misappropriation theory expands the scope of insider trading liability to outsiders of the corporation who possess material NPI about a firm and use it to trade "in breach of a duty owed to the source."[108] This Article proceeds with a focus on the classical theory, which conforms well to the investor relations situation

---

103. 15 U.S.C. § 78j(b) (2012).

104. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202–06 (1976) (quoting *Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the H. Comm. on Interstate and Foreign Commerce*, 73d Cong. 115 (1934) (statement of Thomas G. Corcoran)).

105. 17 C.F.R. § 240.10b-5 (2015).

106. Chiarella v. United States, 445 U.S. 222, 228 (1980).

107. *Id.* at 228–29 (citation omitted).

108. United States v. O'Hagan, 521 U.S. 642, 652 (1997).

where managers privately provide NPI to investors to convince them to buy the firm's stock in the market.[109]

Insider trading liability extends to outsiders who receive information from an insider under the framework on tipping established by the Supreme Court in the still leading case of *Dirks v. SEC*.[110] In this case, Dirks, an investment analyst, obtained information from a former employee of the publicly-traded firm Equity Funding that its assets were fraudulently overstated. The whistleblower informed Dirks that regulators had failed to take any action, and encouraged him to verify and expose the wrongdoing.[111] Dirks met with Equity Funding's employees, some of whom confirmed the allegations, and he then disclosed the information to his clients and investors who sold their stock in the firm.[112] The Supreme Court held that "tippees must assume an insider's duty to the shareholders . . . not to trade . . . when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."[113] The insider's duty to shareholders is to use the information solely for corporate purposes and not for personal benefit.

After *Dirks*, an important test for establishing whether a private disclosure from a corporate insider to an investor is permissible under the insider trading framework is whether the insider receives a personal benefit from the disclosure—without a personal benefit, there is no breach of duty by the insider, and neither the insider nor the outsider recipient can be held liable under section 10(b).[114] The Supreme Court established that the personal benefit assessment needs to be based on objective criteria (not subjective intent), and noted three (ostensibly non-exhaustive) examples of benefits that, whether direct or indirect, would qualify: "a pecuniary gain or a reputational benefit that will translate

---

109. This delineation is for simplicity of presentation as "nearly all violations under the classical theory of insider trading can be alternatively characterized as misappropriations." SEC v. Yun, 327 F.3d 1263, 1279 (11th Cir. 2003). Furthermore, the elements needed to establish tipping liability are the same under both theories. *See id.* at 1274–80; United States v. Newman, 773 F.3d 438, 446 (2d Cir. 2014); SEC v. Obus, 693 F.3d 276, 285–86 (2d Cir. 2012). *But see* SEC v. Sargent, 229 F.3d 68, 77 (1st Cir. 2000).

110. Dirks v. SEC, 463 U.S. 646 (1983).

111. *Id.* at 648-49.

112. *Id.* at 649.

113. *Id.* at 660.

114. *Id.* at 647.

into future earnings . . . [or] a gift of confidential information to a trading relative or friend" (since this would be equivalent to the insider trading personally and gifting the profits to the recipient).[115] As the regular investor meeting setting would not produce a pecuniary gain for the participating manager, the applicable personal benefits would be the scenarios involving a reputational benefit or a gift.[116]

In addition to disclosing material NPI selectively for a personal benefit, an insider tipper needs to act with scienter to be subject to insider trading liability. This means that a manager in our private meeting scenario needs to know or exhibit severe recklessness in not knowing that the information disclosed is both material and non-public.[117] As tippee liability is derivative of tipper liability, an investor who receives negligent disclosure from a manager in a private meeting can thus trade on it without violating the insider trading framework. The test of the required state of mind for a recipient is based partly on a negligence standard, as it is sufficient that the recipient should know that the insider breached fiduciary duty by disclosing the information to her.[118] It appears, however, that the tippee's trading must be intentional or reckless in order to establish liability.[119] When determining whether

115. *Id.* at 663–64. The Supreme Court recently interpreted *Dirks* in a case where an insider gifted inside information to a relative, holding that such a gift was sufficient to satisfy the personal benefit requirement to render the insider liable. *See* Salman v. United States, 137 S. Ct. 420 (2016).

116. Further developments and the current status of the personal benefit requirement are analyzed *infra* Section II.E.

117. VIII LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION 156–57 (4th ed. 2012); *see also Dirks*, 463 U.S. at 674 n.11 (Blackmun, Brennan and Marshall, JJ., dissenting) ("[I]f the insider in good faith does not believe that the information is material or nonpublic, he . . . lacks the necessary scienter.") (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976)).

118. *See supra* text accompanying note 113.

119. The Second Circuit has held that "*Dirks*' knows or should know standard pertains to a tippee's knowledge that the tipper breached a duty . . . to his corporation's shareholders . . . by relaying confidential information," while the "requirement of intentional [or reckless] conduct pertains to the tippee's eventual use of the tip through trading." SEC v. Obus, 693 F.3d 276, 288 (2d Cir. 2012). However, in *United States v. Newman*, 773 F.3d 438, 447–48 (2d Cir. 2014), a criminal case, the Second Circuit interpreted *Dirks* to require that a tippee actually know about the personal benefit. *Newman* involved a tipping chain, so it may be easier to prove knowledge of the benefit in the private investor meeting context as the meeting participant presumably would be

tippees should know that information disclosed to them is material or nonpublic, their level of sophistication in investments and amount of prior contacts with the insider tipper may be taken into account.[120] The scienter requirement is thus an additional defense against honest mistakes in a private meeting setting.

B. THE SEC RESPONDS WITH REG. FD

While *Dirks* did not preclude finding a firm itself guilty for tipping material NPI for its own "personal" benefit, market participants viewed it as permissive in this regard as long as there was no personal benefit to the insider who actually carried out such disclosure.[121] This view may have gained adherents after the Supreme Court decided *O'Hagan*, which suggested that selective disclosure could be authorized by the firm.[122] The SEC found this development troubling as it could lead to a situation where financial analysts were made dependent on information received privately from managers, which could reduce their willingness to undertake independent research and incentivize them to bias their research to maintain management access.[123]

In a settled proceeding, the SEC had previously applied the insider trading framework to selective disclosure by arguing that an insider who provided information about upcoming earnings to selected investment analysts had earned a personal benefit by preserving and strengthening his reputation as Chairman and CEO.[124] This construction was a way for the SEC to connect selective disclosure to the reputational type of personal benefit explicitly covered by *Dirks*. While this theory was not

---

the person alleged to provide it. For further analysis of the scienter requirement as it applies to tippees, see WANG & STEINBERG, *supra* note 24, at 402–04.

120. LOSS, SELIGMAN & PAREDES, *supra* note 117, at 94.

121. Proposing Release, *supra* note 7, at 72,593 (noting that in cases where no clear personal benefit was present, market participants viewed selective disclosure as permitted).

122. O'Hagan, 521 U.S. 642, 655 (1997). See John C. Coffee Jr, *Is Selective Disclosure Now Lawful?*, 218 N.Y.L.J. 5 (1997), for an analysis of the impact of the decision on selective disclosure practices.

123. Proposing Release, *supra* note 7, at 72,591–93 (referring to a large amount of such undesirable disclosures). The SEC also argued that "unerodable informational advantages obtained through superior access to corporate insiders" could lead to a loss of public confidence in the overall fairness of markets. *Id.* at 72,592 (citation omitted).

124. SEC v. Stevens, 48 SEC Docket 739 (Mar. 19, 1991).

subjected to review by a court, its reasoning was criticized as an unduly broad interpretation of *Dirks*.[125]

When the SEC in the late 1990s considered its options for how to address the perceived problem of managers providing material NPI to selected investors without a clear personal benefit to themselves, it recognized two alternatives: it could either seek to extend the *Dirks* anti-fraud framework in the courts to disclosures where the firm itself received the "personal benefit," or it could impose a disclosure obligation on firms to effectively nullify the benefits of selective disclosures.[126] The main author of Reg. FD[127] has explained that while it may have been possible to extend *Dirks*, this was considered a highly undesirable alternative. Broadening the insider trading regime in this way would have had such a strong deterrent effect that it would likely have restricted many legitimate corporate communications as well.[128] Accordingly, the SEC preferred to instead introduce Reg. FD under its

---

125. *Cf.* Coffee, *supra* note 122 (arguing that one may be able to find such mixed—corporate and personal—motives in any selective disclosure situation).

126. Richard L. Anderson et al., *The SEC's Regulation FD*, 6 FORDHAM J. CORP. & FIN. L. 273, 278 (2001) (citing Harvey Goldschmid).

127. *See*, *e.g.*, Mary Jo White, Chair, Sec. & Exch. Comm'n, Statement on Passing of Former SEC Commissioner Harvey J. Goldschmid (Feb. 13, 2015), http://www.sec.gov/news/statement/statement-on-passing-of-harvey-goldschmid.html [https://perma.cc/7X9J-LMJP] (describing Former Commissioner Goldschmid as "the primary architect of Regulation FD"). Former Commissioner Goldschmid himself described his work on Reg. FD modestly: "I was General Counsel at the SEC when FD was first presented. I was a Special Senior Advisor to Chairman Levitt and . . . helped to finalize FD." Anderson et al., *supra* note 126, at 277.

128. Former Commissioner Goldschmid described the situation as follows:

> If we were able to extend *Dirks*, the fraud stigma, private actions, and treble-damage disgorgement, would be available to plaintiffs and could have had a large chilling effect on communication. Large amounts of litigation could have been stimulated and harsh exposures to liability created. The fair and sensible thing to do, was a rule-making that could provide relatively clear and prospective guidance and could be carefully calibrated to preserve the flow of legitimate, non-material information.

Anderson et al., *supra* note 126, at 279; *see also* Adopting Release, *supra* note 7, at 51,718 n.16 (noting the chilling effect of an insider trading action on corporate disclosure and referring to Reg. FD as a "more measured approach").

authority to regulate disclosure, while clarifying that its approach neither altered the insider trading jurisprudence in *Dirks* nor considered selective disclosure to be fraudulent.[129]

The SEC was careful not to tie Reg. FD to sanctions that could have any significant impact on issuers. Public firms and the regulator feared that Reg. FD would have a "chilling" effect on firms' disclosure practices if there was a risk of meaningful enforcement against violators. The problem identified was over-deterrence, and the risk was that firms could stop talking to investors and that market efficiency would suffer as a result.[130] The SEC took several steps to ensure that the new regulation would not over-deter. Reg. FD explicitly provides that "no failure to make a public disclosure required solely by [the regulation] shall be deemed to be a violation of Rule 10b-5,"[131] which means that private enforcement is not possible. It also provides that violations will not impact the eligibility for short-form registration for securities offerings or security holders' ability to resell certain securities.[132] The SEC envisaged that its main enforcement tool and deterrence creator would be "an administrative action seeking a cease-and-desist order, or a civil action seeking an injunction and/or civil money penalties."[133]

Reg. FD provides that "whenever an issuer, or any person acting on its behalf,[134] discloses any material[135] nonpublic information regarding that issuer or its securities to [certain recipients],[136] the issuer shall make public disclosure of that information" either simultaneously (in the case of intentional selective disclosure) or promptly (if non-intentional).[137]

---

129. Proposing Release, *supra* note 7, at 72,594.

130. *Id.* at 72,595.

131. 17 C.F.R. § 243.102 (2015).

132. *Id.* § 243.103 (2015).

133. Adopting Release, *supra* note 7, at 51,726.

134. 17 C.F.R. § 243.101(c) (2015) defines a "[p]erson acting on behalf of an issuer" as "any senior official of the issuer . . . or any other officer, employee, or agent of an issuer who regularly communicates with [securities market professionals] or with holders of the issuer's securities." 17 C.F.R. § 243.101(f) (2015), in turn, defines "senior official" as to cover only a "director, executive officer, . . . investor relations or public relations officer, or other person with similar functions."

135. Reg. FD does not define materiality, as the SEC preferred to refer to the developed securities case law over establishing a bright-line test or presenting an exhaustive list of items to be considered material. *See supra* note 21 and accompanying text.

136. *See supra* note 10.

137. 17 C.F.R. § 243.100(a) (2015).

Disclosure is intentional "when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and non-public."[138] For non-intentional disclosures, Reg. FD allows firms to "promptly" disclose the information up to twenty-four hours after a senior official knows or should know of the mistake.[139] The SEC decided to allow disclosures within this time window so that firms could respond to accidental disclosures in a considered way.[140] Non-intentional selective disclosures of material NPI that are brought to the attention of a senior official and rectified with public disclosure within twenty-four hours thereof consequently do not violate Reg. FD.[141]

Several features of Reg. FD may cause it to fail to restrict selective disclosure as intended. For example, its exception for securities offerings enables roadshows that one commentator has labeled "the structural embodiment of selective disclosure."[142] Another potential opportunity to avoid Reg. FD coverage may be for analysts or investors to speak to firm employees who are not covered by the regulation.[143]

---

138. 17 C.F.R. § 243.101(a) (2015). The SEC remarked that the purpose of the knowing or reckless standard is to reach the same mental state as the anti-fraud provision so that "liability will arise only if no reasonable person . . . would have made the same [materiality] determination." *See* Adopting Release, *supra* note 7, at 51,722.

139. 17 C.F.R. § 243.101(d) (2015). See *supra* note 12 for the text of this provision. *See also* Adopting Release, *supra* note 7, at 51,722-23.

140. *See* Adopting Release, *supra* note 7, at 51,722-23; Proposing Release, *supra* note 7, at 72,596 n.48.

141. "Prompt" disclosure (i.e., disclosure "as soon as reasonably practicable") also implies that when firms are able to disclose sooner than at the end of the twenty-four hour window, they should do so. *See* Proposing Release, *supra* note 7, at 72,596 n.48.

142. *The JOBS Act in Action: Overseeing Effective Implementation That Can Grow American Jobs: Hearing Before the Subcomm. on TARP, Fin. Servs. & Bailouts of Pub. and Private Cos. of the H. Comm. on Oversight & Gov't Reform*, 112th Cong. 2 (2012) (statement of John C. Coffee, Jr., Professor of Law, Columbia University Law School) (arguing that the disapplication of Reg. FD for firms with fewer than 2000 shareholders of record through the JOBS Act should be reconsidered).

143. Soltes, *supra* note 39, interviewed research directors of large sell-side institutions and found a preference to have private discussions with divisional managers because "they know the details of the business and they are less polished when speaking with us." Depending on the exact duties of such personnel, they may not be considered executive officers under Reg. FD (17 C.F.R. §§ 243.101(c),(f) (2015) and 17 C.F.R. § 240.3b-7 (2015)), *see supra* note 134, in which case Reg. FD appears not to cover them unless they regularly engage in such communications. Acknowledging this

The analysis below will, however, put these observations aside to present the features of Reg. FD that are most relevant for establishing the perimeter for day-to-day conversations between senior managers and professional investors.

First, Reg. FD is an issuer disclosure obligation that does not apply to recipients of information. This design has the effect that even if a firm engages in selective disclosure in violation of Reg. FD, the insider trading framework needs to apply to take action against the recipient. Should the insider trading rules not apply, e.g., due to a lack of a personal benefit to the insider, the recipient can lawfully trade on the information obtained—even if it is material under the securities laws. Put differently, Reg. FD is aimed at curbing the supply of selectively disclosed information, not demand. Reg. FD will consequently not prevent investors from trying to obtain the most value-relevant information possible.[144]

Another potentially significant reason for the popularity of private investor meetings is a declaration by the SEC that it will take into account the circumstances surrounding a selective disclosure event in determining whether a manager's materiality determination is reckless: "a materiality judgment that might be reckless in the context of a prepared written statement would not necessarily be reckless in the context of an impromptu answer to an unanticipated question."[145] The SEC thus affords selective disclosure in personal conversations its highest level of deference under Reg. FD. By assessing recklessness more leniently in a private question-and-answer setting, it allows more potent information to be disclosed in private meetings without being characterized as intentional disclosure. As such disclosure then may be classified as non-intentional, it will only need to be publicly disclosed "promptly," i.e., when—or *if*—a senior official knows or is reckless in not knowing that material and non-public information has been

---

ambiguity, one research director noted that discussions with such personnel provided more information but that their statements were never attributed to avoid implicating them. *See* Soltes, *supra* note 39, at 268.

