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Regulation FD

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Regulation FD - Purpose

- How are we sure everyone gets the same important information at the same time?
  - Problem: “Selective disclosure” of material nonpublic information to securities analysts, institutional shareholders and others but not to the public causes an imbalance in disclosure system
  - Response: In 2000, the SEC adopted Regulation FD (Fair Disclosure) requiring an issuer that discloses material nonpublic information to securities market professionals or to a security holder to make public disclosure of such information
  - Goal: To “level the playing field” between small and institutional investors

Regulation FD – The Rule

- Disclosures of material nonpublic information concerning the company or its securities
- Made by (i) a director, (ii) an executive officer or (iii) an IR person to
- (i) securities industry professionals or (ii) security holders who are likely to trade on the information
- That are not exempt

Violate Regulation FD

Applying Materiality Standards

- Amorphous definitions established by case law
  - Information is material if (i) “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision or (ii) there is a substantial likelihood that it “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available”
- Information regarding certain topics will almost always be considered material:
  - Earnings (including ballpark guidance)
  - Sales figures
  - Significant transactions
  - Changes in control
  - Difficulties with auditors
- Confirmation of prior guidance contains a significant risk of an FD violation as such confirmation itself may be material (including statements like “has not changed” or “still comfortable with”)

Communications Not Covered by Regulation FD

- Communications by persons who are not (i) senior officials (i.e., directors or executive officers) or (ii) IR personnel
- Communications to persons who are not (i) securities industry professionals or (ii) security holders who are likely to trade on the information
- Communications of non-material information
- Exempt communications

Exempt Communications

- Communications made to a person who owes a duty of confidence (e.g., attorney, investment banker or accountant)
- Communications made to a person who expressly agrees to maintain the disclosed information in confidence (which need not be in writing)
  - Communications made to ratings agencies were previously exempt from Reg FD but the SEC removed that exemption in 2010 as required by the Dodd-Frank Act. Nevertheless, engagement letters between companies and ratings agencies generally include confidentiality provisions, so the change to the rule has little substantive effect
- Communications made in connection with many types of registered securities offerings

Timing of Public Disclosure

- Intentional or planned disclosures
  - Examples: planned remarks, speeches, presentations, letters to a public audience
  - Timing: Requires prior or **simultaneous** disclosure to the public of any material information
- "Non-intentional" selective disclosures
  - Examples: Responses to questions, unscripted interviews, unplanned comments
  - Requires disclosure to the public of any material information within the later of **24 hours** or the commencement of the **next day's trading on the NYSE** after a senior official learns of the selective disclosure.

Methods of Public Disclosure

- Disclosure must be made by a method or combination of methods that are “reasonably designed to provide broad, non-exclusionary distribution of the information to the public”
- Compliant methods include:
  - filing (or furnishing) a Form 8-K with the SEC
  - disseminating a press release through a widely circulated news or wire service
  - conference calls, press conferences or webcasts (with adequate notice and access)
  - in some cases posting material on company website or through social media

Is Website Posting Public Disclosure

- SEC released guidance in 2008
- Public companies must consider whether:
  - a company website is a “recognized channel of distribution”
  - posting disseminates the information in a manner making it available to the marketplace in general
  - there has been a reasonable waiting period for investors and the market to react to the posted information
- What steps has company taken to identify website as channel of distribution? Is website posting publicized through an email alert?

Evaluating Whether Social Media Disclosures are “Public”

- In April 2013, the SEC issued guidance on the application of Reg FD to disclosures made through social media in its Report of Investigation of Netflix
- According to prior Reg FD guidance regarding websites, a company makes “public” disclosure when it distributes information “through a recognized channel of distribution.”
- Whether a company’s social media channel is a “recognized channel of distribution” will depend on the steps the company has taken to alert the market to its social media channel and its disclosure practices—as well as the use by investors and the market of the company’s social media channel
- Companies are required to conduct a thorough facts and circumstances analysis to conclude that disclosures made via a social media channel will be a “recognized channel of distribution” and thus “public” for Reg FD purposes

