



Fair Disclosure – *SEC Regulation FD*

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Why was Regulation FD Adopted?

- ◆ Went into effect on October 23, 2000
- ◆ SEC addressing what it perceived to be a systemic problem of companies selectively disclosing material, nonpublic information to analysts and institutional investors before the public at large
- ◆ Those receiving the information first are able to make a profit or avoid a loss at the expense of those who do not have the information
- ◆ This erodes confidence in the financial markets



What does Regulation FD Require?

- ◆ Intentional Disclosure:

No covered person, i.e. a person subject to Regulation FD, may make an intentional disclosure of material nonpublic information to market professionals or shareholders unless that information is simultaneously disclosed to the public



What does Regulation FD Require? (cont.)

- ◆ Non-Intentional Disclosure:

If a covered person makes a non-intentional disclosure of material nonpublic information to market professionals or shareholders, public disclosure is required within 24 hours after a “senior official” of the company learns of the disclosure and knows (or is reckless in not knowing) that the information disclosed was material and nonpublic



Key Concepts

- ◆ Covered persons
- ◆ Intentional vs. non-intentional disclosure
- ◆ Market professionals and shareholders
- ◆ Public disclosure
- ◆ Material nonpublic information



Who is a Covered Person?

- ◆ Any senior official:
 - ◆ Directors
 - ◆ Executive officers
 - ◆ Investor relations or public relations officers
 - ◆ Other persons with similar functions

- ◆ Any other officer, employee or agent of the company who regularly communicates with market professionals or shareholders
 - ◆ Important for a company to designate employees who are authorized to communicate with market professionals and shareholders



What is Intentional Disclosure?

- ◆ A selective disclosure of material nonpublic information is **intentional** when the person making the disclosure either knows, or is **reckless in not knowing**, that the information being communicated is both material and nonpublic
- ◆ In determining recklessness, the SEC will consider whether any “reasonable person ***under the circumstances*** would have made the same determination”
 - ◆ Prepared written statement vs. impromptu answer to unexpected question
 - ◆ Important to prepare for one-on-ones
 - ◆ Important to analyze disclosures after the fact to determine whether there were any non-intentional disclosures



Who are Market Professionals or Shareholders?

- ◆ Broker-dealers and their associated persons, including sell-side analysts
- ◆ Investment advisors, institutional investment managers, and their associated persons, including buy-side analysts
- ◆ Investment companies (mutual funds), hedge funds, and their affiliated persons
- ◆ Any shareholder or other holder of the company's securities, including its debt securities, ***under circumstances in which it is reasonably foreseeable that such person would purchase or sell the company's securities on the basis of the information contained in the communication***



Who are Market Professionals or Shareholders? (cont.)

- ◆ Exceptions:
 - ◆ A person who owes the company a duty of trust or confidence (i.e. a “temporary insider” such as an attorney, investment banker, or accountant)
 - ◆ Persons who expressly agree to maintain the communicated information in confidence

- ◆ Regulation FD does not cover:
 - ◆ Disclosures to the media
 - ◆ Ordinary course business communications with customers, suppliers, etc.

- ◆ Must consider the “feedback loop”



What Constitutes Public Disclosure?

- ◆ A method or combination of methods that are reasonably designed to effect broad public distribution of the Information
- ◆ Public disclosure under Regulation FD can be made by:
 - ◆ Filing or furnishing the information on a Form 8-K
 - ◆ Disseminating a press release through a widely circulated news or wire service, such as Dow Jones, Bloomberg, Business Wire, PR Newswire or Reuters
 - ◆ Making an announcement in a forum to which the public has been granted access (in person or by telephone or webcast), so long as adequate prior notice has been given



What Constitutes Material Nonpublic Information?

- ◆ Information is material if there is a substantial likelihood that a reasonable investor would:
 - ◆ Consider it important in making an investment decision
- AND**
- ◆ View the fact as having significantly altered the “total mix” of information available



What Constitutes Material Nonpublic Information? (cont.)