144. The SEC's Director of Enforcement indicated that undue pressure by an outsider to selectively disclose information could also constitute a violation of Reg. FD. Richard H. Walker, Dir., Div. Enf't, Sec. & Exch. Comm'n., Speech Before the Compliance & Legal Division of the Securities Industry Association: Regulation FD–An Enforcement Perspective, (Nov. 1, 2000). However, no enforcement has taken place on this basis.

145. Adopting Release, *supra* note 7, at 51,722.

selectively disclosed.[146] Managers that would like to continue the pre-Reg. FD practices of disclosing material information to selected investors or analysts before they disclose to the public may consequently prefer to make such disclosures in a private conversation, since they can claim that they are non-intentional, impromptu disclosures.

A third reason for the popularity of investor meetings under Reg. FD may be that the regulation creates a window for information trading even in cases where the manager realizes that the information disclosed is material. Non-intentional selective disclosure needs to be rectified by "prompt" public disclosure of the information, but this can take place up to twenty-four hours after a senior official learns of the disclosure mistake. In practice, this gives an investor who privately receives material information a significant trading advantage that could persist for days or weeks. In a scenario where an investor asks probing questions to provoke valuable answers and a manager reacts by releasing value-relevant or even outright material information, the recipient may start trading immediately.[147] From the firm's perspective, it complies with Reg. FD as long as the information is publicly disclosed in accordance with Reg. FD. By the time the firm releases the information to the public (allowing it to become incorporated into the stock price), the initial recipient could have already taken a significant position in the stock to unwind at a profit.

Fourth, there is no oversight over the materiality determination. If a manager makes a mistake in a private meeting without realizing it, the only investor who knows about the information will be the meeting recipient. While firms with a strong desire for correct and complete disclosures may ensure that they have more than one person participating in every investor conversation in order to detect mistaken materiality determinations and effectuate public disclosure of the information, one-on-one meetings do not allow for such oversight. Without oversight, there is less likelihood that cases of mistaken

---

146. 17 C.F.R. § 243.101(d) (2015).

147. *See* John L. Campbell, Brady J. Twedt & Benjamin C. Whipple, *Did Regulation Fair Disclosure Prevent Selective Disclosure? Direct Evidence from Intraday Volume and Returns* (Working Paper, 2016), http://ssrn.com/abstract=2803308 [https://perma.cc/6WTD-Y2QA] (finding that Reg. FD disclosures are preceded by increased trading).

materiality determinations are detected and remediated by public disclosure.

Fifth, Reg. FD does not require firms to take any action to prevent recipients from trading. Reg. FD is designed so that it does not apply to disclosures to recipients who agree to keep the NPI confidential,[148] and the SEC envisaged that managers who unintentionally disclosed material NPI would ask recipients to refrain from trading on or disclosing the information.[149] Should the recipient then proceed to trade anyway, it would constitute insider trading.[150] While this design works well in theory on the assumption that managers do not want to bestow informational advantages on investors, the SEC failed to consider that some managers may want recipients to be able to trade on material NPI. In such cases, managers will not violate Reg. FD as long as they consider their disclosures non-intentional and disclose the information within the stipulated window; there is no requirement that issuers request accidental recipients to refrain from trading on the information. Thus, the design of the rule does not encourage the intended behavior.

A sixth feature of Reg. FD which may cause opportunistic managers and investors to view it favorably is its failure to require reporting to investors or the SEC when firms make corrective disclosures under it. Firms that disclose material NPI by mistake are allowed to make corrective disclosures in any way that "provide[s] broad, non-exclusionary distribution . . . to the public,"[151] and without explaining that it has already been selectively disclosed. Shareholders are consequently unable to tell, either via the method of disclosure or its contents, that the information they are receiving may have been given to, and used for trading by, other investors days—potentially even weeks—earlier. This is a curiously inapt rule design given that the SEC has highlighted that repeated mistaken materiality determinations could

---

148. 17 C.F.R. § 243.100(b)(2) (2015).

149. Adopting Release, *supra* note 7, at 51,720.

150. *Id.*

151. 17 C.F.R. § 243.101(e) (2015); *see also* JESSE H. CHOPER, JOHN C. COFFEE, JR. & RONALD J. GILSON, CASES AND MATERIALS ON CORPORATIONS 459 (8th ed. 2013) (claiming that Form 8-K filings are a less utilized method than press releases for certain Reg. FD disclosures); LAURA S. UNGER, COMM'R, SEC. EXCH. COMM'N, SPECIAL STUDY: REGULATION FAIR DISCLOSURE REVISITED (2001), http://www.sec.gov/news/studies/regfdstudy.htm [https://perma.cc/N2SB-UZ9D] (showing that issuers regarded a Form 8-K filing as the least popular disclosure method).

introduce doubt into the unintentional nature of the disclosure.[152] It is difficult to imagine how the regulator or investors could detect such patterns of suspicious selective disclosures when they have nothing to review.[153] This design means that some managers could make poor materiality determinations followed by public disclosure of the information on a regular basis without investors ever learning about it.[154]

An opportunistic manager could take advantage of Reg. FD while feigning compliance. Consider a manager who would like to selectively disclose material information to curry favor with a particular investor. The manager may consider this venture less risky when aware that the firm will disclose the information to the market in the next twenty-four hours. This is because selective disclosure that the manager designates as "non-intentional" should be cleansed by a public release of the information within this time frame. As Reg. FD does not require any particular form for the required public release of the information, the firm's pre-scheduled press release can also serve as the release that Reg. FD requires. Managers can consequently give selected investors a twenty-four hour trading advantage by selectively disclosing upcoming news to them while labeling such disclosure non-intentional.[155] While such behavior would be a violation of Reg. FD, the SEC would face formidable hurdles to a successful enforcement action, including problems detecting that there has been a private conversation, proving what was said, proving that it was material, and showing that the disclosure was intentional and not—as the manager would claim—non-intentional. Reg. FD may be more of a roadmap for selective disclosures than a roadblock.

---

152. Adopting Release, *supra* note 7, at 51,722 n.57.

153. In addition, research on Form 8-K filings relating to Reg. FD suggests that firms that file after the twenty-four hour window exhibit abnormal stock price and volume several days before these filings, indicating that some investors may have access to the information before filing. *See* Paul A. Griffin, David H. Lont & Benjamin Segal, *Enforcement and Disclosure Under Regulation Fair Disclosure: An Empirical Analysis*, 51 ACCT. & FIN. 947 (2011).

154. Such behavior could even be common practice. *See* Brown et al. (2015), *supra* note 31, at 14 (quoting an analyst describing how managers have "figured out how to 'paper things up' [with an 8-K]").

155. See text accompanying notes 306-310, *infra*, for evidence that institutional investors appear to be systematically informed in advance about firm-specific news releases.

C. THE SEC SUES, LOSES, AND RETREATS

Soon after the introduction of Reg. FD, the SEC indicated that it would seek to enforce only "clear violations" of the rule.[156] Early enforcement actions generally took the form of firms agreeing to cease-and-desist orders in administrative proceedings. The SEC's selection of cases was interpreted as an attempt to provide advice about the types of communications that raised concerns under Reg. FD.[157] In 2005, however, the SEC encountered a setback as it opted to litigate against Siebel Systems, Inc. for violating Reg. FD for the second time.[158] The SEC alleged that the firm's CFO made positive private statements during a one-on-one meeting and at a private dinner organized by an investment bank, which were materially different from the negative statements made by its CEO on an earnings call and a publicly broadcasted conference presentation in previous weeks.[159] As a result of the private disclosures, the SEC alleged, one institutional investor converted a short position to a long position of similar size, and other recipients of the private information purchased shares.[160] Siebel's share price increased 8% the day after the private meetings, and twice as many shares as normal were traded.[161]

The SEC's complaint focused on four disclosures of material NPI at the two private events.[162] The first concerned a statement that "there were some $5 million deals in Siebel's pipeline"[163] for the second quarter. The others related to statements that "*new deals* were coming into the sales pipeline;" "the company's sales pipeline was '*growing*' or

---

156. SEC. & EXCH. COMM'N, WRITTEN STATEMENT CONCERNING REGULATION FAIR DISCLOSURE (2001), http://www.sec.gov/news/testimony/051701wssec.htm [http://perma.cc/ALV8-6JJ2]; *see also* Adopting Release, *supra* note 7, at 51,718 ("[I]ssuers will not be second-guessed on close materiality judgments. Neither will we, nor could we, bring enforcement actions under Regulation FD for mistaken materiality determinations that were not reckless.").

157. Jill Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry*, *in* RESEARCH HANDBOOK ON INSIDER TRADING 112, 118 (Stephen M. Bainbridge ed., 2013).

158. SEC v. Siebel Sys., Inc., 384 F.Supp.2d 694 (S.D.N.Y. 2005).

159. Complaint at ¶¶ 40–51, *Siebel Sys.*, 384 F.Supp.2d at 694 (No. 04-CV-5130) [hereinafter SEC Complaint].

160. *Id.* ¶¶ 46, 53.

161. *Id.* ¶ 54.

162. *Siebel Sys.*, 384 F.Supp.2d at 701.

163. SEC Complaint, *supra* note 159, at ¶ 43.

'*building*;'" and "the company's sales or business activity levels were '*good*' or '*better*.'"[164] In comparison, the CEO had publicly stated on an earnings call the previous week that he anticipated that Siebel would "see lots of small deals . . . some medium deals . . . a number of deals over a million dollars. And I suspect we'll see some greater than five."[165] The SEC argued that while the CEO's public statements were forward-looking, qualified by the word "suspect" and generally also qualified by references to the developments in the overall economy,[166] the CFO's private statements were in the present tense.[167] The court, however, dismissed the case as it did not consider the private disclosures to constitute material information.[168] The court was dismissive of the SEC's arguments and its scrutiny of "the tense of verbs and the general syntax of each sentence," which it held would place "an unreasonable burden on a company's management and spokespersons to become linguistic experts."[169] The court also found it instructive that the information in question was not included among the specific categories of information the SEC had noted in its Adopting Release.[170]

The *Siebel Systems* court also held that that the recipient's opinion regarding the materiality of selectively disclosed private information is not indicative of a Reg. FD violation on its own.[171] As a general rule, this must be correct because any person's trading based on subjective beliefs cannot automatically be considered material in the eyes of the reasonable investor. However, in *Siebel Systems*, even though professional investors assisted by financial analysts found the information sufficiently value-relevant to trade in a manner that increased the share price by 8%, the court's judgment of materiality prevailed.[172] The resulting difference between the court's objective

164. *Siebel Sys.*, 384 F.Supp.2d at 701.
165. *Id.* at 704.
166. SEC Complaint, *supra* note 159, at ¶ 49.
167. *Siebel Sys.*, 384 F.Supp.2d at 704.
168. *Id.* at 696.
169. *Siebel Sys.*, 384 F.Supp.2d at 704.
170. *Id.* at 708; Adopting Release, *supra* note 7, at 51,721 (outlining seven categories of information that firms should examine for materiality).
171. *Siebel Sys.*, 384 F.Supp.2d at 707 (citing Proposing Release, *supra* note 7, at 51,722) (stating that "Regulation FD will not be implicated where an issuer discloses immaterial information whose significance is discerned by the analyst").
172. *See id.*

assessment and investors' subjective valuation can present trading opportunities for recipients of selective disclosure.

The *Siebel Systems* court appears to have concluded that the recipients of Siebel's selective disclosure completed a mosaic of information with non-material NPI from the firm to produce their own material NPI.[173] However, the case file does not show that the recipients completed a mosaic that resulted in material information. Rather, it indicates that the investors had previously received information in a negative light from the firm in the form of an earnings warning and statements from the CEO just two days before the selective disclosures,[174] which were counteracted by more positive (albeit generally phrased) statements from the CFO. Indeed, one of the main conclusions of a research analyst at the investment bank organizing the private dinner was that "the body language was positive."[175]

The SEC's defeat in *Siebel Systems* dampened its enforcement activity. As can be seen from Table 1, which lists all Reg. FD enforcement actions since the rule entered into force in October 2000, the SEC concluded more Reg. FD enforcement actions in the three years leading up to *Siebel Systems* than it has done in the eleven years since that case was decided, and it has not attempted to litigate any further cases.

173. *Id.* at 707.

174. SEC Complaint, *supra* note 159, at ¶ 37 (quoting the CEO, who stated publicly two days before the selective disclosures, in relation to the economy, that "[w]ith war, with famine, with disease, I mean it's like the apocalypse out there").

175. *Id.* at ¶ 52.

	Date	Issuer	Issuer Penalty?	Officer Penalty?
1	2002	Secure Computing[176]	$0	$0
2	2002	Siebel Systems[177]	$250,000	$0
3	2002	Raytheon[178]	$0	$0
4	2003	Schering-Plough[179]	$1,000,000	CEO: $50,000
5	2004	Senetek[180]	$0	$0
6	2005	Flowserve[181]	$350,000	CEO: $50,000
7	2005	Siebel Systems[182]	N/A	N/A
8	2007	Electronic Data Systems[183]	$0	$0
9	2009	American Commercial Lines[184]	$0	CFO: $25,000
10	2010	Presstek[185]	$400,000	CEO: $50,000
11	2010	Office Depot[186]	$1,000,000	CEO: $50,000 CFO: $50,000
12	2011	Fifth Third Bancorp[187]	$0	$0

176. Secure Computing Corp., Exchange Act Release No. 46,895, 2002 WL 31643024 (Nov. 25, 2002) [hereinafter Secure Computing Release].

177. Siebel Sys., Inc., Exchange Act Release No. 46,896, 2002 WL 31643027 (Nov. 25, 2002); Siebel Sys., Inc., Litigation Release No. 17,860, 2002 WL 31643062 (Nov. 25, 2002).

178. Raytheon Co., Exchange Act Release No. 46,897, 2002 WL 31643026 (Nov. 25, 2002).

179. Schering-Plough Corp., Exchange Act Release No. 48,461, 81 SEC Docket 54 (Sept. 9, 2003) [hereinafter Schering-Plough Release].

180. Senetek PLC, Exchange Act Release No. 50,400, 83 SEC Docket 2319 (Sept. 16, 2004).

181. Flowserve Corp., Exchange Act Release No. 51,427, 85 SEC Docket 92 (Mar. 24, 2005).

182. SEC v. Siebel Sys., Inc., 384 F.Supp.2d 694 (S.D.N.Y. 2005).

183. Electronic Data Systems Corp., Exchange Act Release No. 56,519, 91 SEC Docket 1800 (Sept. 25, 2007).

184. Black, Exchange Act Release No. 60,715, 96 SEC Docket 2440 (Sept. 24, 2009).

185. SEC v. Presstek, Inc., 103 SEC Docket 2555 (May 15, 2012); SEC v. Presstek, Inc., 97 SEC Docket 3432 (Mar. 9, 2010).

186. McKay, Exchange Act Release No. 63,154, 99 SEC Docket 2196 (Oct. 21, 2010); Odland, Exchange Act Release No. 63,153, 99 SEC Docket 2193 (Oct. 21, 2010); Office Depot, Inc., Exchange Act Release No. 63,152, 99 SEC Docket 2189 (Oct. 21, 2010).

187. Fifth Third Bancorp, Exchange Act Release No. 65,808, 102 SEC Docket 1779 (Nov. 22, 2011).

13	2013	First Solar[188]	$0	VP (Investor Relations): $50,000
		Total:	$3,000,000	$325,000

Table 1: Reg. FD Enforcement Actions and Penalties Assessed[189]

The SEC has concluded enforcement actions relating to thirteen selective disclosure events; all but one of them (*Siebel Systems*) in the form of settled administrative actions.[190] Based on the information provided in the SEC's announcements of these enforcement actions, the deterrent effect of Reg. FD on a corporate manager considering whether to engage in intentional selective disclosure of material NPI can be estimated from two factors: the risk of detection and the magnitude of the sanctions imposed on detected violators.[191]

As regards the first component of deterrence—the risk of detection—there are only two cases in Table 1 (*Secure Computing* and *Presstek*) where the SEC has taken action in relation to selective disclosures made directly to investors who traded the stock without communicating the information to a broader group. The recipients in these two cases probably attracted the SEC's attention, however, by their uninhibited trading. In *Secure Computing*, the recipients traded the stock price up 15%, at more than double the normal trading volume, in the two days before a significant firm announcement.[192] In *Presstek*, the CEO provided advance information of negative developments to a large shareholder who immediately sold most of its shares, causing the stock

188. Polizzotto, Exchange Act Release No. 70,337 107 SEC Docket 468 (Sept. 6, 2013).

189. The table lists all Reg. FD enforcement actions from the regulation's promulgation until Feb. 10, 2017 (when this Article went to press).

