|  |
| --- |
|  |
| **Analyst independence the issuer perspective.**Source: http://static.accessmylibrary.com/aml2006/images/icn_source.gifInsights: The Corporate & Securities Law AdvisorPublication Date: 01-NOV-03The numerous enforcement and regulatory actions involving securities analysts over the past two years generally have focused on their behavior of investment banking firms and their analysts. Issuers should be on notice, however, that many of the new rules apply to issuers and management in their dealings with analysts. \*\*\*\*\*\*\*\*\*\* Scrutiny of analyst-issuer relationships and related conflicts of interest began as early as the 1990s. Voluntary initiatives, enforcement actions, settlements, and regulatory changes during 2002 and 2003 have collectively left the industry on a significantly different playing field today. Much of the regulatory attention to date, and the commentary thereon, has focused on the behavior of investment bankers and analysts, impacting issuers only indirectly. With so much of the heat focused on investment banking firms, issuers may be left with the impression that they have few affirmative duties or responsibilities; that they can avoid liability even if their underwriters and analysts fail to comply with the rules. However, many of the rules, both new and old, directly apply to issuers and management in their dealings with analysts. Overview of Recent Regulatory Activity Perhaps the most sweeping regulations applicable to analysts are the New York Stock Exchange (NYSE) and National Association of Securities Dealers (NASD) rules, first approved by the SEC in May 2002 with later amendments approved in July 2003 (the SRO Rules). (1) The SRO Rules regulate the behavior of SRO member firms by, for example, limiting the relationship and communications between the investment banking and research departments of financial firms, restricting certain types of communications by analysts with the issuers they cover, regulating analyst compensation schemes, restricting analyst personal trading in securities they cover and requiring disclosure by analysts of conflicts of interest they or their firms have with covered issuers. The Sarbanes-Oxley Act of 2002, directed the Securities and Exchange Commission to promulgate regulations similar in scope to the SRO Rules and this mandate has been satisfied by the recently approved amendments to the SRO Rules. (2) In addition to approving the SRO Rules, the SEC promulgated Regulation AC in February 2003, which requires research analysts to disclose certain conflicts of interest they or their firms have with the issuers on which they report. (3) Settlements arising out of recent government investigations and actions against several Wall Street firms also have resulted in limitations on the analysts employed by such firms. Merrill Lynch's settlement with the New York Attorney General and the settlement by Merrill and nine other Wall Street firms with the NASD, NYSE, New York Attorney General, and other state regulators (the Global Settlement) require the covered firms to, among other things, sever links between research and investment banking and to furnish independent research. (4) Issuer Day-to Day Communications with Analysts Corporate managers have traditionally participated in a personal back-and-forth with the analysts covering their companies to confirm and supplement information collected by the analysts from public and other secondary sources. For example, executives typically reviewed and commented on draft research reports, including earnings estimates, allowing the providing analyst to refine the reports and estimates in response to company reactions. As an ideal, analysts were seen as contributing to the efficiency of the market. Historically, analysts have been viewed as facilitating the flow of information from the companies they investigate down to the persons who invest, or may wish to invest, in those companies. Analysts perform their role by searching for and analyzing corporate information to produce reports that describe the subject company, locate it within its industry and provide predictions, including, most importantly, estimates of the company's future earnings. Regulatory Focus on Selective Disclosure Regulation FD (Fair Disclosure), effective as of October 23, 2000, (5) perhaps has had the most sweeping and direct effect on previously common practices of issuers' day-to-day communications with analysts. The SEC adopted Regulation FD to curtail the practice of issuers selectively disclosing information to analysts and thereby did not fully accept the ideal that analysts served a special role in the dissemination of corporate information to the markets. The SEC stated in adopting Regulation FD:  Although