SEC BANS SELECTIVE DISCLOSURE

On August 10, the Securities and Exchange Commission adopted its controversial new Regulation FD (for “fair disclosure”) banning U.S. public companies from selectively disclosing material nonpublic information to securities analysts, certain other market professionals or existing shareholders (where it is foreseeable that the shareholder will trade on such information). Regulation FD requires that an issuer making an “intentional” disclosure of material, nonpublic information to such persons do so in a manner that provides simultaneous disclosure of the information to the general public. If a “non-intentional” selective disclosure of material information is made, the issuer must “promptly” (generally within 24 hours after a senior official of the issuer knows, or is reckless in not knowing, of the selective disclosure) make public disclosure.

Public disclosure under Regulation FD requires either inclusion of information in a Form 8-K or dissemination by press release or other means of broad, non-exclusionary distribution to the public. Posting of information on the Internet or providing open access to a Webcast or telephone conference will generally not, by itself, suffice as public disclosure for purposes of Regulation FD, but such techniques may be used in combination with a previous press release, “push technology” e-mail alert or other means of communication that gives the public and media notice of availability of the posting or access to achieve sufficient public disclosure.

Failure to comply with Regulation FD may result in SEC enforcement proceedings (leading to cease-and-desist orders, injunctions or fines), but not in private liability claims.

Regulation FD will become effective in mid-October 2000 (60 days after publication in the Federal Register, which is expected this week). SEC Release No. 33-7881 (August 15, 2000).

Practical implications for U.S. public companies

Regulation FD will likely affect the way many U.S. public companies deal with analysts (both buy-side and sell-side), other market professionals and institutional shareholders. It is unlikely that one formula or model will emerge. But Corporate America is taking the prospect of SEC enforcement actions very seriously, and Regulation FD should cause U.S. public companies to move in certain predictable directions:

One-on-one and limited access meetings, telephone conferences, Webcasts and visits are not prohibited under Regulation FD, but they will involve considerable risks. A company spokesperson responding to questions and probing by analysts will rarely have any real certainty that information being disclosed is not material. Companies that are able to do without one-on-one and limited access communications can be expected to begin eliminating or reducing dependence on them. Regulation FD may offer an opportunity to reduce analyst contact without taking a penalty in stock price. Early reports in THE WALL STREET JOURNAL indicate that U.S. public companies are taking advantage of this opportunity even before effectiveness of Regulation FD. Those companies that perceive one-on-one or limited access contact as a
business necessity should adhere to strictly disciplined procedures and record-keeping when engaging in such contact.

**Designated spokespersons and disciplined procedures.** It is more important than ever to designate specific personnel to communicate with analysts, other enumerated professionals and shareholders and to keep a record of the designated personnel. Designated spokespersons must be fully instructed on company policy regarding one-on-one and limited access contact and regarding the obligation to ensure “prompt” public disclosure if mistakes are made. Such spokespersons must have access to legal counsel and must be prepared to hold analysts at arm’s-length until judgment calls on materiality are made if companies are continuing to engage in one-on-ones and limited access contacts. To the extent possible, impromptu contact should be avoided. Company spokespersons should attempt to schedule and structure contact ahead of time and obtain some advance indication of scope of inquiry in order to permit consideration of materiality issues. Spokespersons should also keep records of what they say and when they say it. Such records should be made continually available to other designated spokespersons, senior management and counsel so they can review and assess for consistency and for selective disclosure issues.

*“Guidance” on earnings in one-on-one or limited access settings has been singled out by the SEC as involving an especially “high degree of risk under Regulation FD.”* This is a clear indication that the SEC intends to take an aggressive enforcement posture on this type of disclosure. Already a high-wire act before Regulation FD, giving guidance on analyst projections will now take on even greater risk unless done in open-access settings.

**The SEC model: press release/notice and open access, “live” conferences or Webcasts.** The trend of U.S. public companies toward open-access, real-time telephone conferences or Webcasts as a means of communicating with analysts following press releases should accelerate sharply. The SEC has endorsed this model. The crucial components are to lead with a press release covering the information. The press release should include notice of the time, date and access instructions for the conference. Web posting or “push technology” e-mail alerts with instructions regarding the open-access conference may supplement the release. Access to the conference or Webcast must be “live” but may be listen-only for participants other than the analysts and market professionals. Although this model will not supplant all contact with analysts for most public companies, it should become the standard approach for dissemination and follow-up on earnings information, M&A-related information and information regarding new products or discoveries or developments regarding customers or suppliers (e.g., acquisition or loss of a material contract) and other news in the categories outlined by the SEC in the Regulation FD adopting release as having high materiality potential.

**Form 8-K filings.** Issuers whose releases are not always carried by major wire services should now consider making Form 8-K filings for every press release in order to have the certainty of adequate public disclosure under Regulation FD. Many public companies already file Form 8-Ks voluntarily for each press release they issue. This approach is advisable for smaller public companies.