Consequences of Violating Reg FD

- Possibility of SEC enforcement action
- Does not create private right of action
- Sanctions against company and individual
  - Cease-and-desist order in administrative action
  - Injunction and/or monetary penalties in civil action
- Could complicate Exchange Act reporting
  - SEC position that failure to comply with Reg FD is a violation of disclosure controls and procedures could complicate control disclosures and CEO and CFO SOX certifications

SEC Enforcement Actions under Regulation FD

- Though adopted in 2000, no actions until November 2002
- 2002: Four actions disclosed simultaneously in November (*Raytheon, Secure Computing, Siebel Systems I, Motorola*)
- 2003: One action (*Schering-Plough*)
- 2004: Two actions (*Siebel Systems II, Senetek*)
- 2005: One action (*Flowserve*)
- 2007: One action (*Electronic Data Systems*)
- 2009: One action (*Black*)
- 2010: Two actions (*Presstek, Office Depot*)
- 2011: One action (*Fifth Third Bancorp*)
- 2013: One action (*First Solar*)

Lessons From SEC Enforcement Actions

- Need for coordination in communications policy and understanding what has been publicly disclosed
  - Particular sensitivity to statements that could be seen to contradict previous public disclosure
- Extreme caution in discussing forward-looking information (particularly earnings guidance) in private meetings with analysts and investors
- Disclosures at industry conferences can lead to Reg FD violations if not broadly available to the public
- Material information can be conveyed by how something is said as well as by what is said
- Importance of adopting and complying with a corporate disclosure policy
  - Anything relating to or impacting earnings will be considered material
  - Establish procedures for rapid public dissemination in the event of "non-intentional" selectively disclosed information
- SEC has increasingly imposed financial penalties on officers and companies for Reg FD violations

Early SEC Enforcement Actions

- ***Raytheon*** - Raytheon's CFO held one-on-one telephone calls with sell-side analysts. During the calls, the CFO indicated that the analysts' quarterly EPS estimates were based on incorrect assumptions regarding the seasonality of Raytheon's earnings and were therefore too high. The analysts all lowered their estimates. Raytheon provided no comparable quarterly guidance in its publicly-accessible investor calls.

- ***Secure Computing*** - Secure Computing entered into a contract that would clearly have a material impact on earnings. The CEO disclosed the contract to two portfolio managers from investment advisory companies prior to public announcement. A Reg FD violation was found notwithstanding that the company issued a press release on the evening of the same day on which the CEO made the second of his two nonpublic disclosures.

Early SEC Enforcement Actions

- ***Siebel Systems I*** - During Q&A session at invitation-only conference hosted by bank, CEO made optimistic comments regarding short-term results. This was in direct contradiction to negative statements that he had made three weeks earlier on a publicly-accessible earnings call. Siebel's stock price and trading volume increased sharply on day of conference. Siebel paid $250,000 penalty as part of settlement.

- ***Motorola*** - Motorola disclosed in press release that it was experiencing "significant" weakness in sales and orders. After seeking the advice of in-house counsel, Director of IR called analysts individually and explained that "significant" means 25% or more. SEC concluded that in-house counsel was incorrect in advising that this clarification was not material nonpublic information. Nevertheless determined not to take enforcement action on ground that advice of counsel was sought and given in good faith.

Early SEC Enforcement Actions

- ***Schering-Plough***
  - CEO and Director of IR had one-on-one Q&A sessions with four institutional investors. SEC contended that during these meetings, CEO, "through a combination of spoken language, tone, emphasis and demeanor . . . disclosed negative and material, nonpublic information" regarding the company. Immediately after the meetings, analysts downgraded stock and trading volume increased significantly.
  - SEC imposed $1 million fine on Schering-Plough and $50,000 fine on CEO.

Early SEC Enforcement Actions

- ***Siebel Systems II***
  - During earnings call, CEO expressed pessimism and refused to answer questions about deals in pipeline.
  - At private meetings with analysts and investors three weeks later, CFO, with Director of IR present, made statements that "materially contrast with the negative public statements" previously made by CEO. CFO answered questions that CEO ducked regarding transactions in pipeline.
  - Stock price and volume spiked on day after disclosures.
  - GC asked CFO and Director of IR what was said at meeting. They each indicated that no material nonpublic information was disclosed.
  - SEC brought complaint against Siebel itself and against the CFO and Director of IR individually.