analysts play an important role in  gathering and analyzing information, and disseminating  their analysis to investors, we do not  believe that allowing issuers to disclose material  information selectively to analysts is in the  best interests of investors or the securities markets  generally. Instead, to the maximum extent  practicable, we believe that all investors should  have access to an issuer's material disclosures at  the same time. (6) Regulation FD generally requires that if an issuer discloses any nonpublic material information to analysts (and other market participants specified by the rule (7)) the issuer must simultaneously disseminate that same information to the investing public. The regulation does not define the terms "material" and "nonpublic," but relies on existing definitions of these terms established in case law. (8) However, the FD Final Release specifically enumerates nonpublic "earnings information" as part of a non-exhaustive list of types of information that are often, though not necessarily in all cases, material. The FD Final Release also warns that  When an issuer official engages in a private discussion  with an analyst who is seeking guidance  about earnings estimates, he or she takes on a  high degree of risk under Regulation FD. If the  issuer official communicates selectively to the  analyst nonpublic information that the company's  anticipated earnings will be higher than,  lower than, or even the same as what analysts  have been forecasting, the issuer will likely have  violated Regulation FD. This is true whether the  information about earnings is communicated  expressly or through indirect "guidance," the  meaning of which is apparent though implied.  Similarly, an issuer cannot render material  information immaterial simply by breaking it  into ostensibly non-material pieces. In the wake of Regulation FD, previously common practices have been called into question, including issuer reviews of analyst reports and issuer calls and meetings with selected analysts or institutional investors that are not open to the public. (Editor's note: see SEC recent enforcement action against Scherig-Plough Corporation and its former CEO, SEC Litigation Release No. 48461, September 9, 2003.) Issuer communications with analysts on topics other than earnings estimates also must be carefully controlled by the issuer to comply with Regulation FD. The SEC has stated that an issuer is not prohibited from disclosing a non-material piece of information to any analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a "mosaic" of information that, taken together, is material, when an issuer discloses immaterial information whose significance is discerned by the analyst. (9) Such statements afford little comfort to an issuer seeking to comply with the regulation. Because the materiality of information often is judged with hindsight, many issuers choose to treat virtually all private communications with market professionals as involving material nonpublic information. Limitations on Issuer Review of Analyst Research Reports Issuers will no longer be presented with full draft research reports to review because the member firms of the NASD and NYSE are now prohibited from submitting research reports to the subject company prior to publication, except on a limited basis for the purpose of verifying facts. (10) It is noteable that a Senate committee recommended in October 2002, that all sharing of research reports with subject companies should be prohibited, though this approach does not appear to have been adopted to date. (11) Under the new rules, issuers may be asked to review selected factual portions of a draft research report or may receive fact-checking inquiries from their analysts, but should never receive any draft or excerpt containing a research summary, research rating, or price target. Though issuers are not subject to enforcement under the SRO Rules, receipt by company management of draft research report material should be handled carefully with an eye toward compliance with Regulation FD. For example, because earnings and related predictive information is treated with heightened sensitivity under Regulation FD, issuers who receive such information will probably want to seek advice of counsel with respect to treatment and documentation of the destruction or return of the material and future communications with the offending analyst. It is likely that many issuers will choose not to respond to even factual review requests to avoid risking an in-advertant disclosure of material nonpublic information. Issuers who do receive factual excerpts for review may wish to confirm, prior to such review, that the analyst has complied with the SRO Rules by having the full draft report reviewed