CORPORATIONS, SECURITIES & ANTITRUST

DOES THE SEC BELIEVE IN FREE SPEECH?

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MR. EDWARD FLEISCHMAN: This panel is titled "Does the SEC Believe in Free Speech?" Since it is about the SEC, at least in part, I will tell you that a couple of nights ago, at an SEC-sponsored conference just down the street here in Washington, the dean of Northwestern, who organized the conference, introduced the former chairman of the SEC, who introduced the present chairman of the SEC, who introduced the speaker equivalent to our moderator, Senator Sarbanes.

You are lucky. You get only one anonymous introduction of our moderator here today.

There are two introductions to Judge Kozinski. The formal one, which has been given to us by the Society itself, law clerk here to Circuit Judge Kennedy and Chief Justice Burger, a practitioner at Covington & Burling, legal counsel in the Office of President-Elect and then the Office of Counsel to President Reagan, Chief Judge of the Court of Claims, and, since 1985, Circuit Judge for the 9th Circuit.

His Honor has asked for a different introduction for those of you who are interested. He leaps tall buildings in a single bound, he is faster than a speeding bullet, and there was something about Lois Lane, but I have forgotten it.

More powerful than speeding locomotive.

Judge Kozinski.

JUDGE KOZINSKI: Thank you. I did ask only for the second introduction.

Well, good afternoon, ladies and gentlemen. To introduce the panel, it occurred to me that we have now what is probably on the First Amendment the most liberal, most First-Amendment-friendly Supreme Court in the history of the Republic. The liberals on the Court are pretty friendly to the First Amendment, and the conservatives really love it. Even commercial speech, which for a long time was out in the hinterlands, is being brought into the mainstream. The Court in case after case has shown great sensitivity, and I think rightly so, to government actions that restrict speech.

Yet we have an agency in the government that does nothing but restrict speech. I mean, they really do almost nothing else. They not only prohibit certain kinds of speech; they also compel speech, which we know from our First Amendment cases, like the fabulous opinion in *Wooley v. Maynard*, is something that the First Amendment prohibits. So it bans speech, compels speech, it prohibits speech even when it is truthful.

If there is one thing that the First Amendment greatly abhors, it is prior restraint. After a speech is made, sometimes we can litigate whether or not the speakers can be punished or sued, but it is horror of horrors to have government bureaucrats tell people in advance that they have to submit to them what they may say. Yet we have an agency, a big part of whose business is, in fact, to go over the speech that private parties plan to give and to censor it. You know, of course, we're talking about the SEC.

For many years, there were almost no First Amendment objections to, or issues raised with, SEC enforcement. It is now becoming more of an issue, and we have a really distinguished panel that is here to talk to us about it. I am going to make the introductions very brief because you want to hear from them.

The first one to speak will be Paul Gonson. He was the SEC's chief appellate lawyer between 1979 and 1998. He then served as the solicitor of the Securities & Exchange Commission. He left there about three years ago, and he is now a partner at Kirkpatrick & Lockhart in its Washington, D.C. office.

Next is Robert Giuffra. He is a partner in Sullivan & Cromwell's litigation group. His practice focuses on securities, white-collar criminal and commercial litigation in federal and state courts. Before going to Sullivan, he clerked for the Chief Justice of the United States, Chief Justice Rehnquist, and for Judge Ralph Winter of the 2nd Circuit. He graduated from a place in New Haven that pretends to have a law school.

MR. GIUFFRA: You spoke there several times.

JUDGE KOZINSKI: Yes, I have, and I hire clerks from there all the time, and they pretend to teach them law, too.

And then we have Joseph McLaughlin, who is to my immediate right. Everybody is to my right; that's unusual. He is a partner at Sidley Austin Brown & Wood in New York, and he was General Counsel of Goldman Sachs from 1976 to 1988. Before that, he was at Sullivan & Cromwell.

MR. GIUFFRA: A conspiracy.

JUDGE KOZINSKI: I think so. And he is an adjunct professor of law at NYU Law School, or he was between 1988 and 1992. Paul, you go first?

MR. GONSON: Yes. Judge, thank you.

When I was on the SEC staff and I would appear at programs like this, I would always give the required disclaimer of SEC responsibility. I would say that the views I am about to give are mine and not necessarily those of the SEC. I am now away from the SEC for about three years. However, I think I had better say that anyway. So these are my views and not necessarily the SEC's views.

The title here is, I guess, a provocative one, whether the SEC believes in free speech. I think that if you went into the SEC building and you roamed the halls and you poked into offices and you asked people, "Do you believe in free speech? Do you believe in the First Amendment?", you would get a puzzled answer. No one there really focuses on that question as such, and I think if they reflected on it, they would say, "Why, sure we do."

But what the SEC does is administer six statutes, all passed in the decade of the 1930s, collectively known as the Federal Securities Laws. These statutes are intended in the main to provide a lot of information to people who are asked to purchase securities and to the securities market. So while I would say the First Amendment is not on the agenda of the SEC as such, the SEC's three major agenda items are disclosure, disclosure, and disclosure.

Free speech cases are about, of course, information being available to the public so that this information can be known and can be debated, people can debate ideas, and this is exactly the name of the game of Federal securities regulation.

The Supreme Court has said that the First Amendment looks more kindly on regulation that requires more disclosure than the speaker might give voluntarily. So in that sense, the SEC probably is doing a very good deed. It requires disclosure in a number of areas, but just as a general introduction, I will focus on two of them. One is at the time the securities are offered and sold to the public, and another time is when securities which are already outstanding are bought and sold in the securities markets.

We will hear about a couple of cases today, one of them being *Central Hudson*. *Central Hudson* was a 1981 Supreme Court case in which the Supreme Court said that commercial speech was entitled to First Amendment protection, but to a lesser degree, and gave a four-part test.

One of the parts of the test was whether the government's interest in regulating speech was a substantial interest. A year later, in a 1981 decision, the D.C. Circuit said, referring to the SEC's, "marketplace laws of general applicability, beyond question, those laws serve a substantial public interest."

Our country's securities markets are the envy of the world. Every year, billions of dollars are raised by the securities industry to finance American business and foreign business, and there is no cliche which is truer than the one that says Wall Street is very close to Main Street. The majority of households in the United States own securities, and many, many foreign investors come to the U.S. markets to buy and sell securities.

Why is that so? That's so because the U.S. securities markets, in addition to being efficient, are also believed to be, and in my view are, fair and honest, and the substantial government interest in preserving this jewel of our nation's securities markets rests upon an intangible, a very precious commodity called confidence. If people have confidence in the securities markets, then they will use those markets.

In protecting these markets, the SEC both, as Judge Kozinski said in his introduction, compels speech and restricts speech. When securities are offered to the public, the law requires that the offeror give detailed information to the offeree about the securities being offered, its attributes, and about the company, its assets, and its earnings, in great detail. This is so because the offeree ought to be able to have information to make an informed decision.

