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Communication with Financial Analysts and Related Disclosure Issues

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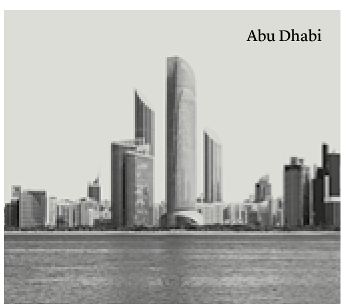
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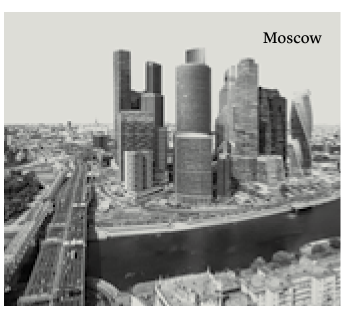
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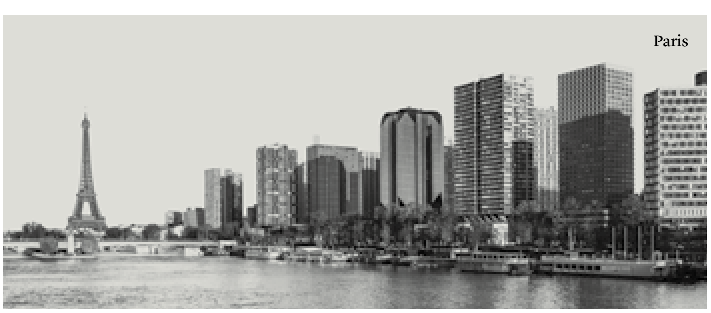
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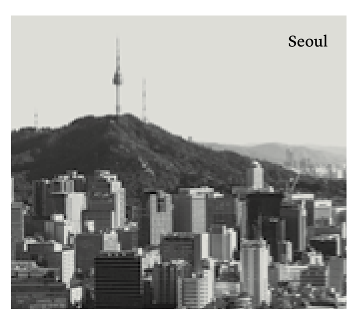
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Securities analysts play a key role in securities markets, and publicly held companies as a matter of market practice regularly brief them to help them understand company results and business trends. There have been some unfortunate instances, however, in which analysts have received nonpublic information on which their clients have acted before the information was disclosed to the general public. In the wake of these cases, as well as Enron and the unanticipated and significant decline in the financial position of other public companies, the role of the securities analyst was scrutinized by Congress, the Securities and Exchange Commission (the "SEC"), state regulators and various self-regulatory organizations.[1] The result was a heightened campaign against selective disclosure, facilitated by the SEC's adoption of Regulation FD (Fair Disclosure) in 2000.[2] For several years prior to 2009, the SEC brought few cases for violations of Regulation FD, but since September 2009 there has been a marked increase in the number of Regulation FD enforcement actions by the SEC. This increase in enforcement action serves as a reminder that ongoing vigilance in this domain is certainly warranted.

This memorandum sets out guidelines for communications between management and securities analysts in light of applicable case law and the SEC's Regulation FD. A one-page summary of the guidelines is attached for your convenience.

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[1] Professional associations representing public companies and analysts also made an effort to shape the parameters of the relationship between these parties. In 2004, the CFA Centre for Financial Market Integrity and the National Investor Relations Institute adopted best-practice guidelines to govern the relationship between corporate issuers and the securities analysts who cover them. *See* CFA Centre for Financial Market Integrity/National Investor Relations Institute, Best Practice Guidelines Governing the Analyst/Corporate Issuer Relations (2004), at http://www.niri.org/Other-Content/Documents/CFAINIRIGuidelines.aspx. The guidelines address: (i) information flow between analysts and issuers; (ii) analysts' conduct in preparing and publishing research reports and making investment recommendations; (iii) issuers' conduct in providing analysts with access to corporate management; (iv) review of analyst reports by issuers; and (v) research that is solicited, paid for or sponsored by the issuer.

[2] Selective Disclosure and Insider Trading, SEC Release Nos. 33-7881, 34-43154, IC-24599 (Aug. 15, 2000).

Introduction

The U.S. rules governing disclosure to analysts by issuers originally emerged from case law construing a basic antifraud rule, Rule 10b-5 under the Securities Exchange Act of 1934 (the "Exchange Act"). As a result, the rules are not straightforward, are at times ambiguous and, in any event, have not been applied, with one known exception,[3] to communications between issuers and analysts. This situation led the SEC to adopt a new disclosure regime, Regulation FD, to prevent material nonpublic information from being given selectively to market professionals (broker-dealers, investment advisers and managers, and investment companies), who could use such information to their own or their clients' advantage. Regulation FD applies to communications on behalf of the issuer with market professionals and with securityholders who may foreseeably trade on the basis of the disclosed information.

Although Regulation FD does not apply to foreign issuers,[4] they too should avoid selective disclosure of material nonpublic information both as a matter of best practice and to avoid potential liability. Ill-considered disclosure can lead to liability both for the company and for its management personally under Rule 10b-5, raise potential issues regarding correcting or updating information and have adverse market consequences.

3 *See SEC v. Stevens*, SEC Litigation Release No. 12813 (Mar. 19, 1991), discussed below.

4 Rule 101(b) of Regulation FD provides that both foreign governments and foreign private issuers, as those terms are defined in Rule 405 of the Securities Act of 1933 (the "Securities Act"), are not considered issuers for the purpose of Regulation FD. Under Rule 405, a foreign private issuer is defined as any foreign issuer, other than a foreign government, except an issuer meeting the following conditions as of the last business day of its most recently completed second quarter: (i) more than 50 percent of the outstanding voting securities of the issuer are directly or indirectly owned of record by United States residents, and (ii) any of the following: (a) the majority of the executive officers or directors are United States citizens or residents, (b) more than 50 percent of the assets of the issuer are located in the United States, or (c) the business of the issuer is administered principally in the United States.

General Disclosure Requirements and Rule 10b-5 Liability

The U.S. Supreme Court has established that there must be a breach of a fiduciary duty or other relationship of trust and confidence, or a misappropriation of information received in violation of such a relationship, before tipping or trading on the basis of material nonpublic information results in a violation of Rule 10b-5.[5] This has led to three general principles with respect to the disclosure of corporate information to securities analysts and the public. First, Rule 10b-5 by itself does not normally require management to disclose material nonpublic information regarding the company to the investment community.[6] Subject to certain exceptions discussed below, the timing of such disclosure is ordinarily left to the business judgment of management. Second, if a company does disclose corporate information (whether voluntarily or otherwise), Rule 10b-5 requires that those disclosures neither contain misleading statements of material information nor omit material facts necessary to make the statements made not misleading.[7] Third, when divulging material nonpublic information, company officials may not disclose it selectively—*e.g.*, exclusively to securities analysts—but rather must make the information available to the general public,[8] if those officials could be found to have gained a personal benefit from the selective disclosure. Selective disclosure can lead to liability for the company and for company officials themselves for insider trading by persons receiving the disclosure.

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5 *Chiarella v. United States*, 445 U.S. 222 (1980); *Dirks v. SEC*, 463 U.S. 646 (1983); *United States v. O'Hagan*, 521 U.S. 642, 650–52 (1997). One recent series of court decisions has cast some doubt on the precise circumstances in which insider trading liability may be found. The District Court for the Northern District of Texas recently held that absent a fiduciary (or fiduciary-like) relationship, liability under the misappropriation theory requires not just an agreement not to disclose material nonpublic information, but also an agreement not to trade. *SEC v. Cuban*, 634 F.Supp.2d 713 (N.D. Tex. 2009). On appeal, the U.S. Court of Appeals for the Fifth Circuit agreed with the SEC's argument that even in the absence of an express agreement not to trade on material nonpublic information, a party that agrees to keep information confidential may be liable for insider trading where there is an implied understanding that trades will not be made based upon the information. *SEC v. Cuban*, 620 F.3d 551 (5th Cir. 2010); see also SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 101.05 (Aug. 14, 2009) (SEC staff expressing the view that a recipient of material nonpublic information subject to an express confidentiality agreement who trades or advises others to trade could face insider trading liability). In addition, in SEC v. Dorozhko, 574 F.3d 42 (2nd Cir. 2009), the Second Circuit held that insider trading liability could be found where a hacker traded on the basis of material nonpublic information acquired through electronic theft, even though there was no breach of fiduciary duty.

6 See Cooperman v. Individual, Inc., 171 F.3d 43, 49 (1st Cir. 1999); see also Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1202 (1st Cir. 1996) (recognizing that "the mere possession of material nonpublic information does not create a duty to disclose it"). Despite the lack of disclosure obligations generally under Rule 10b-5, the courts have found an obligation to disclose material nonpublic information: (i) when the corporation or a corporate insider trades on confidential information; (ii) when a corporation has made inaccurate, incomplete or misleading disclosure; or (iii) when a statute or regulation requires disclosure. See Backman v. Polaroid Corp., 910 F.2d 10, 20 (1st Cir. 1990) (en banc).

Although a corporation under, for example, Delaware law has a fiduciary duty to holders of its common stock and, under certain circumstances, holders of its preferred stock, it generally has no fiduciary duty to its creditors, which include holders of debt securities, whether they be straight debt or convertible debt, or warrants to purchase equity securities. *See Lorenz v. CSX Corp.*, 1 F.3d 1406, 1417 (3d Cir. 1993); *Page Mill Asset Mgmt. v. Credit Suisse First Boston Corp.*, 98 Civ. 6907, 2000 WL 335557, at *11 (S.D.N.Y. Mar. 30, 2000) (citing *Parkinson v. West End St. Ry.*, 173 Mass. 446, 53 N.E. 891, 892 (1899) (Holmes, J.)). Thus, as the court found in *Alexandra Global Master Fund, Ltd. v IKON Office Solutions, Inc.*, "[b]ecause IKON owed no such fiduciary or other analogous duty to its convertible noteholders, it follows that IKON had no duty to disclose its alleged unpublicized intentions to exercise its redemption rights at a date in the future [notwithstanding that IKON's redemption rights were at a premium and IKON was purchasing its debt from a holder at a discount]." *Alexandra Global Master Fund, Ltd. v IKON Office Solutions, Inc.*, 2007 WL 2077153, *8 (S.D.N.Y. July 20, 2007).

Other countries may require disclosure of material information if such information would be deemed to affect the price of a company's listed securities. *See, e.g.,* Entertainment Rights plc, Financial Services Authority Final Notice (Jan.19, 2009) (fining U.K. company for violation of Disclosure and Transparency Rule 2.2.1, which generally requires disclosure of "any inside information which directly concerns the issuer . . . .").

7 Rule 10b-5(b) under the Exchange Act.

8 The SEC staff has made clear, in the context of Regulation FD, that the disclosure of material nonpublic information at a shareholders' meeting does not constitute public disclosure even if the meeting is open to the public, but is not otherwise webcast or broadcast by any electronic means. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 102.05 (Aug. 14, 2009). However, disclosure through an Exchange Act filing may constitute public disclosure so long as the issuer has brought the disclosure to the attention of the readers of the filing. *Id.* at Question 102.02.

Although Rule 10b-5 might not require dissemination of material information, the New York Stock Exchange (the "NYSE") and the NASDAQ Stock Market ("Nasdaq") require listed companies to disclose material information promptly to the public through any Regulation FD-compliant method of disclosure,[9] except under certain limited circumstances.[10] In addition, listed companies are required to notify the NYSE or Nasdaq of the release of any such information prior to its release to the public.[11] NYSE and Nasdaq rules, however, do not have the force of law and cannot be the basis for an implied private right of action. The Second Circuit held in *State Teachers Retirement Board v. Fluor Corp.* that no private right of action exists for a violation of the NYSE Listed Company Manual's disclosure rules.[12] The court reasoned that, given the extensive regulation in this area by Congress and the SEC, "a federal claim for violation of the [NYSE's Listed] Company Manual rules regarding disclosure of corporate news cannot be inferred."[13]

In addition to annual reports on Form 10-K and quarterly reports on Form 10-Q, a domestic issuer subject to Exchange Act reporting must file current reports on Form 8-K with the SEC to disclose certain specified events. In many cases, disclosure is required within four business days of an event's occurrence.[14] For a foreign private issuer, Form 6-K requires submission to the SEC of all significant information that (i) must be made public under local law in the issuer's country of incorporation or domicile, (ii) is filed with any foreign stock exchange on which the issuer's securities are listed

[9] These methods include, e.g., filing a Form 8-K (or, presumably for foreign issuers, a Form 6-K), distributing a press release through a widely circulated news or wire service, or holding a press conference to which the public is granted access. See infra Section VII.