by the analyst's internal legal or compliance department. However, issuers have no obligation under the SRO Rules to make any such confirmation. Issuers should also be aware that, if, after submitting sections of a report to the subject company, the analyst intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, the analyst's internal legal or compliance personnel for the change. Issuers should expect the analyst's legal or compliance personnel to review contacts at all levels with the issuer to determine the basis for any change. Finally, company management will be notified of an analyst's decision to change his or her rating only after the close of trading in the issuer's principal market, on the business day before the research analyst announces the rating change. Selective Disclosure under Rule 10b-5 Though it is likely that Regulation FD has eclipsed Rule 10b-5 as the focus of SEC enforcement against selective disclosure, issuers should be aware of the nexus between the two. Prior to Regulation FD, the SEC sought to regulate selective disclosure by issuers to analysts under Rule 10b-5 using an unlawful tipping analysis. (12) Court interpretations of Rule 10b-5 in this context, however, recognized analysts as valuable to the marketplace and stopped well short of prohibiting selective disclosure to analysts as a rule. (13) Namely, a corporate executive violates Rule 10b-5 if he or she discloses material nonpublic information in a situation when the disclosure would confer a personal benefit on the executive, directly or indirectly, including any "pecuniary gain or a reputational benefit that will translate into future earnings." (14) The application of this rule to corporate executives' communications with analysts, especially when actual or potential conflicts of interest are involved, is an open question, especially in light of the broad scope of the "personal benefit" prong of the test. Indeed, in 1991, the SEC invoked this rule and alleged that the CEO of Ultrasystems violated Rule 10b-5 when he disclosed nonpublic quarterly results and earnings information to analysts under circumstances in which he allegedly believed the disclosures would protect and enhance his reputation as a corporate manager. (15) The SEC has acknowledged, however, that many commentators believe that issuer communications with analysts serve valid corporate purposes and that a personal benefit to the disclosing executive under Rule 10b-5 would be difficult to establish in this context. (16) Regulation FD was adopted as a disclosure rule and not an antifraud rule and the regulation makes clear that it does not establish a duty for purposes of Rule 10b-5. When the regulation is violated by a company executive, the SEC could bring administrative action seeking a cease and desist order, or a civil action seeking an injunction and/or civil penalties. Senior officials and other individuals at an issuer will face liability under Regulation FD if it can be shown that they knew or were reckless in not knowing that information they disclosed was both material and nonpublic. (17) Though violation of Regulation FD alone will not give rise to an enforcement action or shareholder lawsuit under Rule 10b-5, issuers and executives can expect that a violation of Regulation FD would be presented and considered in a fraud suit. Public Offering Process; Issuer Road Shows The public offering process is another area in which issuers can expect to see a significant change in the traditional role of analysts as a result of recent developments. Issuer road shows, a tradition established in the 1970s, typically consist of a series of meetings held in major US cities, at which the underwriter introduces the issuer and its management to selected institutional investors, portfolio managers, analysts and securities sales personnel as part of the marketing effort preceding a public offering. (18) Road shows typically occur during the "waiting period" between when the issuer files a registration statement and when the SEC declares it effective. In the IPO context, analysts affiliated with the lead underwriter were often called on to review the issuer's internal projections in order to formulate earnings estimates to be presented during road show meetings and in other sales efforts by the underwriter. In IPOs as well as offerings of already public issuers, analysts typically also assisted in the underwriter's due diligence process, advised on how to present the issuer in the prospectus and provided other related assistance. Following the offering, analysts employed by the lead underwriter typically provided continuing reporting coverage of the issuer. Due to their important role in the offering process, analysts also have been used by investment