190. The SEC has also issued two reports of investigation to aid issuers in the application of Reg. FD. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, Exchange Act Release No 46,898, 2002 WL 31650174 (Nov. 25, 2002) [hereinafter Motorola Report]; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Exchange Act Release No 69,279, 105 SEC Docket 4327 (Apr. 2, 2013).

191. *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 465 (6th ed. 2011).

192. Secure Computing Release, *supra* note 176.

price to drop 19%.[193] In fact, all Reg. FD violations pursued by the SEC entailed public circumstances that would have been relatively easy for the regulator to observe, as each case either exhibited significant unexplained movement in stock price or volume (nine cases),[194] or involved selective disclosure to sell-side analysts who disseminated the information (ten cases).[195] The SEC has never enforced Reg. FD in a case where the recipient kept the NPI private and traded cautiously.[196] The risk of detection appears very low for such cases involving more sophisticated information trading.

With regard to the second component of deterrence—the magnitude of sanctions—Table 1 shows that just over half of the SEC enforcement actions have resulted in civil penalties; the remainder typically concluded only with the issuance of cease-and-desist orders. The amounts of the penalties are clearly unlikely to create deterrence. Penalties assessed on firms do not have any direct impact on managers and may not deter them,[197] and penalties assessed on managers are negligible,[198] even before scaling them to expected value to account for

---

193. Complaint, SEC v. Presstek, Inc., 97 SEC Docket 3432 (No. 1:10-cv-10406), https://www.sec.gov/litigation/complaints/2010/comp21443.pdf [https://perma.cc/D9LC-GTW4]. Drawing further attention to the case, the press reported a potential leak. *Update 1-Presstek Shares Hit Year-Low After Weak Q3 Outlook*, Reuters, Sept. 26, 2006, Factiva, Doc. No. LBA0000020060929e29t0018d. Expressed in the mode of analysis in Section I.C.3.a, *supra*, the shareholder appears to have decided that the option to trade more aggressively and risk ending the relationship with the firm had a higher present value than trading slowly and maintaining access to information in future periods.

194. *See* enforcement actions 1–2, 4, 6–7, and 9–12 *supra* Table 1.

195. *See* enforcement actions 2–9, 11, and 13 *supra* Table 1.

196. Of course, one cannot infer that selective disclosure under less public circumstances than *Secure Computing* and *Presstek* would not be enforced, but the lack of any such Reg. FD enforcement action is nonetheless a strong indication that the SEC does not have the ability to detect disclosures without publicly observable elements.

197. *Cf.* Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691 (1992) (demonstrating the inefficient circularity of enterprise liability for securities fraud).

198. The maximum penalty the SEC has imposed on a manager—$50,000—equals no more than a few days' pay for a senior manager of a public firm. *See* J.M.F., *Inequality in America: Why CEO-Pay Rules Won't Help*, ECONOMIST: GRAPHIC DETAIL (Aug. 6, 2015, 6:19 PM), http://www.economist.com/blogs/graphicdetail/2015/08/inequality-america [http://perma.cc/97X5-LD5R] (estimating average annual CEO pay among 3000 companies to be $5 million).

the low risk of detection. Furthermore, managers typically have indemnification arrangements to shield them from paying penalties out of personal funds.[199] A manager may, of course, incur a reputational cost as a result of an enforcement action, but the direction of the reputational effect is not clear-cut: recipients of valuable selective disclosures may view the manager more favorably, whereas those that did not receive NPI may take an unfavorable view.

The reason why penalties assessed on managers fail to deter selective disclosure is that they do not relate to the trading advantages actually conferred on information recipients. Put differently, the penalties that may be imposed for detected violations do not outweigh the value of investor goodwill managers can purchase by engaging in selective disclosure. For example, in *Schering-Plough* two informed investors saved tens of millions of dollars by trading before the public release of information, while the manager incurred a relatively miniscule $50,000 penalty.[200] The manager awarded the favored investors a trading gain that was more than 1000 times larger than the penalty imposed on him.[201] The insignificant effects of a Reg. FD violation may, in such circumstances, invite managers to ignore the regulation in order to

199. Only once in 16 years—in *Office Depot*—has the SEC barred a violating manager from seeking reimbursement or indemnification. All Reg. FD settlements have been on the basis of the managers and firms neither admitting nor denying any violation, circumstances which typically enable firm indemnification. *E.g.*, DEL. CODE ANN. tit. 8, § 145 (2015).

200. Fidelity and Putnam were among the recipients of advance information and each sold more than 10 million shares during the Reg. FD violation period. Schering-Plough's stock price was $21.32 before the violation started, $17.64 when trading closed on the final day before the information was publicly disclosed, and $16.10 when the market opened after having received the information. Estimating that these two investors sold at the average stock price during the persisting Reg. FD violation (as their actual trading data is not available), they would have saved $3.38/share, calculated as (($21.32+$17.64)/2)-$16.10), or at least $67.6 million. *See* Schering-Plough Release, *supra* note 179; Floyd Norris, *Market Place; S.E.C. Penalizes Schering-Plough over a Fair Disclosure Violation*, N.Y. TIMES, Sept. 10, 2003, at C5.

201. This calculation uses the estimated private trading gains as calculated in note 200, *supra*, but the actual gains were greater as there were further private recipients (for whom we do not have trading details). As discussed in note 199, *supra*, the manager could also have been indemnified by the firm. The end result seems to be that neither the shareholders who sold due to the information they received selectively nor the disclosing manager paid any penalties. However, the shareholders who bought shares from the informed investors would, as shareholders and residual claimants, be paying part of the penalty.

preserve or improve their reputation with important investors.[202] This creates significant opportunities for value extraction from uninformed shareholders.

The SEC has little ability to create deterrence through Reg. FD enforcement actions. The penalties it may assess against natural persons are capped at $160,000,[203] while the benefits managers confer relate to the market capitalization of their firms. As an illustration, consider a case where the facts of the Reg. FD enforcement action relating to Schering-Plough[204] are applied to a hypothetical firm with the same market capitalization as the country's largest public firm ($693 billion).[205] In Schering-Plough, the privately released NPI reduced the firm's market capitalization by 24.5% when the private information was publicly released but the investors who were tipped off had the opportunity to avoid losses by selling early.[206] If that same scenario were applied to the hypothetical firm, it would lose $169 billion of market capitalization. If investors owning just 5% of that firm were given advance information and sold their stock before others found out, they could save $8.4 billion—an amount 53,000 times larger than the maximum penalty the SEC is able to assess on the manager. This imbalance between the benefits that can be conferred and the penalties that can be imposed may produce an attractive risk-return trade-off to some managers wishing to build personal goodwill with investors.

The deterrent effect of a dollar-denominated penalty decreases with market capitalization due to the size of the benefit available to investors, but also because managers of larger firms have higher salaries. The current practice of imposing a monetary penalty with a predetermined cap is unlikely to achieve deterrence; this would require more significant

202. Note that no actions have been taken against the recipients in any of the Reg. FD actions, since they may lawfully trade on the information. When asked about Fidelity's sales of more than 10 million Schering-Plough shares on the private information, their representative could truthfully answer: "We complied with all rules and regulations in our meeting with Schering-Plough and in our conduct thereafter." Norris, *supra* note 200.

203. 15 U.S.C. § 78u(d)(3) (2012); 17 C.F.R. § 201.1005 (2015).

204. Schering-Plough Release, *supra* note 179.

205. See the market capitalization of Apple, Inc. as of Feb. 10, 2017 at https://ycharts.com/companies/AAPL/market_cap [https://perma.cc/ PW5M-SF7].

206. *See supra* notes 200-201 and accompanying text.

enforcement tools than those used by the SEC in Reg. FD enforcement actions to date.[207]

If SEC enforcement actions themselves are not a deterrent, however, it may be that the stock market reaction to selective disclosure events could produce such an effect. One study found that an SEC announcement of a Reg. FD violation caused firms to lose an average of 4% of their market capitalization.[208] As the loss in market value does not reflect the penalties imposed by the SEC, a reasonable interpretation seems to be that the market penalizes firms with poor selective disclosure practices, viewing them as riskier and charging them a higher cost of capital, which lowers the stock price. This suggests that investors in the stock market could be enlisted to assist with creating deterrence, which will be analyzed further in Part IV.

D. MARKET PARTICIPANTS ADAPT

With valuable corporate NPI available to enrich those who acquire or discover it, we should expect analysts and investors to try to satisfy their demand for information as much as possible within the perimeters of the securities laws. Investors already employ various ingenious methods to lawfully refine their discovery and analysis of value-relevant information. Equity research providers have been known to hire former CIA agents to analyze management's verbal and non-verbal cues during earnings conference calls.[209] A brokerage firm hired an FBI profiler to teach its analysts and portfolio managers to interpret managers' cues and determine the veracity of the managers' statements.[210] Specialized speech software analyzing a CEO's voice during earnings conference calls can predict whether firms will later be subject to adverse

---

207. For example, § 32 of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff (2012), which allows for higher fines and prison sentences for willful violations, has never been employed in Reg. FD cases.

208. *See* Griffin et al., *supra* note 153, at 966-968 (finding that firms lost approximately 4% on average in the four days following an SEC announcement and 9% in the ten days following an announcement, although with very limited data due to the low frequency of Reg. FD enforcement).

209. EAMON JAVERS, BROKER, TRADER, LAWYER, SPY: THE SECRET WORLD OF CORPORATE ESPIONAGE 173-179 (2010).

210. Brown et al. (2015), *supra* note 31, 16.

restatements of their financial statements.[211] These examples all illustrate the high level of inventiveness and ever-increasing sophistication on the demand side of the market for information. Since investors may trade on NPI they receive from insiders as long as they do not provide them with any personal benefit in return, we should expect professional investors to push for as much private information as possible. Similarly on the supply side, managers may find that the benefits of selective disclosure outweigh the expected costs of Reg. FD enforcement.

It is inevitable that a regulation aiming to prevent willing parties from transacting with each other will be closely examined for potential functional substitutes. This section explores how market practices have evolved after the introduction of Reg. FD, and it appears likely that this evolution can be at least partially explained as a response to changes in the regulatory environment. In addition to Reg. FD, the Global Analyst Research Settlements have contributed to changes in investors' and analysts' interactions with public firms because they prevent sell-side analysts from being compensated in relation to investment banking services and may have forced them to seek other sources of revenue.[212] However, while regulatory changes may have triggered the emergence of the phenomena below, their causes are less important than their effects as we continue to evaluate the efficacy of Reg. FD today.

1. *Analyst Research Goes Private*

In *Dirks*, the Supreme Court wanted to protect the activity of securities analysts.[213] Quoting the SEC's brief, the Court noted that it was "commonplace for analysts to 'ferret out and analyze information' .

---

211. Jessen L. Hobson, William J. Mayew & Mohan Venkatachalam, *Analyzing Speech to Detect Financial Misreporting*, 50 J. ACCT. RES. 349 (2012).

212. *See* SEC. & EXCH. COMM'N, SEC FACT SHEET ON GLOBAL ANALYST RESEARCH SETTLEMENTS (2003), http://www.sec.gov/news/speech/factsheet.htm [https://perma.cc/9353-C69A] (describing settlement terms); *Spotlight on the Global Research Analyst Settlement*, U.S. SEC. & EXCH. COMM'N (Oct. 12, 2005) https://www.sec.gov/spotlight/globalsettlement.htm [https://perma.cc/6KV8-4A2M] (providing references to major documents related to the settlement).

213. For an analysis of the policy rationale, see, e.g., Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization's Strains and Opportunities*, 41 VA. J. INT'L L. 653 (2000-2001).

. . by meeting with and questioning corporate officers," and that this activity could improve market efficiency for the benefit of investors.[214] *Dirks*, however, had an unusual fact pattern involving a financial analyst who was informed of fraud within a public firm. Financial analysts did not at that time, nor do they now, prioritize searching for fraud in the firms they cover.[215] In *Dirks*, when protecting the relevant disclosure and noting the positive effects of analysts' work, the court clearly had in mind traditional sell-side analysts who disclose information they uncover by sending market letters to their clients. However, *Dirks* had broader effects by allowing any tippee to trade freely on acquired information as long as it does not provide a personal benefit to the insider tipper in exchange. In effect, *Dirks* protects selective disclosures regardless of whether the envisaged market efficiency benefits actually materialize in the individual case.

As NPI is more valuable in private forums, it is not surprising that the work product of sell-side analysts is increasingly disseminated in private and without any written reports.[216] One particular business model for analysts is to provide research only to a very limited number of clients who pay large amounts for such private information on the basis that it can be used for profitable trading.[217] This trend towards increasing secrecy is important to consider in approaching selective disclosure regulation because it shows that, regardless of whether a manager chooses an investor or an analyst as the recipient of selective disclosure, the information may never become public or incorporated into the stock

---

214. Dirks v. SEC, 463 U.S. 646, 658 (1983).

215. Brown et al. (2015), *supra* note 31, at 24 (finding from interview and cross-sectional evidence that analysts do not prioritize investigating potential financial misrepresentation); Brief for the Securities and Exchange Commission at 43, *Dirks*, 463 U.S. at 646 (No. 82-276) (arguing that analysts do not view themselves as "investigators of criminal activities").

216. *See* Green et al., *supra* note 95, at 144 (describing how brokers who previously used research to target individual investors now instead focus on hedge funds, who dislike written reports and prefer private discussions); Jill Fisch, *Does Analyst Independence Sell Investors Short?*, 55 UCLA L. REV. 39, 73–74 (2007) (detailing practices of research firms to provide customized research to institutional clients). *Cf.* John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717, 726 (1984) (writing the year after *Dirks* that "[t]ypically, securities research is reduced to an analyst's report that is circulated among prominent institutional investors").

217. Fisch, *supra* note 216, at 73-74 (citing work indicating that hedge funds pay up to $350,000 per quarter for access to private research).

price.[218] When recipients receive information privately and trade in a way that does not allow for decoding,[219] the rationale for protecting the work product of analysts endorsed in *Dirks*—that the benefits of selective disclosure redound to all investors—fails to materialize. The development towards increased private dissemination of research consequently reduces the market efficiency justification for selective disclosure embraced by the SEC and the Supreme Court.

The benefit of *Dirks* in an environment where information is increasingly disseminated privately is not that information selectively disclosed to analysts or investors regularly benefits investors at large. Instead, the contrary becomes more likely: investors keep their information advantages private.[220] Neither can the benefit be that very positive information will become known to investors because corporate managers themselves have strong incentives to publicly disclose such information relatively promptly. Instead, the value of *Dirks* may come from its protection of selective disclosures of transformatively bad information. As follows from the stylized five considerations affecting how a selective disclosure recipient may be expected to trade,[221] the largest chance that investors will trade in a way that allows for decoding occurs when they find themselves in a last-period scenario where they are no longer concerned about their reputation with the managers of the firm. Highly negative information is also, however, the kind of information that managers typically prefer to keep private. It may thus be that the main benefit of *Dirks*, as investors adapt to maximize their benefits of its wide protective perimeter by keeping both the disclosure event and their trading away from public view, is that it protects whistleblowers within the firm.

2. Corporate Access Cuts Out the Implicated Intermediary

Corporate access appears to have been introduced in response to regulatory changes when financial analysts who were no longer able to distribute material NPI from public firms sought other ways to

218. *See supra* Section I.C.3.a.
219. *See supra* Section I.C.3.a.
220. *See supra* Section I.C.3.a.
221. *See supra* Section I.C.3.a.

intermediate between managers and investors.[222] Corporate access may be a cost-effective method for firms to have several investor meetings in one day at one venue with the administration covered by another party. By attending a broker's event, managers can also confer value on the broker to build goodwill for the benefit of the firm which may be drawn upon in the future. More investor conferences are being held following the introduction of Reg. FD,[223] which could mean that selective disclosure has moved to such venues. Corporate access also presents a few potential problems, however, that will now be introduced and briefly explored.

The first problem relates to potential conflicts of interest. When corporate access is paid for by investors' trading commissions[224] and structured so that brokers can influence the selection of investors firms meet with, there is a conflict of interest for the corporate access intermediary who may prefer that the firm meets with its investor clients who trade the most instead of the investors most suitable for the firm. There are many examples and warnings in the investor relations literature that suggest that this conflict of interest is frequently borne out in practice.[225] Corporate access providers have themselves

---

222. According to the head of corporate access at one large investment bank, Reg. FD and the Global Analyst Research Settlement made it more difficult for financial analysts to provide the NPI its large investor clients demanded, which provided the impetus for them to instead supply clients with direct connections between investors and senior managers. Brinkley, *supra* note 92, at 15.