[10] NYSE Listed Company Manual §202.01 and §202.05 (stating the general rule that "[a] listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities" but outlining circumstances, such as negotiations leading to mergers and acquisitions or arrangements preparatory to an exchange or tender offer, under which "premature public announcement may properly be avoided"); Nasdaq Stock Market Rule 5250(b)(1) ("Except in unusual circumstances, a Nasdaq-listed Company shall make prompt disclosure to the public through any Regulation FD compliant method (or combination of methods) of disclosure of any material information that would reasonably be expected to affect the value of its securities or influence investors' decisions."). Although the NYSE amended its immediate release policy in May 2009 to allow an issuer to use any method of disclosure allowed by Regulation FD (an approach that matches Nasdaq's), rather than to require exclusively the use of a press release, the NYSE's amended rule continues to "encourage" issuers to use press releases. SEC Release No. 34-59823 (Apr. 27, 2009); NYSE Listed Company Manual §202.06. While foreign private issuers are not required to comply with Regulation FD (see supra Note 4), NYSE Listed Company Manual §202.06 requires foreign private issuers listed on the NYSE to comply with the timely alert policy set forth in §202.05 by any method (or combination of methods) allowed by Regulation FD for a domestic U.S. issuer. NYSE Listed Company Manual §202.06.

[11] The NYSE requires issuers to notify the NYSE in advance if news of a material event or a statement dealing with a rumor is released shortly before the opening of or during market hours. NYSE Listed Company Manual §202.06. Similarly, Nasdaq requires issuers to notify Nasdaq prior to the public announcement of certain specified information during Nasdaq market hours. For these purposes, the NYSE currently requires advance notification of any announcement between the hours of 9:30 a.m. and 5:00 p.m., New York time, and Nasdaq currently requires advance notification of any announcement made between 7:00 a.m. and 8:00 p.m., New York time (with notification required by 6:50 a.m., New York time, on the next trading day if announcements are made after 8:00 p.m. or on days the market is closed). *Id.*, NASDAQ Stock Market Rule IM-5250-1. Advance notification must be provided to Nasdaq prior to announcing events requiring the filing of a Form 8-K and news relating to: (i) company financials, such as earnings announcements, (ii) reorganizations and acquisitions, (iii) developments regarding products, customers or suppliers, (iv) management changes, (v) resignation or termination of auditors, (vi) defaults on securities or securities redemption or repurchase plans and (vii) significant legal or regulatory developments. NASDAQ Stock Market Rule 5250(b)(1), IM-5250-1.

[12] State Teachers Retirement Board v. Fluor Corp., 654 F.2d 843, 852 (2nd Cir. 1981).

[13] *Id.* at 852-53; accord In re Verifone Sec. Litig., 11 F.3d 865, 870 (9th Cir. 1993) ("We decline to hold that a violation of exchange rules governing disclosure may be imported as a surrogate for straight materiality analysis under §10(b) and Rule 10b-5.").

[14] See Form 8-K. In 2004, the SEC expanded the disclosure requirements of Form 8-K to require disclosure of certain additional material events on Form 8-K within four business days of the event's occurrence. The expanded items include: (i) the entry into a material nonordinary course agreement; (ii) the termination of a material nonordinary course agreement; (iii) the creation of a material direct financial obligation or a material contingent off-balance sheet obligation; (iv) the occurrence of a triggering event that accelerates or increases a material direct financial obligation or a material off-balance sheet obligation; (v) the incurrence of material costs associated with exit or disposal activities; (vi) the occurrence of a material impairment; (vii) the receipt of a notice of delisting or failure to satisfy a continued listing rule or standard or a transfer of listing; (viii) the conclusion or notice that securityholders may not rely on the company's previously issued financial statements or a related audit report or interim review as a result of error; (ix) the departure of directors and officers; (x) the election of directors or appointment of officers; (xi) the amendment of the charter or bylaws; (xii) the changing of the fiscal year; (xiii) the unregistered sale of equity securities; and (xiv) the material modification of securityholder rights. See SEC Release Nos. 33-8400, 34-49424 (Mar. 16, 2004). More recently, Form 8-K has been amended to also require the disclosure of the following events within four business days of their occurrence: (i) the receipt of a notice or order related to mine safety; (ii) the results of votes on matters submitted to securityholders; and (iii) the determination of the deadline for submission of shareholder director nominees. See SEC Release Nos. 33-9089, 34-61175 (Dec. 16, 2009); 33-9089A, 34-61175A (Feb. 3. 2010); 33-9136, 34-62764 (Aug. 25, 2010); 33-9178, 34-63768 (Jan. 25, 2011); and 33-9286, 34-66019 (Dec. 21, 2011).

and made public by such exchange or (iii) is distributed to the issuer's securityholders.[15]

Finally, when preparing disclosure responsive to the SEC's Exchange Act reporting requirements, companies should be mindful of Rule 12b-20, which requires inclusion of any information beyond what is expressly required "as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading." The SEC has brought enforcement actions for violating Rule 12b-20 even in the context of Form 6-K filings, where there are no express disclosure requirements.[16]

[15] Form 6-K specifies that the information required to be furnished on the form "is that which is material with respect to the issuer and its subsidiaries concerning: changes in business; changes in management or control; acquisitions or dispositions of assets; bankruptcy or receivership; changes in registrant's certifying accountants; the financial condition and results of operations; material legal proceedings; changes in securities or in the security for registered securities; defaults upon senior securities; material increases or decreases in the amount outstanding of securities or indebtedness; the results of the submission of matters to a vote of security holders; transactions with directors, officers or principal security holders; the granting of options or payment of other compensation to directors or officers; and any other information which the registrant deems of material importance to security holders."

Although the SEC did not amend Form 6-K when it amended Form 8-K in 2004 or subsequently (*see supra* Note 14) to require new disclosures by foreign private issuers or to change the illustrative list of disclosure items in the instructions to Form 6-K, foreign private issuers should view the changes to Form 8-K as an important signal. At a minimum, foreign private issuers should consider the expanded list of items in Form 8-K in deciding whether particular press releases or home-country filings are material (and thus covered by Form 6-K) and which Form 6-K reports should be incorporated into their Securities Act registration statements.

[16] See In re Sony Corporation and Sumio Sano, SEC Release No. 34-40305 (Aug. 5, 1998) (SEC found that Sony failed to identify greater than anticipated losses at Sony Pictures and to discuss a "known trend" involving cumulative losses of more than $1 billion); see also SEC v. Sony Corp., SEC Litigation Release No. 15832 (Aug. 5, 1998) (proceeding against the individual Sony officer responsible for disclosure matters).

The Nature of "Material" Information

Because the U.S. securities laws, including Rule 10b-5 under the Exchange Act, generally impose liability only when the information disclosed or omitted is "material," it is important, but also exceedingly difficult in many cases, to distinguish "material" from "immaterial" facts. Courts have formulated a number of tests in recent years attempting to define the types of information that would be material for purposes of Rule 10b-5. The Supreme Court has held in *Basic Inc. v. Levinson* that information is material if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[17] The Second Circuit has enunciated a more specific standard, holding before *Basic Inc. v. Levinson* that a fact is to be considered material if it is "reasonably certain to have a substantial effect on the market price of the security"[18] and holding subsequently that a fact is to be considered material "if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to buy or sell shares."[19] The SEC has consistently stated that materiality is not solely a quantitative determination and that qualitative materiality judgments must be made based on "all the facts and circumstances."[20] The SEC, in Staff Accounting Bulletin No. 99, discussed the necessity and difficulty of making these determinations and provided some examples.[21]

While these judicial standards are imprecise, certain types of information would almost always be considered material. The most obvious example would be earnings reports or earnings projections (whether favorable or unfavorable) because these data usually have an immediate, and often dramatic, impact on a company's stock price.[22] The following list of potentially material information illustrates by way of example other types of facts that may be so important to investment decisions that their selective disclosure to analysts could lead to Rule 10b-5 liability:

— a decrease or increase in dividend rate or a proposed stock split;

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[17] Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (internal quotation omitted). See Matrixx Initiatives, Inc. v. Siracusano, 131 S.Ct. 1309, 1318-22 (2011) (affirming the continued application of Basic's "total mix" standard, and refusing to adopt a bright-line rule for determining materiality of adverse events reports associated with a pharmaceutical company's products based solely on such reports' statistical significance). In Matrixx Initiatives, Inc., the Court explained that "assessing the materiality of adverse event reports is a 'fact-specific' inquiry . . . that requires consideration of the source, content, and context of the reports. This is not to say that statistical significance (or the lack thereof) is irrelevant – only that it is not dispositive of every case . . . . This contextual inquiry may reveal in some cases that reasonable investors would have viewed reports of adverse events as material even though the reports did not provide statistically significant evidence of a causal link." *Id.* at 1321.

[18] SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc), cert. denied sub nom. Coates v. SEC, 394 U.S. 976 (1969).

[19] Azrielli v. Cohen Law Offices, 21 F.3d 512, 518 (2d Cir. 1994).

[20] In Ganino v. Citizens Utilities Co., the Second Circuit relied on Basic Inc. v. Levinson and SEC Staff Accounting Bulletin No. 99 in declining to hold immaterial as a matter of law misstatements regarding revenue recognition because the revenue in question amounted to only 1.7% of the defendant's total revenue for the year. 228 F.3d 154 (2d Cir. 2000). The court rejected a bright-line test for materiality, emphasizing that materiality judgments must be made in the context of all relevant facts and circumstances. *Id.* at 165.

[21] SEC, Staff Accounting Bulletin No. 99—Materiality (Aug. 12, 1999), Fed. Sec. L. Rep. (CCH) ¶ 75,563. For example, improper revenue recognition designed to ensure earnings do not fall outside the range of analysts' expectations could be material even if the effect were only one or two cents a share.

[22] In both SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 14–15 (2d Cir. 1977) and Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163-67 (2d Cir. 1980), the Second Circuit found earnings projections to be material. The award of a significant supply contract would also most likely constitute material information. In State Teachers Retirement Board v. Fluor Corp., for example, the Second Circuit held that management's selective disclosure to an analyst regarding the "imminence" of being awarded a major contract could generate liability under Rule 10b-5. 654 F.2d 843, 854. The court also noted that even the mere decision to bid on this billion dollar project would represent significant information to the reasonable investor. *Id.* While the court in Fluor noted that the award of a major contract and the decision to bid on a large project could constitute material information, the court nevertheless found that the company's actions did not violate Rule 10b-5, as discussed in more detail below. On remand, the district court further held that capital expenditure projections could be considered material. State Teachers Retirement Bd. v. Fluor Corp., 566 F. Supp. 945, 950 (S.D.N.Y. 1982).

— a significant acquisition or disposition of assets or businesses, including pursuant to a joint venture or merger;

— significant labor problems;

— the discovery or development of a significant new product;

— the acquisition or loss of an important contract or major change in backlog or other significant development involving customers or suppliers;

— the proposed sale of a significant amount of additional securities or the incurrence of significant new indebtedness or a default under existing indebtedness;

— a change in control or significant change in management;

— a tender offer for another company's shares;

— significant litigation; and

— another event requiring the filing of a current report under the Exchange Act.[23]

Courts, however, have found certain types of statements not to be material as a matter of law. For example, they have held that statements such as "our company is poised to carry the growth and success of the past year well into the future" to be soft, puffing statements that are not material for purposes of Rule 10b-5.[24] Courts have also held that an omission is not material where the information omitted is already in the public domain.[25] In adopting Regulation FD, the SEC made clear that an analyst's ability to piece together immaterial information into a mosaic of information that, taken together, is material would not result in a violation of Regulation FD (or, presumably, Rule 10b-5).[26]

Nevertheless, in light of the broad range of information that has been found to be material, management should be cautious when concluding that any factual information is not material and therefore may be selectively disclosed to analysts. Management should do so only when it is confident the information in question is entirely consistent with information that already is publicly available so that the additional disclosure will have no impact on the market price of the company's securities.