**Confidentiality agreements.** Public companies engaged in registered and unregistered financing transactions should confer with counsel regarding use of confidentiality agreements to
avoid Regulation FD public disclosures that could violate the Securities Act of 1933 or destroy exemptions or safe harbors. Any financing transaction must now be viewed by public companies and their counsel through the lens of Regulation FD.

Disproportionate impact on small public companies. There is little doubt that smaller public companies will have more difficulty finding a new equilibrium under Regulation FD than large companies. The realm of the clearly immaterial is even more elusive for small companies, and they have fewer analysts following them and a greater concern about driving analysts away by being dilatory and unresponsive. Smaller companies also may not have in-house counsel and trained investor relations personnel to help make materiality calls. Ironically, companies with the thinnest markets for their securities, the greatest potential for stock volatility and the least ability to say “no” to one-on-one and limited access communications are probably also the least equipped to manage the tightrope walk entailed in continuing such communications after Regulation FD.

A Closer Look at Regulation FD

In the view of the SEC, selective disclosure of material information by public companies undermines the integrity and fairness of securities markets. When analysts, portfolio managers, institutional investors or others receive advance notice of corporate developments, financial results or projections, the informed segment of the market can profit before the average investor has a chance. SEC Chairman Arthur Levitt has called selective disclosure “a stain on our markets.”

In the past, the SEC has attempted to stem selective disclosure by application of insider trading law, but has been largely unsuccessful in doing so. This is because the U.S. Supreme Court has held that selective disclosure (or “tipping”) of material nonpublic information must be for the personal benefit of the person disclosing in order to be in violation of Rule 10b-5 under the Securities Exchange Act of 1934. The typical informal exchange of information between a public company and analysts, portfolio managers and institutional investors has generally been viewed as being for the benefit of the company, not the personal benefit of the spokesperson making the selective disclosure.

In Regulation FD, the SEC has taken a new approach. Regulation FD does not purport to change insider trading law under Rule 10b-5. Regulation FD seeks instead to ban selective disclosure by imposing a new disclosure obligation on U.S. public companies. Under Regulation FD, whenever (1) an issuer, or any person acting on its behalf, (2) discloses material nonpublic information, (3) to certain enumerated persons not bound by duty of confidentiality, (4) the issuer must (a) simultaneously (for intentional disclosures), or (b) “promptly” (for non-intentional disclosures) (5) make public disclosure of that same information.

Issuers covered. The new duty applies only to domestic U.S. issuers subject to SEC reporting requirements under the Exchange Act (including closed-end investment companies, but not including other types of investment companies). Foreign issuers are not covered.

Enumerated persons. Regulation FD applies only to communications with four categories of persons: (1) broker-dealers and their associated persons; (2) investment advisers, certain institutional investment managers and their associated person; (3) investment companies,
hedge funds and affiliated persons; and (4) holders of the issuer’s securities, under circumstances in which it is reasonably foreseeable that such holder would purchase or sell securities on the basis of the information. Explicitly excluded from the enumerated categories are ratings agencies. Also excluded are any persons who owe the issuer a duty of trust or confidence (so-called “temporary insiders,” such as lawyers, investment bankers or accountants) as well as any person who expressly agrees to maintain the information in confidence. A confidentiality agreement must be express, but need not be in writing. Such an agreement may also be reached after a disclosure is made. Consequently, a spokesperson who mistakenly reveals material information to an analyst may avoid a Regulation FD public disclosure obligation by obtaining the agreement of the analyst not to disclose or trade on the information.

**Issuer personnel.** Regulation FD applies only to communications made by (1) any senior official of the issuer (defined as any director, executive officer, investor relations or public relations officer or other person with similar functions); or (2) any other officer, employee or agent of an issuer who regularly communicates with the enumerated persons. Issuers and covered personnel may not avoid the reach of Regulation FD by having a non-covered person make a selective disclosure. The SEC’s adopting release indicates that the issuer or covered person would be held responsible for any communication that another person was directed to make.

**Materiality.** Regulation FD does not define “material,” but relies on the prevailing meaning of such term under the federal securities laws. Information is material if “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision and if it would have “significantly altered the ‘total mix’ of information made available.” The Supreme Court has held, and the SEC has recently affirmed in Staff Accounting Bulletin No. 99, that there are no bright-line tests of materiality and that materiality of both financial and non-financial information always turns on assessment of all the facts and circumstances. Both the courts and the SEC (in SAB 99) have indicated that market reaction is one of the important indicators of materiality. So, a company spokesperson contemplating a selective disclosure will rarely be able to predict with any certainty that information to be disclosed is immaterial.