223. Brian J. Bushee, Michael L. Jung & Gregory S. Miller, *Conference Presentations and the Disclosure Milieu*, 49 J. ACCT. RES. 1163, 1173 (2011) (presenting data showing that the number of conferences grew from approximately 2000 conferences in 1999—the year before Reg. FD was introduced—to just over 16,000 conferences in 2007).

224. *See supra* Section I.D.

225. *See* GUIMARD, *supra* note 30, at 163 (stating that banks try to persuade issuers to meet with high-volume traders); *id.* at 166 (noting that banks may try to schedule more one-on-one meetings than the issuer's managers can efficiently manage); IPREO, GLOBAL CORPORATE ACCESS STUDY (2013) 2, 4 (quoting issuer representatives describing it as a "battle between who we would like to meet and who the broker sets us up with" and "the usual frustration" where brokers want issuers to meet with their preferred clients while the issuers "want to visit long-only, low-turnover institutions"); REAL IR, WHO SERVES THE IR DIRECTOR? (2007) 47 (quoting survey participants describing it as "the perennial problem" and "a huge conflict"); Brusch, *supra* note 51 (noting that since intermediaries are compensated on commission, "their natural focus is on marketing you to their high-frequency trader clients"); Laurie Havelock and Tim Human, *The IRO View*, IR MAG., SPECIAL REPORT 1: CORPORATE ACCESS, 2014, 12 at

acknowledged the risk of a conflict of interest when they are allowed to choose or influence which investors firms meet.[226] Yet, more than one third of firms that participate in one-on-one meetings in private investor conferences may leave investor selection to the conference organizers.[227] The decision of which investors to meet must, however, ultimately be the responsibility of firms' senior corporate managers. While shareholders may legitimately be interested in learning which investors receive information advantages from managers, the corporate purposes of selective disclosures or the process for selecting information recipients, there is no reason to subject investor selection in corporate access events to different rules than investor meetings organized by the firm itself.

The second potential problem stems from the fact that managers confer value on brokers by attending their conferences because they may leverage their participation in such events to indirectly pressure brokers into providing positive research on their firms. This would be another version of the problem that Reg. FD set out to solve: managers providing material NPI to supportive brokers and withholding it from unsupportive brokers.[228] A strong reason for the SEC's enactment of Reg. FD was that the perception of systematic inequalities in access to information could lead the public to lose confidence in the securities markets.[229] The problem the SEC identified was that managers—with personal incentives tied to the stock price—could try to censure the public discussion and evaluation of their firms by awarding or withholding information. If managers were to succeed in such censuring, it could bias analysts' stock recommendations and result in share prices that were higher than warranted, thus distorting the market's pricing function and allocative efficiency.[230] This problem may not have been solved by the introduction of Reg. FD; instead, it may

---

13 (quoting a large US firm saying that corporate access meetings are "a constant battle to suppress the sell side's attempts to fill our schedules with hedge funds").

226. Brinkley, *supra* note 92, at 16.

227. NAT'L INV'R RELATIONS INST., *supra* note 32, at 11 (finding that 36% of firms do not always participate in selecting which investors to meet).

228. *See, e.g.,* Adopting Release, *supra* note 7, at 51,716-17.

229. *See* Proposing Release, *supra* note 7, at 72,592.

230. *Cf.* Michael C. Jensen, *The Agency Costs of Overvalued Equity and the Current State of Corporate Finance*, 10 EUR. FIN. MGMT. 549, 552–53 (2004) (describing how overvaluation has negative effects on individual firms).

simply have transformed so that disclosures that were previously made to supportive financial analysts are now made directly to the investors they designate.[231]

The third possible problem is that corporate access results in unequal access to information among investors without disadvantaged investors being aware. It is generally accepted that the market for secondary information about a public firm is tiered so that investors can choose whether and to what extent to pay for information to reduce uncertainty about securities pricing. Such secondary information sources may range from a cheap newspaper to an expensive database containing daily sales figures for certain products.[232] However, it is less satisfactory that firms themselves supply information to investors by employing a tiered structure, even though the charge is levied by an intermediary.[233] The problem is not the involvement of intermediaries in firms' monetization of NPI, but the lack of transparency about the fact that NPI is monetized and the extent of this activity in individual firms, as well as the resulting unfairness if investors are unable to assess the criteria for access to such events.[234] The fact that particularly valuable information may be disclosed in the setting of an unrehearsed private question-and-answer session and used by the recipient for trading suggests that practices similar in effect to those that precipitated the introduction of Reg. FD are still possible. With a lack of transparency surrounding the selection of participants in these events, private investor meetings are equally capable of causing a loss of public confidence in the fairness of securities markets as pre-Reg. FD practices were.[235]

---

231. See also text accompanying notes 216–217, *supra*, for further discussion of how information may increasingly be exchanged in less public forums.

232. *Cf.* Peter Landers, *Drug-Data Chasm Punishes Small Investors*, WALL ST. J., Oct. 6, 2003, at C1 (claiming that subscribers to certain databases costing between $25,000 and $50,000 per year were able to observe daily sales data for hepatitis C medications and conclude ahead of other investors that Schering-Plough was losing market share to Roche).

233. *See supra* text accompanying note 47 (acknowledging that firms release additional information in private).

234. *Cf.* Victor Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 346 (1979) (discussing how nontransparent advantages in access to information results in perceived unfairness).

235. *See* Proposing Release, *supra* note 7, at 72,592 (outlining the SEC's view of how selective disclosure of material information to analysts or investors would lower public confidence in the market).

In summary, both the increasingly private dissemination of research and the practices of corporate access demonstrate how regulatory changes may have caused analysts to take a less visible, although equally instrumental, role in disseminating valuable information. Similar practices to those that caused the SEC to promulgate Reg. FD may still be occurring, but in less public settings.

E. The Second Circuit Further Raises the Insider Trading Threshold

The concept of "personal benefit" is central to tipping cases.[236] Since a pecuniary gain is far-fetched in the private meeting situation, the two types of personal benefits that could accrue are reputational benefits and gifts.[237]

The Eleventh Circuit found a sufficient reputational benefit where the tipper and tippee had "worked together for several years, and split commissions on various real estate transactions."[238] Elements resembling both a gift of information and reputation enhancement were present in *SEC v. Sargent*, where the First Circuit found the personal benefit requirement fulfilled because the tipper used the tippee's network for business contacts and the tipper's relatives owed the tippee money and had also threatened his business.[239] A purer gifting benefit was established in *SEC v. Maio*, where the Seventh Circuit found that a CEO and Chairman had improperly gifted NPI for a personal benefit by establishing a history of gift-giving from the insider to the recipient and a lack of a corporate purpose for the disclosure.[240] While courts have generally not found it particularly difficult to establish a reputational

236. *See supra* Section II.A.

237. *See supra* note 115 and accompanying text.

238. SEC v. Yun, 327 F.3d 1263, 1274–80 (11th Cir. 2003). This was a misappropriation case but the court established, following substantial analysis, that the element that the tipper intended to benefit from her disclosure was the same as under the classical theory.

239. SEC v. Sargent, 229 F.3d 68, 77 (1st Cir. 2000). The court noted that information could have been disclosed in order to "effect a reconciliation . . . and to maintain a useful networking contact."

240. SEC v. Maio, 51 F.3d 623 (7th Cir. 1995). The court established that the tipper had promised a mutual friend shortly before his death to "look after" the tippee and had previously lent the tippee a significant amount of money without documentation. *Id.* at 627.

benefit or a gift,[241] the recent Second Circuit decision in *United States v. Newman* appears to have increased the demands on the type of personal benefits required to satisfy *Dirks*.

In *Newman*, two investment managers were accused of trading on material NPI leaked by insiders at Dell and Nvidia.[242] As a result of tipping chains, the actual traders were three and four levels removed from the insider tippers.[243] The Second Circuit held that a tippee, in order to be liable, needs to know that the insider tipper breached a duty to keep the NPI confidential and that the tipper received a personal benefit for the disclosure.[244] The court also held that "the mere fact of a friendship, particularly of a casual or social nature" was not enough to show a personal benefit to satisfy the *Dirks* standard.[245] Rather, "a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature" was required.[246] While noting that this quid pro quo did not need to be "*immediately* pecuniary," the court emphasized that it "must be of some consequence."[247] The court indicated what type of benefit it may have had in mind by distinguishing *United States v. Jiau*,[248] *SEC v. Yun*,[249] and *SEC v. Sargent*[250] from the

---

241. *See* U.S. v. Jiau, 734 F.3d 147, 153 (2d Cir. 2013) ("The proof required to show personal benefit to the tipper is modest."); SEC v. Obus, 693 F.3d 276, 292 (2d Cir. 2012) ("In light of the broad definition of personal benefit set forth in *Dirks*, this bar is not a high one."); *Yun*, 327 F.3d at 1280 ("The showing needed to prove an intent to benefit is not extensive.").

242. United States v. Newman, 773 F.3d 438 (2d Cir. 2014).

243. *Id.* at 443.

244. *Id.* at 450 (2d Cir. 2014).

245. *Id.* at 452. In an earlier ruling, the Second Circuit had found the personal benefit requirement fulfilled where the tipper, a director of a firm subject to a takeover, and the tippee were close friends. *See* SEC v. Warde, 151 F.3d 42 (2d Cir. 1998).

246. *Newman*, 773 F.3d at 452.

247. *Id*.

248. For one tipper the benefits received included "an iPhone, live lobsters, a gift card, and a jar of honey," and for another it consisted of an invitation to join an investment club. *See Jiau*, 734 F.3d at 153.

249. *See supra* note 238 and accompanying text.

250. Unfortunately, the Second Circuit mischaracterized the relevant relationship in *Sargent*, stating that the "tipper passed information to a friend who referred others to the tipper for dental work," *Newman*, 773 F.3d at 452-53, when it was the tipper (Shepard) who referred others to the tippee (Sargent) for dental work. The *Sargent* tippee provided the tipper with contacts and networking opportunities, and relatives of the tipper owed the tippee money and had threatened his business. The court held that

case at hand. In *Newman*, career advice provided by one selective disclosure recipient to an alleged insider tipper was deemed to be only what could be expected from a casual acquaintance, and the fact that another recipient knew his alleged tipper from church did not suffice to meet the *Dirks* standard. For an investor who does not meet management regularly enough to establish a meaningfully close relationship and does not provide, or could objectively be deemed to provide, any consequential personal benefit to the manager, *Newman* appears to have reduced the risk of incurring securities fraud liability for trading on privately received material NPI.

Important evidence in favor of the Newman defendants showed that Dell and Nvidia regularly disclosed apparently value-relevant NPI in private forums to analysts and investors.[251] A supervisor of one of the insider tippers testified that investor relations departments often helped analysts improve their financial valuation models.[252] The head of investor relations in one of the firms had also privately indicated the likely outcome of operating expenses and certain margins in an upcoming quarterly report.[253] The court noted that the corporate purpose of such disclosures appeared to be to build relationships with professional investors who could be interested in buying the firm's stock.[254] The fact that information similar to that which the defendants had allegedly used for insider trading was regularly selectively disclosed

---

this sufficed to indicate that the tip had the purpose of "effect[ing] a reconciliation . . . and maintain[ing] a useful networking contact." Given that the Second Circuit appears to have misunderstood the exchanges between tipper and tippee in *Sargent*, the court's apparent endorsement of the case may not have much precedential value. *See generally* SEC v. Sargent, 229 F.3d 68 (1st Cir. 2000).

251. *Newman*, 773 F.3d at 454–55.

252. *Id.* at 454. An analyst also testified that he would frequently ask public firms' investor relations departments to confirm "whether his assumptions were 'too high or too low' or in the 'ball park.'" While the SEC considers it acceptable for firms under Reg. FD to assist analysts with public historical data or mosaic construction, *Newman* was a case where the government claimed material forward-looking information was provided. For the SEC's position, see the answer to Question 101.03 in SEC. & EXCH. COMM'N, REGULATION FD COMPLIANCE AND DISCLOSURE INTERPRETATIONS (2010), https://www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm [https://perma.cc/V9UD-7TEA].

253. *Newman*, 773 F.3d at 454–55.

254. *Id. Cf. supra* note 48 and accompanying text (noting the professed importance of having investors available to buy stock).

by investor relations personnel contributed to the court's finding that the defendants could not have known of an improper motive for such information being privately available to them.[255] While the *Newman* defendants were part of tipping chains and several steps removed from the disclosing insiders, the court's analysis could have some relevance to direct tipper-tippee interactions as well. For example, where managers regularly disclose certain information in private to investors who do not provide any direct personal benefits in return, investors may be afforded some additional margin in concluding that such disclosures are not improper. Since investor relations activities such as private meetings or telephone calls with investors are undertaken in the interests of the firm, there would typically not be an obvious personal benefit to the manager.

Interestingly, the source for the Dell information, who worked in its investor relations department, was never charged with any wrongdoing.[256] Thus, the selective disclosure concerning Dell did not lead to any charges being brought successfully, even though the ultimate recipients earned approximately $62 million.[257] The fact that information of such a magnitude may be disclosed without any consequences for the tipper is unexpected,[258] and suggests that insiders may now be able to confer significant value on selected recipients without SEC

---

255. *Newman*, 773 F.3d at 455.

256. The source for the Nvidia information worked in its finance department and paid $30,000 to settle civil charges, not facing other charges. *See* Press Release, Sec. & Exch. Comm'n, SEC Charges Technology Company Insider in California With Tipping Confidential Information Exploited by Hedge Funds (Apr. 23, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541624596 [https://perma.cc/C3N7-3WKJ]. As regards the status of the Dell insider tipper, see *Newman*, 773 F.3d at 443.

257. Press Release, Fed. Bureau of Investigation, Two Former Portfolio Managers Found Guilty in Manhattan Federal Court of Insider Trading Schemes That Netted More Than $72 Million in Illegal Profits (Dec. 17, 2012), https://archives.fbi.gov/archives/newyork/press-releases/2012/two-former-portfolio-managers-found-guilty-in-manhattan-federal-court-of-insider-trading-schemes-that-netted-more-than-72-million-in-illegal-profits [https://perma.cc/Q53B-LHE6].

258. The Second Circuit appeared to find the situation where the tippees were charged criminally but the insider tippers were not, noteworthy. See *Newman*, 773 F.3d at 443, where the court pointed out that "[a]lthough [the Dell insider] has yet to be charged administratively, civilly, or criminally . . . for insider trading or any other wrongdoing, the Government charged that [the investment managers who traded] were criminally liable for insider trading."

enforcement. The reason why the SEC did not take any Reg. FD action is likely due to the regulation's interaction with insider trading law. As Reg. FD does not apply to disclosures by an insider "in breach of a duty of trust or confidence to the issuer,"[259] the SEC could not enforce its regulation without admitting that the disclosure was for a legitimate corporate purpose. As the SEC was supporting the efforts by the Department of Justice to have *Newman* overturned,[260] it thus appears to have refrained from enforcing Reg. FD for policy reasons.[261]

A comparison of *Newman* and the recent Supreme Court decision in *Salman v. United States*[262] highlights that a gift of information to a relative (as in *Salman*) is relatively easy to define as a personal benefit due to the obvious lack of corporate purpose, but selective disclosure to others (as in *Newman*) requires an analysis of the relationship between the tipper and the tippee to determine whether the reason for the tipper's selective disclosure was to benefit the firm or provide a gift to the tippee with the ultimate aim of procuring some reciprocal personal benefit for the insider.[263]

In conclusion, *Newman* may provide more flexibility for disclosures in private investor meetings going forward due to its requirement that the personal benefit be more than an inference of some personal relationship, but also by potentially allowing firms' prior disclosure practices to be taken into account when evaluating the tippee's assessment of whether the disclosure was improper. Overall, *Newman* may lead to an increase in demand for private meetings as the

---

259. 17 C.F.R. § 243.101(c) (2015).

260. *See* Brief for the SEC as Amicus Curiae Supporting the Petition of the United States for Rehearing or Rehearing En Banc at 11–12, *Newman*, 773 F.3d at 438 (No. 13-1837) [hereinafter SEC Amicus Brief]; *see also* Petition for Writ of Certiorari at 15, *Newman*, 773 F.3d at 438 (discussing the Department of Justice's argument that the Second Circuit's *Newman* decision would "impair the government's ability to protect the fairness and integrity of the securities markets").

