

June 13, 2000

The Honorable Isaac C. Hunt, Jr.
Commissioner, United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Commissioner Hunt:

We are writing in response to your speech at the 20th Annual Ray Garrett, Jr. Corporate and Securities Law Institute on April 13, 2000. In your remarks you suggested some possible modifications to proposed Regulation FD, and invited responses to your suggestion. The purpose of this letter is to take up your invitation.

On many levels the Regulation FD proposal conflicts with the Supreme Court's views in Dirks v. SEC. The Court emphatically recognized that analysts play a role "necessary to the preservation of a healthy market" because they "ferret out and analyze information ... by meeting with and questioning corporate officers and others who are insiders." Nowhere in Regulation FD or its proposing release does the Commission seriously address or even consider the corollary stated by the Court, that "it is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally." Instead, Regulation FD essentially adopts the "idea that the [securities laws] require equal information among all traders," an idea that the Court roundly rejected in the context of the antifraud provisions. Nor does the proposal take account of the Court's warning, issued in Chiarella v. United States and repeated in Dirks, that " 'formulation of an absolute equal information rule' should not be undertaken absent some explicit evidence of congressional intent."

Below we will summarize what we see as the core concerns raised by commenters about Regulation FD, point out dangers and benefits that we see in some of the proposals that have been made to address the flaws in Regulation FD, and then respond directly to your suggestions.

The Fundamental Problem with Regulation FD

If there is one statement on which all sides of the debate on Regulation FD can agree, it is your observation that "this is not an easy problem to solve and . . . in adopting a solution, I believe we should take some advice from the medical profession: 'First, do no harm!'" We strongly concur with your concerns that Regulation FD, in its current



form, could do more harm than good. Regulation FD will pose the risk of an SEC enforcement investigation over every nonpublic communication between corporate officials and outsiders, whether they are analysts, investors, the news media or rating agencies. Corporate officials will seek to involve legal counsel to a much greater degree in all such communications, and the standard advice of counsel will be to limit such contact, and to communicate as little as possible where contact is unavoidable.

An illustration of how such a chilling effect can arise is the issue of U.S. news media access to foreign press conferences. Foreign issuers conducting an offering or tender offer outside the United States for many years were advised by their U.S. counsel to exclude the U.S. news media from those press conferences. The reason for this advice was that by including the U.S. media, the foreign issuer might trigger an SEC investigation into whether the issuer meant to extend its offer indirectly to U.S. investors without observing U.S. registration or tender offer requirements or attempting to condition the U.S. market. Senior SEC staff consistently stated for years that they would not bring an enforcement action against a foreign issuer in such circumstances.¹ These assurances were never sufficient to dispel this concern, and the U.S. media continued to be excluded on advice of counsel. As a result, U.S. new media organizations sought, and ultimately achieved, passage of federal legislation to ensure that providing the U.S. financial press with access to foreign merger and acquisition press conferences would not trigger this obligation.² It was only then that the chilling effect of regulatory ambiguity was finally dispelled.

The same dynamic will likely occur under Regulation FD as occurred with these press conferences: a regulatory requirement of uncertain scope leads to cautious legal advice to clients, regardless of any assurances from the SEC staff that they will be reasonable in enforcing the requirement. Regulation FD will thus dampen the flow of information to all of those who gather and distribute it, including the financial press as well as analysts and advisers to institutional investors.

The comment letter file reveals that our concerns about the potential chilling effect of Regulation FD are shared by other parties likely to feel the negative effects of the rule. As Dow Jones & Company stated in their comment letter: “[T]he Proposed Rule could have a devastating impact on . . . the dissemination of timely and accurate information to the investing public. . . . Candor, informality and speed, all important to the interviewing and newsgathering process, would be buried under legal caution and

¹ See Preliminary Note 7 to Regulation S, and Reuters Holding plc, SEC No-Action letter (March 6, 1990).

² See Section 109 of the National Securities Markets Improvement Act of 1996 and Securities Act Rule 135e.



timidity.”³ Notably, every major group representing the private securities bar that has commented has also voiced this as their fundamental concern.⁴ While we have not read all of the roughly 5000 letters that were filed, we have read as many as possible, and have not found a single letter from any investor or other market participant that substantially refutes this concern.⁵

Issues Posed by Proposals for Changing Regulation FD.

We will not attempt to catalogue all of the many suggestions made by commenters for cures to the ills of Regulation FD. We would like to highlight some suggestions that we think might minimize some of the Rule’s more egregious problems, as well as one suggestion that we think would make the rule far worse.

As we and other commenters have suggested, some of the more egregious problems with Regulation FD that particularly deserve attention if it is to be adopted in any form include its dependence on the amorphous concept of materiality, and its application to (i) foreign governments, (ii) foreign private issuers, (iii) persons acting on behalf of an issuer below the level of senior officers or employees designated to speak to the press or investors, (iv) outside directors, (v) the measurement of the 24 hour “prompt

³ Letter to Jonathan G. Katz from Peter G. Skinner, Dow Jones & Company, Inc., April 28, 2000 (available at www.sec.gov/rules/proposed/s73199/skinner1.htm). *See also, e.g.*, letters to Jonathan G. Katz from Robert C. Puff, Jr., American Century Inc., Arthur Zeikel, Association for Investment Management and Research (April 26, 2000), Brian T. Borders, Association of Publicly Traded Companies (April 26, 2000), Irshad Karim, The Bond Market Association (April 28, 2000), John J. Goggins, Moody's Investors Service, Inc., (April 27, 2000), Vicky A. Tillman, Standard & Poors (April 17, 2000), Bonnie Burdett Dennis, National Investor Relations Institute (April 11, 2000), Jeffrey S. Sherman, American Home Products (March 29, 2000), Dina Kennedy, National Federation of Municipal Analysts (March 27, 2000).