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[23] The list of additional events the SEC requires issuers to disclose on Form 8-K is also representative of presumptively material events. See supra Note 14.

[24] Raab v. Gen. Physics Corp., 4 F.3d 286, 289 (4th Cir. 1993); accord Lasker v. New York State Elec. & Gas Corp., 85 F.3d 55, 59 (2d Cir. 1996) (per curiam) (observing that "broad, general statements" are "precisely the type of 'puffery' that this and other circuits have consistently held to be inactionable"); San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 807, 811 (2d Cir. 1996) (holding that company statement that "[w]e expect 1993 to mark another year of strong growth in earnings per share" constituted inactionable puffery); see also In re K-tel Intern., Inc. Sec. Litig., 300 F.3d 881, 897 (8th Cir. 2002) (stating that "[i]mmaterial statements include vague, soft, puffing statements").

[25] See Longman v. Food Lion, Inc., 197 F.3d 675, 685–86 (4th Cir. 1999), cert. denied, 529 U.S. 1067 (2000).

[26] Selective Disclosure and Insider Trading, SEC Release Nos. 33-7881, 34-43154, IC-24599 (Aug. 15, 2000).

Liability for Misleading Statements and Omissions of Material Fact

Rule 10b-5 liability can also arise if a communication made to analysts or to the general public contains a misleading material statement or omits a material fact necessary to make the statements made not misleading.[27] Two SEC administrative rulings, *In re Carnation Company*[28] and *In re E.ON AG*,[29] demonstrate the extent to which liability can attach under these circumstances.

In *In re Carnation Company*, a corporate official publicly stated that no company news or corporate developments could account for recent stock activity and that, to the best of his knowledge, the company was not engaged in any acquisition negotiations. The official, however, was unaware that negotiations were actually taking place regarding the acquisition of Carnation by Nestle. The SEC ruled that, despite the official's ignorance of company developments, such comments violated the Rule 10b-5 prohibition against material misstatements. Because an official cannot be expected to know everything that happens in a corporation, officials communicating with analysts or the public should consult with senior executives prior to making a statement about matters of which they are not certain.

I*n re E.ON AG* involved management denials of merger discussions that were in fact occurring. The merger discussions involved two German companies, and the denials were not, according to E.ON AG, a violation of German law. While one of the parties was listed on the NYSE, only a small percentage of its shares was held by U.S. investors. Moreover, both companies were persuaded that a no-comment policy would be construed by the German press as a confirmation that talks were going on and that premature disclosure would have jeopardized the ultimate merger. Nevertheless, the SEC ruled that the statements denying the merger discussions were false and a violation of Rule 10b-5. E.ON subsequently adopted a no-comment policy, as have most other German companies publicly traded in the United States.

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[27] To prevail under Rule 10b-5 in private causes of action alleging material misrepresentation or omission, the plaintiff must also prove reliance upon such misleading disclosure. See Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988) (holding that "reliance is an element of a Rule 10b-5 cause of action . . . . Reliance provides the requisite causal connection between a defendant's misrepresentation and a plaintiff's injury.").

[28] SEC Release No. 34-22214 (July 8, 1985).

[29] SEC Release No. 34-43372 (Sept. 28, 2000). It is worth noting that a recent Supreme Court decision has reduced significantly the extraterritorial applicability of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in private rights of action. Morrison v. National Australia Bank, 130 S. Ct. 2869 (2010). In Morrison, the Court held that Section 10(b) did not provide a cause of action for Australian plaintiffs who purchased securities on a foreign exchange because the securities were listed only on a foreign exchange and "all aspects of the purchases . . . occurred outside the United States." *Id.* at 2888. Morrison arose out of a class action lawsuit filed by a group of plaintiffs against National Australia Bank, an Australian entity, alleging that National Australia Bank's public disclosure contained fraudulent information relating to a U.S. subsidiary. After reciting the long-standing presumption against extraterritorial application of U.S. law, the Court established a new "transactional" rule that Section 10(b) only reaches "transactions in securities listed on domestic exchanges, and domestic transactions in other securities." *Id.* at 2884. Subsequent district court cases interpreting Morrison have held consistently that the determinative factor in applying Morrison is the location of the transaction and not the location of the purchaser. See, e.g., In re Vivendi Universal, S.A. Securities Litigation, 765 F.Supp.2d 512 (S.D.N.Y. 2011); Cornwell v. Credit Suisse Group, 270 F.R.D. 145 (S.D.N.Y. 2010); In re Alstom SA Securities Litigation, 741 F.Supp.2d 469 (S.D.N.Y. 2010). In Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60 (2nd Cir. 2011), the Second Circuit Court of Appeals held that "transactions involving securities that are not traded on a domestic exchange are domestic if irrevocable liability is incurred or title passes within the United States." *Id.* at 67. Under the first part of this standard, the purchaser must incur irrevocable liability within the United States to take and pay for the securities or the seller must incur irrevocable liability within the United States to deliver the securities. *Id.* at 68. Although Morrison was a private shareholder action and the Court did not tether its territorial limit on Section 10(b) and Rule 10b-5 to that fact, for purposes of actions brought by the SEC, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") effectively revived the "conducts and effects" test. See §929P(b) of the Dodd-Frank Act. For a discussion of applications of the "conducts and effects" test, see, e.g., Morrison v. National Australia Bank Ltd., 547 F.3d 167 (2d Cir. 2008), aff'd on other grounds, 130 S. Ct. 2869 (2010); SEC v. Berger, 322 F.3d 187 (2d Cir. 2003); IIT v. Vencap, Ltd., 519 F.2d 1001 (2d Cir. 1975); Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir.), cert. denied, 423 U.S. 1018 (1975).

Duty to Correct or Update Previous Communications

A duty to correct previous communications arises when the issuer of the statement discovers that the statement was inaccurate or misleading when made.[30] Even if a company's statements are accurate when made, a duty to update explicit or implicit forward-looking statements may arise if circumstances change and such statements become inaccurate or misleading.[31] Currently, the circuits are split on whether a duty to update exists. The First, Second and Third Circuits have recognized a duty to update but generally have construed it narrowly (including rejecting its applicability to routine earnings guidance in the Third Circuit and the Southern District of New York), while the Seventh Circuit has held that there is no duty to update forward-looking statements. Other circuits either appear to have approved a duty to update in *dicta*[32] or have not yet decided whether a duty to update exists.[33]

Courts have considered a variety of factors in determining whether a company had a duty to update. Some courts have emphasized that "optimistic, vague projections of future success which prove to be ill-founded are not, without more, sufficiently material to incur Rule 10b-5 liability."[34] Other courts have concluded that a duty to update forward-looking disclosure requires an implicit factual representation that remained "alive" in the minds of investors as a continuing representation.[35] *In McCarthy v. C-COR Electronics, Inc.*, the court suggested certain elements that could be considered in determining whether or not a duty to update exists.[36] For example, the specificity of the predictions was one factor that could weigh in favor of a duty to update. Predictions of corporate success more distant in the future were also believed to be "necessarily less reliable."[37] Finally, the court suggested that the "degree to which the prediction . . . is inherently [more] difficult or unreliable" also should be considered.[38]

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30 See, e.g., Stransky v. Cummins Engine Co., 51 F.3d 1329, 1331 (7th Cir. 1995) (stating that the duty to correct is often confused with the duty to update and that the "former applies when a company makes a historical statement that, at the time made, the company believed to be true, but as revealed by subsequently discovered information actually was not. The company then must correct the prior statement within a reasonable time."); Backman v. Polaroid Corp., 910 F.2d 10, 16–17 (1st Cir. 1990). While the duty to correct generally applies only to statements of historical fact, it may also apply to forward-looking statements if they are based on historical facts that a company later discovers were incorrect. See In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1431 (3d Cir. 1997).

31 See In re Int'l Bus. Mach. Corp. Sec. Litig., 163 F.3d 102, 110 (2d Cir. 1998); Weiner v. Quaker Oats Co., 129 F.3d 310, 316 (3d Cir. 1997); Backman, 910 F.2d at 16–17; Greenfield v. Heublein, Inc., 742 F.2d 751, 758 (3d Cir. 1984), cert. denied, 469 U.S. 1215 (1985). But see Gallagher v. Abbott Labs., 269 F.3d 806, 810–11 (7th Cir. 2001) (reasoning duty to update would undermine purpose of periodic reporting regime); Stransky, 51 F.3d at 1332 (holding no duty to update forward-looking statements that become untrue because of subsequent events).

32 See, e.g., Hillson Partners Ltd. P'ship v. Adage, Inc., 42 F.3d 204, 219 n.13 (4th Cir. 1994); Rubinstein v. Collins, 20 F.3d 160, 170 n.41 (5th Cir. 1994).

33 See, e.g., Helwig v. Vencor, Inc., 251 F.3d 540, 561 n.6 (6th Cir. 2001) (en banc), cert. dismissed, 536 U.S. 935 (2002); In re Yahoo! Inc. Securities Litigation, No. C 11–02732 CRB, 2012 WL 3282819 (N.D. Cal Aug. 10, 2012).

34 In re Healthco Int'l Inc. Sec. Litig., 777 F. Supp. 109, 113 (D. Mass. 1991); accord In re Burlington Coat Factory Sec. Litig., 114 F.3d at 1432; Kowal v. MCI Communications Corp., 16 F.3d 1271, 1276–77 (D.C. Cir. 1994); Friedman v. Mohasco Corp., 929 F.2d 77, 79 (2d Cir. 1991). The law is clear, however, that statements of opinion by top corporate officials may be actionable if made without a reasonable basis, see Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1093–94 (1991), or not in good faith, see Kowal, 16 F.3d at 1277.

35 See, e.g., Oran v. Stafford, 226 F.3d 275, 286 (3d Cir. 2000); Weiner, 129 F.3d at 321. See also Illinois State Board of Investment v. Authentidate Holding Corp., 369 Fed.Appx. 260, 263 (2d Cir. 2010) and infra Note 152, regarding the "bespeaks caution" doctrine and the duty to update.

36 McCarthy v. C-COR Elecs., Inc., 909 F. Supp. 970 (E.D. Pa. 1995).

37 *Id.* at 977.

38 *Id.*

In Backman v. Polaroid Corp., the company released a quarterly report that allegedly misrepresented the prospects for the sales and profitability of a new camera.[39] The plaintiffs argued that although the company had instructed its manufacturers to significantly reduce production, the report expressed the company's continued optimism regarding the product. The First Circuit stated that if a disclosure is misleading when made, the company is under a duty to correct the statement promptly. The court also recognized that "in special circumstances, a statement, correct at the time, may have a forward intent and connotation upon which parties may be expected to rely."[40] In such circumstances, "further disclosure" could be necessary to avoid misleading the investing public.[41]

In *In re Time Warner Inc. Securities Litigation*, corporate officials had previously disclosed that the company was seeking foreign strategic alliances, and plaintiffs alleged that management had a duty to update such disclosure when problems arose concerning negotiations within the proposed alliance.[42] The Second Circuit held that, pursuant to Rule 10b-5, companies have a duty to update prior statements not only if intervening events completely negate such earlier remarks but also if such events render previously disclosed information materially misleading.[43] However, the court refused to hold the company liable under the facts of this case, emphasizing that company statements were not definitive predictions that such deals would be struck, but rather merely expressed management hopes that negotiations would be successful. For this reason, the court found that the attributed public statements lacked the sort of definitive projections that might require later correction.