261. Similarly, there may be other policy reasons behind the decision to prosecute the ultimate Dell tippees but not the Dell insider tipper, even though a successful prosecution of the Dell tippees would have implied that the tipper could have been found guilty as well. *See* Dirks v. SEC, 463 U.S. 646, 662 (1983) ("[A]bsent a breach by the insider, there is no derivative breach.").

262. Salman v. United States, 137 S. Ct. 420 (2016).

263. Against this background, it is not surprising that the Second Circuit analyzed the personal relationships in *Newman* in significant detail, see *Newman*, 773 F.3d at 451-54 and *supra* text accompanying notes 246-247.

ruling appears to result in a lower likelihood that an insider trading case will be successful.

F. REG. FD: "FUNDAMENTALLY DISJOINTED"

The lack of a consequential personal benefit to the manager from typical disclosures made to investors and analysts, as well as difficulties in establishing scienter and materiality, means that the insider trading framework is typically inapplicable for purposes of policing the subtle breaches of the duty of loyalty that may occur in the selective disclosure context.[264]

The SEC opted to tackle this issue based on its view that equality in information distribution is an important contributor to the public's confidence in the markets.[265] It enacted Reg. FD to require prompt public disclosure of information, but failed to anticipate how managers and investors might adapt to the new regulation. As a result, the SEC—eager to avoid a chilling effect on legitimate selective disclosures—ensured that it would not have any strong enforcement tools on hand or the ability to detect any but the most egregious violations. Consequently, Reg. FD not only fails to deter selective disclosures but also provides a roadmap for how managers can give preferred investors advance information with little risk of liability. If Reg. FD today serves its intended purpose of increasing investor confidence in the market, it is only because information exchanges are more private, making investors at large unaware of how easy it still is for managers to hand out information to favored investors and analysts.

When the SEC enacted Reg. FD as an issuer disclosure obligation, it chose as its aim to restrict *supply* of selective disclosure, not *demand*. Against this background, it is surprising that the *Newman* case only resulted in actions against the trading information recipients. One may wonder if it would not have been easier for the SEC to contain selective disclosure at its source, i.e., before it leaves the firm, instead of targeting the point at which investors trade on it. In examining potential ways to improve the regulation, however, it is useful to first consider selective disclosure in context.

---

264. See Proposing Release, *supra* note 7, at 72,592–93, and Adopting Release, *supra* note 7, at 51,716–18, which both note how managers may use information to "curry favor" with investors or gain biased reporting from analysts.

265. *See, e.g.*, Proposing Release, *supra* note 7, at 72,593.

III. INFORMATION AS PROPERTY, ITS DEPLOYMENT, AND THE RISK OF APPROPRIATION

A. NON-PUBLIC INFORMATION AS PROPERTY OF THE FIRM

When the Supreme Court in *Dirks* required the receipt of a personal benefit by a disclosing manager in order to trigger liability for selective disclosure, it established a rule that considered selective disclosure similar to dealing in firm property.[266] Where the manager does not gain a personal benefit, selective disclosure is treated much like any corporate transaction and the tippee may freely monetize the acquired information in the stock market. Where the manager does take some personal profit, however, the transaction is actionable, broadly similar to how a conflicted-interest transaction may be voidable in state corporate law. If the information recipient knows about the manager's profit (in the typical example, by providing it), that person is also liable, effectively aiding and abetting the manager's breach of duty. The Supreme Court has subsequently affirmed in the insider trading context that "[a] company's confidential information . . . qualifies as property to which the company has a right of exclusive use."[267]

The formulation of the personal benefit requirement in *Dirks* raised the fundamental question of whether a firm's selective disclosure of

---

266. Several commentators have related the insider trading framework to property rights concepts in detailed analyses. *See, e.g.,* Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 32 (1980) (arguing, pre-*Dirks*, that corporate NPI is the corporation's property); *see also* Stephen M. Bainbridge, *Regulating Insider Trading in the Post-Fiduciary Duty Era: Equal Access or Property Rights?*, *in* RESEARCH HANDBOOK ON INSIDER TRADING 80, 96-97 (Stephen M. Bainbridge ed., 2013) (arguing that a property rights approach is more suited as the basis for current insider trading regulations than a securities fraud perspective); JONATHAN MACEY, INSIDER TRADING: ECONOMICS, POLITICS AND POLICY 56–58 (1991) (arguing that the Supreme Court in *Dirks* noted the rationale behind the preservation of property rights in valuable information, but also noted that a firm cannot have "a legitimate property interest" in the information that it itself is committing fraud, which is why the tipper was not in breach of his duty by informing Dirks. For further references, see Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1252 n.266 (1995).

267. United States v. O'Hagan, 521 U.S. 642, 654 (1997).

material NPI for its own benefit could incur liability.[268] Several commentators doubted that this could be the case, while others noted the internal conflicts in the insider trading doctrine that would otherwise result.[269] However, when viewing information as firm property it is entirely logical that a firm may trade it for value.

The practical validity of the judiciary's theoretical construct of information as property is borne out by the actions of stock market participants. As this Article has documented, firms use information as a corporate resource[270] and sophisticated intermediaries have developed special services to facilitate its transfer to investors that pay significant amounts to receive it.[271] Theory and practice consequently coincide in the view that NPI is valuable firm property controlled by corporate managers.

For public firms, the property right in its own confidential information that it will later release to the stock market is an asset with different attributes than other firm property, even other intangible property. Unlike an invention that is patentable, such NPI is incidental to the firm's productive activities and can be immediately monetized in the stock market. Consider two identical debt-free firms, one with publicly traded stock currently worth \$1.0 billion and the other privately held. The CEO of each firm knows that the actual value of their firm is actually \$1.5 billion due to a significant contract win, which will be disclosed to the market in a few days.[272] In the case of the private firm, this information is useless for a professional investor.[273] Where it relates to the public firm, it is incredibly valuable. The manager of the public

---

268. See the initial paragraphs *supra* Section II.B. For a substantial literature review on this topic, see WANG & STEINBERG, *supra* note 24, at 323-335. *See also* Anderson et al., *supra* note 126, at 279 (former SEC Commissioner Goldschmid outlining his post-*Dirks*, pre-Reg. FD view that firms would not have been allowed to trade their own shares with material information but may have been able to selectively disclose such information for a benefit to the firm due to the Supreme Court's formulation of the personal benefit requirement in *Dirks*).

269. WANG & STEINBERG, *supra* note 24, at 323-335.

270. *See supra* text accompanying note 47.

271. *See supra* Sections I.D and II.D.2. For evidence of how managers use NPI opportunistically, see *infra* Section III.C.

272. Form 8-K requires firms to file within four business days of the event. *See* 17 C.F.R. § 249.308 (2015).

273. One may, of course, imagine an oligopoly or other industry composition scenario where the state of a private firm may predict the state of one or more public firms. This is not considered here.

firm can opt to confer this value on chosen recipients via selective disclosure before its public disclosure.[274]

This begs the question of whether the public firm is worth more than the private firm. After the disclosure of the contract win, the productive assets of each firm are worth $1.5 billion. Before the disclosure, however, the public firm is able to monetize the information about its own true value in the stock market. Assume the public firm provides this information to an information trader and receives consideration worth $100 million for the trading advantage.[275] When both firms later publicly disclose the contract win, is the public firm then worth $1.6 billion while the private firm is worth $1.5 billion? And, if so, where did this value come from? The value will come from shareholders who sell their shares below the new fair market value to the intermediary informed by the firm. The receipt of this value enables the intermediary to, in turn, provide value to the firm. The value of the public firm's property right in NPI that will soon be released to the public thus comes from its agreement to, in effect, issue a license to the selected investor to transact with its uninformed shareholders at a favorable price. In the example, the intermediary is buying the firm's equity from shareholders exiting the firm at a price below actual market value. Had the information instead been negative, the intermediary could sell the firm's shares to shareholders entering the firm at a price above actual market value. Firms are consequently able to use selective disclosure to effectively raise equity from shareholders when they enter and exit the firm in a way that is similar to imposing a transaction cost on them via a chosen information trader.[276]

---

274. Intentional selective disclosure of such material NPI would be a breach of Reg. FD but as outlined in the last paragraph of Section II.B, *supra*, the regulation can be violated at low expected cost where a manager knows that the firm will disclose valuable information in the near future.

275. The value to the firm is typically delivered in non-pecuniary form, such as goodwill or loyalty. *See supra* Section I.C.1.

276. If the shareholders of the public firm are aware that the firm is monetizing information in this way, it should face a higher cost of capital, however, since the bid-ask spread of the firm's stock should reflect the risk of trading against the better informed trader.

B. A TAXONOMY OF METHODS FOR DEPLOYMENT OF INFORMATION

As the value of NPI comes from the ability to trade in the stock market, it is useful to examine the various ways in which a firm may cause this to occur, in order to place selective disclosure regulation in its appropriate context.[277] Depending on who trades on the NPI, we can distinguish between different methods for deployment. The choice of deployment method largely rests with managers. This Article proposes that a manager with access to value-relevant, firm-specific NPI has four options for monetizing it by trading, or causing trading, in the firm's stock: personal trading, firm trading, selected investor trading, and market trading. General attributes of these methods are set out below.

	Personal trading	**Firm trading**	**Selected investor trading**	**Market trading**
Person trading	Manager	Firm	One selected investor	Market (unknown)
Method of receiving the NPI	Incidental (through employment)	Incidental (through manager)	Selective disclosure (chosen by manager)	Public disclosure
Relative efficiency	Low	Low	Low	High
Trading value to recipient	High	High	High	Low

Table 2. Methods for Deployment of Firm-Specific NPI[278]

277. The closest precedent found in the literature for this functional approach considers three alternatives for use of information, but not selective disclosure. *See* Andrea M. Buffa & Giovanna Nicodano, *Should Insider Trading Be Prohibited when Share Repurchases Are Allowed?*, 12 REV. FIN. 735 (2008).

278. While Figure 2 shows that the attributes of selective disclosure vary depending on the number of initial recipients, the example here only reviews such a disclosure to a single investor. The last two rows of the table follow from Figure 2.

The methods in Table 2 all ultimately result in information reaching the market through stock prices, but with different degrees of relative efficiency. The first three methods are of a private nature and involve direct monetization of the property by trading against uninformed investors. Public disclosure, in contrast, results in immediate public knowledge and only indirect monetization through the market price. The private methods are non-exclusive, while public disclosure extinguishes the opportunity to monetize information through the private methods.

C. The Risk and Evidence of Managerial Appropriation

Due to the separation of ownership and control in public firms, managers will have an incentive to divert value to themselves instead of distributing it to shareholders.[279] Value-relevant NPI is a highly suitable asset for appropriation by managers for several reasons. First, managers acquire NPI about their firms by virtue of their position, typically without personal cost.[280] Second, NPI is not recorded on the firm's balance sheet or otherwise, so it is impossible to monitor its use. This also means that the firm is not visibly affected, or harmed, by the selective disclosure. Third, it is impossible for firms to create a system to monitor managers to determine whether they selectively disclose valuable NPI in private discussions. Fourth, other market participants and shareholders are not necessarily aware that private disclosure has taken place and certainly not aware of what particular information has been shared.[281] Fifth, private meetings where NPI is disclosed appear legitimate even when they are not, since they are assumed to be in the

279. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

280. *See, e.g.,* CLARK, *supra* note 22, at 507–08. To the extent any outlay is necessary to acquire particular information, corporate funds can likely be spent. *See* Hirshleifer *supra* note 65, at 35.

281. Even if other investors were aware, they could be disinclined to call attention to the practice, since they may also systematically benefit from it. This means that such "informal private enforcement" is unlikely. *Cf.* John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, *in* RATIONALITY IN COMPANY LAW: ESSAYS IN HONOUR OF DD PRENTICE 71, 102-118 (John Armour & Jennifer Payne eds., 2009) (outlining how informal private enforcement may work, but not when other institutional investors may be conflicted).

interest of the firm.[282] Sixth, neither the manager nor the recipient has anything to gain from publicizing the fact that a transfer of valuable NPI has occurred. Finally, the recipient monetizes the NPI by anonymous trading in the stock market which typically cannot be decoded.[283] In sum, it is currently very difficult to discern to what extent a manager may have selectively disclosed NPI.

Not even the disclosing manager will know the exact value of the benefit conferred on the selective disclosure recipient.[284] Since information does not have an assigned value within the firm, and since its value is realized on the shareholder level with no visible impact on the firm level, attention may be deflected away from the size of the value transfers that occur. In absolute terms, managers may reallocate highly significant sums of money among investors when they opt for selective disclosure over alternative uses of information.[285]

Managers may act in two ways to increase the value of the information property that they control. First, they can delay public disclosure for as long as possible in order to have more time to utilize the information. While Form 8-K requires disclosure of certain events within four business days, other events may not have to be disclosed until the next periodic report.[286] Second, managers may prefer public disclosure to be convoluted and fragmented so that they can maintain control over as much information as possible, making investors dependent on them to be able to fully interpret the public disclosure.[287] This creates a risk that the public disclosure becomes formalistic in order to achieve superficial compliance with reporting requirements but still leaves out valuable details necessary to fully understand it.[288] The

---

282. *See* GUIMARD, *supra* note 30, at 97–103 (noting selective activities to attract shareholders); *id.* at 168-70 (noting how "analyst days" or "capital market days" serve to educate analysts).

283. *See supra* Section I.C.3.a.

284. From another perspective, the fact that NPI does not have a value within the firm may allow managers to feign ignorance of the values they distribute.

285. *See supra* Section II.C.

286. *See supra* note 6.

287. The observation that 43% of analyst interactions occur after firm-initiated news releases may be an indication that public disclosure is incomplete from the perspective of professional financial analysts. *See* Soltes, *supra* note 39, at 257.

288. *See* Michael Rapoport, *Five Years Later*, WALL ST. J., Oct. 17, 2005, at R8 (citing concerns that publicly disclosed information was "dumbed down" following the introduction of Reg. FD). See also JOHN HOLLAND, A MODEL OF CORPORATE FINANCIAL COMMUNICATIONS (2006), a UK study of disclosure which documented how

SEC appears to have recognized the risk of delay[289] but not the risk of convolution or fragmentation. While the SEC took care to ensure that Reg. FD would not have a defensive "chilling" effect—which would cause managers to stop talking to investors to avoid incurring liability[290]—it did not appear to recognize this opposite risk of "offensive chilling" of public disclosures, where firms reduce the quality of their public disclosures to be able to monetize it via private deployment methods.[291]

There is evidence that managers time their firms' news releases to increase their own option awards and to transact in the firm's shares in favorable market conditions.[292] There is also evidence that managers trade profitably in the period between the occurrence of an important

---

managers deliberately did not include complete information in their public disclosure in order to be able to explain it in private and maintain control over information as a corporate resource. By having some public disclosure on the topic, albeit fragmented, managers considered the public disclosure obligations satisfied, which allowed them to draw attention to and elaborate on particular items in private, partly for purposes of managerial opportunism.

289. *See* Proposing Release, *supra* note 7, at 72,592.

290. *See* Adopting Release, *supra* note 7, at 51,718.

291. *Cf.* Mark Maffett, *Financial Reporting Opacity and Informed Trading by International Institutional Investors*, 54 J. ACCT. ECON. 201 (finding that "firms with more opaque information environments . . . experience more privately informed trading"); John L. Campbell et al., *supra* note 147 (finding that selective disclosure is more common in firms that have weaker information environments).