- ◆ Quantitatively small amounts may be qualitatively material
- ◆ Factors to consider are whether the item:
 - ◆ Is capable of precise measurement, or is based on an estimate (and the degree of imprecision inherent in the estimate)
 - ◆ Affects the trend in earnings or other key items
 - ◆ Is consequential to meeting analysts' consensus expectations
 - ◆ Changes results from positive to negative
 - ◆ Is significant to a segment
 - ◆ Is consequential to compliance with regulatory requirements or loan or other contractual requirements
 - ◆ Affects compensation
 - ◆ Is intentionally wrong or misleading, or conceals unlawful transactions
 - ◆ Prompts significant market reaction
 - ◆ Key consideration
 - ◆ Trigger of SEC inquiry
 - ◆ "Catch 22"



What Constitutes Material Nonpublic Information? (cont.)

SEC Guidance - Following should be treated with extreme care and are more than likely material

- ◆ Earnings information
 - ◆ Reaffirming guidance or expressing confidence in or concern about guidance
 - ◆ Commenting on analyst estimates
 - ◆ **Examples:**
 - ◆ “We are comfortable with your estimate”
 - ◆ “We expect to generate one-third of our EPS in the first half of the year”, when quarterly guidance was not provided publicly
 - ◆ Discussing prospects for quarter or year using another company’s results as a proxy
 - ◆ **Example:**
 - ◆ “We are subject to the same cost pressures as X Co.”, when X Co. just announced earnings that missed analysts’ expectations



What Constitutes Material Nonpublic Information? (cont.)

- ◆ Providing indirect commentary on earnings
 - ◆ **Example:**
 - ◆ “Due to X, our expenses for the quarter/year will be greater than anticipated”
- ◆ Mergers, acquisitions, tender offers, joint ventures, or changes in assets
 - ◆ **Example:**
 - ◆ “What are your thoughts about acquiring X Co.?”
- ◆ New products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract)
 - ◆ **Examples:**
 - ◆ “Our sales pipeline looks good”, contrasting to earlier more negative statements (Siebel 1 and Siebel 2)
 - ◆ Quantifying what “significant weakness in sales” meant (Motorola)
 - ◆ Disclosing new OEM agreement (Secure Computing)



What Constitutes Material Nonpublic Information? (cont.)

- ◆ Changes in control or in management
- ◆ Change in auditors or auditor notification that the company may no longer rely on an auditor's audit report
- ◆ Events regarding the company's securities – e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security-holders, public or private sales of additional securities
 - ◆ **Example:**
“We do not favor repurchasing our shares”, when prior public statements had indicated that no decision had been made (Schering-Plough)
- ◆ Bankruptcies or receiverships



Penalties for Regulation FD Violations

- ◆ Company:
 - ◆ Cease and desist order in an administrative action
 - ◆ Injunction and/or monetary penalties in a civil action
 - ◆ Violations of Rule 13a-15, which requires companies to maintain disclosure controls and procedures
 - ◆ Implicates CEO and CFO certifications

- ◆ Individuals:
 - ◆ Cease and desist order in an administrative action
 - ◆ Aiding and abetting claim in a civil action seeking injunction and/or monetary penalties

- ◆ Analyst/investor:
 - ◆ None

- ◆ There is no private right of action under Regulation FD



Regulation FD Policies

- ◆ Some companies adopt formal written policies to document their Regulation FD compliance procedures and practices
- ◆ Such a policy will typically limit who is authorized to communicate with analysts and shareholders
- ◆ One benefit of having such a policy is that the company will not be liable under Regulation FD for a selective disclosure made by a person who is not an executive officer or director and not authorized under the policy to communicate with market professionals and shareholders



SEC Enforcement of Regulation FD

Five enforcement actions in 2002; one a year for a couple of years after than; then three in the past year or so after a four-year hiatus

- ◆ Office Depot (October 2010)
 - ◆ Referred analysts to recent earnings statements by comparable companies that discussed the effect of the slowing economy and reminded analysts that Office Depot had earlier expressed similar concerns
 - ◆ Schering-Plough paid \$1 million penalty
 - ◆ Its CEO and its former CEO each paid a \$50,000 penalty
- ◆ Presstek, Inc. (March 2010)
 - ◆ Two days before end of quarter, CEO told managing partner of firm with big stake in company that the summer was “not as vibrant” as expected and a “mixed picture” overall
 - ◆ Firm sold shares before earnings announced and stock price dropped 20%
 - ◆ Presstek paid a \$400,000 penalty; its former CEO has not yet settled
- ◆ Flowserve Corporation (2005)
 - ◆ CEO reaffirmed guidance to analysts in a private meeting late in the quarter; IR officer stayed silent
 - ◆ CEO fined \$350,000; IR officer fined \$50,000