Siebel Systems II (Cont'd)

- Complaint notes that the Director of IR had been appointed after Siebel I and charged with doing everything possible to comply with Reg FD.
  - In his own job description, Director of IR identified one job priority was to "fully comply with Regulation FD." This was given a 10% weighting, which the SEC suggested showed it was a low priority.
- Complaint notes that company did little to improve its compliance with Reg FD following Siebel I.
  - No formal training was given. No policy was promulgated or additional safeguards implemented.
- Siebel elected to fight SEC rather than settle complaint.
- In August 2005, district court threw out complaint, stating that Reg FD does not require management to become "linguistic experts" who "only utter verbatim statements that were previously publicly made."
- No violation of Reg FD because the private statements did not constitute material nonpublic information.

Early SEC Enforcement Actions

- ***Senetek***
  - Two firms engaged by Senetek PLC prepared and submitted for review draft research reports containing financial projections about the company for the 2002 fiscal year.
  - Senetek's CEO and CFO provided the firms with revisions to their financial projections based on material nonpublic information, but did not disclose that information to the public.
  - The nonpublic data provided by the CEO and CFO caused the firms to lower the revenues and earnings projections contained in their final reports from those included in the draft reports.
  - SEC brought administrative action against Senetek resulting in Senetek consenting to a cease-and-desist order.

Early SEC Enforcement Actions

- ***Flowserve***
  - On two occasions during 2002, Flowserve publicly lowered its earnings guidance. On October 22, 2002, it reaffirmed its lowered guidance in a press release.
  - On November 19, the CEO reaffirmed the lowered guidance in a non-webcast meeting with analysts.
  - On November 20, an analyst who attended the meeting issued a report stating that Flowserve had reaffirmed.
  - On November 21, Flowserve's stock price was up 6% and volume was up 75%.
  - On November 21, after the close of trading, Flowserve issued a Form 8-K regarding the reaffirmation.
  - SEC charges company, CEO and Director of IR.
  - Charges are settled, company pays $350,000 fine, CEO pays $50,000 fine.

More Recent SEC Enforcement Actions

- ***Electronic Data Systems***
  - EDS entered into "capped collar contracts" which required cash payments by EDS if EDS' stock price fell below a certain threshold. In 2002, following a disappointing earnings announcement, EDS stock fell far enough to trigger the settlement requirement.
  - Prior to public disclosure, EDS personnel informed analysts of settlement obligation and that it intended to settle its $225 million obligation under the contracts by issuing commercial paper. Public disclosure was made 5 days after first analyst was notified.
  - In 2007, SEC took enforcement action, despite no direct earnings impact of the settlement; SEC concluded that payment was material to EDS.
  - However, EDS admitted to various other violations of the securities laws:
    - Derivative contracts at issue had not been properly disclosed in EDS' 10-Ks and 10-Qs
    - FCPA violation

More Recent SEC Enforcement Actions

- ***SEC v. Christopher A. Black***
  - Black was CFO of American Commercial Lines and served as ACL's designated investor relations contact.
  - On Monday, June 11, 2007, ACL revised its previously-issued 2007 earnings guidance. In the release, ACL stated that the company expected "2007 second quarter results to look similar to the first quarter." (Emphasis added). First quarter EPS were $0.20.
  - During that week, Black and ACL's CEO met with analysts covering ACL's stock.
  - Following the meetings, ACL's CEO requested that Black send a "recap" email to the analysts (not all of whom had been present for all meetings) summarizing the information discussed in the analyst meetings.
  - ACL's CEO instructed Black to send the email by close of business on Friday, June 15, 2007. CEO also instructed Black to provide a draft of the email to outside counsel prior to sending it.
  - Black was unable to finalize the email to analysts before close of business on Friday, June 15, 2007. Before leaving work, Black forwarded the email to his personal email account so that he might work on it over the weekend.
  - Sometime before leaving work on June 15th, however, Black received an updated internal analysis indicating that ACL's EPS for the second quarter could be as low as $0.13 (much lower than the first quarter's actual results).