292. *See* Anne Beyer et al., *The Financial Reporting Environment: Review of the Recent Literature*, 50 J. ACCT. ECON. 296, 306 (2010); Paul M. Healy & Krishna G. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature*, 31 J. ACCT. ECON. 405, 422 (2001); Alex Edmans, Luis Goncalves-Pinto, Yanbo Wang & Moqi Xu, *Strategic News Releases in Equity Vesting Months* (ECGI Finance, Working Paper No. 440/2014, 2014), http://ssrn.com/abstract=2489152 [http://perma.cc/6JDC-9QZ5] (suggesting that "managers strategically time the disclosure of discretionary corporate news to coincide with the scheduled vesting of their equity grants . . . lead[ing] to temporary increases in the stock price and trading volume"); Eliezer M. Fich, Robert Parrino & Anh L. Tran, *Timing Stock Trades for Personal Gain: Private Information and Sales of Shares by CEOs* (Working Paper, 2015), http://ssrn.com/abstract=2579047 [http://perma.cc/TQ7S-D243] (presenting evidence that managers time their firms' disclosures to maximize trading profits from so-called 10b5-1 plans; also listing many previous studies that show that managers use private information for profitable trading).

event in their firms and the official disclosure of that event.[293] Opportunistic managerial use of NPI in voluntary *private* disclosures to financial analysts has also been a long-standing concern of regulators.[294] While the SEC intended to restrict such behavior with the introduction of Reg. FD, evidence suggests that managers still engage in similar practices, cutting off the supply of selective disclosure to analysts who produce unfavorable research.[295] Managers also give analysts with positive views of their firms the right to ask questions on public earnings calls.[296] As a result, analysts pay more attention to corporate managers' perception of them than investors' assessments of them.[297]

While NIRI's official position cautions issuers not to "[d]iscriminate among recipients of information . . . based on the recipient's prior research,"[298] a recent article in its official magazine co-authored by one of its board members[299] declared that a broker with a "sell" rating on a firm should reduce its expectations of being awarded other business and "be careful about third-party conversations, because the buy side will share [the broker's] comments with management."[300] Even senior investor relations professionals may thus harbor conflicted views on whether NPI may be used to reward or deter stakeholder behavior.

---

293. Alma Cohen, Robert J. Jackson, Jr. & Joshua R. Mitts, *The 8-K Trading Gap* (Ctr. for Law and Econ. Studies, Columbia University Sch. of Law, Working Paper No. 524, 2015), http://ssrn.com/abstract=2657877 [http://perma.cc/LG2N-HV2V].

294. *See* Adopting Release, *supra* note 7, at 51,717. The UK authority has made similar observations. *See* Fin. Servs. Auth., *Investment Research: Conflicts and Other Issues* §§ 4.24–26 (Discussion Paper No. 15, 2002).

295. Brown et al., *supra* note 31, at 28, 37 (surveying 365 sell-side analysts and finding that nearly half of them regarded their relationship with managers to be an important factor for their compensation). Analysts also stated that without positive stock recommendations issuers would not attend their conferences, thus depriving them of the opportunity to earn corporate access fees. *Id.* For earlier evidence, *see* Jill E. Fisch & Hillary E. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1054-56 (2003).

296. *See* William J. Mayew, *Evidence of Management Discrimination Among Analysts During Earnings Conference Calls*, 46 J. ACCT. RES. 627 (2008).

297. *See* Brown et al., *supra* note 31, at 37.

298. CFA CENTRE FOR MARKET INTEGRITY & NAT'L INV'R RELATIONS INST., BEST PRACTICE GUIDELINES GOVERNING ANALYST/CORPORATE ISSUER RELATIONS 4 (2004).

299. *See* NIRI 2014 ANNUAL REPORT, *supra* note 29.

300. Bob Burton & Jeff Tryka, *IRO's Wish List for Analysts*, IR UPDATE, May 2012, at 7, 9.

Opportunistic use of NPI by managers is consequently well-documented across the spectrum of the methods for information deployment. Although the SEC appeared to focus on how managers' control of information could lead to *analyst* conflicts of interest (as they would try to maintain profitable access by pleasing the managers with favorable research), *active investors* are equally dependent on management access. The nature of active investing means that such investors are reliant on NPI—information not incorporated into market prices—in order to outperform their benchmarks and stay in business over the long term. While disclosure to analysts may lead to more publicity, it is no less likely that managers use private meetings to also reward or deter investor behavior.

An important reason for firms to take part in private investor meetings is to convince investors to become shareholders,[301] so managers may be able to influence the profile of shareholders who take or maintain a stake in the firm by granting one or more investors NPI and withholding it from others. Through such investor discrimination, managers can reduce their risk of attracting hostile shareholder action. For example, a manager may prefer a shareholder that is passive or strongly supportive of the firm's current strategy to one that is less cooperative, providing the former with useful NPI and withholding it from the latter.[302]

Discriminative behavior could also occur with investors who are already shareholders of the firm. Managers may use NPI to reward those shareholders who offer them tacit support by voting for their proxy proposals or compensation and withhold NPI from investors who challenge their views.[303] Managers may also award NPI with an expectation or hope of such future action.[304] Similarly, investors may

---

301. *See supra* Section I.C.1.

302. The investor relations literature acknowledges that managers may be inclined to favor certain investors. *See* MARCUS, *supra* note 30, at 27 (recognizing such tendencies); *see also* GUIMARD, *supra* note 30, at 161 (recommending that investor relations officers should attend private meetings to "avoid the CEO or CFO giving (*intentionally* or unintentionally) price-sensitive information") (emphasis added).

303. *Cf.* Coffee, *supra* note 122 (arguing that selective disclosures could be used by managers to buy votes).

304. Even in situations where awards of material NPI result in a personal benefit to the manager at a later point in time, it would be very difficult to prove that such a benefit was sufficiently consequentially related to the selective disclosure event to

indicate that they will support a manager if they are provided with useful NPI.[305] As the favored investors in such cases reciprocate by participating in ostensibly legitimate corporate actions that serve to compensate managers via the firm, there are no signs of personal benefits to managers.

Empirical evidence shows that institutional investors have access to corporate NPI and trade profitably on it. For example, institutional investors have been found to systematically trade in advance of news about unexpected firm-specific events, such as earnings announcement surprises.[306] Furthermore, mutual fund managers who share educational ties with corporate managers overweight and outperform in such investments, with nearly all of the outperformance occurring around corporate news announcements.[307] Such mutual fund managers are not only able to make more profitable trades, but are also "more likely to vote against shareholder-initiated proposals to limit executive compensation."[308] This finding is consistent with a scenario where certain active investors receive better information from managers they know and reciprocate by supporting their contentious pay packages.[309] Providing personal benefits to managers via the firm through shareholder voting in this way may be the easiest and least obvious way for investors to reciprocate while superficially complying with *Dirks*' personal benefit requirement. The absence of consequential benefits to managers from subtle investor discrimination makes it highly unlikely

---

trigger insider trading law. Furthermore, it is currently impossible to monitor for such events, as the disclosure itself is unobservable. With no potential for monitoring, there is likely little deterrence created.

305. *Cf.* Langevoort, *supra* note 78, at 1042 (making a similar argument for analysts).

306. Terrence Hendershott, Dmitry Livdan & Norman Schürhoff, *Are Institutions Informed About News?*, 117 J. FIN. ECON. 249 (2015).

307. Lauren Cohen, Andrea Frazzini & Christopher Malloy, *The Small World of Investing: Board Connections and Mutual Fund Returns*, 116 J. POL. ECON. 951 (2008).

308. Alexander W. Butler & Umit G. Gurun, *Educational Networks, Mutual Fund Voting Patterns, and CEO Compensation*, 25 REV. FIN. STUD. 2533 (2012).

309. *Id.* This study also found that "higher levels of the CEO compensation are associated with a larger likelihood of a shareholder-initiated proposal to limit executive compensation," but only for firms with stronger educational connections between managers and mutual fund managers. This is consistent with the view that such managers' compensation may include an element of private compensation from connected investors that is objectively harder to justify, thereby causing shareholder initiatives.

that such actions would trigger the insider trading framework as developed in *Newman*. This empirical evidence and the analysis of Reg. FD suggest, as does the principle of parsimony, that selective disclosure by managers is a plausible source for active investors' information advantages.[310]

D. COMPARING THE METHODS FOR DEPLOYMENT OF INFORMATION

It is important to place the regulation of selective disclosure in private investor meetings in the correct context. This Article considers the appropriate context to be the different methods available to corporate managers for deployment of their firms' NPI. Ideally, these different alternatives should be coherently regulated to avoid exploitable inconsistencies. Without coherence, managers in control of the corporate property may find that certain methods offer better possibilities for opportunistic actions. The remainder of this section will compare selective disclosure to the other methods for deployment of information identified in Section III.B.

1. *Selective Disclosure Compared to Public Disclosure*

The choice between public and selective disclosure involves a trade-off from the perspective of the value conferred on the recipients: if the manager chooses broad public disclosure, it may benefit investors generally but no individual shareholder (or investor), but if selective disclosure instead is preferred, value may be bestowed on the selected recipient. Thus, managers exercise discretion over whether a piece of NPI should be turned into a public good through broad dissemination or a private good through selective disclosure.

Firm benefits of public disclosure may include reduced managerial agency costs and enhancement of price accuracy, which increases allocative efficiency, improves liquidity, and decreases share price

---

310. Brokers, for example, have been found *not* to be transmitting valuable NPI for client trading. *See* John M. Griffin, Tao Shu & Selim Topaloglu, *Examining the Dark Side of Financial Markets: Do Institutions Trade on Information from Investment Bank Connections?*, 25 REV. FIN. STUD. 2155 (2012).

volatility and the cost of capital.[311] Costs of public disclosure include preparation costs, risk of weakening the firm's competitive position, and increased risk of liability.[312] While reviews of the empirical disclosure literature have catalogued much research in the area of voluntary *public* disclosure (i.e., increased information in public reports), there is little research in the field of voluntary *private* (i.e., "selective") disclosure.[313]

Healy and Palepu surveyed empirical research to identify different motives for voluntary public disclosure in the literature and found varying degrees of support for the hypotheses that voluntary disclosure increases in firms that expect to issue public debt or equity, firms subject to corporate control contests, and firms where managers are compensated more in stock, wish to trade in the stock or affect the share price in their favor prior to stock option awards.[314] At least the last two of these findings appear explainable on the basis of managerial agency costs. Graham et al. surveyed more than 400 executives of public firms on their voluntary disclosure decisions, although without distinguishing between voluntary public and voluntary private disclosures, and found that firms make voluntary disclosures to "promote a reputation for transparent reporting," "reduce the information risk," and "address the deficiencies of mandatory reporting."[315] This survey also found that voluntary disclosure was constrained by managers' fears of establishing

---

311. Luca Enriques & Sergio Gilotta, *Disclosure and Financial Market Regulation*, *in* THE OXFORD HANDBOOK ON FINANCIAL REGULATION 511 (Niamh Moloney et al. eds., 2015).

312. *Id.*

313. Healy & Palepu, *supra* note 292, at 427 (2001) (noting that private voluntary disclosure has typically not been included in prior studies of voluntary disclosure). Another review of theoretical and empirical work on disclosure did not note any theoretical work on the topic of selective disclosure. *See* Christian Leuz & Peter Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, 54 J. ACCT. RES. 525 (2016). A third notes that one of the main outstanding questions in the disclosure literature concerns the costs and benefits of voluntary disclosure. *See* Beyer et al., *supra* note 292, at 298, 314 (encouraging researchers to recognize the changing regulatory landscape).

314. The authors found only weak support for the hypothesis that firms voluntarily disclose to avoid litigation, no support either for or against the hypothesis that talented managers will voluntarily disclose to reveal their skill, and some support for the hypothesis that firms' disclosure policies are affected by their competitive position. Healy & Palepu, *supra* note 292, at 420–25.

315. John R. Graham, Campbell R. Harvey & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. ECON. 3, 53-65 (2005).

a pattern of disclosure which may not be sustainable in the long-term, disclosing proprietary information to the detriment of their firms, and drawing unwanted scrutiny.[316]

While firm benefits of selective disclosure are significantly less explored in the literature, the motives for private investor meetings[317] likely comprise the most important rationales for selective disclosure as well. As noted, these reasons involve monetization of NPI for intangible value such as loyalty and goodwill.[318] This means that selective disclosure is essentially different from broad public disclosure.

Anecdotal evidence shows that both investors and managers may prefer not to make NPI a public good.[319] An investment manager reported in a recent investor letter that it had been watching a firm's invitation-only investor day via a public webcast in order to gauge management's response to newspaper allegations about overstated sales figures only to learn after the event that they had answered such sensitive questions during a break.[320] Similarly, firms now often supplement the practice of having public earnings conference calls by individually calling analysts after such calls.[321] When firms choose to provide such private forums to investors and analysts, we should expect investors to utilize them as much and as far as firms allow, since information is more valuable in private.[322]

To be sure, information exchanges between investors and managers may often require a private setting. Managers may be reluctant to subject themselves to tough questioning in public as unexpected questions may produce answers that differ from the view they would

---

316. *Id*.
317. *See supra* Section I.C.1.
318. *See supra* Section I.C.1.
319. *Cf.* HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET 64-65 (1966) (arguing that managers should not be expected to readily surrender a valuable informational asset when some form of exchange is possible). *But see infra* note 333.
320. Letter from Greenlight Capital to Partners 4 (Oct. 15, 2013) (on file with author).
321. Brown et al., *supra* note 31, at 19.
322. *Cf. id.* at 20 (quoting an analyst stating that he does not ask questions on the public conference calls, as any useful information resulting from such would be shared with all participants).

otherwise carefully project.[323] Similarly, investors would not undertake the activity if the results were instantly available to other market participants, since they would be unable to use the information for profitable trading to cover their acquisition costs. Furthermore, some information that investors gather in private meetings cannot possibly be publicly disclosed. This is the case for subtle pieces of information, such as managers' body language, tone, and cautiousness in answering questions, which may be useful to observe for monitoring or verification purposes.[324]

It is, of course, impossible to draw any general conclusion as to whether information disclosed in private would imply net benefits or net costs to a firm if it had been publicly disclosed instead.[325] The same is true for firms' monetization of NPI before its public release. All we can say with certainty is that when a firm creates an information asymmetry among investors through selective disclosure, it enables the recipients to reallocate value from uninformed investors to themselves through trading in the stock market. This is an activity with net negative social value as the trading among investors is a zero-sum game with added search and trading costs for investors and supply costs for the firm.[326] There is also a further cost of information asymmetry, since market makers and investors will adapt their bid-ask quotes to account for the risk of trading against an informed trader.[327] For selective disclosures to be a socially useful activity, the sum of these costs would need to be outweighed by benefits to the firm[328] or investors.[329]

---

323. *Cf.* Soltes, *supra* note 39, at 265 (quoting a research director saying that in the interest of maintaining access to senior management, it is important for analysts not to pressure them with challenging questions on public conference calls).

324. *See, e.g.,* Ng & Troianovski, *supra* note 4 (describing how a manager's unwillingness to elaborate in private on the firm's need to raise capital was correctly interpreted as a negative sign by meeting attendants, causing the share price to decline 15% before the firm announced an equity offering).

325. Furthermore, tacit information imparted in such meetings could not be publicly disclosed, and it would be fruitless to attempt to distinguish explicit statements from tacit information for purposes of regulating them differently.

326. See Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 AM. ECON. REV. 561 (1971), for the argument that private, but not social, foreknowledge of circumstances that will eventually be disclosed is valuable.

327. *See* Adopting Release, *supra* note 7, at 51,731; Kraakman, *supra* note 22, at 49.

328. *See supra* Section I.C.1.

329. *See supra* Section I.C.3.

Regardless of the benefits of selective disclosures to investors collectively, the significant private value available to investors who successfully acquire or find such information will entice them to engage in the activity. The availability of selective disclosure could thus lead to a collective action problem: investors who know that they can receive information privately may not compel firms to improve their public disclosures, since private information is more valuable to them. Active investors may all seek to receive selective disclosures based on the belief that they are able to produce superior returns, even though the business model of active investment means that they, on average, do not.[330] Many active investors may then seek to have private meetings with managers, potentially using more of firms' (and their own) resources than if the information was broadly disclosed. This collective action problem may even lead investors with management access to prefer less and less useful public disclosure, in order to be able to gain more from private meetings. As a result, investors as a collective could be worse off than if they had been able to agree to have managers publicly disclose as much information as possible. In particular, shareholders without access to private meetings may lose twice: both when trading against more informed investors and when the firm spends its resources to help those investors gain trading advantages against them.

The value of public disclosure to managers comes from their share of the general shareholder benefits and their private benefits of public disclosure.[331] A cost, possibly to both the firm and the manager, will be that the potentially valuable option to monetize the information via selective disclosure is extinguished when it is publicly disclosed. Managers' personal costs of public disclosure may include time spent preparing or overseeing the disclosure, which may have to be provided on an ongoing basis since disclosure on a topic, once initiated, creates market expectations of similar disclosure in the future.[332] Given that managers tend to own minority stakes in their firms, voluntary public

---

330. *See* Kenneth R. French, *Presidential Address: The Cost of Active Investing*, 43 J. FIN. 1537, 1561-62 (2008).