The Third Circuit's decision in *Weiner v. Quaker Oats Co.* indicates how courts may analyze differently the broad range of forward-looking statements companies make.[44] On the one hand, the court held that a failure to update a statement regarding a specific targeted debt-to-equity ratio guideline that ceased to apply because of a subsequent acquisition could be actionable.[45] On the other hand, the court refused to find actionable a failure to update an earnings projection rendered inaccurate by that same acquisition, because the projection was presented more vaguely as "earnings growth of at least 7 percent *over time*."[46]

The Seventh Circuit is the only circuit that has affirmatively taken the position that there is no duty to update. *In Stransky v. Cummins Engine Co.*, the company issued optimistic statements in press releases about its redesigned engines.[47] The engines were later discovered to have design problems that led to higher than anticipated warranty costs. The court held that there was no duty to update forward-looking statements that become untrue due to subsequent events.[48]

Regulation FD's prohibition on selective disclosure resulted in the public issuance of earnings guidance becoming more prevalent, making the question of

[39] Backman v. Polaroid Corp., 910 F.2d 10 (1st Cir. 1990).

[40] *Id.* at 17.

[41] *Id.*

[42] In re Time Warner Inc. Sec. Litig., 9 F.3d 259 (2d Cir. 1993), cert. denied, 511 U.S. 1017 (1994).

[43] *Id.* at 267–68.

[44] Weiner v. Quaker Oats Co., 129 F.3d 310 (3d Cir. 1997).

[45] *Id.* at 314–18. Although the court in Weiner discusses the company's duty to update the forward-looking debt-to-equity ratio guideline when it became unreliable, at other points it suggests that the duty may be limited to not repeating a forward-looking statement that has become unreliable. *Id.* at 317, 320 n.11. On remand, the district court denied the defendants' motion to dismiss, concluding that the company had a "duty to update" its debt-to-equity ratio guideline. Weiner v. Quaker Oats Co., No. 98 C 3123, 2000 WL 1700136, at *11 (N.D. Ill. Nov. 13, 2000).

[46] Weiner, 129 F.3d at 313 (emphasis added).

[47] Stransky v. Cummins Engine Co., 51 F.3d 1329 (7th Cir. 1995).

[48] *Id.* at 1332; accord Higginbotham v. Baxter Int'l Inc., 495 F.3d 753, 760 (7th Cir. 2007); Gallagher v. Abbott Labs., 269 F.3d 806, 810–11 (7th Cir. 2001); see also Eisenstadt v. Centel Corp., 113 F.3d 738, 746 (7th Cir. 1997) (observing that no legal duty exists in the Seventh Circuit to revise predictions that subsequent events prove incorrect).

whether there is a duty to update earnings guidance more important.[49] The Third Circuit is the only circuit that has both recognized the duty to update and expressly addressed whether it applies to ordinary earnings guidance. In *In re Burlington Coat Factory Securities Litigation*, the Third Circuit declined to impose a duty to update an ordinary earnings projection, noting that "disclosure of a specific earnings forecast does not contain the implication that the forecast will continue to hold good even as circumstances change."[50] This holding arguably is inconsistent with other cases in the Third Circuit and in other circuits that recognize a duty to update, because it appears to create a *per se* exception for earnings guidance, whereas the other cases generally exclude only statements that are too vague or optimistic to be treated as ongoing factual representations.[51] Nevertheless, the Third Circuit reaffirmed this decision in *In Re Advanta Corp. Securities Litigation*, holding that Advanta had no duty to update a statement made by one of its investor relations officers in a Dow Jones article that "[o]ver the next six months Advanta will experience a large increase in revenues as it converts more than $5 billion in accounts that are now at teaser rates of about 7% to its normal interest rate of about 17%" when Advanta later decided to reprice the accounts at 13% or 14%.[52]

A case decided in the Southern District of New York in 2003 indicates that the Second Circuit may strike a similar balance between the duty to update and routine earnings guidance. In *In re Duane Reade Inc. Securities Litigation*, the court held that Duane Reade did not have a duty to update quarterly sales projections for its non-prescription products before releasing quarterly results of the products' sales performance that did not meet the projections.[53] The district court held that the non-prescription sales projections were immaterial and therefore not subject to a duty to update.[54] Moreover, quoting the Seventh Circuit's decision in *Stransky*, the court stated that a "'company has no duty to update forward-looking statements merely because changing circumstances have proven them wrong.'"[55] The district court, however, did not attempt to harmonize its holding with the Second Circuit's decision in *In re Time Warner Inc. Securities Litigation*, which suggested in *dicta* that a duty to update "definite" projections or opinions may arise if intervening events have rendered them misleading.[56] Nor did the district court address Second Circuit precedent, albeit dated, finding earnings projections material.[57] Nevertheless, the Second Circuit affirmed the district court decision in *Duane Reade*, although in a nonprecedential, unpublished summary order, and we believe other courts are likely to follow the Third Circuit trend and reject a duty to update routine earnings guidance.

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49 The SEC staff has stated, however, that Regulation FD did not change existing law with respect to any duty to update. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 101.02 (Aug. 14, 2009).

50 In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1433 (3d Cir. 1997).

51 The court attempted to distinguish its holding from earlier decisions involving the duty to update, which the court characterized as relating to a potential fundamental change to a company's business. *Id.* at 1433.

52 In re Advanta Corp. Sec. Litig., 180 F.3d 525, 536 (3rd Cir. 1999) (citing In re Burlington Coat Factory Sec. Litig., 114 F.3d at 1433) ("[T]he voluntary disclosure of an ordinary earnings forecast does not trigger any duty to update."); see also US v. Schiff, 602 F.3d 152, 170 (3rd Cir. 2010) (citing Burlington, 114 F.3d at 1433-1434, and noting that the duty to update concerns fundamental changes in the nature of a company, such as mergers, liquidation or takeover attempts and when subsequent events produce an extreme or radical change in the continuing validity of a statement); see generally In re Verity, Inc. Sec. Litig., No. C99-5337CRB, 2000 WL 1175580, at *5 (N.D.Cal. Aug. 11, 2000) (discussing cases regarding duty to update disclosure).

53 In re Duane Reade Inc. Sec. Litig., No. 02 Civ. 6478(NRB), 2003 WL 22801416, at *7 (S.D.N.Y. Nov. 25, 2003) aff'd sub nom. Nardoff v. Duane Reade, Inc., No. 03-9352, 2004 WL 1842801 (2d Cir. Aug. 17, 2004) (unpublished summary order).

54 *Id.* at *7.

55 *Id.* at *7 (quoting Stransky, 51 F.3d at 1333 n.9).

56 In re Time Warner Inc. Sec. Litig., 9 F.3d 259, 267 (2d Cir. 1993) (holding that company's hopeful statements regarding strategic alliances "lack[ed] the sort of definite positive projections that might require later correction").

57 See Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 164 n.12 (2d Cir.1980) ("Liability may follow where management intentionally fosters a mistaken belief concerning a material fact, such as its evaluation of the company's progress and earnings prospects."); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) ("[M]aterial facts include . . . information disclosing the earnings and distributions of a company.").

In sum, the case law demonstrates that outside the Seventh Circuit, forward-looking statements may be subject to a duty to update. Generally, this duty applies unless the statements in question are vague or in the nature of puffing, or, as concluded in *Burlington*, *Advanta* and *Duane Reade*, involve routine earnings guidance or similar estimates of future results.

Correcting or Confirming Market Rumors

As described above, under Rule 10b-5 companies generally do not have an obligation to disclose material nonpublic information to either analysts or the public at large. In *State Teachers Retirement Board v. Fluor Corp.*, the Second Circuit held that corporate officials have no duty to correct or verify rumors in the marketplace unless such rumors can be attributed to the company.[58] The test for attribution in the context of market rumors mirrors the test described below in the section on analysts' reports, *i.e.*, whether the company has "sufficiently entangled itself" with the disclosure of information giving rise to the rumor. In *Fluor*, the company had been awarded a major contract, and before it publicly released information regarding this contract, its share price and volatility began to increase dramatically. The court held that the company could not be held liable for its decision not to confirm these contract rumors because there had been no evidence linking corporate employees to such rumors and because company officials had refused to respond to inquiries by analysts.[59]

[58] State Teachers Retirement Bd. v. Fluor Corp., 654 F.2d 843, 850 (2d Cir. 1981); accord Elec. Specialty Co. v. Int'l Controls Corp., 409 F.2d 937, 949 (2d Cir. 1969) ("While a company may choose to correct a misstatement in the press not attributable to it, . . . we find nothing in the securities legislation requiring it to do so."); see also Eisenstadt v. Centel Corp., 113 F.3d 738, 744 (7th Cir. 1997) (noting that "a corporation has no duty to correct rumors planted by third parties"). But cf. In re Sharon Steel, SEC Release No. 34-18271 (Nov. 19, 1981) (holding that a company must assume a duty to make corrective disclosure where there is either evidence that the rumors originated from within the company or trading by insiders in the company's shares).

[59] While courts have required that rumors be attributable to corporate officials before imposing a duty upon companies to either correct or verify them, the NYSE and Nasdaq place more stringent obligations upon management of listed corporations. Section 202.03 of the NYSE Listed Company Manual states that "[i]f rumors or unusual market activity indicate that information on impending developments has leaked out, a frank and explicit announcement is clearly required," and "[i] f rumors are in fact false or inaccurate, they should be promptly denied or clarified." Furthermore, according to the NYSE Listed Company Manual, "if rumors are correct or there are developments, an immediate candid statement to the public as to the state of negotiations or of development of corporate plans in the rumored area must be made directly and openly." Nasdaq guidance is to the same effect. NASDAQ Stock Market Rules, IM-5250-1. It is important to note that while the NYSE and Nasdaq place more onerous duties upon companies in this regard, violations of their disclosure rules have been held not to give rise to private causes of action, no issuer's shares have been delisted for violation of the policy and many companies adhere to a no-comment policy if there are rumors of unusual market activity.

Regulation FD

In August 2000, the SEC adopted rules[60] that prohibit U.S. issuers from selectively disclosing material nonpublic information to market professionals and to securityholders under circumstances in which it is reasonably foreseeable that the holders will trade on the basis of the information. Regulation FD (Fair Disclosure) requires that whenever an issuer intentionally discloses material nonpublic information, it must do so through a general public disclosure, and that whenever an issuer learns that it has made a non-intentional selective disclosure, it must make public disclosure of that information promptly. All U.S. issuers filing periodic reports with the SEC under the Exchange Act are subject to the regulation. Although Regulation FD does not apply to foreign issuers,[61] foreign issuers should continue to avoid selective disclosure of material nonpublic information out of concern for potential liability under Rule 10b-5 and should look to Regulation FD for guidance as a matter of best practice. In fact, many foreign issuers have elected to comply with Regulation FD.[62]

The following are the key provisions of Regulation FD:

— The regulation applies to communications with market professionals (broker-dealers, investment advisers and managers, and investment companies), and with securityholders that will reasonably foreseeably trade on the basis of the disclosed information.[63] It focuses on what the SEC believes to be the core problem—selective disclosure to those who will foreseeably trade on that information or prompt others to do so.[64] The regulation therefore does not apply to communications with, among others, media representatives, advisers in a relationship of trust or confidence with the issuer (such as legal advisers and investment bankers), employees[65] and government officials.[66]

— The regulation applies to communications by senior officials, and officers, employees or agents of the issuer who regularly communicate with market professionals or securityholders.[67]

[60] Selective Disclosure and Insider Trading, SEC Release Nos. 33-7881, 34-43154, IC-24599 (Aug. 15, 2000).

[61] See supra Note 4.

[62] Voluntary compliance with Regulation FD became more widespread in response to several high-profile enforcement actions brought by the SEC under the regulation, which are discussed below. In addition, a number of jurisdictions have similar regulations. For example, Korea has its own version of Regulation FD, and the EU has adopted a directive relating to insider dealing and market manipulation that prohibits certain persons who are in possession of inside information from disclosing that information to any other person unless such disclosure is made in the normal course of the exercise of their employment, profession or duties. See Article 3(a) of Directive 2003/6/EC of the European Parliament and of the Council on insider dealing and market manipulation (market abuse). The directive requires that "whenever an issuer, or a person acting on behalf or for his account, discloses any inside information to any third party in the normal exercise of his employment, profession or duties, . . . he must make complete and effective public disclosure of that information, simultaneously in the case of an intentional disclosure and promptly in the case of a non-intentional disclosure." Article 6(3) of Directive 2003/6/EC of the European Parliament and of the Council on insider dealing and market manipulation (market abuse).