⁴ *See* letters to Jonathan G. Katz from Stanley Keller, Karl A. Groskaufmanis and Richard E. Gutman, Committee on Federal Regulation of Securities, Business Law Section, American Bar Association (May 8, 2000), Steven J. Schulte and Richard A. Drucker, Committee on Securities Regulation, Association of the Bar of the City of New York (April 28, 2000), Guy P. Lander, Committee on Securities Regulation, New York State Bar Association (April 28, 2000), Cleary Gottlieb, Steen & Hamilton (April 28, 2000), Corporation, Finance and Securities Law Section, District of Columbia Bar (April 28, 2000), Sullivan & Cromwell (April 28, 2000).

⁵ As you noted in your speech, the overwhelming majority of the letters in the comment letter file provide “little... input regarding some of the questions the Commission raised in its proposing release,” and in many cases offer no evidence that the author has even read the proposal. While there is an enormous amount of e-mail traffic of this type favoring the proposal, we think that any objective person who carefully surveys the comment letter file will conclude that the preponderance of serious comment letters leans strongly against the proposal. We have every confidence that the Commission will rely on its own expertise to assess the best public policy in this matter, rather than bend to populist sentiment regardless of the actual merits.



disclosure” requirement,” (vi) information transmitted to governmental recipients, (vii) eligibility for shelf registration and Rule 144, and (viii) communications in connection with other offerings. Your suggestions addresses some of these concerns, as do the letters of many of the commenters cited earlier in this letter.

One suggested change to Regulation FD that we find highly objectionable is the idea that Regulation FD can be fixed by the expedient of exempting the news media and rating agencies from its coverage. This would be grossly unfair and anti-competitive, turning the title “Fair Disclosure” into a complete misnomer. These groups are competitors of securities analysts, particularly with regard to retail investors, and the SEC should not write rules that give competitive advantage to one group over another. Analysts and reporters (and to some degree rating agencies) are increasingly part of a seamless web performing the same general economic function – digesting and transmitting information from issuers to investors. The primary distinction between them is the business model under which they operate (analysts provide highly detailed information and related analysis and forecasts to intermediaries such as mutual fund managers or retail brokers for the ultimate benefit of a financial institution’s retail and institutional clients, while financial reporters provide less elaborate information directly to the investing public via a media outlet). The growing availability of analysts and their reports over cable television and the Internet demonstrates that the functional distinctions between these groups are blurring as the competition to get information efficiently to the markets becomes more intense. Any regulatory approach that creates a regulatory franchise favoring information flows to one group over another will weaken this healthy competition and will disserve investors.

Response to Your Comments

The comments that you put forward in your remarks at the Garrett Institute are a thoughtful attempt to fix some of the more obvious flaws with Regulation FD. Some of your suggestions would help to improve the rule in some respects. Particularly, we agree with recommendations 1 (excluding communications made in connection with an offering of securities), 2 (limiting Regulation FD to communications made by senior management or Investor Relations personnel), and 6 (allowing companies to comply with Regulation FD via a conference call or webcast open to the public, provided that a transcript or summary is submitted to the SEC within two business days).

Recommendations 4 and 5 would accomplish little to improve the rule. Recommendation 4, that companies can make public disclosure through filing Form 8-K, would satisfy neither the Rule’s proponents nor its critics. As we pointed out in our comment letter of April 6, 2000, there is great disparity in the ways that information contained in Form 8-K reaches the market, and so relying on this as a means of public disclosure could perpetuate a disparity of disclosure. Moreover, a flood of 8-K filings prompted by Regulation FD would clutter up shelf registration statements and add unnecessary complications to directors’ and underwriters’ due diligence burdens. We



agree with your statement that, in any event, "I would expect few companies to choose

Recommendation 5, that companies can satisfy the rule by submitting the material information to the SEC within two business days, provided that the recipients have agreed to keep it confidential for that period, is also unlikely to be used with any frequency. As we pointed out in our April 6, 2000 comment letter, there are enormous practical problems with confidentiality agreements in these situations that make it unlikely that very many analysts or investors will ever enter into them.

More importantly, your suggestions would not cure the fundamental problem that Regulation FD will disrupt the flow of information to investors. Recommendation 3, that "Regulation FD would apply only to material communications made to analysts or institutional investors" would in our view actually make the rule worse, because it would preserve the smothering effect that the rule would have on those communications while giving the financial press an unfair competitive advantage.

Viewing your suggestions alongside those that we and other commenters have offered, it is obvious that it is not easy to address the problems created by Regulation FD. At the end of the day, if Regulation FD is adopted in any form, the capital markets will be left either with a simplistic rule that raises many subtle and far-reaching problems, or a very complex rule that tries to patch up the problems that it creates, but inevitably raises approximately as many new issues as it resolves.

Conclusion

We applaud you for your intense interest in this complex subject. We believe that your suggestions, as well as other approaches to curbing the harmful effects of the Regulation FD proposal represent valiant attempts to fix a deeply flawed regulatory approach. In anything like its current form Regulation FD will do more harm than good.

Please contact us or George Kramer of the SIA staff at 202-296-9410 if you would like to discuss this further.

Sincerely,

Lee B. Spencer, Jr.
Chairman,
Ad Hoc Working Group
On Proposed Regulation FD

Stuart J. Kaswell
Senior Vice President and
General Counsel

Cc: The Honorable Arthur Levitt, Chairman
The Honorable Paul R. Carey, Commissioner



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The Honorable Laura S. Unger, Commissioner
David Becker, General Counsel, Office of General Counsel
Meyer Eisenberg, Deputy General Counsel
Harvey Goldschmid, Adviser to the Chairman
Steven Cutler, Deputy Director, Division of Enforcement