331. This could include the maximization of incentive compensation through disclosure timing or signaling of management talent. *See* Healy & Palepu, *supra* note 292, at 422, 424; *supra* text accompanying note 292.

332. *See supra* text accompanying note 316.

disclosure could in many cases produce net personal benefits in the form of private benefits, but often produce net personal costs. It is therefore unlikely that voluntary public disclosure would be a default choice for managers.[333]

2. Selective Disclosure Compared to Insider Trading

Selective disclosure could be a substitute for insider trading. Instead of trading personally, managers could grant the right to trade to outsiders who provide some other benefit in return.[334] As we have seen,[335] insider trading doctrine recognizes this problem and prohibits selective disclosure if the manager takes a personal benefit.

Insider trading is the most direct route for a manager to use NPI to signal confidence in the firm: an action which may benefit the manager if and when the market interprets the signal to increase the value of her shares or when the value-relevant NPI otherwise materializes in public disclosures at a later point in time. There are, however, many reasons why personal trading often may not be an attractive or available option: managers may simultaneously be in possession of material NPI which would make trading unlawful; they may not wish to engage in trading too frequently because they have to publicly report it,[336] which would attract attention from the regulator and the media; managers may consider themselves too undiversified to further pool their financial capital with their human capital in the firm; they may consider the firm's share price to be subject to other short-term risks which they are unable

333. Some commentators appear, however, to be taking the contrary view: that voluntary public disclosure would be the default choice for managers. *See* Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 723, 739 (2006) (arguing that competition among information traders (defined as not having access to inside information) incentivizes managers to make disclosures beyond the level set by mandatory disclosure regulation to the benefit of all investors); Langevoort, *supra* note 78, at 1028-29 (suggesting that capital markets benefits such as a lower cost of capital may predispose firms to public disclosure). However, neither article seeks to conduct a review of the relative appeal of the various possible uses of corporate information.

334. *Cf.* David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449, 1459 (1986) ("[W]hen insiders cannot trade, something of exactly the same form as the banned insider trading will still occur, but the set of beneficiaries is altered.").

335. *See supra* Section II.A.

336. 15 U.S.C. § 78p(a) (2012).

to efficiently hedge; and managers may due to other trading find themselves in a situation requiring disgorgement of short-swing profits if they were to trade.[337] Firms may also establish policies of "blackout" or "quiet" periods to ensure that managers do not trade or speak to investors at certain times when they are particularly likely to possess material NPI (such as before the release of a quarterly report).[338] However, while 98% of firms in a 2010 survey had instituted blackout periods, only 82% also employed quiet periods,[339] meaning that in some firms managers were unable to trade but could still speak to investors. More curiously, 79% of firms still participated in private calls or meetings during their quiet periods,[340] meaning that they are not actually quiet at all.

This shows a clear contrast between managers' trading and their selective disclosures to outsiders who trade. Under both securities regulation and the typical firm-imposed requirements, managers are significantly more constrained and monitored in their own trading than if they disclose to an outside investor who trades. Information recipients are only subject to reporting if they cross the 5% ownership threshold under the regime for notification of major holdings.[341] If managers possess material NPI, they have a further preference for selective disclosure as their personal trading would be unlawful. As demonstrated, if such NPI is disclosed to an outsider without a personal benefit, all that is required (if the manager labels the disclosure non-intentional) is eventual public disclosure of the information under Reg. FD.[342] Managers may thus rationally prefer to monetize the information through selective disclosure. In doing so, managers would be expected

---

337. 15 U.S.C. § 78p(b) (2012).

338. As defined in a 2010 NIRI survey of investor relations practices, a "blackout period" is "a specific period of time when the company's officers, executives and certain employees are prohibited from trading in the company's stock," while a "quiet period" is "a period during which the officers of a company will not talk about the company's financials." *See* NAT'L INV'R RELATIONS INST., TRADING BLACKOUT AND QUIET PERIODS: SURVEY RESULTS (2010).

339. *Id*.

340. *Id*. The survey conclusions aptly note that "trading blackout periods tend to be more formal and codified" while "quiet periods are much more art than science." *NIRI Survey Sheds Light on Trading Blackout and Quiet Period Practices*, NIRI - EXECUTIVE ALERT (Mar. 24, 2010) (on file with author).

341. 15 U.S.C. § 78m(d) (2012).

342. *See supra* Section II.B.

to consider the available firm benefits from selective disclosure of the information,[343] their personal benefits from selective disclosure,[344] and their personal cost, which would mainly be the time spent on such private disclosures.

The value of insider transaction reporting obligations is twofold: they serve notice of trading by managers based on potentially value-relevant NPI, and they deter trading on material information. The fact that insiders have a blanket obligation to report their trades, while outsiders who receive information from them do not, could add to the popularity of private investor meetings. Opportunistic managers may prefer selective disclosure over personal trading due to the lack of transparency.

3. Selective Disclosure Compared to Firm Trading

The effect of selective disclosure to an investor who uses the firm's NPI to conduct profitable trading and compensates the firm for the information received is that the firm raises equity indirectly.[345] This is because the value the firm receives in return comes from the intermediary's profitable transactions in the firm's stock with uninformed shareholders. Firms can of course freely monetize value-relevant, but non-material,[346] information through selective disclosure. Furthermore, although a monetization of material NPI would be intentional and consequently a violation of Reg. FD, some firms may consider it a project with a positive expected value given that both the risk of detection and the penalties assessed by the SEC in these cases are low.[347]

---

343. *See supra* Sections I.C.1 and I.C.3.

344. *See supra* Section III.C.

345. *See supra* Section III.A.

346. *See supra* Section I.A.

347. Seen as equity raisings, Schering-Plough may have raised over $67 million at a realized regulatory cost of $1.05 million (assuming it received the same value as the recipients earned), *see* Schering-Plough Release, *supra* note 179; text accompanying notes 201–203, while Dell raised $62 million without any regulatory cost on the same assumption, *see supra* note 257 and accompanying text. The information trader assisting the firm in monetizing the information would not be violating the insider trading framework as interpreted by leading SEC officials. *See supra* notes 127–128 and accompanying text.

Firms deploying their NPI to trade their own stock—using, for example, share repurchases or at-the-market offerings—can achieve a result similar to that of a selective disclosure transaction as outlined above. However, such transactions are, in contrast to selective disclosure, subject to the antifraud rules of the securities laws, which means that material NPI must be disclosed before any such trading takes place.[348] While neither repurchases nor at-the-market offerings require more than summarized disclosure in the next quarterly report,[349] this is still more transparent than selective disclosure, which offers complete secrecy and thus lower transaction costs.

From a manager's perspective, the choice whether to deploy information through selective disclosure or firm trading would likely depend on personal preferences for the factors outlined above, but she would share in the firm benefits from either method proportionally to her level of firm ownership.

4. Concluding Remarks on Deployment Methods

The analysis above indicates that selective disclosure is so different to public disclosure that the methods are best considered complementary. Selective disclosure is more similar to the other private methods for deployment of information and may be a substitute for insider trading and, to a lesser extent, firm trading. A summarizing comparison of the methods for deployment of information with a focus on monitoring and deterrence is set out in Table 3.

---

348. *See, e.g.,* James D. Small III, W. Clayton Johnson & Leslie N. Silverman, *The Resurgence of United States at-the-market Equity Offerings to Raise Capital in Volatile Equity Markets*, 4 CAP. MARKETS L. J. 290 (2009); ADAM FLEISHER, JOON HUR & JESSE BRUSH, ALTERNATIVES TO TRADITIONAL SECURITIES OFFERINGS (2013), https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/alternatives-to-traditional-securities-offerings.pdf [https://perma.cc/P5ZL-D5UX]. The topic of firms trading their own stock while possessing value-relevant NPI has been analyzed by Fried, *supra* note 22, who proposes that firms should be subject to similar disclosure obligations as insiders when they trade their own stock. Fried also presents a more detailed overview of the disclosure rules applicable to firm trading than is possible in this Article.

349. Fried, *supra* note 22, at 814-15, 823-24; Small et al., *supra* note 348, at 302.

	Personal trading	**Firm trading**	**Selected investor trading**	**Market trading**
Disclosure type	Incidental	Incidental	Selective disclosure	Public disclosure
Antifraud rules applicable?	Yes	Yes	No[350]	Yes
Internal firm monitoring?	No	Yes	No	Yes
Market monitoring (through disclosure)?	Yes	No (only consolidated quarterly data)	No	Yes

Table 3. Anti-Fraud Applicability and Available Monitoring Methods

Analyzing the ability to monitor the different ways in which firms may cause informed trading in their stock, selective disclosure involves the least oversight and the most risk of managerial value appropriation. This is due to the inapplicability of the antifraud framework within the realm of Reg. FD (which allows for investor discrimination without consequential personal benefits to the manager) and the inability for anyone to monitor the disclosure event or the recipient's trading in the market.

Another interesting finding in the analysis above is that the value of the three private methods of disclosure will be higher if the quality of public disclosure is lower. A manager seeking to maximize the value of NPI for purposes of engaging in any of the three private deployment methods may thus prefer to have public disclosure of a lower quality.

The "pecking order" for a manager seeking to deploy information will likely depend on her level of ownership in the firm (as this

350. For selective disclosure favoring certain investors or analysts without consequential personal benefits to the manager, the SEC does not apply the antifraud rules. *Cf. supra* Section II.B (outlining the SEC's considerations in disapplying antifraud liability in Reg. FD); *supra* Section II.E (discussing how the Dell insider in *Newman* was never charged with any wrongdoing).

determines the relative attraction of participating in firm benefits over taking personal benefits) and the firm's and the manager's utility of bonding with investors. Managers may be particularly inclined to prefer selective disclosure in cases where their participation in firm benefits is relatively small and their personal utility of bonding with investors is comparatively large.

IV. RECONSIDERING SELECTIVE DISCLOSURE REGULATION

A. SELECTIVE DISCLOSURE AS A TRANSACTION

This Article has argued that Reg. FD does not currently work as intended because it offers corporate managers significant opportunities to provide material NPI to preferred investors. Although there have been reports to suggest that SEC officials have recently expressed interest in the details of private investor meetings,[351] the regulator has not yet taken any initiatives in this area. It may be suspected that calls for increased shareholder engagement have made the SEC reluctant to intervene for fear of being viewed as hampering shareholder engagement efforts.[352]

Viewing information as valuable property of the firm means that selective disclosure can be considered an intermediated stock sale or repurchase where the issuer provides the intermediary with a license to use its NPI to transact in its stock and the intermediary provides some value in return.[353] Selective disclosure is also inherently a conflicted-interest transaction, since a corporate manager selects investors upon

351. Charlie Gasparino, *Regulators May Expand Definition of Insider Trading*, FOX BUSINESS (Feb. 15, 2012), http://www.foxbusiness.com/industries/2012/02/15/regulators-may-expand-definition-insider-trading/ [http://perma.cc/CBL9-5F84] (noting that an SEC official expressed concern over issuer practices of one-on-one meetings and private calls in relation to Reg. FD); *see also* Kara Scannell, *SEC Pushes for Hedge-Fund Disclosure*, WALL ST. J., Sept. 19, 2007, http://www.wsj.com/articles/SB119013484429231164 [http://perma.cc/2F42-WCZW] (reporting that the SEC requested "a list of all 'one-on-one' meetings arranged at conferences sponsored by brokerage firms").

352. *See, e.g.*, Mary Jo White, Chair, Sec. & Exch. Comm'n, Speech at Society of Corporate Secretaries and Governance Professionals 69th National Conference: Building Meaningful Communication and Engagement with Shareholders (June 25, 2015), http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html [http://perma.cc/D9NM-RLJB]

353. While the *function* is an intervention in the market for the firm's stock, this is not observable to the manager; only the transaction with the intermediary is.

which to bestow the firm's valuable property, and these investors are in turn able to influence the manager's position when they elect directors and vote on executive compensation. Importantly, the SEC already has statutory authority to regulate both issuers' transactions in their own stock and conflicted-interest transactions.[354]

While the SEC has recently argued that general adoption of the personal benefit test as articulated in *Newman* would interfere with its ability to protect the "fairness and integrity of the securities markets,"[355] this is not necessarily the case. The SEC could itself remedy the root cause of *Newman*—disclosure by an employee of a public firm ostensibly for the benefit of the firm itself—by better aligning its Reg. FD with the Supreme Court's insider trading doctrine.

This Article proposes that the SEC should treat selective disclosure as a special type of conflicted-interest transaction. As with related-party transactions, participation in such can be beneficial to firms but these transactions also involve a managerial conflict of interest.

In considering how to regulate selective disclosure as a transaction, we should prefer a legal strategy that minimizes the risk that undesirable transactions will occur while maximizing the opportunity for desirable transactions to still take place, taking the costs of the various regulatory strategies themselves into account.[356] Investors would consider transactions where managers provide selected investors with valuable information in return for insufficient consideration to the firm undesirable, as they may be motivated by a wish to reward investors for past behavior or encourage future behavior that is favorable to managers.

In considering regulatory options, we can dispense with the alternative to prohibit selective disclosures because it would be a blunt method that would remove the potential benefits of private meetings. Ensuring approval by directors or some independent contingent or

---

354. If the SEC had considered selective disclosures to be conflicted-interest transactions when promulgating Reg. FD, it would perhaps have found it more suitable to regulate it akin to its treatment of related-party transactions where disclosure thresholds are based on absolute dollar amounts. Item 404 of Regulation S-K requires disclosure of related-party transactions in excess of $120,000 where related persons have a "direct or indirect material interest." 17 C.F.R. § 229.404 (2015).

355. *See* SEC Amicus Brief, *supra* note 260, at 2.

356. Luca Enriques, *Related Party Transactions: Policy Options and Real-World Challenges (with a Critique of the European Commission Proposal)*, 16 EUR. BUS. ORG. L. REV. 1, 13 (2015).

committee thereof would be practically impossible, since there is no way to actually review the information that will be or has been selectively disclosed. The same goes for shareholder approval. This Article will instead continue by considering how disclosure, one of the most powerful corporate law tools for curbing expropriation by managers,[357] may be utilized.

B. DESIGNING AN APPROPRIATE REPORTING OBLIGATION

This Article has identified several weaknesses in the current Reg. FD. In proposing improvements, the lack of information available to shareholders about significant disclosure mistakes should first be corrected. While Reg. FD encourages prompt public disclosure of the selectively disclosed information *itself* where a firm disclosed it by mistake, the lack of a requirement to report the *fact* that the firm made a disclosure mistake could be abused to regularly supply favored investors with material information without other shareholders being aware.[358] To remedy this problem, it is recommended that firms should be required to file a Form 8-K following such mistakes, noting when the information was originally disclosed and to whom. This new requirement would add significantly to the deterrence function of Reg. FD, as shareholders could then assess the quality of an individual firm's selective disclosure practices.[359] Furthermore, as Reg. FD intended but curiously failed to provide a mechanism for,[360] such a reporting requirement would also enable shareholders to see which firms exhibit a pattern of making mistaken selective disclosures. The inclusion of the identity of the recipient in the new Form 8-K requirement would also deter repeated

---

357. *See* Brudney, *supra* note 234, at 336 ("[A] prime function of the disclosure system . . . is to prevent a costly breach of a fiduciary duty to the corporation and its stockholders . . . ."). *See generally* Luca Enriques, Gerard Hertig & Hideki Kanda, *Related-Party Transactions*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 153, 155 (Reinier Kraakman et al. eds., 2d ed. 2009).

358. *Cf.* Brown et al. (2015), *supra* note 31, at 14 (quoting an analyst describing how managers have "figured out how to 'paper things up' [with an 8-K]").

359. Just as is currently the case, this could be done on the basis that the firm's disclosure is not deemed to be an admission that the information is material. *See* Adopting Release, *supra* note 7, at 51,723.

360. *Cf. supra* text accompanying notes 152–153.

disclosures to the same investors by allowing other shareholders to monitor such activity.

The substantial value invested in acquiring access to private meetings raises questions regarding the criteria managers use to select information recipients. Investors would be better placed to assess the risk of self-dealing and how managers use information as corporate property if firms disclosed their principles for shareholder and investor engagement. This information could be provided in their proxy statements. Such disclosure could include the methods employed for selection of investors and analysts to meet, the amount of meetings senior managers participated in during the previous year, the extent to which the firm employs quiet or close periods, as well as the firm's objectives or reasons for private investor meetings. Investors at large would also benefit from knowing whether firms meet with particular selected investors or analysts regularly, in order to assess management's choice of counterparties for ongoing relationships in information trading, whether for purposes of monitoring as envisaged in *Dirks*, provision of liquidity in the firm's stock,[361] or other reasons. This Article therefore recommends that the SEC consider such additional annual disclosure.