banking departments to solicit underwriting business--issuers often selected an underwriter that employed a rated analyst with expertise in the issuer's industry. Issuer Communications "In Connection With" an Offering As outlined, despite the SEC disclosure regime applicable to the public offering process, issuers traditionally have shared enough information with underwriter's analysts to allow earnings estimates to be presented by such analysts during road show meetings. Regulation FD does not apply to issuer communications made "in connection with" a registered offering. However, due to the unsettled nature of the rules surrounding analyst involvement in the offering process, issuers must be cautious concerning their communications with analysts when in registration. First, the SEC disclosure regime and the civil liability provisions of the Securities Act already place significant limitations on issuer selective disclosure of material information in connection with a registered offering. (19) This regime generally provides that prior to the filing of a registration statement, offers to sell a security are prohibited in any form. After a registration statement has been filed, but prior to its effective date, oral offers are permitted, but written offers may only be made by means of the "red herring" filed as part of the registration statement. The term "offer" has been broadly defined and interpreted to restrict any communications that could be considered "conditioning the market" for the sale of the security. Second, the SEC has not explained what issuer communications with analysts would be considered to be made "in connection with" an offering. It does not appear safe to assume that traditional road show practices are permitted under Regulation FD. For example, an issuer's inviting analysts to road show presentations who are unrelated to underwriters may be considered selective disclosure under Regulation FD. This seems clear in light of the SEC's example that issuer statements made during a regularly scheduled conference call including analysts would not be considered to have been made "in connection with" an offering simply because the call is held while the issuer is in the midst of a registered offering. The level of information that issuers may share with the underwriter's analysts, however, is less clear. For example, the SRO Rules allow analysts to assist in their firms' due diligence conducted in connection with the offering process and also permit "other activities traditionally associated with research functions that do not involve solicitation of investment banking, such as helping to screen potential investment banking clients." (20) This and the fact that underwriter-employed analysts are subject to new and lengthier post-offering quiet periods may bolster arguments that an issuer's sharing information with an analyst in connection with an underwriting should be considered permissible and outside the prohibitions of Regulation FD. (21) For issuers using one of the 10 firms covered by the Global Settlement, the answer may appear simpler because their research analysts are prohibited from participating in road shows. (22) Although this prohibition may become more broadly applied in the industry, voluntarily or otherwise, the actual scope of the prohibition is still in flux. For example, it was widely reported shortly after the Global Settlement that a Bear Stearns analyst pitched a company to investors via an electronic road show prior to the company's public offering. Bear Stearns issued an immediate apology, stating that it had not adequately communicated the finer points of the rules separating the research and investment banking departments internally. Government entities involved in the Global Settlement expressed concern that the Settlement would have to be reviewed to ensure that the ban was clear and broad enough. (23) On a related note, company management will no longer have access to a prospective underwriters' analysts as part of shopping for investment banking services. The SRO Rules now prohibit research analyst participation in "any efforts to solicit investment banking business," including "pitches" and "other communications fwith companies for the purpose of soliciting investment banking business." (24) Research Coverage of an Issuer After a Public Offering Issuers can now expect a delay in broad research coverage following their public offerings. Analysts employed by any member of the underwriting syndicate or selling group of a public offering are prohibited for varying lengths of time, depending on the circumstances, from issuing research reports regarding the company involved in the offering or discussing such company at public appearances. (25) These quiet periods