If you go out and buy a refrigerator, or if you buy a car, you can look at it, you can test it, you can kick the tires, you can open the door. If you are asked to buy securities, you know nothing about it unless you can get some information about it. So the law is sometimes called truth-in-securities.

No Federal official passes on the merits of the offering. No one says, "Well, it's a good deal or it's a bad deal." The idea is to get all the information out. The investor makes his or her own decision, makes a good decision or a bad decision, but it's the investor's decision. So this is compelled speech, no question about it, in much more detail than would be voluntarily given.

The law also restricts speech in that you can not make this offer to the public, you can not give the prospectus out, until you first submit it to the SEC and the SEC staff has gone through it to make sure that, indeed, it does have full and complete disclosure. The SEC will then say it's okay to issue it. This is what Judge Kozinski referred to as a prior restraint; that is, the government will not let you make this speech until the SEC staff has approved it.

Much of these securities are traded on our nation's securities markets. The law then requires that these companies make periodic and detailed disclosure by filing documents with the SEC, annual and other reports, again

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including a lot of required, detailed information. This information today is sent out instantaneously by computer to the securities markets so that buyers and sellers in these markets can make decisions about whether to buy or sell these securities based upon information.

There has been a small amount of litigation concerning the SEC and the First Amendment, mostly in the area of publishers and politicians, and we may talk about some of those cases.

As to business generally, there are virtually no First Amendment litigation challenges, even though these laws that I speak of have been on the books since the 1930s. That is because I believe that the securities industry, corporations, and the corporate securities bar have generally accepted the regulations as workable. That isn't to say that there isn't some grumbling, comments, and suggestions about them from time to time, but rarely on First Amendment grounds.

That is sort of a general overview as to how these laws work and what I think is the SEC's views about them.

JUDGE KOZINSKI: Thanks, Paul.

MR. GIUFFRA: Our topic today is, does the SEC care about free speech? And I think the answer is generally no.

But I don't think we should be too hard on the SEC, because if one asked 99 percent of the securities lawyers in America whether they care about free speech, the answer would be no.

I was at lunch at my law firm last week and asked several lawyers -- "Does the First Amendment have any application with respect to the securities laws?" And one looked at me and said, "Have you been speaking to Joe McLaughlin?"

If you were to walk into my law firm and do a survey of the lawyers there who were in the securities area and ask them, "Does the First Amendment apply to the securities laws?," virtually everyone would say no. You must start from that premise in considering today's topic. I suspect that the Framers would be surprised if they knew that we lived in a country where Larry Flynt has greater rights to decide what to put in Hustler Magazine, than if Bill Gates wants to speak about Microsoft.

Now, if we are going to have the best capital markets in the world, they must be free and open capital markets. Ten blocks from here at 450 5th Street, we probably have, as the Judge said at the outset, one of the preeminent censoring bodies in the world. At the SEC's headquarters, there literally are floors of government regulators who censor the speech of public companies. If you're the head of a Fortune 500 company, and you want to make an offer to sell your securities in writing, you can't do so unless you receive the SEC's approval. The SEC is going to review what you say, the agency will give you comments, and you will have to hire lawyers to respond to those comments. Professor Richard Painter is in the front of our audience. He used to do this at our firm, responding to the comments and making sure that every word is the way the SEC wants it. In fact, if you do anything without getting the SEC's approval, you can have big problems. You could lose your job or even go to jail.

If one were to guess, Wall Street law firms collectively earn billions of dollars every year from responding to the SEC's comments. We all have a vested interest in preserving and protecting this system of regulation

Now, why is it that the First Amendment is considered to be irrelevant to the securities laws, and why do we have a government agency reviewing corporate speech. If you are an oil company and you want to run an ad, you don't have to run it by the Department of Energy.

As Paul pointed out, the securities laws were enacted to protect unsophisticated investors. The Congress was concerned about fraud in the wake of the 1929 crash. Our securities markets are the envy of the world. Our securities markets date back to the Great Depression and the disaster that followed. Our securities laws have not been substantially updated since 1933 and 1934. At that time, there was no question that the First Amendment did not apply to commercial speech. In fact, it was only 25 years ago in the *Virginia Pharmacy* case that the Supreme Court first recognized that the First Amendment protected commercial speech. In that case, the Court held that consumers had an interest in the free flow of information.

Now, Paul referred to the *Central Hudson* case, and I think there is one prong of the *Central Hudson* test that's critical in thinking about the securities laws, and that's the prong that says the restriction should be no more extensive than necessary to serve the government's interest.

One interest the government clearly has is preventing fraud. There is no question that the First Amendment does not permit someone to make fraudulent statements in connection with the purchase and sale of securities. If the government wants to come and swoop down on someone who is making fraudulent statements about a public company, it can do so. If the government doesn't do so, swarms of securities lawyers certainly will do so. So there already exists substantial enforcement if someone is, in fact, making a fraudulent statement.

At the same time, the law is somewhat ambiguous as to what constitutes securities fraud, because there are cases that, depending on the circuit involved, require either deliberate recklessness or just recklessness to constitute

securities fraud. So public companies must be careful when they make public statements, because whenever a company makes an announcement of bad news and the stock price drops substantially, plaintiffs' lawyers will, in fact, sue that company.

It is up to the SEC and Congress to reinvigorate the First Amendment in the context of the securities laws. The vested interests in the private bar, and I'm part of it, will not rock the boat. The only Supreme Court case addressing the issue of the First Amendment and the securities laws is the *Lowe* case, where the majority of the Court tried to avoid addressing the constitutional issue. Three justices made quite clear that there is a First Amendment problem if you limit the ability of an investment newsletter to make statements that provide non-personalized investment advice to the public.

In sum, the Congress does not focus on the First Amendment, the SEC does not focus on the First Amendment, and the securities bar does not focus on the First Amendment, and we all need to do so.

Now, before I end I want to make clear, the securities laws do play a very important role in our economy, and some of the censorship and some of the compelled speech is, in fact, good.

We want to have efficient capital markets, and we want to reduce the cost of raising capital. What the SEC's rules do, although they need to be updated and reformed, and those rules need to take into account changes in the way information is communicated today, is provide, as Ralph Winter said in a speech that he gave about ten years ago, is a form of standard weights-and-measures for disclosures by public companies.. If an investor wants to know information about a public company, he or she can look in a 10Kor 10Q, he can look in an annual report, he can look in a proxy statement, and there is certain standardized information in those documents filed by all public companies. That standardized disclosure serves an important purpose, because if General Motors put out documents containing certain financial information and Microsoft put out documents containing other sorts of financial information, the cost of raising capital in America would be higher. It would be harder for investors to compare the performance of companies, for example. At the same time, the SEC should consider the First Amendment in fulfilling what is a very important task of protecting investors.

MR. McLAUGHLIN: Thank you, Bob.

Let me make very clear that what we are not talking about today is protecting fraud. Fraudulent statements are not entitled to First Amendment protection, and neither I nor anyone else has suggested anything to the contrary.