These proposals would improve the ability of shareholders to make a broad assessment of the risk of self-dealing in corporate property. Investors would, however, not be able to detect all disclosures of value-relevant or even material information in private meetings for three main reasons. First, firms themselves undertake the materiality determination and may use their discretion to place the threshold higher than the SEC or the courts intended.[362] Mistakes about materiality, whether honest or dishonest, in a private meeting where only one officer of the firm participates may never be discovered and disclosed to the market as the SEC intended. Second, information may be value-relevant even if it is not material under the securities laws.[363] Third, the SEC's enforcement activity in relation to Reg. FD may not create much deterrence and managers may consequently consider a violation as a project with

361. *See supra* note 51.

362. For an example, see Motorola Report, *supra* note 190, in which in-house counsel made an incorrect assessment of the application of the terms "material" and "nonpublic."

363. *See supra* Section I.A.

expected net positive value. To tackle these concerns, a more comprehensive approach is required.

This Article recommends that the SEC embrace the Supreme Court's treatment of corporate information as firm property by regulating selective disclosure as a conflicted-interest transaction. Following this approach, the SEC should recognize that firms may transact in their own information for the benefit of shareholders. It should also recognize that such transactions involve managerial conflicts of interest that are better assessed by the firm's shareholders than the SEC. Firms should consequently disclose private investor meetings as transactions in order to inform their shareholders and allow them to evaluate such meetings via the stock price.

An initial question about the design of a transaction reporting rule is which party should be required to disclose. One could consider a disclosure obligation placed on recipients of selective disclosure to the effect that they should disclose when they trade the firm's shares after receiving NPI from a firm, similar to the requirement on the firm's own directors and officers.[364] However, such a regime would quickly become unworkable when we consider that NPI may be relayed to other entities, for instance, by sell-side analysts, before it is used for trading. Tying the rule to trading activities would thus make it under-inclusive and easy to bypass through the establishment of informal chains for information dissemination. It appears most efficient to instead place the disclosure requirement on the SEC-registrant issuer, which ensures uniform disclosure that is easy to locate. Best practices in investor relations already involve keeping records of private meetings and other methods of selective disclosure,[365] so firms will already have a compliance framework in place to collect this data. For purposes of efficient enforcement, the SEC may also consider it useful to require investment managers and broker-dealers to keep internal records of their private interactions with public firms, in order for the regulator to have two sources to review in cases of suspicious trading activity.

In drawing up the revised regulation, the SEC would need to decide which transactions ought to be disclosed. Since the disclosing firm will not be aware of the value the recipient may derive from a transaction,

364. 15 U.S.C. § 78p(a) (2012).

365. GUIMARD, *supra* note 30, at 191.

this cannot form the basis for the disclosure threshold.[366] Similarly, it appears difficult to require firms to value the consideration received, since it is typically in intangible form such as loyalty or goodwill. Materiality is also not a suitable threshold for the three reasons outlined earlier in this subsection. Instead, the purpose of the transaction could serve as a screening device. The proposed disclosure obligation could thus target communications with securities market professionals, such as analysts and investors, as well as others that may be expected to trade in the market using the information. The boundaries of such a disclosure obligation could be refined to ensure that it only catches completed transactions in information. The SEC could, for example, stipulate that a firm that releases NPI by mistake in a private meeting be exempt from disclosing that as a transaction if the recipient agrees not to trade, since any trading in such a case would violate the insider trading prohibition.

The SEC will also need to consider what information ought to be reported about the information transactions. It must be recognized that it would be a large administrative burden to require managers to keep detailed notes of conversations.[367] It is also undesirable to publicize the details of private discussions, as it may cause managers and investors to participate in fewer beneficial meetings. To accomplish deterrence of undesirable transactions, it should be enough to require disclosure of the fact that an information transaction occurred. Additionally, although it is not feasible to require details on recipient trading to be publicized, shareholders should be given the opportunity to assess the value conferred by managers. Thus, it seems reasonable to include in the transaction reporting some standard details about the meeting such as the identity of the counterparty, date, start and end time, and a brief description of the corporate purpose of the meeting. These details will allow shareholders to determine whether the firm is communicating with investors before it issues public disclosures, which would indicate that it is monetizing NPI that will be publicly disclosed in the short term.[368] Such transaction reporting will assist shareholders and investors in their assessment of whether managers are undertaking beneficial transactions,

---

366. *See supra* text accompanying notes 284-285.

367. *But cf.* Solomon & Soltes, *supra* note 42 (suggesting firms should publicly provide transcripts of private meetings).

368. As even firms that claim to have quiet periods do not abide by them (see Section III.D.2), disclosure of dates and times of private interactions is necessary to give shareholders the correct view of how managers monetize firm property.

the risk of managerial self-dealing, as well as the amount of asymmetric information to expect in the market for an individual firm's stock.

Selective disclosure transactions could be reported at regular intervals with some delay, for example, quarterly or semi-annually, as the purpose is not to prevent recipients from profiting on the information or to allow non-participating investors to trade on it, but to provide investors with the tools to assess the risk of self-dealing and ability to exercise oversight of how managers are using NPI as the property of the firm. The SEC could stipulate that firms make this information available on their websites. The SEC could also allow firms or investors to request that particularly sensitive meetings be anonymized for some period. From the perspective of the recipients, the publicity of the fact that they have met management should be a small price to pay for an information advantage provided by the firm and indirectly paid for by its shareholders as a group.

C. BENEFITS OF INCREASED TRANSPARENCY

Public enforcement is costly and difficult to the point where the SEC appears subdued, concluding an enforcement action biennially at the current rate. At the time of writing, the SEC is on a record run of over three years without Reg. FD enforcement actions. While the SEC imposes penalties at a frequency and magnitude unlikely to produce much deterrence, the fact that the stock market reacts negatively to announcements of Reg. FD violations may be a more effective deterrent.[369] Firms who are seen to be engaging in selective disclosure practices that shareholders consider undesirable or inefficient may see their share prices decline. However, firms that meet with skillful investors who have a reputation for diligent monitoring may instead see their stock prices react favorably.[370] With the new framework proposed

---

369. *Cf.* Jeffrey N. Gordon, *Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley*, 35 CONN. L. REV. 1125, 1131-32 (2003) (positing that the "explicit monitoring by the boards of directors" may be complemented by "implicit monitoring by the market," and noting that firm disclosure policies may impact the quality of market monitoring). See Section II.C, *supra*, for the discussion of how share price losses on the announcement of Reg. FD violations are larger than the penalties imposed by the SEC.

370. The stock market is able to attribute reputation value to actions by investors who have better track records; *see* C.N.V. Krishnan, Frank Partnoy & Randall S.

herein, such firms can credibly distinguish themselves from firms with worse disclosure practices and will have a clear incentive to do so. The requirement to disclose meeting details would consequently both deter undesirable behavior and reward prudent behavior.

Another benefit stems from the difficulties the SEC is facing under the current Reg. FD that relate to tracking the flow of information, an activity which is very expensive. The new framework would make SEC enforcement easier by providing the opportunity to review transactions to ascertain whether they were conducted using material NPI. It would also allow other market participants and the media to review disclosure transactions, similar to how insiders' transaction reporting obligations allow for efficient scrutiny and deterrence. From an SEC enforcement perspective, the suggested shift in focus to the information *transaction* rather than the information *itself*, could also be easier to enforce: since at least two parties are required for selective disclosure, a requirement to keep records of the basic details of meetings would allow the SEC to inspect records of either party to ensure firms' public disclosures are correct.[371] Requiring analysts and investors to keep records of their non-public interactions with public firms, with penalties imposed for failures to do so, would also allow the SEC to break the circularity problem that plagues the enforcement of securities actions.[372] By requiring such third parties to keep records, against which the disclosures of public firms can be verified, the probability of full disclosure by the public firms themselves increases.

This Article does not suggest that there is any magic formula of meetings or a certain type of investor that firms ought to be meeting with. Depending on their individual circumstances, firms would be expected to establish different strategies for deployment of their information. Some firms may wish to selectively disclose information to specific analysts who have high credibility in order to disseminate some

---

Thomas, *The Second Wave of Hedge Fund Activism: The Importance of Reputation, Clout, and Expertise* (Vanderbilt Law & Economics, Research Paper No. 15-9, 2015), http://ssrn.com/abstract=2589992 [http://perma.cc/6PR7-3JM4].

371. Given the collective action problem among active investors, discussed in Section III.D.1, *supra*, the transaction reporting approach proposed herein would instead allow public enforcement to be focused on the quality of firms' public disclosures, in order to ensure that they are not unduly convoluted to increase the value of private disclosures.

372. *Cf.* Arlen & Carney, *supra* note 197 and accompanying text (describing how monetary penalties may not deter if ultimately paid by innocent shareholders).

specific datum to the market, while other firms may desire higher liquidity in their stock and meet with certain investors for that purpose.

A secondary effect of a regulation that permits firms to acknowledge that they monetize their NPI will also be that firms can be transparent with shareholders and disclose details on their process for selecting which investors to meet with, what the purposes of such meetings are, and how they benefit the firm. Transparent treatment of corporate transactions in NPI should lead to a more transparent market for its transfer and to more efficiently priced transactions in information. Transparency will also improve the stock market's monitoring ability, which in turn increases the likelihood that managers will be deterred from entering into undesirable NPI transactions.

Furthermore, this Article is agnostic about the suitable placement of the materiality threshold employed for Reg. FD enforcement in an environment where firms inform investors of the scope of their information transactions. It instead considers the main problems with selective disclosure to be the risk of unmonitored self-dealing and the absence of internal and external oversight of significant corporate transactions. For example, if a firm were to inform investors that it may sell its quarterly results announcements a week in advance to one selected investor via an auction, the bid-ask spread should adjust to account for this. As the SEC's current enforcement fails to produce deterrence, the SEC could instead consider whether its oversight should be replaced by transparent disclosure practices by firms. The idea is simple: investors cannot be deceived if firms are fully transparent about their selective disclosure transactions, and with full transparency the SEC can shift its focus from undertaking complicated and expensive investigations into the details of private conversations, which at best result in miniscule penalties unlikely to produce deterrence, to ensuring that firms provide complete reporting of their selective disclosure transactions.

Another efficiency benefit of the new framework is that it allows analysts and other information traders the opportunity to assess the amount of current information trading in a firm's stock supplied by the firm itself. This transparency may help direct analyst resources to the firms offering the most promising opportunities for information trading.

The new framework would also inform shareholders about the amount of investor monitoring in firms. Since managers choose their own monitors and meetings are entirely private, investors at large are currently unable to distinguish firms whose managers subject themselves to more frequent monitoring by expert investors from firms where managers are not participating in private meetings at all, do so only rarely, or only meet investors with little skill or interest in monitoring. Giving shareholders information about selective disclosure events would consequently increase the likelihood that the benefits of selective disclosure that the Supreme Court envisaged in *Dirks* actually accrue to shareholders at large.

Finally, while this Article is focused on federal securities regulation, the disclosure of transactions in firm information may provide shareholders with information they currently lack to pursue claims under state corporate law.[373]

D. COSTS OF INCREASED TRANSPARENCY

One cost of the new framework is that some firms could currently be transacting in private information with many investors who all believe they have a unique level of management access. When such firms need to disclose their information transactions, some investors may realize that they do not have a privileged position for information trading and decide to participate in fewer meetings. However, this is not necessarily a social loss since the reporting obligation may deter unnecessary activity.

Disclosure is generally seen as a relatively inexpensive regulatory strategy. The proposal involves additional costs for record-keeping and publishing, but this would not be expected to impose a significant burden.[374]

As with any regulation, there is a risk of over-deterrence. The aim of the proposed regulation is to deter selective disclosure transactions which reduce firm value (as judged by stock market investors) but there is no reason to fear that increased disclosure would deter favorable transactions. For this reason, the revised rule would not have any significant negative effects on market efficiency.

Over-enforcement could also be a risk. However, the current Reg. FD offers no private right of action, and this proposal would not do so

---

373. Delaware courts have long considered insider trading a breach of the duty of loyalty. *See* Brophy v. Cities Service Co., 70 A.2d 5 (Del. Ch. 1949). For a more recent confirmation of this principle, see *Pfeiffer v. Toll*, 989 A.2d 683 (Del. Ch. 2010). The application of state law is outside the scope of this Article.

374. *See supra* note 365 and accompanying text.

either. Enforcement of full selective disclosure transaction reporting is envisaged via the SEC, which can hardly be blamed for over-enforcing the current Reg. FD. The aim is to allow the SEC to let the market penalize undesirable selective disclosures, so that the regulator only needs to take action when it notices transgressions that may constitute insider trading.

E. Implications for Other Research

This Article will conclude by noting its relevance to some other ideas. The recent removal of the requirement for European Union firms to publish quarterly reports appears to have been met with approval by at least one influential commentator in the United States.[375] This Article has argued that public disclosure is one of several methods for corporate managers to deploy NPI and that a reduced amount of public disclosure will increase the value of the information under managers' control. This is particularly so in the U.S., where federal securities regulation does not, in contrast to European rules, contain a general requirement for immediate disclosure of material information. Accordingly, fewer public disclosures would be expected to intensify investor demand for private meetings and consequently increase the utility of the new disclosure obligation advocated herein.

Finally, to end with a wider perspective, this Article has reviewed an activity in which only active investors, by definition, participate. While firms may derive important benefits from selective disclosure of information, active investors also expend significant resources to obtain private information from public firms. While the amount of money spent compensating brokers for provision of corporate access services is notable, it must be the case that amounts several magnitudes greater are spent by active investors on procuring and attempting to profit from private information, considering that they require private information to outperform and survive in the long term. Active investment activities can improve price discovery and the efficient allocation of resources in

375. *See* Martin Lipton, *Legal & General Calls for End to Quarterly Reporting*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG., (Aug. 19, 2015) http://corpgov.law.harvard.edu/2015/08/19/legal-general-calls-for-end-to-quarterly-reporting [https://perma.cc/CA7S-35HJ].

society but active investment products can still be overproduced.[376] From the perspective of the ultimate investors in active investment vehicles, the risk is that private investor meetings manifest a collective action problem where investment managers participate in an expensive and largely futile pursuit of private information instead of agreeing on a general demand for public firms to issue high-quality public disclosure for common benefit. As this collective action problem may even result in investors with private access demanding less public disclosure,[377] improved transparency of the extent to which managers of public firms and professional investors engage in these activities could provide a positive externality by allowing ultimate investors the opportunity to assess the scale and perceived utility of private investor meetings as a phenomenon. At the same time, neither active investors nor corporate managers would be expected to support a proposal as outlined herein, since the current regulatory framework affords them significant discretion to effectuate value transfers from other investors. Such conflicts highlight why disclosure regulation needs to be mandatory.

CONCLUSION

This Article has aimed to do four things.

First, it has tried to introduce the phenomenon and function of investor meetings, show that it is an activity that both firms and investors spend significant resources on, and that it is useful and interesting to review the practices that have been established within the investor relations field from a securities law perspective.

Second, it sought to show that the current regulation of selective disclosure fails to deter violations. It did so by showing that Reg. FD does not fulfill its stated purposes and that corporate managers can hand out very valuable information to favored investors at a very low expected cost to themselves.

Third, it suggested that we ought to place further emphasis on agency costs within the disclosure system. Building on the Supreme Court's recognition that firm-specific NPI is the firm's property, it suggested a classification of the various methods in which a corporate

---

376. French, *supra* note 330, has estimated that society's capitalized cost of active investing (which includes all active investment strategies and not just those where investors meet with managers) exceeds 10% of the capitalization of the stock market.

377. *See supra* Section III.D.1 for the discussion of collective action problems.

manager as agent may consider her alternatives for deployment of the firm's information. Reviewing the regulation of these alternative methods, it found selective disclosure to be an attractive method for managers and their favored investors to extract private benefits from public firms.

Finally, the Article suggested that it would be more efficient if a method was introduced that allowed for oversight over managers' dealings in their firms' valuable information. It proposed that a selective disclosure event should be treated as a transaction that is similar to equity raising from uninformed shareholders and susceptible to conflicted managerial interests, and that firms should be required to report such transactions in order to allow shareholder oversight and investor assessment via the stock price.