are intended to reduce the ability of investment banking personnel to improperly reward issuers for underwriting business by publishing favorable research regarding an issuer after completion of an offering. An issuer's manager or co-manager, in the case of an initial public offering, may not issue a research report regarding the issuer within 40 calendar days following the effective date of the offering. For an offering of an already public company, the quiet period for an analsyt employed by the manager or co-manager is 10 calendar days following the effective date of the offering. Finally, analysts employed by non-managing underwriters or dealers that participated in an initial public offering are subject to a 25-day reporting/appearance quiet period. These rules, however, all provide exceptions for reports concerning the effects of significant news or a significant event on the subject company, provided that the analyst's legal and compliance department pre-authorizes the publication or appearance. (26) An additional quiet period has been instituted covering managers and co-managers of offerings that prohibits reports and appearances regarding the company involved in the offering during the 15-day period both before and after the expiration, waiver, or termination of a lock-up agreement that restricts the sale of securities held by the company or its shareholders after the completion of the offering. This restriction is aimed at preventing "booster shot" research reports, leaving market forces to determine the price of the security in the aftermarket unaffected by reports and appearances by firms having a substantial interest in the success of the offering. (27) This rule, however, does not apply to reports and appearances regarding a company with "actively traded securities" as defined in Regulation M. (28) Spinning "Spinning" is the term of art that Wall Street generally uses to refer to the practice whereby executive officers and directors of public or soon to be public companies are allocated shares by the underwriter of an IPO as, at least, an implied inducement for such officers and directors to cause their companies to engage the underwriter's services in the future. (29) Spinning has proven to be a risky enterprise for executives and investment banks alike. As early as 1997, wide-spread media criticism of spinning resulted in several investment banking firms and venture capitalists adopting internal policies regulating or prohibiting the practice of spinning. (30) More recent events indicate that the securities industry is headed for a formal ban and penalties will be imposed to deter the practice. Therefore, one can expect issuers to review carefully their policies regarding receipts of gifts or inducements to the issuer's officers or directors. Under the Global Settlement, the 10 firms covered have agreed to a voluntary ban on allocating securities to executive officers and directors of public companies in offerings that begin trading in the aftermarket at a premium. (31) The NASD sought comment from its members during 2002 and on September 15, 2003, filed with the SEC proposed new rules regarding the regulation of IPO allocations and distributions. These proposed rules would prohibit allocations to company CEOs and directors on the condition that they send their companies' investment banking business to the NASD member. (32) The NASD's proposal would also prohibit a member firm from allocating IPO shares to the executives of a given company if the firm has either received investment banking compensation from the company during the past 12 months or expects to receive or intends to seek compensation for investment banking services from the company during the next three months. In addition, the SEC Chairman William Donaldson, in testimony before a Senate committee in May of 2003, indicated that the SEC intends to evaluate the need for specific rulemaking in this area. (33) These regulatory actions have come too late to spare the five senior executives subject to the complaint filed in 2002 by New York Attorney General Spitzer under New York's Martin Act. The complaint alleges that the executives benefited from receiving hot IPO shares in other companies as "incentives" from investment banks and profited from the rise on the market value of shares of such executives' own companies as a result of the same investment bank's stock analysts providing high ratings of such companies' shares. (34) The complaint states that by failing to disclose both their respective allocations of hot IPO shares and the nature of the investment banking relationships described previously, defendants unjustly enriched themselves.