We are also not talking here today about mandated disclosure. Yes, the SEC is in the business of telling public companies what they must disclose, and that does serve an important function. As Bob said, it's a template; it makes it easier for analysts to compare companies. There are probably economists out there who might disagree with this proposition, but again that is not the issue before us today.

To orient ourselves in terms of what else is going on out there today, you will find in your materials an outline that we prepared that describes the First Amendment issues cases that will serve as the background for what we are talking about today.

In addition, there is an article that I wrote a couple of years ago called "The SEC's Coming Regulatory Retreat," which talks about the SEC's restrictions on speech and suggests that there are two reasons why those are likely to be challenged. One is the First Amendment, and the other is, in the international arena at least, the concept of subject matter jurisdiction.

To turn to why this is becoming more of an issue today, let me also refer you to a paper that was prepared by the other group -- I am told that on the Hill they say "the other side" or "the other place." Simultaneous with this meeting, the American Bar Association's Federal Securities Law Committee is meeting here in Washington. The committee sent a letter to the SEC a few months ago suggesting that the SEC ought to consider some fundamental reforms in the way in which it regulates speech related to securities offerings.

What kind of speech are we talking about? Let me outline three types of speech. First, if you're doing a registered public offering, an IPO, for example, the only permitted written material that you can use is the prospectus. Anything else is an illegal prospectus and creates all sorts of problems.

Second, if you are doing a private placement, even if you have directed that placement to the correct people, but you have somewhere trespassed and engaged in what the SEC calls a general solicitation, that takes away the exemption afforded to the private placement and again you have a lot of problems.

Finally, for offshore offerings, if the offering is sold to people outside the United States but somehow there occur within the United States what the SEC calls directed selling efforts, again you lose your exemption, with equally bad consequences.

Now, we got along fairly well for a long time in all these areas, but what is happening today? Well, two things: international offerings or globalization, and, two, technology, in particular electronic communication.

A broker who would pick up the phone and call his best customer upon being informed of his firm's participation in a hot issue, might say, "Paul, I've got a great deal here, it's the new Microsoft. Can I send you a prospectus?" That's perfectly legal. Let's assume, however, the broker sends an e-mail to Paul with the same words. Potential criminal violation and all sorts of bad civil consequences, including a one-year put back to the seller.

Electronic roadshows. We used to be able to have roadshows at the Waldorf, and we still do. We invite people to lunch at the Waldorf. But today, the technology permits us to invite people to see the roadshow on the Internet. The SEC says you can not do that: that is a written communication and it is an illegal prospectus unless you follow some particular rules.

How about a foreign company, or, for that matter, a U.S. company's website? It's up there during the course of the public offering. Is that going to be construed to be a written communication and therefore cause a violation of the Securities Act?

How about Bloomberg and similar services? They provide information to investors, but if the information relates to securities that have been offered privately, have you somehow lost your exemption?

These are some of the reasons that have led to the First Amendment, among other policy reasons, arising a basis for challenging the SEC's traditional command and control method of regulating communications in the context of securities offerings.

MR. GONSON: I think you all understand, if you are securities mavens, and others perhaps don't, that the law says that an offer to sell securities is subject to the restrictions that I talked about a little earlier, and Joe gives some variations on the theme.

Back in 1933 when this law was passed, the distinction between written communications and picking up a phone and calling your customer was a very well understood and very well-defined distinction. Today it is obviously much less so with the use of the Internet and the use of the e-mail.

Joe talked about a couple of things. First of all, he said that you have to use the prospectus and nothing else. Well, that sort of makes sense. If you do have a law that says that the SEC is supposed to look at what you are going to tell your offeree to make sure that it's honest and full and complete, to the extent that one uses writings in addition to or outside the prospectus, he undermines that regulatory effort. So the only-the-prospectus rule has been in effect a very long time.

The private placements Joe referred to is a system where there is something called a private offering, or it may more precisely not involve a public offering. In general, if the offerees are persons who can fend for themselves, generally affluent, they generally don't need the protections that a registration statement would give, then you don't have to go through this drill to register your offering and give a prospectus. But as Joe points out, if, in fact, offers are made advertently or inadvertently to the general public, the so-called general solicitation that Joe referred to, then you are back into the teeth of the statute again that says that if you're going to offer to the general public, you have got to comply with these laws.

With respect to the offshore, that was an effort by the SEC to take the sting out of these requirements by saying to U.S. offerors, if you are going to offer your securities only to offshore persons, only to foreigners, not residents of the United States, you don't have to jump through all these hoops. But there have been leakages back. So the SEC asserts its concern that maybe these are various kinds of schemes by which there are purported offers overseas, but then they float back into the U.S. and are being offered and sold to persons in our country without the protections of the securities laws.

The one-year put that Joe refers to is Section 12(1) of the Securities Act, that says that if you should have registered your securities with the SEC but you did not, then the purchaser has up to one year to get his money back. An absolute liability. That's referred to as a one-year put.

MR. McLAUGHLIN: I tell my clients I don't mind their selling puts to customers so long as they get paid for them. It's not a good idea to do it for free.

JUDGE KOZINSKI: I should say that the formal part of the program has finished, and I do want to invite statements and questions. So what you should do is sort of like an auction: catch my eye.

By the time the prospectus is given, there is already so much information about that offering available around the world almost instantaneously. So maybe some better way has to be found than was devised in 1933.

JUDGE KOZINSKI: Richard.

PROF. PAINTER: My name is Richard Painter from Illinois, a member of the New York Bar. There are just two tensions I want to explore here in more detail. I want to explore the tension between the '33 Act embargo on speech before a registration is filed in a registered deal on a private placement pursuant to the general solicitation rules, and the '34 Act requirement of continuous speech and continuous disclosure.

One of the things I find very troubling is that, particularly with some of the older releases, the gun-jumping releases under the '33 Act suggests that meetings with analysts are appropriate so long as you don't give the

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analyst any piece of paper that could possibly be taken out of the room and given to the mere commoners who might read this material. Of course, we have Regulation FD where the SEC has said under the '34 Act, in effect, that this would be selected disclosure that we do not want to permit where you can talk to analysts and not to the world as a whole.

At least in that instance, there needs to be some revisitation of the gun-jumping rules, and this may require examining the general solicitation area under Regulation D to see if there is conformity with general disclosure requirements of the '34 Act. Not to say that Regulation FD is a good idea; it has its other problems.

The other is a tension of political speech. You didn't mention yet the *Long Island Lighting* case where Judge Winter wrote a very intelligent dissent. There you had a proxy fight over whether the company should be a nuclear power, going on side by side with a political election on Long Island on the exact same issue. It is true that the same parties were involved with the proxy solicitation as were involved with the general election and taking out advertisements in the newspapers.

But there was an advertisement that seemed to be strictly political. It was not addressed to shareholders at all, dealing with the nuclear power issue, and that's at the core of political speech under the First Amendment. Yet there was litigation over this under Section 14 of the '34 Act.