SEC v. Black (Cont'd)

- On Saturday, June 16, 2007, Black sent an email from his personal email account to eight sell-side analysts who covered ACL.
  - Email provided additional detail regarding the previously-disclosed weakness in shipping volumes.
  - In addition, stated that the company expected that "EPS for the second quarter will likely be in the neighborhood of about a dime below that of the first quarter based on this pressure." (Emphasis added).
- Black never provided his email to anyone else at ACL, or to outside counsel, before transmission.
- Upon learning of Black's email, ACL notified the SEC. Within two months after the incident, Black announced plans to leave ACL.
- In September 2009, the SEC filed an enforcement proceeding against Black, but not against ACL. In determining not to bring charges against ACL, the SEC noted:
  - "Culture of compliance" created at ACL as a result of Reg FD training
  - Black's sole responsibility for the violation; Black acted outside of the controls established by ACL to prevent such disclosures
  - Prompt filing of a Form 8-K
  - ACL's "extraordinary cooperation" with the SEC's investigation
- Black consented to a settlement and agreed to pay a fine of $25,000.

Recent SEC Enforcement Actions

- ***SEC v. Presstek***
  - Edward Marino was Presstek's CEO, and 1 of 3 persons authorized to speak to investors, analysts and other securities industry professionals.
  - Presstek maintained an internal policy of "corporate silence" beginning on the 15th day of the last month of any given quarter.
  - In September 2006, Marino was informed that Presstek's forecast for the quarter would be lower than expected and that a preliminary announcement would be made in early October 2006 to report such performance.
  - On the morning of September 28, 2006, Marino spoke with the managing partner of a registered investment advisor regarding Presstek's lower-than-expected financial performance for the third quarter.

SEC v. Presstek (Cont'd)

- Specifically, Marino stated that "[s]ummer [was] not as vibrant as [they] expected in North America and Europe" and that although "Europe [had] gotten better since [the summer]" it was "overall a mixed picture [for Presstek's performance that quarter]."
- Promptly after the telephone conversation, the registered investment advisor sold substantially all of its Presstek holdings. Presstek's stock price dropped approximately 19%.
- At or about 12:01 a.m. on September 29, 2006, Presstek issued its preliminary announcement for the third quarter 2006, stating that its performance was below its earlier publicly disclosed estimates. That day, Presstek's opening stock price was 20% lower than the prior day's closing price, and its closing price was 10% lower than the prior day's closing price.
- Presstek settled the SEC's charges for $400,000.
- Marino settled the SEC's charges that he aided and abetted Presstek's violations by agreeing to pay a $50,000 civil penalty.

SEC v. Presstek (Cont'd)

- Though the facts look similar to those in Black, SEC instituted enforcement action against Presstek but not American Commercial Lines.
  - Both executives behaved similarly and each alone were responsible for violating the policy.
  - The companies both had disclosure policies in place to prevent improper disclosures by company officials.
  - Each company promptly disclosed the information to the public upon learning of the selective disclosure and took significant remedial actions to prevent future violations.
- However, SEC noted that ACL had:
  - "cultivated an environment of compliance" by
    - training its employees regarding the requirements of Reg FD
    - adopting policies that implemented controls to prevent violations
  - self-reported the violation to the SEC staff the day after it was discovered and
  - subsequently provided "extraordinary cooperation" with the SEC's investigation.
- Significantly, the SEC did not make any similar comments with respect to Presstek.