(35) Moreover, the complaint raises the possibility that other investment banks and executives could be targeted in the furture for similar behavior. Indeed, New York's Martin Act is a very broad anti-fraud rule, which requires no proof of scienter or even intentional fraud. (36) NYSE/NASD IPO Advisory Committee Report In August 2002, at the request of then SEC-Chairman Harvey Pitt, the NASD and NYSE convened a Blue Ribbon Panel of business and academic leaders to conduct a broad review of the IPO process, including the role of issuers and underwriters in the pricing and offering process. The Committee issued its report in May 2003 (37) and many of its recommendations could, if adopted into the regulatory framework, have a significant impact on issuers in the public offering context. Highlights of the Committee's recommendations that specifically relate to issuer involvement in the offering process include: \* Mandating IPO pricing committees of the board, including at least one independent director (if any qualifies); \* Raising the SEC's threshold requirement for amending prospectuses without triggering delay or review from 20 percent to 40 percent in cases of increases to the offering price or number of shares offered (to allow issuers more flexibility to address excess demand for an offering); \* Expanding on the Global Settlement's and NASD proposed rules' prohibitions on spinning; \* Requiring issuers' codes of ethics to include a policy regarding spinning (including, for example, pre-approval processes or absolute bans) (to "provide investors comfort that IPO allocations do not unduly interfere with the fulfillment of directors' and officers' fiduciary duties"); \* Imposing limits and disclosure requirements on issuers' "friends and family" allocations in IPOs; \* Explicitly characterizing the electronic broadcasting of road shows as permitted offers under SEC rules and requiring the posting of road show presentations on issuer Web sites; and \* Requiring issuers to disclose underwriter-granted exemptions to lock-up agreements following an offering. Disclosure by Analysts May Impact Issuers Issuers can expect increased public disclosure regarding their relationships with underwriters and financial firms as several new disclosure requirements have recently been imposed on financial institutions and research analysts, most aimed at airing potential conflicts of interest. Though these rules do not impose disclosure obligations on issuers, issuers should be aware of the types of information that now will be readily available in the marketplace. Perhaps of most concern to issuers and commentators alike is that securities firms will now disclose in research reports if they expect to receive or intend to seek compensation for investment banking services from the subject company during the next three months. Research reports also will disclose if the firm responsible for the report managed or co-managed a public offering of equity securities for the covered company or if it received any compensation for investment banking services from such company in the past 12 months. Many commentators believe that the requirement to disclose even the possibility of future compensation and/or services raises significant Chinese Wall and signaling issues. (38) In response to these critics, exceptions have recently been adopted permitting noncompliance with these and similar disclosure rules to the extent that disclosure would "reveal material nonpublic information regarding specific potential future investment banking services transactions." Issuers can also expect greater publicity if an analyst terminates coverage of their company. Member firms of the NASD and NYSE now must give public notice when research covereage of a company is terminated. (39) Such notice must be distributed by means similar to that used to distribute prior reports on the company and must contain information comparable in scope to prior reports, including a final recommendation. If it is not practicable for the firm to produce a final report, a rationale for the termination must be disclosed. Other information regarding issuers that will now be included in research reports, include: \* Whether the reporting analyst or any family member of the analyst personally owns securities of the subject company or is an officer, director or advisory board member of the subject company; \* Whether the subject company is a client of the reporting analyst's firm, including the general types of services provided; \* If the analyst's firm owns one percent or more of the recommended company's equity securities; \* If the analyst's firm received non-investment banking compensation from the subject company in the last 12 months; \* If the analyst or a household member is an officer, director or advisory board member of the subject company; and \* Any other actual, material conflict of interest of the analyst or firm of which the firm or analyst knows or has reason to know at the time of the research report's issuance. (40) Many of these same disclosures also are required to be made by an analyst when he or she discusses an issuer during a public appearance.Finally, as a result of pending lawsuits, and some settled SEC actions, industry practice may evolve to the point that issuers will need to disclose (or expect their investment banking firms to disclose) the multiplicity of connections between an issuer and all its financial firms. For example, in the case of Enron, in which financial firms acted as swap counter parties, asset managers, analysts, underwriters, lenders, structural finance counter parties, investors, etc., the complex of relationships allegedly helped obscure Enron's financial condition. NOTES (1.) Release Nos. 34-45908 (May 10, 2002) and 34-48252 (July 29, 2003) (hereinafter SRO Releases). On July 29, 2003, each of the NYSE and NASD filed with the SEC an Amendment No. 3 to the proposed rule changes and the July 29, 2003 Rulemaking Release stated that the Amendment No. 3s would be approved on an accelerated basis. When used in this article, the term "SRO Rules" refers to the proposed rules inclusive of the respective third sets of amendments. (2.) Sarbanes-Oxley Act of 2002, Title V [section] 501, 15 U.S.C. [sub section] 780-6, 78u-2. Release No. 34-48252 (stating that the post May 2002 proposed amendments to the SRO Rules fulfill the mandate of the Sarbanes-Oxley Act). (3.) Regulation Analyst Certification, Release No. 34-47,384, 79 SEC Docket 1921 (Feb. 20, 2003). (4.) Press Release, Spitzer, Merrill Lynch Reach Unprecedented Agreement to Reform Investment Practices: Merrill Lynch to Pay $100 Million Penalty (May 21, 2002) http://www.oag.state.nv.us/press/2002/may/may21a\_02.html. SEC Fact Sheet on Global Analyst Research Settlements, available at http://www.sec.gov/news/speech/factsheet.htm. The nine firms are: Bear, Stearns & Co. Inc.; Credit Suisse First Boston LLC; Goldman, Sachs & Co.; Lehman Brothers Inc.; J.P. Morgan Securities Inc.; Morgan Stanley & Co. Incorporated; Citigroup Global Markets Inc., f/k/a Salomon Smith Barney Inc.; UBS Warburg LLC; and U.S. Bancorp Piper Jaffray Inc. (5.) Release No. 34-43154 (Aug. 15, 2000) (FD Final Release). (6.) Id. (7.) Regulation FD covers only disclosures made by a company to analysts and other securities market professionals, including broker-dealers, investment advisors, investment companies and hedge funds, and to holders of the company's securities when it is reasonably foreseeable that the security holders will trade on the information. (8.) In the FD Final Release, the SEC summarized the relevant case law as follows: "Information is material if 'there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision. To fulfill the materiality requirement, there must be a substantial likelihood that a fact "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.' Information is nonpublic if it has not been disseminated in a manner making it available to investors generally." FD Final Release at footnotes 38-40. (9.) FD Final Release. (10.) Release No. 34-45907 (discussing NASD Rule2711 and NYSE Rule 472). (11.) Financial Oversight of Enron: The SEC and Private-Sector Watchdogs, Report of the State to the Senate Committee on Governmental Affairs, at 94, (Oct. 8, 2002), http://www.senate.gov/~govt-aff/\_ffiles/100702watchdogsreort.pdf (hereinafter Watchdogs Report). (12.) 17 C.ER. [section] 240.10b-5 (1992). (13.) In re Dirks, 463 U.S. 646, 658 n.17 (1983) (quoting 21 SEC Docket 1401, 1406 (1981)). (14.) Id. at 663; 659. (15.) SEC v. Stevens, 91 Civ. 1869 (CHS), (S.D.N.Y.); described in SEC Litigation Release No. 12813 (Mar. 19, 1991). The SEC alleged that in reaction to one analyst ceasing his coverage of Stevens' company and publicly challenging the Stevens' representation of corporate financial figures, Stevens called several other analysts and disclosed quarterly results, in order to protect and enhance his reputation. The complaint was settled through a consent decree under which Stevens paid $126,445 without admission or denial of the allegations. (16.) FD Final Release at note 7. (17.) See, e.g., SEC Litigation Release No. 48461 (September 9, 2003) (relating to an enforcement action against Schering-Plough Corporation and Richard J. Kogan, Schering's then-CEO and Chairman, in which the SEC alleged that through a combination of spoken language, tone, emphasis, and demeanor, Kogan disclosed negative and material, nonpublic information regarding Schering's earnings prospects. Pursuant to a settlement, cease and desist orders were entered and Kogan and Schering agreed to pay