The 2nd Circuit, by majority opinion, over Judge Winter's dissent, refused to have any kind of a clear rule as to when a seemingly clear political ad that did not even mention the proxies is something that people should be able to do without Section 14 problems.

JUDGE KOZINSKI: I know that Bob Giuffra will want to disagree with Judge Winter.

MR. GIUFFRA: No. I learned never to disagree with my former judge.

I think that the issue that needs to be considered is, number one, the '33 and '34 Acts need to be substantially revised because they are antiquated laws that do not confront the present reality of an Internet age as opposed to what went on in 1933 and 1934 when you had communications that were by telephone. There were no faxes and no websites when the securities laws were enacted.

Beyond that, we must keep in mind that there already is a prohibition against fraud in the securities laws. If you engage in fraud in connection with the purchase or sale of securities, you are going to get sued. The SEC can come after you, there is no dispute about that.

But we also have another regime that has been put in place with respect to offers that imposes rules and requirements as a second layer of protection. It is hard to think of another area of commerce where you have as many regulations governing non-fraudulent speech as you do in the securities area. The question is whether this regulation is worth it.

Now, clearly it's worth it to have the weights-and-measures standardized disclosure, but are some of the hyper-technical rules that make it possible for Wall Street lawyers to earn a lot of money needed or necessary? That's the question.

PANELIST: Bob, there is another illustration which is similar to the *Long Island Lighting* situation. Recently Weyerhauser was trying to take over Willammette, and some employees of Wilhammet set up a website the address of which was, I think, rather catchy: Justsaynoway.com. They were trying to get people to oppose Weyerhaueser's tender offer, and the SEC is reported to have communicated with the Willammette employees and told them, "Sorry, you can't keep that website up there unless you prepare and file a Schedule 14(d)(9)," which is a particular SEC document, the estimated cost of preparing which would have been about $50,000. The employees, not having $50,000 lying around, shut down the website. That is an example, again, of how the SEC will prevent somebody from doing what I think is pretty close to core political speech.

MR. GONSON: We are dealing here in the proxy area now with the example that was given by the *Long Island Lighting Company* case and the Weyerhauser case, and the proxy area is a little different, really, because the securities laws give authority to the SEC to provide rules with regard to proxies.

I think all of you are aware that state law governs corporate law as to when there should be annual meetings, what should be discussed at annual meetings and who can vote and so on. But Federal law governs how the communications will go between the company and the shareholders and among the shareholders.

The Federal law with respect to proxies is not so much a law that relates to the offer to sell securities or trading in securities as it does to what we might call corporate governance. It also grows out of some of the abuses that preceded the laws in 1934. There were Senate committee hearings, and part of these hearings also governed abuses of this kind, and so it was a reaction to that.

I guess the point I might say with regard to both the *Long Island Lighting* case – the LILCO case, as we call it -- and the Weyerhauser situation is that if you do have communications that are going back and forth, those communications are subject to regulation by the SEC. To the extent that there is something also going on at the same time,

a dispute about nuclear power or labor relations or something, that still does not change the question as to whether at least from the SEC's point of view, these communications nonetheless should be subject to the requirements of the regulations.

PANELIST: I think it's important that people understand that in this LILCO case, a public company wanted to run a big ad in the newspaper.

No, the other side wanted to run a big ad in the newspaper, the dissent, and before they could run the ad, they had to get the SEC's approval with respect to what the content of the ad was going to be.

PROF. PAINTER: And it was not addressed to shareholders; it was addressed to the public about nuclear power.

PANELIST: About nuclear power.

MR. GONSON: Possibly the shareholders might read it nonetheless.

PROF. PAINTER: Yes. Absolutely.

JUDGE KOZINSKI: Larry. Larry Callahan.

MR. CALLAHAN: Yes. My name is Larry Callahan. I am left to ask the simple question concerning Section 12 '33 Act. I would hate to have to predict what is going on in the Commission, but under that strict liability standard, you have a public offering, even though it's an offering circular, irrespective of the fact that everyone that bought signed the subscription agreement and they were totally sophisticated. Under the one-year statute, you can still get all your money back. If you put it on the Internet it's probably going to be called a public offering.

Is there any feeling at the Commission that maybe public offerings could be redefined so we could make use of this increased technology?

MR. GIUFFRA: Joe is a better one, I think, to respond.

MR. McLAUGHLIN: Yes, I can speak to that.

I was on the the drafting committee for the ABA letter, and one of our main purposes was to fix this problem. Suppose a small company were to put an ad in the *Wall Street Journal* saying, "We need to raise $10 million. We can only sell to accredited investors," which is a particular kind of person that is deemed under SEC rules to have enough money and sophistication to be able to participate in a private placement, "but we can't find an underwriter who will work with us to go out and find these people. We are therefore putting this ad in the paper in the hope that accredited investors will respond and buy our $10 million of securities so we can go and build our new factory and hire additional people."

Even if the company completed the deal by selling only to accredited investors, it would in the SEC's view have engaged in a general solicitation. The transaction would then be without an exemption, resulting in a Section 5 violation, with potential criminal penalties and civil liabilities.

I guess the question, Paul, is if you were at the SEC and you were aware of a situation like this where the private placement had been completed after such an ad had been published, would you expect the defendant successfully to be able to raise a First Amendment challenge to your prosecution?

MR. GONSON: I doubt it. I think the staff would let it go as a practical matter. I do not think they would sue anybody or put anybody in jail. They would let it go. But it is a problem.

Another answer is that one of the proposals that has been made repeatedly is to change the format where no longer is the law subject to offers, but only to sales. That is, you allow your offer to go ahead and then you regulate at the point of sale. That is much easier to do on the Internet today than to try to regulate at the point of offering. And then you're tough at the point of sales.

MR. McLAUGHLIN: No one is objecting to being tough at the point of sale. Only the eligible person should buy.

MR. GONSON: Right.

MR. McLAUGHLIN: This morning, one of the senior SEC people said he anticipated some movement on the staff's part in this area, possibly within the next three years. So it's not a very high priority.

JUDGE KOZINSKI: I think that gentleman was next.
Fred.

MR. ANSON: Fred Anson. I would like to ask you a question not about securities law, but about another area of law. I would like to get your sense because I think this might bear on what you're talking about. The SEC is not the only government agency that prior restrains corporate America in what it can say and compels it to say other things.

If you make drugs and you want to advertise what your drug does, the FDA says what you can say and what you can not say. It says you have to warn of various kinds of side effects. Without regard to fraud, the FDA has banned even truthful information from being displayed to the public, fearing that we do not know enough to ask our doctors what kind of medicine we should be taking. That was the regime for a long time, and a lot of it still remains, but a lot of it was challenged on First Amendment grounds. The D.C. Circuit has handed the FDA its head on some of these kinds of rules, and now you see a lot more ads for drugs on television than you used to.

PANELIST: Do they still have to be pre-cleared?