Recent SEC Enforcement Actions

- ***SEC v. Office Depot***
  - In October 2010, SEC charged Office Depot and two of its executives with violations of Reg FD for making statements to analysts that included implicit warnings about declining earnings.
  - SEC alleged that the company executives made telephone calls to analysts in an attempt to encourage them to lower previous estimates, which company executives deemed no longer feasible.
  - In February and April 2007, Office Depot held two public conference calls in which CEO and CFO (i) described a business model which contemplated mid- to upper-teens EPS growth over the long-term and (ii) warned that its largest business segments were facing a softening in demand. In early May, in another publicly available investor conference, Office Depot made similar disclosures.
  - In late May, CEO alerted Board of Directors that Office Depot would not meet the analysts' consensus EPS estimate for the second quarter and that senior management was discussing a strategy for advance communication to avoid a complete surprise to the market.
  - In mid June, CEO and CFO jointly decided that instead of telling analysts that Office Depot would not meet expectations, the company would talk individually with each of its eighteen analysts "just to touch base" and to point them towards earnings releases of comparable companies noting slowed growth, noting that such releases were "interesting" and repeating warnings of a softening economy.

SEC v. Office Depot (Cont'd)

- The Director of IR made these calls initially on Friday, June 22. Over the weekend he reported back to the CEO and CFO and they both encouraged the calls to continue on Monday, June 25.
- Also on Monday, the CEO obtained an update on analyst estimates, which were still a bit too high. In response, the CFO asked the Director of IR to call the top 20 institutional investors and relay same talking points, which was done on Tuesday.
- More than one analyst expressed concern that the company had not released the information to the public, and the executives noted that the analysts were lowering their estimates in response to the calls; nevertheless, the executives continued to encourage the calls.
- Office Depot filed Form 8-K on Thursday, six days after the calls initially began. From Friday to Thursday, the stock price dropped 7.7%.

SEC v. Office Depot (Cont'd)

- Office Depot and the executives settled the charges. The company agreed to pay a $1 million penalty and each of the executives agreed to pay a $50,000 penalty and sign a cease-and-desist order.

Recent SEC Enforcement Actions

- ***Fifth Third Bancorp***
  - In May 2011, Fifth Third selectively disclosed to certain investors its intention to redeem a class of its trust preferred securities (TruPS) for approximately $25 per share. The securities were then trading at approximately $26.50 per share.
  - Fifth Third did not issue a Form 8-K or other public notice of the redemption until it became aware that investors with knowledge of the redemption were selling the securities to purchasers who were unaware of the redemption.
  - In settling the charges with the SEC, Fifth Third agreed to compensate harmed investors, adopt various additional policies and procedures relating to the redemption of securities and sign a cease-and-desist order. No civil penalty was imposed upon Fifth Third based on its cooperation with the investigation.

Recent SEC Enforcement Actions

- ***SEC v. Polizzotto***
  - After learning that the U.S. Department of Energy would not award First Solar, Inc. one of the loan guarantees that it had sought from the DOE, Polizzotto, the head of investor relations of First Solar, communicated privately with more than 30 analysts and investors to notify them that there was a "low probability" that First Solar would receive that guarantee but there was a "high probability" it would receive others.
  - Less than 10 days before that, First Solar's CEO had expressed confidence at an investor conference that First Solar would receive the lost guarantee.
  - In-house counsel had specifically advised Polizzotto (and others at First Solar) by email that news of the failure to obtain the loan guarantee could not be selectively disclosed, including in response to questions from analysts and investors.
  - Polizzotto had sent internal emails noting that the news was "material" and could create a "huge concern."

SEC v. Polizzotto (Cont'd)

- At the time of Polizzotto's disclosures, First Solar had not received a formal notice from the DOE, but knew of its decision. At the time of Polizzotto's statements, analyst reports regarding Congressional oversight of the loan guarantee program had resulted in concern within the solar industry regarding the DOE's ability to move ahead with the guarantee.
- These concerns had resulted in numerous inbound calls to First Solar's IR department and an 8% drop in First Solar's stock price.
- The SEC did not charge First Solar, citing its "extraordinary cooperation" with the SEC's investigation, as well as its cultivation of an "environment of compliance through the use of a disclosure committee that focused on compliance with Regulation FD". The SEC also noted that First Solar had immediately discovered Polizzotto's misconduct and had issued a press release regarding the matter early on the next day following the disclosures and quickly self-reported the matter to the SEC.
- The SEC settled with Polizzotto for a $50,000 fine and a cease-and-desist order.