civil penalties of $50,000 and $1,000,000, respectively). (18.) For a general discussion of road show practices prior to the recent scrutiny, see Linda C. Quinn & Ottilie L. Jarmel, "The Road Less Traveled: The Advent of Electronic Roadshows," INSIGHTS, July 1997 at 3; and Joseph McLaughlin, "The Changing Role of the Securities Analyst in Initial Public Offerings," INSIGHTS, Aug. 1994, at 6. (19.) FD Final Release. (20.) NASD Amendment No. 3 to File No. SR-NASD-2002-154 (July 29, 2003) (proposal to amend NASD Rule 2711(c)(4)) and NYSE Amendment No. 3 to File No. SR-NYSE-2002-49 (July 29, 2003) (proposal to amend NYSE Rule 472(b)(5)). Pursuant to Amendment No. 3, the NASD deleted prior proposed language specifically permitting certain due diligence communications, while NYSE Amendment No. 3 retains the permissive language. (21.) Release No. 3448252 (July 29, 2003). (22.) SEC Fact Sheet on Global Analyst Research Settlements, at http://www.see.gov/news/speech/factsheet.htm. (23.) Landon Thomas Jr., "Wall Street's New Rules Off to a Shaky Start," International Herald Tribune, May 22, 2003. (24.) Release No. 34-48252 (July 29, 2003). (25.) Id. (discussing NASD Rule 271 l(f) and NYSE Rule 472(f). (26.) Id. (27.) Id. (28.) Id. Under Regulation M, "actively traded security" means securities that have an ADTV value of at least $1 million and are issued by an issuer whose common equity securities have a public float value of at least $150 million. "ADTV" means the worldwide average daily trading volume during the two full calendar months immediately preceding, or any 60 consecutive calendar days ending within the 10 calendar days preceding, the filing of the registration statement; or, if there is no registration statement or if the distribution involves the sale of securities on a delayed basis pursuant to Rule 415 under the Securities Act of 1933, two full calendar months immediately preceding, or any consecutive 60 calendar days ending within the 10 calendar days preceding, the determination of the offering price. (29.) See Therese Maynard, "Spinning in a Hot IPO: A Matter of Business Ethics," INSIGHTS, Nov. 2002, at 11. (30.) See, e.g., Michael Siconolfi & Anita Raghavan, "Robertson Stephens Tries to Stop "Spinning' of Shares of Hot IPOs," WALL ST. J., Nov. 18, 1997, at C1. (31.) SEC Fact Sheet on Global Analyst Research Settlements, http://www.sec.gov/news/speech/factsheet.htm (last modified Apr. 28, 2003).(32.) Press release, NASD Board Approves Proposed Conduct Rules for 1PO Activities (July 28, 2002), http://www.nasdr.com/news/pr2002/release 02\_037.html. (33.) Testimony Concerning Global Research Analyst Settlement, Before the Senate Committee on Banking, Housing and Urban Affairs, 2003 WL 21030268, available at http://www.sec.gov/news/testimony/ts050703whd.htm (statement of William H. Donaldson, SEC Chairman, May 7, 2003).(34.) New York v. Anschutz, Complaint (N.Y. Sup. Ct. filed Sept. 30, 2002) http://www.oag.state.ny.us/press/2002/sep/sep30c\_02\_complaint.pdf. Joseph P. Nacchio, former Chief Executive Officer of Qwest Communications International, Inc. agreed to disgorge $400,000 in profits pursuant to a settlement announced in October, 2003. Phillip E Anschutz, the former Chairman of Qwest, agreed to disgorge $4.4 million in May, 2003. Claims against the other three executives named in the complaint are still pending. (35.) Id. The lawsuit seeks to require defendants to disgorge over $28 million in profits the defendants made by selling the IPO shares they were allocated by SSB, and over $1.5 billion obtained through the sale of stock in defendants' respective companies, including through defendants' exercise of their stock options. Plaintiff also seeks to enjoin defendants from further fraudulent practices and other violations of the Martin Act. (36.) McKinney's General Business Law [section] 352; See, e.g., State v. Rachmani Corp., 525 N.E. 2d 704, 708, fn. 6 (N.Y. 1988). (37.) NYSE/NASD IPO Advisory Committee, Report and Recommendations, at http://www.nasdr.com/pdf-text/ipo\_report.pdf (May 2003). (38.) The SEC summarized concerns about this disclosure rule in the adopting release. Release No. 34-45908, text accompanying Note 39; see also, Comments of Committee on Federal Regulation of Securities to NASD and NYSE Proposed Rule Amendments (Apr. 30, 2002) available at http://www.sec.gov/rules/sro/nd200221ny200209'kellerl.htm#P29\_604. (39.) Release No. 34-48252 (discussing NASD Rule 2711(f)(5) and NYSE Rule 472(f)(6)). (40.) Id. (discussing NASD Rule 2711(h) and NYSE Rule 472(k)). Issac Lustgarten is a partner at Arnold & Porter in New York, NY and Amanda Paracuellos is an associate at Arnold & Porter in Washington, DC The authors wish to thank law clerk Angela Thompson for her contributions.  |