MR. ANSON: There are still regs that say what you can say and what you can not say. I don't know that they actually review the copy. I don't know the answer to that. But there are regs. I don't know enough about prior restraint to know whether it's technically a prior restraint, but it might be. The government says what you can and cannot say, and it will go after you if you violate those regs.

But the point is that there was a regime that was very much like what you're describing in securities law. Part of it still remains and part of it does not. The FDA has not decided how to comply with some of these rulings.

I just offer that to you as food for thought.

JUDGE KOZINSKI: Well, is this a good thing? It is hard for most of us to relate to securities -- obviously there are securities lawyers here, but we know about drugs.

PANELIST: Drugs are more dangerous than securities.

JUDGE KOZINSKI: Drug ads on TV, First Amendment questions -- we buy and use drugs in our personal lives. Are we better off now that you get prescription drug ads in newspapers magazines, TV and the like? Putting aside the First Amendment question, sometimes the First Amendment can really cause harm, and sometimes we know it does and we live with the harm, because we are committed to its values. But it still should cause us to ask the question, does it move us in a better direction? I am not convinced that drug ads on TV are a good thing, but maybe the panelists have a thought on how this relates to securities laws.

MR. McLAUGHLIN: Well, I think I recall the case you're talking about. It involved off-label uses where a doctor could, for example, perfectly legally prescribe a drug for a use not contemplated by the label. But I believe the drug companies themselves were prohibited from helping doctors promote off-label uses, and that's what I believe was struck down as being contrary to the First Amendment.

JUDGE KOZINSKI: I'm sorry, we had a comment or question over here.

MR. FLEISCHMAN: Ed Fleischman from New York.

MR. GONSON: Former SEC Commissioner.

MR. FLEISCHMAN: Mr. Giuffra, you talked about the fact that there are no challenges. Would talk to this audience a little bit about whether it is, in fact, the agency affirmatively dispelling challenges, or whether there is something to the notion that simply the way the markets function, if people want to get their transactions done, they don't have time to challenge? And in anticipation of your answer, could I pose something to Messrs. Gonson and McLaughlin? With all that you've told us about the way it functions, I am sure the two of you have thought about how it could function in an alternative manner with less intrusion, less prior restraint. Would you talk to us a little bit about that? The proxy area, offering area, anything you choose.

JUDGE KOZINSKI: No pre-clearance?

MR. FLEISCHMAN: Alternatives to pre-clearance. There must be ways. Are there not?

JUDGE KOZINSKI: Good question.

MR. GIUFFRA: On the first question, I think there are no First Amendment challenges because no Fortune 500 company wants to go to war with the SEC, and the better way to deal with this is to work it out and address their concerns and essentially live with these rules.

You had a challenge in a newsletter case because the SEC's rules limited the very business conduct at issue.

JUDGE KOZINSKI: Well, but let's say we get a challenge and the Supreme Court, lo and behold, says it's just like requiring newspapers to submit their copy before they print it. So we're in that universe now. What would that universe look like?

Paul, you have expressed perhaps the strongest commitment to the current regime, and it is a very persuasive case. Would we live in the wilderness? Would people all over the world, including people in the United States, lose confidence in the securities markets? Is there an alternative market solution?

MR. GONSON: There probably are alternatives. It has been said that the atmosphere today in this country is much different than it was in the New Deal era when Franklin Roosevelt was elected President in 1933 and had to deal with widespread depression, closed banks, the 1929 market crash and the aftermath.

So one proposal that has been made is that large public companies today no longer should need to jump through those hoops. They have so many incentives as a practical matter to make complete disclosures anyway, they should just simply be left to their own devices, and there should only be policing for fraud.

With regard to new companies coming to market, what's referred to as initial public offerings or IPOs, some people say the focus should be on those companies only. There have been proposals of all kinds, and Joe is much more involved in this proposal business. He has served on committees that write these things, and he is much more knowledgeable than I am, and I am sure he will have something to say. But there have been many proposals that have dealt with ways in which this could be changed to be less intrusive.

The one that I mentioned before and the one that I personally like the most would be to abandon the whole idea of regulating offers and simply regulate sales, because nothing bad happens until the sale occurs, and all this apparatus that deals with the offers could then be largely eliminated.

MR. McLAUGHLIN: Paul is absolutely right. I think the least defensible current SEC practice is its regulation of offers in the context of private placements. As long as the securities end up in the hands of eligible investors able to fend for themselves, there is no regulatory interest in policing offers.

As far as prior review of offering documents is concerned, the European Union has a directive out that contemplates prior review of a company's documents where the company has not previously made a public offering and is therefore not yet in the reporting system. As Paul says, the typical divide among U.S. companies is those who are public companies and those who are not. So you would expect initial public offerings to continue to get prior SEC review.

I think people generally do not object to the idea of submitting the mandatory disclosure package to the SEC, because the comments are sometimes very helpful. What is disturbing is that if a public company -- General Motors, Procter & Gamble -- wants to register additional securities for resale, it runs the risk of being delayed because of an unexpected SEC review of its disclosure documents. What the staff really should have been doing all along was reviewing companies' periodic disclosure documents as they are filed, not just at the point where a company happens to be ready to offer new securities.

The ABA proposal that I mentioned, which is available on the ABA's website, draws a sharp line between IPOs, which do get prior SEC review, and offerings by seasoned companies where they file a registration statement, but essentially it's one for life. It becomes effective automatically, and the total focus is on the periodic reports on which the secondary market depends on a day-to-day basis.

MS. WACHTEL: My name is Bonnie Wachtel. In my day job, I run a brokerage firm.

It's Wachtel & Company, but you can't hurt me now.

MS. WACHTEL: NASDAQ, which is the second largest stock market in the world, has had the largest collapse of any stock market recently since 1933. An investor came up with the idea that the only reason he lost this money is because he read these beautiful analyst reports from Goldman Sachs and other places and got a buy rating on them. At the same time, he found out, that Goldman was getting investment banking fees from those companies. Well, of course they are, and there are so many conflicts of interest going on at all times in the securities industry.

There is no reason in the world to believe disclosure of that conflict would have made a difference to any buyer,

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because the mutual funds understood completely what the conflicts were. They are the most sophisticated buyers. They couldn't get enough of those stocks at those high prices.

In the face of complaints from these investors the SEC responded by putting on this congressional hearing about this issue about not disclosing possible conflicts which is such a small non-issue, a non-problem. Setting that up in the wake of this huge market collapse, it makes it look as if the SEC is endorsing the fact that it's okay for investors to believe that relying on an opinion allows them to bring that to court or bring it somewhere and actually make a claim, as opposed to making their own judgments in their own self-interest.

My question is, are you at all concerned about that, because I am. I don't think the SEC should have reacted that way.

PANELIST: Yes, I am concerned. If you read my comment letter on Regulation FD, which is on the SEC website, I describe how the SEC had demonized analysts for a period of more than a year in an effort to sell the idea of FD.

In addition, the chairman of the SEC at one point said it is ridiculous to think investors need analysts; they can sit there on their computer and get the information right from Yahoo. That was, of course, in the days of more euphoric markets. Now everyone is blaming the analyst.