[63] Effective October 4, 2010, the SEC removed the specific exemption previously provided for communications with credit rating agencies for the purpose of determining or monitoring credit ratings. The removal was carried out to implement Section 939B of the Dodd-Frank Act. SEC Release Nos. 33-9146, 34-63003, IC-29448 (Sept. 29, 2010). Following the Dodd-Frank Act, however, the major credit rating agencies incorporated confidentiality clauses into their standard agreements to facilitate issuers' ablity to disclose confidential information to them without violating Regulation FD.

[64] Material nonpublic information may be disclosed to a market professional or a securityholder as long as the recipient expressly agrees to maintain confidentiality until the information is public. SEC, Compliance and Disclosure Interpretations, Regulation FD, Questions 101.04-.06 (Aug. 14, 2009) and Question 101.11 (June 4, 2010).

[65] SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 101.09 (Aug. 14, 2009).

[66] Recently there has been a renewed focus on prohibiting insider trading by government officials, particularly by members of Congress. The Stop Trading on Congressional Knowledge Act, Pub. L. No. 112-105, 126 Stat. 291 (2012), prohibits members of Congress and federal employees from trading securities based on material nonpublic information obtained from their work.

[67] Statements made by officials of an issuer not authorized to communicate information to market professionals and securityholders for Regulation FD purposes are made in breach of a duty of trust or confidence to the issuer and are not covered by Regulation FD. Such disclosure may, however, trigger insider trading liability. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 101.10 (Aug. 14, 2009).

— The regulation applies to selective disclosures of "material" nonpublic information.[68] "Materiality" is not further defined in Regulation FD and is thus left to the guidance provided by case law and the SEC.[69]

— Whenever an issuer makes an "intentional" disclosure of material nonpublic information (where the issuer knows or is reckless in not knowing that the information being disclosed is both material and nonpublic), simultaneous public disclosure is required.[70] Whenever an issuer learns that it has made a non-intentional selective disclosure, it must make public disclosure of that information "promptly" (in any event, generally within 24 hours).

— Violations of Regulation FD are subject to SEC enforcement actions, but cannot give rise to Rule 10b-5 liability or private causes of action. They also do not result in a loss of short-form registration eligibility or of the Rule 144 resale safe harbor for an issuer's securities.

Public disclosure for purposes of Regulation FD can be made by filing or furnishing a Form 8-K[71] or by disseminating the information through a method or combination of methods that is "reasonably designed to provide broad, non-exclusionary distribution of the information to the public." The most common method is by press release.[72] Posting information to a company website also may be a sufficient method of public

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[68] Selective confirmation of a forecast by an issuer can trigger the public reporting requirements of Regulation FD, depending on, among other things, the amount of time that has elapsed between the original forecast and the confirmation. If asked about a prior forecast, an issuer should be cautious about saying there is "no change" to, or that it is "still comfortable" with, the forecast because this is tantamount to a confirmation. If the issuer does not wish to confirm the forecast, it simply should say "no comment"; the issuer also may refer back to the prior estimate without implicitly confirming it by making clear that the forecast was as of the date it was given and is not then being updated. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 101.01 (Aug. 14, 2009).

[69] Regulation FD was controversial particularly for this reason, and concerns were expressed that it would reduce the flow of information to investors.

In 2001, a senior member of the SEC's Division of Corporation Finance stated that the following nonexclusive factors increase the likelihood that the SEC will consider information released by an issuer to be material for the purposes of Regulation FD: (i) the issuer is releasing the information late in its earnings cycle; (ii) the issuer has not released information to the public in a relatively long period of time; or (iii) major intervening news events affecting the issuer have occurred since the issuer's last public communication. Michael Bologna, Disclosure: Most Companies Seeking to Comply With Reg FD Disclosure Requirements, Sec. L. Daily, Apr. 20, 2001. In In re Fifth Third Bancorp, the SEC determined that a redemption notice to the holders of Fifth Third's trust preferred securities was material nonpublic information, principally because of the significant disparity between the trading price of the securities and the redemption price. See infra Note 79.

[70] A disclosure is "intentional" when the person making it either knows, or is reckless in not knowing, that the information the person is communicating is both material and nonpublic. For example, if an official of an issuer did not plan on making a disclosure at a meeting but, after hearing the direction of the discussion, decided to make it and knew that the information was material and nonpublic, Regulation FD would be violated without simultaneous public disclosure. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 102.04 (Aug. 14, 2009).

[71] In general, any document publicly filed on EDGAR with the SEC within the timeframe required by Regulation FD would satisfy the rule. In considering whether disclosure is sufficient, however, companies must: (i) take care to bring the disclosure to the attention of the readers of the document; (ii) not bury the information; and (iii) not make the disclosure in a piecemeal fashion throughout the filing. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 102.02 (Aug. 14, 2009).

Once a Form 8-K is publicly available on EDGAR, an issuer need not wait before making disclosure of the information in a nonpublic forum. SEC, *Compliance and Disclosure Interpretations*, Regulation FD, Question 102.03 (Aug. 14, 2009).

[72] When issuing a press release to satisfy the NYSE's immediate release policy, the exchange requires listed companies (domestic and foreign) to contact Dow Jones, Reuters and Bloomberg and suggests that the release also be given to a number of other news services. NYSE Listed Company Manual §202.06.

disclosure, depending on the facts and circumstances.[73] If an issuer wishes to make public disclosure of material nonpublic information by means of a conference call, adequate notice must be given, including the date, time, subject matter and dial-in information for the call.[74] Disclosure at a shareholders' meeting, even one that is open to the public, is not sufficient if the meeting is not webcast or broadcast by electronic means, and the mere presence of the press at an otherwise nonpublic meeting does not render the meeting public.[75]

Soon after the adoption of Regulation FD, the Director of the SEC's Division of Enforcement indicated that the SEC would look for egregious violations involving the intentional or reckless disclosure of unquestionably material information, such as those involving earnings, as well as cases against people deliberately attempting to take advantage of the system either by speaking in code or by stepping over the line again and again and therefore diminishing the credibility of any claim that disclosures were non-intentional, noting in particular that "walking the Street up or down is almost certainly prohibited and can no longer be done privately."[76] In 2002, the SEC released its first three enforcement actions[77] and a Section 21(a) investigation report[78] under Regulation FD, and since then has engaged in further enforcement actions from time to time. Since September

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[73] To determine if website posting by itself is a sufficient method of public dissemination, an issuer would need to consider whether: (1) its website is a recognized channel of distribution; (2) posting of information on its website disseminates the information in a manner making it available to the securities marketplace in general; and (3) there is a reasonable waiting period for investors and the market to react to the posted information. Commission Guidance on the Use of Company Websites, SEC Release Nos. 34-58288, IC-28351, at Section II.A.2 (Aug. 1, 2008). Certain issuers have decided to announce earnings on their websites, rather than through a commercial news service (in addition to the announcement required under Item 2.02 of Form 8-K). We recommend that if an issuer chooses to announce earnings on its website, rather than through a commercial news service, the issuer should announce in a press release several days in advance of such posting that earnings will initially be posted to its website.

Issuers and their officers should exercise caution when making announcements over social networks, such as Twitter and Facebook, particularly where those announcements are not accompanied by prior or contemporaneous disclosure using an established Regulation FD-compliant method. In December 2012, Netflix and its CEO, Reed Hastings, each received a notice from the staff of the SEC indicating the staff's intent to recommend that the SEC institute cease-and-desist proceedings or bring a civil injunctive action against Netflix and Mr. Hastings for violations of Regulation FD. The notice followed a post by Mr. Hastings to his public Facebook page announcing certain business metrics, even though Mr. Hastings' post reached more than 200,000 followers and provided information that was in line with prior guidance. Netflix, Inc., Current Report (Form 8-K) (Dec. 6, 2012). The SEC staff also has suggested in a comment letter that Twitter updates by an issuer's CEO may violate Regulation FD. The issuer responded by arguing that the CEO's "tweets" regarding future acquisitions, stock option purchases and new services were not material nonpublic information, and even if they were, the tweets, which were linked to the company's website, would qualify as publicly disseminated for purposes of Regulation FD. The SEC staff appeared to accept that explanation. WebMediaBrands Inc., SEC Correspondence (CORRESP) (Jan. 7, 2011).

[74] Although several days' notice may be reasonable for a quarterly earnings announcement made by an issuer on a regular basis, the notice period may be shorter when unexpected events occur and the information is critical or time-sensitive. In addition, if a transcript or rebroadcast of the analysts' call will be available, such as through an issuer's website, the SEC staff has encouraged issuers to indicate in the notice how, and for what length of time, such a record will be available to the public. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 102.01 (Aug. 14, 2009).

[75] SEC, Compliance and Disclosure Interpretations, Regulation FD, Questions 102.05-.06 (Aug. 14, 2009). Regulation FD does not prohibit a director from speaking privately with a shareholder or group of shareholders. However, where a director speaks on behalf of the company, Regulation FD prohibits the selective disclosure of nonpublic information. Companies should consider implementing Regulation FD compliance procedures, including pre-clearing comments or having counsel participate, if a director is authorized to speak on behalf of the company and plans on speaking privately with investors. SEC, Compliance and Disclosure Interpretations, Regulation FD, Questions 101.11 (June 4, 2010).

[76] Richard H. Walker, Director, SEC Division of Enforcement, Remarks at Compliance and Legal Division of the Securities Industry Assoc., Regulation FD—An Enforcement Perspective (Nov. 1, 2000).

[77] See In re Raytheon Co., SEC Release No. 34-46897 (Nov. 25, 2002) (CFO spoke directly to 11 securities analysts and, based on his knowledge of their earnings estimates, told them that those estimates were "too high," "aggressive" or "very aggressive"); In re Siebel Systems, Inc., SEC Release No. 34-46896 (Nov. 25, 2002) (CEO spoke to a number of individuals at an invitation-only technology conference and disclosed that, contrary to public statements made three weeks earlier, Siebel expected its sales activity levels to be in line with previous years); In re Secure Computing Corp., SEC Release No. 34-46895 (Nov. 25, 2002) (CEO, on calls with two separate portfolio managers (the first of which also involved a representative of a brokerage firm) and in an e-mail to a managing partner of the brokerage firm, disclosed (non-intentionally, and then intentionally) that Secure had entered into a new material supply agreement, and the company failed to publicly release the non-intentionally released information in a timely fashion).

[78] Section 21(a) Report of Investigation: Motorola, Inc., SEC Release No. 34-46898 (Nov. 25, 2002) (investor relations director spoke directly to a number of securities analysts and clarified to them that previous guidance that Motorola's sales and orders were experiencing "significant weakness" meant a "25% or more" decline in sales and orders for the quarter, while not making any timely public disclosure of this quantitative information based in part on erroneous advice from in-house counsel).

2009 the SEC has exhibited a renewed emphasis on enforcement actions.[79]

Issuers should take care to monitor their disclosures in all circumstances, and use particular care when disseminating information in semi-public or private forums, such as invitation-only conferences, private offering roadshows, one-on-one meetings with investors or analysts and even conference calls or webcasts where inadequate or no notice of the event has been given to the public. Moreover, if an issuer believes that analysts require supplemental information about earnings releases or other releases about important business information, that information is probably material and should not be selectively disclosed. The enforcement actions also confirm that the SEC will look to market reaction as an indicator of the materiality of selective disclosure. One significant similarity among the enforcement actions is that visible and in some actions dramatic stock trading price and volume shifts occurred in the aftermath of the selective disclosures, and the SEC has stated that a very significant market reaction to selectively disclosed information requires public disclosure of that information.

These proceedings are also noteworthy because of their varying penalties. Each of Raytheon and Secure submitted an offer of settlement in anticipation of an enforcement proceeding, and agreed to a cease-and-desist order barring it from future violations of

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[79] In In re Schering-Plough Corporation, the CEO met in separate private meetings with analysts and portfolio managers of four institutional investors, three of which were among Schering's largest investors, and through a combination of words, tone, emphasis and demeanor, disclosed material nonpublic information, including the fact that analysts' earning estimates were too high and that next year's earnings would decline significantly. The CEO subsequently met with approximately 25 other analysts and portfolio managers and indicated that Schering's 2003 earnings would be "terrible." SEC Release No. 34-48461 (Sept. 9, 2003).