Many commentators on the proposed form of Regulation FD released by the SEC last December suggested that Regulation FD should apply only to defined categories of information in order to make determination of materiality less difficult. The SEC refused to do this in final Regulation FD, but in the adopting release the SEC provided some significant, although rather obvious, guidance. First, the SEC gave a non-exclusive list of categories of information that are more likely to be material, including information regarding: (1) earnings; (2) mergers, acquisitions, tender offers, joint ventures or changes in assets; (3) new products or discoveries or development regarding customers or suppliers (e.g., the acquisition or loss of a contract); (4) changes in control or in management; (5) changes in auditors or auditor notification that the issuer may no longer rely on an auditor’s report; (6) events regarding the issuer’s securities (e.g., changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and (7) bankruptcies or receiverships. The SEC noted that it did not mean to imply that information in the listed types was *per se* material or that other types of information would not be material.
Second, the SEC singled out the practice of offering analysts “guidance” regarding earnings forecasts in private discussion as involving an especially “high degree of risk under Regulation FD.”

Third, the Commission confirmed its view that materiality turns on the assessment of the “reasonable investor,” not the expert analyst. Information that a reasonable investor finds unimportant does not become material simply because an expert analyst (through specialized knowledge, persistence and insight) uses that information to complete a “mosaic” of information that, viewed as a whole, materially changes the analyst’s assessment of the issuer.

The recklessness standard. Regulation FD provides that selective disclosure of material nonpublic information will be deemed “intentional” (and therefore requiring simultaneous public dissemination) only if the speaker knows, or is reckless in not knowing, that (1) he or she is making the disclosure and (2) the information is material and (3) it is nonpublic. The proposing release last December had given the example of a slip of the tongue as an illustration of a non-intentional disclosure. Commentators pointed out that the far more likely non-intentional disclosure scenario would be one in which the speaker intends to say what he or she says but makes a mistaken assessment with respect to the materiality or nonpublic status of the disclosure. As adopted, Regulation FD makes it clear that the recklessness threshold applies not only to the making of the statement, but also to the assessment of materiality and public status. A material disclosure will be deemed intentional only if the speaker was reckless in not knowing it was material or, in the words of the adopting release, “only if no reasonable person under the circumstances would have made the same determination” of immateriality.

Promptly. Material nonpublic information that is selectively disclosed non-intentionally must be “promptly” disclosed to the public. “Promptly” means as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day’s trading on the New York Stock Exchange) after a senior official of the issuer knows, or is reckless in not knowing, that there has been a non-intentional selective disclosure. Consequently, if the non-intentional selective disclosure is discovered after the close of trading on Friday, the issuer has until the beginning of NYSE trading on Monday to make the necessary public disclosure.

Public disclosure. Regulation FD offers two choices to achieve necessary public disclosure: include the information in a Form 8-K or disseminate it “through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”

- Form 8-K. If information is included in a Form 8-K, public disclosure is effective under Regulation FD at the time it is furnished to or filed with the Commission, even though there is generally a 24-hour delay before the Form 8-K is posted on the SEC’s EDGAR Website and actually becomes easily accessible to the investing public. Companies using Form 8-K for Regulation FD disclosures should confer with counsel regarding the advisability of including information under existing Item 5 (in which case it is deemed “filed” and thereby incorporated by reference in short-form Securities Act registrations and subject to Securities Act liability) or new Item 9 (in which case it is only “furnished” and not incorporated by reference or subject to Securities Act liability). In either case,
revised Form 8-K provides that inclusion of the information is not an admission that it is “material” for purposes of federal securities laws.

- **Alternative means.** The SEC affirmed in the adopting release that, as a general matter, a press release distributed through a widely circulated news or wire service (such as Dow Jones, Bloomberg, Business Wire, PR Newswire or Reuters) will suffice. The release notes, however, that an issuer whose press releases are not normally carried by major business wire services may not achieve sufficient public distribution simply by submitting the release to such services and may instead have to furnish or file a Form 8-K or rely on some combination of local media distribution, Web posting and use of a press placement service to achieve the necessary alternative means.

The adopting release also affirms that Web posting or open real-time access to a press conference or telephone conference or Webcast will not, by themselves, suffice for public disclosure unless these techniques are combined with a previous press release or other means of communication, such as Web-based “push technology” e-mail alert, that gives the public and media notice of availability of the posting or access to achieve sufficient public disclosure. The adopting release cites the following model as an example of how the alternative means of public disclosure may be satisfied:

- First, issue a press release, distributed through regular channels, containing the information;
- Second, provide adequate notice, by press release and/or website posting, of a scheduled conference call to discuss the announced results, giving investors both the time and date of the conference call, and instructions on how to access the call; and
- Third, hold the conference call in an open manner, permitting investors to listen in either by telephonic means or through Internet webcasting.