There are the cases and hearings that you mentioned, and I was asked by Representative Baker to write a comment letter, which one of these days will get published.

All of this appeared very important before September 11. I have not heard a word about it since, because I hope we are worried about more important things.

MR. GIUFFRA: I think your question raises a point that is important. Anyone who has ever read one of these prospectuses or any sort of public disclosure for a public company will see pages and pages and pages of warnings that are drafted about that company. In fact, if you read the warnings, you would never buy stock because you would think that the company is going to go bankrupt in a week.

But I think the First Amendment question is, to what extent can the government protect shareholders from what may be market risk. That is probably one of the reasons why the average person probably should buy S&P 500 index fund and not be in individual stocks.

JUDGE KOZINSKI: The gentleman in the back row.

MR. JAFFE: My name is Eric Jaffe. I'm an appellate attorney here in Washington, D.C.

Given the securities background, obviously everybody has spoken on the securities interest, but very little about the First Amendment interests. The only comments so far have been in reference to *Central Hudson*. But in much of the speech regulated by the SEC, *Central Hudson* would not apply because it is not commercial speech.

Even things that we like to think of as commercial in nature -- for example, my profits last quarter were X. Unless you're saying that on the brink of an IPO or on the brink of a reissue of some further stock, that is not commercial speech. It is a speech about economics, it is a speech about yourself, but you are not trying to induce people to buy. It's all information given to a secondary market, and the actual speaker is, in fact, not engaging in commercial speech at all. Other examples like G37 similarly are not commercial speech.

So I was wondering whether or not, while many of these regulations may be nice, may be helpful, may, in fact, be quite good, whether they are compelling, because there are a lot of things that are nice and helpful and good that can't quite overcome the strict scrutiny which presumably would be applied.

And then even as to things that the commercial speech doctrine would apply to, is protecting the securities markets in the abstract a substantial governmental interest? There is no question about that. But most of the regulations do not, in fact, protect the securities market starting from scratch; they protect only some marginal beneficial interest in it. For example, the no further written communications versus oral communications other than the prospectus rule. The marginal gain on protection of that particular regulation, (which says the SEC thinks you will be misled by this e-mail because you won't have read the prospectus, too, which is fully available to you, even if the e-mail asked you to, please read our prospectus), that is not substantial. To my mind, that is not substantial. aut I'm wondering how the panelists might think it would be.

JUDGE KOZINSKI: I want to focus on one aspect before you answer the question. How far is any of the stuff non-commercial speech? Presumably the commercial stuff is covered by *Central Hudson*, right? And so if you are buying, selling, offering, that test would apply. But is any of this pure speech, or is all of it at best the middling standard?

MR. JAFFE: The proxy stuff, the solicitation of votes back and forth, that's not commercial speech.

JUDGE KOZINSKI: Let's hear what the panelists say.

Mr. McLAUGHLIN: I think the only speech that we have been talking about that fits comfortably within the commercial speech definition is the ad in the Wall Street Journal looking for accredited investors to invest in a deal. The rest of what we've been talking about is probably outside the area of commercial speech.

PANELIST: I think that offers of securities are commercial.

JUDGE KOZINSKI: Buying and selling, but giving investment advice?

PANELIST: Investment advice --

JUDGE KOZINSKI: Pure speech. Compelling government interest.

PANELIST: Courts have given it intermediate scrutiny in the past.

JUDGE KOZINSKI: But that was the question, I thought, or at least my assumption of the question was that at least some of it is pure speech and you need to come up with a compelling governmental interest.

PANELIST: You are familiar with --

MR. JAFFE: It has been suggested it wasn't commercial speech in that case, and I am suggesting whether or not some lower court may have said it is commercial speech, they are wrong.

MR. GONSON: Mr. Jaffe, you are familiar -- I know you to be an expert in this area — with *Zauderer v. Office of the Disciplinary Council*, a 1988 case in the Supreme Court.

MR. JAFFE: Sure.

PANELIST: That's a case that I referred to obliquely when I said that apart from commercial speech, if the regulation is to require more speech than normally a person would voluntarily give, then the Court generally is hospitable to that.

MR. JAFFE: That is only in the scenario in *Zauderer*, for example, where you are, in fact, soliciting someone to hire your services, which I think becomes more like a speech act, which falls into the offer purchase and sale category, and is not pure speech, in fact. So yes in those circumstances. But when you are a company which has already sold its securities, and it doesn't have any more in the pipeline waiting to be sold, and it says we made 10 percent profit last quarter, that's not --

PANELIST: But you're a company and you're interested, as many companies are, in your stock price, because that has relationship to your business.

Let me just suggest that I think the SEC is fond of taking the position that everything we're talking about here is commercial speech, and I think that is an overstatement, that very little of what we're talking about here today is really commercial speech as such.

Mr. McLAUGHLIN: The bottom line is that a lot of this has never been tested, and it may well be something beyond commercial speech.

JUDGE KOZINSKI: Yes, sir.

THOMAS MORAN: I have a particular question in the context of the self-regulatory organizations and the way that the Commission exerts fairly extensive influence over those organizations to get those quasi-public or quasi-private organizations to enforce regulations and restrictions on speech on behalf of broker-dealers and the way they do advertising and such.

I'm curious of the panel's reaction as to what the exposure might be to an SRO. Does the fact that it's a private entity of voluntary membership, as some would argue, insulate it from a First Amendment challenge or does its derivative regulatory authority from the SEC potentially expose it to actions based upon the First Amendment?

MR. GONSON: There is a case now pending in the 9th Circuit called E-n-g, *Eng v. SEC*, which raises that very question.

I happen to have the SEC's brief.

As many of you know, the over the counter markets thought that Mr. Eng had made a false and misleading statement, exaggerated, unwarranted and misleading, in violation of the NASD advertising laws. The NASD brought a proceeding against Mr. Eng and found that he had violated the advertising rule that says you can't advertise falsely and in a misleading manner, and sanctioned him, and placed a bad letter in his file, gave him a reprimand.

He then appealed to the SEC, which acts as an appellate tribunal over the self-regulatory organizations. The NASD ruling was affirmed. Mr. Eng now goes to the 9th Circuit appealing the SEC's order affirming, and he makes two arguments. First, he says that the NASD is a state actor, as the phrase is sometimes used, subject to the First Amendment, which applies, of course, only to government people, and second, that his speech was protected by the First Amendment.

The SEC never reached the state actor issue or the First Amendment issue, but the SEC noted in not reaching the First Amendment issue that many courts have said that the NASD is a private organization not subject to the Fifth Amendment, not subject to the Fourth Amendment, in many, many cases, although there is no case of which I am aware that actually deals in the First Amendment area.

In the 9th Circuit, the SEC argues in its brief that the court need not decide whether the NASD is a state actor, but because the information was false and misleading, the First Amendment does not protect it because the First Amendment does not protect false and misleading information, and that's the issue there.