The charges in *SEC v. Siebel Systems, Inc*. were subsequently dismissed by the court. SEC Litigation Release No. 18766 (June 29, 2004); *SEC v. Siebel Systems, Inc*., 384 F.Supp.2d 694 (S.D.N.Y. 2005). The significance of the court's ruling is discussed below.

In *In re Senetek PLC,* the CEO and CFO sent nonpublic information on two separate occasions to different research firms that was subsequently included in the firms' research reports on Senetek. SEC Admin. Proc. File No. 3-11668 (Sept. 16, 2004).

In *SEC v. Flowserve Corp*., the CEO met privately with several analysts and reaffirmed publicly-available earnings guidance. The SEC highlighted that the disclosure to the analysts had led to an increase in the price of and trading volume in Flowserve stock and that the director of investor relations waited more than 53 hours after the selective disclosure and nearly 26 hours after the dissemination of the analyst's report before filing a Form 8-K disclosing the information revealed to the analysts. SEC Litigation Release No. 119154 (Mar. 24, 2005).

In *In re Electronic Data Systems Incorporated*, company personnel violated Regulation FD in selectively disclosing the cost of settling certain derivative contracts weeks before the amounts were made public in the company's Form 10-Q. SEC Release No. 34-56519 (Sept. 25, 2007).

The SEC settled an enforcement action in September 2009 against the former CFO of American Commercial Lines Inc. after he sent a message to analysts from his personal email account on a Saturday indicating substantially reduced earnings expectations for the quarter. The following Monday, the issuer's stock price decreased nearly 10% on three times the normal trading volume. Notwithstanding his familiarity with Regulation FD, the CFO acted without prior consultation with counsel and without going through the proper investor relations channels for publicly disseminating material information. *SEC v. Black*, S.D. Ind. Case No. 09-CV-0128 (Sept. 24, 2009); *In re Black*, SEC, Admin. Proc. File No. 3-13625 (Sept. 24, 2009).

In March 2010, the SEC brought and settled an enforcement action against Presstek, Inc. (which was previously the subject of enforcement proceedings in 1997; *see* text accompanying Note 109) for violations of Regulation FD in 2006 after the company's CEO disclosed material nonpublic information regarding the company's poor quarterly financial performance to the managing partner of an investment advisor, who sold the firm's holdings within minutes. The information was not simultaneously disclosed to the public. Presstek settled the SEC's charges without admitting or denying the allegations and paid a $400,000 civil fine. Charges against the CEO Edward J. Marino were not settled until more than two years later, after he agreed to a $50,000 fine and the issuance of an administrative order finding that he caused Presstek's violations and ordering him to cease and desist from committing or causing any future violations of Regulation FD. SEC Litigation Release No. 21443 (Mar. 9, 2010); SEC Litigation Release No. 22369 (May 15, 2012).

In October 2010, the SEC brought and settled enforcement actions against Office Depot, Inc., its CEO and former CFO after investor relations personnel, at the direction of the CEO and CFO, placed unprecedented private calls to analysts in advance of the release of quarterly earnings to signal that the company would not meet consensus earnings estimates. Company personnel did not explicitly state that estimates would not be met, but reminded analysts of prior statements made by company officials and also referred to other companies that had announced lower-than-expected results. Analysts concluded the company would not meet earnings estimates, and between the time calls were initially made and the company's public announcement on Form 8-K six days later that earnings would be negatively impacted by economic conditions, the price of the company's shares fell 7.7%. *SEC v Office Depot, Inc.*, Fla. S.D. Case No. 10-CV-81239 (Oct. 21, 2010); *In re Office Depot, Inc.*, SEC, Admin. Proc. File Nos. 3-14094 (Oct. 21, 2010); *In re Odland*, SEC, Admin. Proc. File Nos. 3-14095 (Oct. 21, 2010); *In re McKay*, SEC, Admin. Proc. File Nos. 3-14096 (Oct. 21, 2010).

The SEC issued a cease-and-desist order against Fifth Third Bancorp for violation of Regulation FD in November 2011. In *In re Fifth Third Bancorp*, Fifth Third issued a redemption notice to the holders of a series of its trust preferred securities through DTC, but did not file a Form 8-K or issue a press release to alert the public to the redemption. The redemption price was significantly lower than the price at which the securities were then trading, which resulted in heavy sales of the trust preferred securities by existing holders. Fifth Third filed a Form 8-K announcing the redemption only after it learned of the impact its selective disclosure had on the market. The SEC determined that the redemption notice was material nonpublic information because a reasonable investor would consider it important that a security was to be redeemed at a price lower than the current market price. Without admitting or denying the SEC's findings, Fifth Third consented to the issuance of the cease-and-desist order. *In re Fifth Third Bancorp*, SEC Release No. 34-65808 (Nov. 22, 2011).

Regulation FD and §13(a) of the Exchange Act. Siebel did the same in the 2002 action, and also agreed to pay a fine of $250,000 as part of its settlement. Both Schering-Plough and Richard Kogan, its CEO, also agreed to cease-and-desist orders and to pay fines of $1,000,000 and $50,000, respectively. Office Depot, its CEO and former CFO similarly agreed to cease-and-desist orders; the company also agreed to pay a fine of $1,000,000 and each executive agreed to a fine of $50,000. Flowserve and its CEO agreed to cease-and-desist orders and fines of $350,000 and $50,000, respectively, and Flowserve's Director of Investor Relations agreed to a cease-and-desist order. Senetek agreed to a cease-and-desist order without admitting or denying the SEC's findings, and, according to the order, the SEC took no action against any individual at Senetek and imposed no monetary penalty because of remedial acts promptly taken by Senetek and the cooperation it provided to the staff.[80] The SEC elected not to bring an enforcement action against Motorola or its senior officials because those officials sought in-house counsel's advice, which, although erroneous, was given in good faith. The SEC cautioned, however, that reliance on counsel may not provide a successful defense in future cases, especially in light of the Section 21(a) report issued in connection with the *Motorola* proceeding, and that the availability of this defense will depend on the facts and circumstances of each case.[81]

SEC Commissioner Campos dissented as to the lack of a penalty in the *Raytheon* and *Secure* proceedings, while SEC Commissioners Glassman and Atkins dissented as to the imposition of the $250,000 penalty against Siebel and Commissioner Atkins dissented as to the imposition of the $1,000,000 penalty against Schering-Plough. Although the SEC does not explain the different approaches, one factor that may have contributed to the penalty in the first *Siebel* case is that the information selectively disclosed by Siebel's CEO was diametrically the opposite of the company's recent public disclosure. This contrasts with the Raytheon case, where the information selectively disclosed was broadly consistent with publicly available information, including Raytheon's results from the previous year. In the *Secure* case, there were extenuating circumstances, such as the need for a third party's consent before the material nonpublic information could be disclosed to the public. In addition, Secure's management, at least with respect to the initial non-intentional disclosure, immediately sought permission to disclose the information in question, but was unable to do so as a result of Secure's existing confidentiality agreement with the supply agreement counterparty and that counterparty's refusal to allow publication. In *Schering-Plough*, although the information selectively disclosed by the company's CEO was consistent with the company's previous public disclosures, it was materially more definite and clearly intended to talk down Wall Street estimates, which is exactly the type of conduct Regulation FD was adopted to prevent. In *Flowserve*, however, a fine was imposed even though the information shared with the small group of analysts merely reaffirmed earnings guidance

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80 Although the former CFO in the Black proceeding agreed to a settlement comprised of a $25,000 civil penalty and a bar against future violations of Regulation FD, the SEC determined not to bring charges against American Commercial Lines itself due in part to its extraordinary cooperation with the SEC. The SEC indicated that it was not bringing charges against the issuer because: (i) prior to the selective disclosure, the issuer had cultivated an environment of compliance by providing Regulation FD training and implementing appropriate policies and controls designed to prevent violations; (ii) the CFO alone was responsible for the violation and he acted outside the control systems established by the issuer; (iii) the issuer acted promptly to correct the selective disclosure once it was discovered, filing a Form 8-K with the SEC on Monday afternoon; (iv) the issuer reported the selective disclosure to the SEC staff the day after it was discovered and provided extraordinary cooperation with the staff's investigation; and (v) the issuer took remedial steps to address the improper conduct, including by adopting additional controls to prevent a repetition of similar conduct. SEC v. Black, S.D. Ind. Case No. 09-CV-0128 (Sept. 24, 2009); In re Black, SEC, Admin. Proc. File No. 3-13625 (Sept. 24, 2009); SEC Files Settled Regulation FD Charges Against Former Chief Financial Officer, SEC Litigation Release No. 21222 (Sept. 24, 2009).

81 Section 21(a) Report of Investigation: Motorola, Inc., SEC Release No. 34-46898 (Nov. 25, 2002). Recognizing that an officer may better understand the importance of information to investors, the SEC stated that consultation with counsel "will not relieve the officer from responsibility for disclosure of information that he or she personally knows, or is reckless in not knowing, is material and nonpublic." The SEC also noted that if counsel does nothing more than recite the legal standard and then ask the officer in question whether a reasonable investor would consider the information significant, the resulting judgment is the officer's, not counsel's. In addition, the SEC clarified that, although counsel's advice may initially provide an officer with a good-faith basis for making a selective disclosure when the advice is received, that officer "may become aware of a very significant market reaction and may learn facts indicating that this reaction was a result of the selective disclosure. At that point, even though the officer's original selective disclosure was not intentional, the issuer has learned that it has made a non-intentional disclosure and must make the prompt public disclosure required by Regulation FD." *Id.*

that had been publicly disclosed less than four weeks before.[82]

Another key development in Regulation FD jurisprudence was the unwillingness of a court in the Southern District of New York to find a violation of Regulation FD in the *Siebel II* proceeding.[83] In June 2004, the SEC filed a civil action against Siebel charging the company with violating Regulation FD, as well as the prior cease-and-desist order barring it from future violations of Regulation FD.[84] In its complaint, the SEC alleged that Siebel's chief financial officer disclosed material nonpublic information by issuing positive comments in private meetings about the company's business activity that contrasted with negative public statements made during the prior three weeks.[85] The SEC claimed that these comments led to an increase in Siebel's stock price the following day. Siebel filed a motion to dismiss the suit claiming that the remarks were neither material nor nonpublic and that Regulation FD unconstitutionally restricts free-speech rights under the First Amendment of the U.S. Constitution because the scope of the regulation extends beyond "commercial speech." After examining the statements in their context, the court dismissed the charges and chided the SEC for what it clearly viewed as an overzealous approach to the enforcement of Regulation FD, stating that the SEC had placed "an unreasonable burden on a company's management and spokespersons to become linguistic experts, or otherwise live in fear of violating Regulation FD should the words they use later be interpreted by the SEC as connoting even the slightest variance from the company's public statements."[86] Significantly, the court held that private statements could vary from prior public statements so long as they were "equivalent in substance."[87] The court also held that movements in stock prices were relevant but not determinative in establishing whether the disclosed information was material or nonpublic.[88]

[82] The cease-and-desist order that Flowserve consented to referred to the SEC's view that the selective disclosure had been "intentional" in this case. The SEC stated that "selective disclosure is 'intentional' when the person making the disclosure knows, or is reckless in not knowing, that the information being communicated is both 'material' and 'nonpublic.'" SEC Release No. 34-51427 (Mar. 24, 2005). On the basis of that definition, the SEC concluded that the CEO's selective disclosure had been intentional.

[83] SEC v. Siebel Systems, Inc., 384 F.Supp.2d 694 (S.D.N.Y. 2005).

[84] SEC v. Siebel Systems, Inc., Litigation Release No. 18766 (June 29, 2004). Siebel's chief financial officer and investor relations director were also charged with aiding and abetting the Regulation FD violations.