By following these steps, an issuer can use the press release to provide the initial broad distribution of the information, and then discuss its release with analysts in the subsequent conference call, without fear that if it should disclose additional material details related to the original disclosure it will be engaging in a selective disclosure of material information.

The release indicates that listen-only access to a conference call or Web-cast is sufficient in this combined model. Access must, however, be “live” or real-time. The release also notes that, over time, some issuer Websites may attain a sufficient following in the investment community that posting of information, by itself, may constitute sufficient public disclosure.

**Special issues for issuers doing registered or unregistered offerings**

Public disclosures required by Regulation FD may cause a number of problems under the Securities Act of 1933 for issuers engaged in financing transactions. For example, an officer of a public company doing a “road show” in connection with a registered public offering might
trigger a Regulation FD public disclosure requirement by non-intentionally disclosing material nonpublic information in response to a question during a session with brokers and institutional fund managers. Without an explicit exclusion, a press release disclosing such information to the public, however, could be deemed to be an illegal prospectus in violation of Section 5(b) of the Securities Act.

As adopted, Regulation FD deals with this problem by excluding from coverage any disclosures made in connection with a securities offering registered under the Securities Act, other than certain continuous shelf offerings. Under this exclusion, the officer’s statement at the road show session would not trigger a Regulation FD public disclosure requirement in the first place and would not pose the illegal prospectus problem. The adopting release makes it clear, however, that not all communications made by issuer personnel during the period in which the issuer is in registration are “in connection with” the public offering. For example, recurring communications with analysts regarding quarterly financial results would probably not be covered by the exclusion even if they occurred while the issuer was in registration. Until the SEC liberalizes restrictions on issuer communications during a registered offering, as it proposed to do in the Aircraft Carrier initiative, required public disclosures under Regulation FD may still pose legal problems under the Securities Act for issuers doing registered offerings.

The exclusion only covers disclosures made in connection with registered offerings. Regulation FD does not address the effect of required public disclosures on unregistered offerings. An issuer forced to make FD disclosures during a private placement may be engaging in “general solicitation” that would destroy Securities Act exemptions under Section 4(2) or Regulation D. An issuer forced to make public disclosures during a Rule 144A offering to “qualified institutional buyers” may be deemed to be making offers to non-QIBs. An issuer engaged in an offshore securities offering may be deemed to be engaged in “directed selling efforts” and lose the Regulation S safe harbor. The SEC’s advice to public issuers engaged in unregistered offerings is simply to try to avoid having to make Regulation FD public disclosures during such offerings. The adopting release suggests that any disclosures to enumerated persons in connection with such offerings (e.g., in private placement memos or offering circulars or in the process of due diligence) should be made under binder of confidentiality to avoid mandatory public disclosures that could destroy exemptions or safe harbors.

**Liability and adverse consequences**

Noncompliance with Regulation FD may result in government enforcement proceedings (leading to cease-and-desist orders, injunctions or fines), but not private damage claims. To clarify this point, Regulation FD provides that “[n]o failure to make a public disclosure required solely by [Regulation FD] shall be deemed to be a violation of Rule 10b-5.” The adopting release confirms that this provision is intended to prevent private plaintiffs from relying on an issuer’s violation of Regulation FD as a basis for a private action alleging Rule 10b-5 violations. Obviously, this provision does not prevent private claims under Rule 10b-5 based on allegations of material misstatements or omissions to state material facts in a public disclosure required under Regulation FD. It only prevents private claims based solely on failure to comply with Regulation FD.
A failure to comply with Regulation FD could be viewed as a failure to file a Form 8-K (even though required public disclosure may be accomplished through a press release or other means). A company that fails to file a Form 8-K in a timely manner loses eligibility for short-form Securities Act registrations (Forms S-2, S-3 and S-8) and may not be able to engage in shelf registrations. Failure to file a required Form 8-K also results in loss of the Rule 144 exemption which effectively blocks officers, directors, other affiliates and holders of “restricted securities” from selling issuer securities into the public market. As adopted, Regulation FD makes it clear that noncompliance with Regulation FD will not result in ineligibility to use short-form Securities Act registration statements on Form S-2, S-3 or S-8 and will not prevent selling of securities in reliance on Securities Act Rule 144.

**The future of analyst communications**

It is impossible to predict the exact ways in which analyst communications will evolve over the coming months and what new mechanisms public companies and the investment community will develop to maintain the free flow of communication that is essential to our markets. The SEC is now armed with a new weapon in its fight against selective disclosure. Public companies must now take a vigilant, disciplined and well-documented approach to dealing with analysts in one-on-one and limited access settings and should move, where possible, toward the open-access model espoused by the SEC. These legal realities and the rapidly changing environment of communications technology will shape the new standards of ongoing disclosure in U.S. securities markets.

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