There is another case called *Blount v. SEC*, in the D.C. Circuit.

Mr. Blount challenged a ruling of the Municipal Securities Rulemaking Board, another self-regulatory organization, and the D.C. Circuit did hold that the MSRB was a state actor and then reached the merits of the First Amendment, finding no violation.

PANELIST: Anybody knows how Arthur Levitt, Jr. of the MSRB and the NESD would conclude they were state actors. Maybe that's more than you wanted to know, but I have this brief right in front of me.

JUDGE KOZINSKI: You know what I haven't heard yet, and we do have a question, but let me interject. Usually when you hear discussion of the First Amendment, you hear of the theoretical underpinning and so on, and people usually as part of the argument say: Here are the great benefits, for example, of commercial speech for people who are interested in advertising. I have heard a lot about how we have a really fabulous market that's envied all over the world and works terribly well. Maybe there's a problem that comes inherently with the provision of our Constitution, which, of course, is an important problem. We certainly do not want to be violating the Constitution. But I have not heard anything to tell me that -- maybe such an argument cannot be made -- "Gee, if only we follow the Constitution, the wisdom that comes from the great document will also give us benefits. Here is how we will be better off than we are now."

Is there a consensus here that the First Amendment is one of those things that we may have to deal with to make us worse off or at least no better off?

MR. GIUFFRA: Well, there are strong arguments that if the First Amendment is at least considered in the context of securities regulation, there are at least two benefits. One, complying with all these rules and restrictions is costly and slows the process down. It literally costs billions of dollars for public companies to comply with all these regulations. The second argument would be that the flow of information unimpeded by government intervention would presumably result in more efficient capital markets.

A good example would be Regulation FD, which says that if you are a public company and you're going to announce material information, you've got to do it in such a way that it's communicated to the marketplace as a whole.

Since Regulation FD has been put in place, and particularly immediately thereafter, there was a lot of volatility in the market as companies announced that they, for example, were not going to meet their earnings estimates, and all of a sudden at four o'clock one afternoon after the market closed, Cisco or Intel announced they weren't going to meet the earnings expectations, and then the stock dropped precipitously the next day.

Prior to the imposition of Regulation FD, companies would condition the market through their analysts and say, "Well, we have some problems. We're concerned about whether we're going to meet our earnings forecast", and the markets were less volatile. The bad information was probably communicated to the markets faster than under the present regime, although there were concerns about selective disclosure.

JUDGE KOZINSKI: Why is that good? Why doesn't that simply shift the loss? Rather than having the stock drop and everybody takes an equal loss, what happens is the people who get the information first get out early at the expense of everyone else.

MR. GONSON: Well, that's the argument in favor of regulation.

JUDGE KOZINSKI: Why is that a better result?

MR. GONSON: That's a good question. Regulation FD was premised on the notion that ordinary investors in the market did not like the situation where a corporation whispers in the ear of a favorite analyst and gives him material inside information. Then that analyst, either himself or in some cases the company tips the clients directly, and then, based on this inside information, the analyst or the clients buy or sell before the public is aware of the information.

There were 6,000 comments received on that proposal, and overwhelmingly, the average person very much wanted the equal playing field. That's really the basis for this rule.

The Securities Industry Association opposed it, the American Bar Association opposed it.

MR. McLAUGHLIN: I opposed it.

PANELIST: -- Joe McLaughlin sent in a letter saying he didn't like it either. There were a few people, but maybe, I would say a fraction of 1 percent opposed it. The big hitters opposed it; the little guys loved it.

Mr. McLAUGHLIN: I think the answer to the Judge's question is not really Regulation FD. The large savings are going to come from somewhere else. Certainly small businesses and other companies that do private placements will reap immediate benefits if they can do private placements without having to worry about crossing the line into general solicitation.

So a small company going into the *Wall Street Journal* with an ad to collect investors, accredited investors, will see an immediate savings.

Second, it is also the use of technology. I mentioned before the inhibitions on the use of e-mail, electronic roadshows, websites, Bloomberg. We have all these vehicles available. The SEC says we're in the age of information, but we can't use the vehicles best suited to disseminate information, and that's where the savings will come from.

JUDGE KOZINSKI: Is that a First Amendment problem or is that simply needing to kick the SEC in the behind to say "Come up to speed. We're now living in a different world."

MR. McLAUGHLIN: Well, the ABA letter does not mention the First Amendment. I think it makes a very good case based solely on economics and policy that the SEC ought to relax its restrictions in these various areas. But I think there is a First Amendment argument as well.

JUDGE KOZINSKI: Yes, sir. You waited patiently.

MR. GOLDSTEIN: Bill Goldstein. I am an investment advisor. I've run about twelve proxy contests.

I am going to address your question. While I think that there is way too much regulation in the area of the selling of securities, I can at least understand the rationale, when an investor is only given one side of the story. Perhaps there is an agency that should independently review these documents, but because of the potential danger from fraud, it's something that may be unworkable.

I do not understand, and I tried to get it through the SEC staff, why, in proxy contests, we need the SEC as a mediator. To me, it would be as crazy as having a political election where every time somebody criticized his opponent, you would have to run it by the FEC, who would say, what is the basis for that allegation?

The advantage of getting rid of the SEC, getting it out of the business of mediating proxy contests, is that I think there is a better way to get at the truth by letting the two sides make the charges, respond to the charges, then let the shareholder decide.

My question -- I will finish up with a question -- is, can anybody actually sitting on this panel or in this room say that a proxy contest is covered by commercial speech under the *Central Hudson* doctrine?

JUDGE KOZINSKI: Let's turn to the panel.

PANELIST: Well, the argument would be that in the heat of a proxy contest involving, for example, a closed-end fund and whether it should go open-end, and you can make some money that way, the proponent would make some arguments that would influence the shareholders. Before you could do anything about it in court, the proxy contest would be over and the vote would have been taken. I think that is the argument in favor of SEC review of those communications.

PANELIST: Well, that's what happens in political campaigns, too, though.

MR. GOLDSTEIN: Why can't the other side respond to that?

PANELIST: With e-mail.

MR. GOLDSTEIN: Point out the flaws in my arguments.

PANELIST: You would have to have a rule that keeps it open for a certain amount of time, like the tender offer rules?

MR. GOLDSTEIN: A proxy contest?

PANELIST: Yes.

PANELIST: In other words, unlike the election, which takes place on a date certain, the idea would be that if a particular inflammatory communication came out 24 hours before the vote, you would have to postpone the vote by 48 hours.

PANELIST: That's what happens in the tender offer areas; you have to postpone it.

JUDGE KOZINSKI: Robert.

MR. KRY: Robert Kry, Yale Law School.

One question that was asked before was the hypothetical about what the world would look like without pre-clearance, and another concerned SROs and state action. It seemed that, Mr. Gonson, you earlier presented the issue as a question between, on the one hand, do we want to sacrifice First Amendment values, or on the other hand, sacrifice a well-developed securities market with a lot of transparency?