[85] The SEC also charged Siebel with violating Rule 13a-15 under the Exchange Act, which requires issuers to maintain disclosure controls and procedures to ensure the proper handling of information required to be disclosed in reports filed or submitted under the Exchange Act and to ensure that management is provided the information necessary to make timely disclosure decisions. The SEC alleged that Siebel's failure to publicly disseminate the information in compliance with Regulation FD is evidence of inadequate disclosure controls and procedures in violation of Rule 13a-15. This represented the first time the SEC had charged an issuer with a violation of Rule 13a-15 and it bears noting that this claim was made in connection with Regulation FD rather than financial statements or periodic reports. This charge highlights the need for companies to address the disclosure requirements under Form 8-K, because a failure to file, or a late filing of, a required Form 8-K may serve as the basis for allegations that the issuer's disclosure controls and procedures were inadequate.

[86] Siebel, 384 F.Supp.2d 694, 704 (S.D.N.Y. 2005).

[87] Siebel, 384 F.Supp.2d 694, 705 (S.D.N.Y. 2005).

[88] The court also dismissed the charge relating to the violation of Rule 13a-15 on the basis that there were no factual allegations providing independent support for this claim absent the alleged violation of Regulation FD. See supra Note 85. Because the court ruled that the SEC had failed to state a cause of action, the court did not have an opportunity to consider Siebel's constitutional claims.

Selective Disclosure to Analysts and Measures to Avoid Rule 10b-5 Liability

Aside from Regulation FD, liability for selective disclosure has been based on the principles of securities fraud, particularly the law of insider trading. Under some early insider trading case law, which appeared to require that traders have equal access to corporate information, selective disclosure of material information to securities analysts could generally give rise to liability.

This understanding changed with the Supreme Court's landmark decisions in *Chiarella v. United States*[89] and *Dirks v. SEC*.[90] In *Chiarella*, the Court rejected the "parity of information" approach, which deemed trading to be fraudulent whenever the trader possessed material information not generally available to the public. The Court instead held that there must be a breach of a fiduciary duty or other relationship of trust and confidence before the law imposes a duty to disclose information or abstain from trading.[91]

In *Dirks*, the Supreme Court addressed the disclosure, or "tipping," of material nonpublic information by an insider to an analyst and disclosure by that analyst to its clients. The Court rejected the idea that a person is prohibited from trading whenever he or she knowingly receives material nonpublic information from an insider. Instead, it stated that a recipient of inside information is prohibited from trading only when the information has been made available to him or her "improperly"—that is, in breach of the insider's fiduciary duty to shareholders—and the recipient knew or should have known of that breach. Whether a breach of duty occurs depends on whether the insider receives a direct or indirect "personal benefit" from the disclosure.

The *Dirks* decision was widely construed as providing considerable latitude to insiders who made selective disclosure to analysts, and to the analysts (and their clients) who received selectively disclosed information and acted on it. Commentators interpreted the "personal benefit" requirement to involve primarily a pecuniary gain, and many corporate insiders took comfort in the fact that absent a financial reward, the *Dirks* personal benefit test would seem to insulate them from liability.

There has been surprisingly little testing since *Dirks* of the limits of the personal benefit test. In one controversial case, *SEC v. Stevens*, the SEC alleged that a corporate CEO, before making a general release to the public, had disclosed information regarding disappointing revenues to certain analysts and told them that earnings, therefore, might be lower than expected.[92] The SEC further maintained that the CEO had made such disclosures in an effort to enhance his reputation within the investment community. In settling with the SEC, the CEO agreed to pay $126,455, representing the amount of losses avoided by those shareholders who sold the company's stock prior to the eventual public announcement of such financial information. The danger of the SEC's broad

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89 Chiarella, 445 U.S. 222.

90 Dirks, 463 U.S. 646.

91 Although a decision in the district court for the Northern District of Texas recently cast doubt on whether a breach of a duty of trust and confidence requires an explicit agreement not to trade, in addition to an agreement to keep material nonpublic information confidential, the Fifth Circuit Court of Appeals reaffirmed in September 2010 that no explicit agreement is required if the parties understood that they were not to trade on the information when it was disclosed. See supra Note 5.

92 SEC Litigation Release No. 12813 (Mar. 19, 1991).

interpretation of "reputational benefit" in Stevens is that virtually all selective disclosure to the investment community is likely to have been made to some extent on the basis of self-interest.[93] Thus, any executive, even one who believes he or she is mainly serving the corporation's interests, may be charged with deriving a "reputational benefit" when he or she communicates with analysts.

The *Stevens* case has proven to be something of an anomaly. It is the only post-*Dirks* insider trading case brought by the SEC based on selective disclosure to, or trading by, securities analysts or their clients. Indeed, the SEC's recognition of the difficulties it faced in proving "personal benefit" led to its decision to adopt Regulation FD and abandon exclusive reliance on Rule 10b-5 to regulate selective disclosure to analysts. Even though Regulation FD does not apply to foreign issuers, inherent uncertainty about the scope of Rule 10b-5 and the Stevens case has led many advisers to conclude that whenever material information is disclosed to analysts, it should be publicly disclosed at the same time.[94]

Companies can take a number of measures to avoid the selective disclosure of material nonpublic information to analysts. Permitting the public to listen to a call with analysts, whether by a dial-in procedure or a webcast, will make any disclosures made during the call nonselective, provided adequate notice of the call is publicly given.[95] In addition, U.S. companies can make disclosure nonselective by furnishing the relevant information on a Form 8-K pursuant to Item 7.01 of that form, titled "Regulation FD Disclosure."[96] Foreign companies are similarly able to make disclosure nonselective by furnishing the relevant information on a Form 6-K.

Any selective presentations to analysts should be scripted and reviewed prior to the meeting, both by officials personally familiar with the issues to be raised as well as by counsel, to reduce the likelihood of the disclosure of material information. Furthermore, it generally would be advisable to place responsibility for such presentations upon a limited number of officials within the company, enabling them to develop the sophistication to deal effectively with this matter. Finally, if the company anticipates that a sensitive issue will most likely be raised by an analyst during a meeting, it might be advisable for the corporate official to state diplomatically near the beginning of the presentation that he or she is not at liberty to discuss the issue. Because a company generally does not have a duty to disclose material nonpublic information, a "no comment" position is permissible. The Supreme Court in *Basic Inc. v. Levinson* noted that silence is not misleading under Rule 10b-5 absent a duty to disclose and that "'[n]o comment' statements are generally the functional equivalent of silence."[97]

Although the consequences of selective disclosure of material information can be serious, the federal judiciary and the SEC, as well as the NYSE and Nasdaq, have recognized that inadvertent disclosures may arise. In the event of any allegation of intentional selective disclosure, procedures to avoid disclosure of material information (such as those described above)

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93 Cf. SEC v. Maxwell, 341 F. Supp. 2d 941, 948–49 (S.D. Ohio 2004) (holding an executive did not receive any "reputational benefit" for disclosing material nonpublic information to his barber).

94 The requirements and scope of Regulation FD are discussed above.

95 According to the SEC staff, adequate advance notice under Regulation FD must include the date, time, subject matter and call-in information for the analysts' call. SEC, Compliance and Disclosure Interpretations, Regulation FD, Question 102.01 (Aug. 14, 2009). Public notice should be provided for a reasonable period of time in advance of the conference call. For example, while several days' notice may be reasonable for a quarterly earnings announcement made by an issuer on a regular basis, the notice period may be shorter when unexpected events occur and the information is critical or time-sensitive. In addition, if a transcript or rebroadcast of the analysts' call will be available, such as through an issuer's website, the SEC staff has encouraged issuers to indicate in the notice how, and for what length of time, such a record will be available to the public. *Id.*

96 A company may elect to submit nonpublic information required to be disclosed by Regulation FD pursuant to Item 8.01 of Form 8-K, providing for disclosure regarding "Other Events," rather than Item 7.01. Unlike information furnished pursuant to Item 8.01, however, the information in a report furnished pursuant to Item 7.01 is not automatically incorporated by reference in short-form registration statements under the Securities Act or deemed to be "filed" for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the registrant specifically states the information is to be considered filed under the Exchange Act or incorporates it by reference into a filing under the Securities Act or the Exchange Act.

97 Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988).

can provide useful support for the position that any such disclosure that did occur was inadvertent. If such an inadvertent disclosure were to occur, the company should immediately prepare and disseminate broadly to the investing public a press release of such information[98] and should request that the analysts to whom the disclosure was made maintain confidentiality pending such release.[99]

The preceding discussion regarding potential liability for selective disclosure of material information under Rule 10b-5 produces a corollary principle: management should generally avoid giving favored treatment to particular analysts either in the timing of disclosures or in the frequency of granting interviews. In *SEC v. Geon Industries, Inc.*, a company official was accused of tipping a particular analyst about a planned merger involving the company.[100] The Second Circuit could find no direct evidence that the official had leaked information of the impending merger to the analyst. Nevertheless, the court concluded that such a "tipping" had occurred based on the evidence that the official spoke often with the analyst, "lunched with [him] alone, something [the official] did with no other broker, accepted two bottles of liquor [the analyst] sent him following this lunch, and honored one of the [the analyst's] telephone messages by a return call from home."[101] The court also emphasized that the analyst had made a number of trades in Geon stock following such conversations and meetings. The *Geon* case was decided before *Dirks* and thus does not represent a finding of liability on the more limited basis now required by the Supreme Court in *Dirks*.

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[98] A company subject to Regulation FD is required to disclose the information generally within 24 hours pursuant to a Regulation FD-compliant method of disclosure.

[99] The NYSE Listed Company Manual requires listed companies promptly and publicly to release material information that has been inadvertently leaked to analysts and offers explicit instructions regarding such a release. NYSE Listed Company Manual § 202.03 and § 202.06. Section 202.06(C) states that such information must be disseminated "by the fastest available means," which ordinarily requires a "release to the public press by telephone, facsimile or hand delivery, or some combination of such methods." Adequate disclosure to the investment community requires companies to release information to the Dow Jones, Reuters and Bloomberg news services. *Id.* at § 202.06(C). The NYSE Listed Company Manual also encourages companies to distribute promptly their releases to the Associated Press and United Press International, as well as to newspapers in New York City and in cities in which the company has its headquarters, plants or other major facilities. Copies of such releases should be sent to the company's NYSE representative by email. *Id.*

A company listed on Nasdaq is obliged to disclose to the Nasdaq MarketWatch Department material information that the company is not otherwise disclosing to the investing public or the financial community. Nasdaq Stock Market Rules, IM-5250-1. Where changes in market activity indicate that information has become known to the investing public, Nasdaq may work with the company to effect a timely public release of such information, subject to the company's views as to the business advisability of disclosing the information and the nature of the event itself.

The importance of keeping the stock exchange on which the company is listed fully informed about inadvertent disclosures of material information was illustrated in SEC v. Geon Industries, Inc., 531 F.2d 39 (2d Cir. 1976) and State Teachers Retirement Board v. Fluor Corp., 654 F.2d 843 (2d Cir. 1981). The Second Circuit ruled in Geon that an officer of the company had violated Rule 10b-5 because, when asked by an AMEX representative if there were any developments regarding the previously announced merger of Geon with Burmah Oil Co., Ltd. to account for the imbalance of sell orders in Geon stock, the officer failed to disclose information that would indicate the possible collapse of the merger. See Geon, 531 F.2d at 47. On the other hand, in Fluor the Second Circuit's decision that the company was not liable under Rule 10b-5 relied, in part, on the fact that company officials had informed a NYSE representative that the unannounced award of a substantial contract could be the reason for increased trading volume in company securities. See Fluor, 654 F.2d at 851. Following an inadvertent disclosure of material information to an individual or group of individuals, the company should also consider contacting the stock exchange on which it is listed to discuss the possible need for a halt in trading of the company's securities pending dissemination of the press release. In Fluor, the Second Circuit's decision that the company was not liable under Rule 10b-5 also emphasized that the company had acted in "good faith" by endorsing the NYSE decision to halt trading.

[100] SEC v. Geon Indus., Inc., 531 F.2d 39 (2d Cir. 1976).

[101] *Id.* at 47.