But to me, it seems like even if we didn't have an SEC, there would still be many other private organizations, including stock exchanges, that could fill that role.

To what extent is the First Amendment a reason to have bona fide non-state actors like stock exchanges not acting under the pertinent Federal agencies set the rules and make appropriate determinations of the balances between transparency and more speech?

MR. GONSON: Well, that's a very complex question, really. I think many of you know that the securities laws work unlike most other government agencies that regulate business. The SEC regulates, except for initial offerings, trading through what is called self-regulatory agencies. These are the stock exchanges and the NASD for the most part, and these organizations are given quasi-governmental powers to regulate their members. They are exempt from the anti-trust laws.

Under the law, to be a stockbroker in the United States, you have to be a member of the NASD or a stock exchange. If you violate their rules, they can throw you out of the business, and then you are out of the business.

These self-regulatory agencies are run under the close oversight of the SEC, so there is a two-tiered regulatory system.

Now, let's say that you took the SEC out of that system and you still had these regulators. You need some government protection. If you're going to take the anti-trust laws away and allow these organizations to remove people from membership then they can't make a living, you need some governmental organization to oversee and make sure that's fair. I guess you could do that in a more limited way than now exists.

But then you would still have the question one step down. That is, you would still have regulatory agencies -- i.e., the stock exchange and the NASD -- doing to a great extent what the SEC is now doing. They have all their elaborate rules about advertising and sales practices and so on. You violate those and, boom, you can get sanctions, including getting tossed out of the securities business. So you are just displacing the First Amendment question one step down.

If you want to lessen regulation by these self-regulatory organizations, it becomes a problem and a question. I really do not know what the answer is.

I do know that when I read, to use your Food & Drug Administration question, these advertisements in magazines, the first page shows this middle-aged couple happy, smiling in the glow of health, and the ad for a pill on the bottom. Then when you turn the page, you get in four-point type -- you get elaborate disclosures of complications.

PANELIST: Has anyone in this room ever read a prospectus before you bought stock?

Prospectuses in recent years under the SEC's aegis have been made in so-called plain English, sort of like GEICO auto insurance policies. I try to read those, too. But for a long time, prospectuses were believed to be written for the professional, not for the average investor, and would be translated by these intermediaries to investors. That is why they

have long elaborate, information.

But I guess in answer to the Judge's original question, I suppose there could be a lessening of regulation, of the detail of SEC rules, to allow much greater latitude which would probably make it.

The SEC stabs at that. They have special regulations for small business designed to make it easier for small business to raise money at less cost and so on, and I suppose if you take all prohibitions out, you're out entirely.

JUDGE KOZINSKI: In the interest of having everybody ask one question before anybody asks a second question, we will go to this gentlemen.

AUDIENCE MEMBER: I am a corporate attorney in Chicago.

It seems at the very least, the securities laws brushed against the First Amendment by compelling and restricting various kinds of speech. What reason do we have to believe that when it comes to setting aside fraud that the market wouldn't bring about the efficient amount of information? Why shouldn't we just chuck all of these aside and not worry about it?

MR. McLAUGHLIN: Well, I think Jack Coffee at Columbia wrote the most compelling article on that subject a number of years ago in which he made the template argument that Bob referred to before.

MR. GIUFFRA: The weights-and-measures argument.

MR. McLAUGHLIN: The weights and measures argument. In the securities area at least, people don't buy securities because they read a 10-K or read a prospectus. They buy securities because they talk to a salesperson, who in turn talks to an analyst.

The only efficient way for an analyst to cover twelve companies in an industry is to look at documents that are roughly comparable in terms of their content.

So if we left it up to the marketplace to let companies decide for themselves what they want to disclose, it would be difficult for an analyst to cover the same number of companies. He might be able to cover only six instead of twelve. That's a decline in efficiency.

AUDIENCE MEMBER: But Joe, if the companies want to raise the capital, they are going to release the information in a format where analysts can cover them and they are going to do that voluntarily so that people will access them.

JUDGE KOZINSKI: Why isn't the information competition or the competition in the way of disseminating information as legitimate a way for people to compete for investment dollars as anything else?

MR. McLAUGHLIN: Well, we do that in the private market, of course. In the private market, people are not compelled to serve up a given template to the investors. The private investors are pretty much able to specify for themselves what they want in the way of information.

The intermediaries, on the other hand, have something else at stake. The worst that could happen to an issuer if there is false or misleading disclosure is that the issuer gives back the money. As far as the intermediary is concerned, the intermediary may be earning a couple of percentage points on the transaction, but if the intermediary is sued after the company has gone broke, the intermediary can be held liable for the full amount of the offering. So it may be that the intermediary is exerting pressure is to put the issuer's disclosure into some kind of standard format.

JUDGE KOZINSKI: Leslie.

MS. HAKALA: Leslie Hakala from Palo Alto. I understand that at least some members of the panel are unhappy with Reg FD because it has led to more volatility in the market.

PANELIST: That's an argument, anyway, against it.

PANELIST: Yes. I'm not sure that's established.

MS. HAKALA: Well, I am curious. If a company calls its favorite analyst and tells him it's going to miss the earnings this month or this quarter, and then the analyst turns around and trades based on that, why isn't that just insider trading?

MR. McLAUGHLIN: Well, the Supreme Court said it's not, in the *Dirks* case. It's not insider trading unless the analyst is

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breaching a duty of trust and confidence.

PANELIST: Paying money to the company.

MS. HAKALA: But why isn't the company tipping?

MR. McLAUGHLIN: Well, tipping is like parking. There's legal parking and tipping and there's illegal parking and tipping. Tipping would be illegal if it were in exchange for some kind of consideration. So if an analyst pays the chief financial officer $1,000 for the tip, that's clearly a breach of the chief financial officer's duty to his corporation and the analyst is participating in that. But in *Dirks*, the Supreme Court, in a decision that I keep telling Paul has constitutional underpinnings, the --

MR. GONSON: I argued the case in the Supreme Court and I tell Joe that no lawyer and no justice and no judge ever even breathed the Constitution. No one ever mentioned the Constitution.

MR. McLAUGHLIN: But on the other hand, if you read Justice Powell's opinion, it is very eloquent in terms of the need to avoid labelling information. You can not paint information red or green and say that it can or cannot be used for a specific purpose. The only way you can really regulate conduct in this area is to focus on the relationship of trust and confidence, which is really at the bottom of all insider trading law.

MR. GIUFFRA: On the Reg FD point, two points. Reg FD is a rule that was just put in recently. We did not have Reg FD until this point, and the markets survived. There are many commercial transactions that occur in the world where there are informational inequalities.

The reason why Reg FD may be problematic is it does slow the flow of information to the market and puts corporations in a position where they must be extremely careful about everything they say, and one could argue that, as a result, stock prices are artificially inflated for some period of time when people are engaging in transactions without full information.

JUDGE KOZINSKI: I think that's all the time we have. This has been remarkably informative and a riveting panel this late in the day. We really are very grateful to the participants.