Participating in the Preparation of Analysts' Reports

Management is sometimes requested to comment upon the information included in the reports of securities analysts before such reports are distributed to clients. If company officials participate too actively in the preparation of analysts' reports, however, the reports may be deemed company statements.[102] Under such circumstances, the company may be liable for any material misrepresentations contained in analyst reports and may have a subsequent duty to update information in them. The company also may be liable for selective disclosure.[103]

In *Elkind v. Liggett & Myers, Inc.*, the Second Circuit stated that potential corporate liability for third-party statements depends upon whether management "sufficiently entangle[s] itself with the analysts' forecasts to render those predictions 'attributable to it.'"[104] The court further explained that such entanglement can occur when company officials make an implied representation that the information they have reviewed is accurate or at least comports with the company's views. The court in *Elkind* ultimately held that the company was not liable for material misrepresentations in an analyst's report because management did not "sufficiently entangle itself" with the information contained in the report by simply correcting the report's factual errors and not commenting on earnings forecasts.

The First Circuit adopted the *Elkind* test for entanglement in *In re Cabletron Systems, Inc.*[105] In this instance, statements in analyst reports about the company were drawn from representations made or information furnished by Cabletron officials. In remanding the case to determine whether the statements were in fact misleading, the court held that "liability may attach to an analyst's statements where the defendants have expressly or impliedly adopted the statements, placed their imprimatur on the statements, or have otherwise entangled themselves with the analysts to a significant degree."[106]

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[102] The opportunity for company officials to participate too actively in the preparation of analyst reports (at least those prepared by U.S. analysts) diminished as a result of rules adopted in 2002 by the Financial Industry Regulatory Authority, Inc. ("FINRA," as successor to the National Association of Securities Dealers, Inc., or NASD) and NYSE to address analyst conflicts of interest. See NASD Conduct Rule 2711, NASD Manual (CCH) and NYSE Rule 472. These rules, among other things, prohibit analysts employed by FINRA and NYSE member firms from submitting draft research reports to the covered company for its approval prior to the report's publication. Instead, the company may only be asked to review the report for factual accuracy and the version of the report sent to the company for review must not contain the analyst's research summary, rating or price target. (Certain firms apply the same restrictions even to analysts employed by their non-U.S. affiliates.)

In addition, the guidelines adopted by the CFA Centre for Financial Market Integrity and the National Investor Relations Institute (*see supra* Note 1) would permit issuers only to review portions of an analyst report for factual accuracy and only comment on historical or forward-looking information that is in the public domain. *See* CFA Centre for Financial Market Integrity/National Investor Relations Institute, Best Practice Guidelines Governing the Analyst/Corporate Issuer Relations (2004), at http://www.niri.org/Other-Content/Documents/CFAINIRIGuidelines.aspx.

[103] See supra Part VII for a discussion of SEC enforcement actions under Regulation FD.

An issuer may review and comment on an analyst's report without triggering disclosure requirements under Regulation FD so long as it refrains from communicating material nonpublic information. For example, an issuer ordinarily would not be disclosing material nonpublic information if it corrected historical facts that were a matter of public record or if it shared seemingly inconsequential data that, when pieced together with public information by a skilled analyst with knowledge of the issuer and the industry, resulted in a report that revealed material nonpublic information. However, the SEC staff has made clear that an issuer may not use the discussion of an analyst's report as a vehicle for selectively communicating—either expressly or implicitly—material nonpublic information. SEC, *Compliance and Disclosure Interpretations*, Regulation FD, Question 101.03 (Aug. 14, 2009).

[104] Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163 (2d Cir. 1980).

[105] In re Cabletron Sys., Inc., 311 F.3d 11 (1st Cir. 2002).

[106] *Id.* at 37–38 (internal quotation omitted); see also Schaffer v. Timberland Co., 924 F. Supp. 1298, 1310 (D. N.H. 1996); Stack v. Lobo, Civ. No. 95-20049 SW, 1995 WL 241448, at *9 (N.D. Cal. Apr. 20, 1995).

In *SEC v. Wellshire Securities, Inc.*, an analyst asked an executive to confirm information contained in an upcoming report about his company.[107] The executive said that the information was inaccurate and asked the analyst to send him a copy of the report so he could review and comment on it. The executive reviewed the draft, corrected it and then circulated it to other company officials. The company's secretary and director passed these comments on to the analyst, and then reviewed the revised report once more. The SEC contended that this activity constituted entanglement sufficient to satisfy the *Elkind* test, but the district court disagreed, without much reasoning. However, the SEC's position in *Wellshire* and thus the risk of enforcement actions, should also warn company officials to take a very cautious approach toward reviewing analyst reports.[108]

Concern that issuers may be held liable for the content of research reports that they participate in preparing was heightened by a 1997 SEC enforcement action against Presstek, Inc.[109] Presstek manufactured technology for printing press equipment and was heavily dependent on sales to a German press manufacturer. In late 1995, the German manufacturer encountered technical difficulties in the development of a new press and postponed the start of production of this press, which had a material adverse impact on Presstek's projected financial results for 1996. In November 1995, Presstek's chairman reviewed the draft of a research analyst's report on Presstek, providing numerous revisions of the report's narrative text and earnings projections. According to the SEC's findings, some of these changes made the research report more consistent with Presstek's internal projections; however, others made the report more misleading and some misleading information in the report remained uncorrected. In general, the distributed research report substantially overestimated Presstek's sales and earnings expectations for 1996 and failed to account for the impact of the delay in the production of the press and other negative developments. Despite these errors, Presstek distributed the research analyst's report to investors for more than six months without a disclaimer. In 1994 and 1995, Presstek also distributed to investors copies of a third-party financial newsletter that contained earnings projections that (according to the SEC) Presstek management knew, or was reckless in not knowing, far exceeded Presstek's internal forecast, although there was no allegation that Presstek participated in the preparation of this newsletter.

The SEC determined that Presstek violated §10(b) of the Exchange Act and other provisions of the U.S. federal securities laws on two principal grounds. First, the SEC found that by commenting on the research report, Presstek "sufficiently entangled" itself with the research report to be liable for the material misstatements and omissions therein. Second, the SEC found that, as a result of Presstek's subsequent distribution of the research report and financial newsletter without disclaimer (and notwithstanding that Presstek was not involved in the preparation of the newsletter), Presstek "adopted" these documents and thereby became fully liable for the misstatements and omissions contained in them. The *Presstek* administrative proceeding demonstrated that issuers must exercise extreme caution in commenting on analyst research reports and must refrain from distributing these reports under any circumstances. Similarly, issuers should be cautious about creating hyperlinks on their websites to sites containing analyst reports, and if they decide to do so, to include appropriate disclaimers and, more importantly, not be selective in their links.

The courts have also addressed when a company may become liable for analyst projections because it expressly "adopts or endorses" an analyst's report. This can occur if company officials confirm an analyst's projections or simply guide the analyst to the correct

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[107] SEC v. Wellshire Sec., Inc., 773 F. Supp. 569 (S.D.N.Y. 1991).

[108] In a pre-Dirks decision, one district court held that even when a company does not review an analyst's report, liability for fraud may still be found if a well-established relationship existed between the company and the analyst. See Green v. Jonhop, Inc., 358 F. Supp. 413 (D. Or. 1973). However, liability after the decision in Dirks would now require a finding of breach of fiduciary duty.

[109] In re Presstek, Inc., SEC Release No. 34-39472 (Dec. 22, 1997).

answer. In *In re Burlington Coat Factory Securities Litigation*, the company's chief accounting officer stated during a securities analysts' conference that he was "comfortable" with analysts' earnings forecasts within a certain range. The Third Circuit concluded that "[t]o say that one is 'comfortable' with an analyst's projection is to say that one adopts and endorses it as reasonable. When a high-ranking corporate officer explicitly expresses agreement with an outside forecast, that is close, if not the same, to the officer's making the forecast."[110]

Case law also suggests that to plead entanglement by a company, plaintiffs are required to present specific facts that link an analyst's statements to insiders of the company and must satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act of 1995 (the "Litigation Reform Act").[111] *In re Navarre Corporation Securities Litigation* involved a securities class action suit alleging that Navarre issued false and misleading statements about spinning off a subsidiary in order to inflate demand for Navarre's shares. Because the allegations of liability for third-party statements in the news failed to identify "who made the alleged announcement, where it was made, what it entailed, when it was made, why it was false when made or how plaintiffs [would be] able to substantiate the allegation other than through an independent news source story," the Eighth Circuit held that the allegations did not satisfy the heightened pleading requirements under the Litigation Reform Act as applied to an entanglement claim and affirmed the district court's dismissal of the complaint.[112]

In Raab v. General Physics Corp.,[113] shareholders sued the company, claiming it had misled investors through false statements supplied to analysts and the media. The plaintiffs sought to attribute a statement in a Goldman Sachs research report to the company on the basis that the report stated that the company "had indicated" to Goldman Sachs an increase in procurement contracts. The district court dismissed the complaint for failure to plead specific facts supporting their allegation of fraud, and the Fourth Circuit affirmed the dismissal, holding that plaintiffs had not pled facts from which the analyst's report could be attributed to the company, such as who supplied the information to Goldman Sachs, how it was supplied, or how the company could have controlled the content of the Goldman Sachs report.[114]

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110 In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1429 (3d Cir. 1997); contra Malone v. Microdyne Corp., 26 F.3d 471, 479–80 (4th Cir. 1994) (holding that statement of "comfort" with predictions of future earnings not actionable).

111 Federal Rule of Civil Procedure 9(b), which previously governed allegations of fraud in all federal cases, requires that "[i]n all averments of fraud or mistake, the circumstances constituting the fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally." Fed. R. Civ. P. 9(b). In an effort to curb abuses of securities litigation, the Private Securities Litigation Reform Act bolstered the scienter, or knowledge, pleading requirements in securities fraud cases, requiring plaintiffs to "state with particularity facts giving rise to a strong inference that the defendant acted with" the intent to deceive, manipulate or defraud. 15 U.S.C. § 78u-4(b)(2); accord In re Navarre Corp. Sec. Litig., 299 F.3d 735, 741–42 (8th Cir. 2002); see also In re Advanta Corp. Sec. Litig., 180 F.3d 525, 530–31 & n.5 (3d Cir. 1999); Press v. Chemical Inv. Servs. Corp., 166 F.3d 529, 537–38 (2d Cir. 1999).

112 In re Navarre Corp. Sec. Litig., 299 F.3d 735, 744 (8th Cir. 2002).

113 Raab v. Gen. Physics Corp., 4 F.3d 286 (4th Cir. 1993).

114 *Id.* at 288; see also Suna v. Bailey Corp., 107 F.3d 64, 68 (1st Cir. 1997); San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., 75 F.3d 801, 808–13 (2d Cir. 1996) (plaintiffs must allege in what respects the statements at issue were false and also allege facts that give rise to a strong inference of fraudulent intent); Acito v. IMCERA Group, Inc., 47 F.3d 47, 53 (2d Cir. 1995).

Non-GAAP Financial Measures

In January 2003, the SEC adopted Regulation G and Item 10(e) of Regulation S-K, which address the use of "non-GAAP financial measures"[115] by public companies in their SEC filings and other public disclosures.[116] The SEC also adopted Item 2.02 of Form 8-K, which requires that U.S. companies furnish to the SEC on Form 8-K "earnings releases" and other material financial information (including any update of an earlier announcement or release) that is made publicly available with respect to any completed annual or quarterly fiscal period. In particular, these rules raise a number of practical questions for companies that issue earnings press releases and discuss their results in earnings webcasts or conference calls.

The application of these rules depends in significant part on whether the company is a U.S. domestic issuer or a foreign private issuer. Significantly, Regulation G exempts foreign private issuers from its limitations in certain circumstances.[117] Foreign private issuers that do not qualify for this exemption should be guided by the rules and practices discussed below that are applicable to U.S. companies.

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[115] "Non-GAAP financial measure" is defined as a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that (i) excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or (ii) includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented. SEC Release No. 33-8176 (Jan. 22, 2003).

However, "non-GAAP financial measure" would not include (i) ratios or measures calculated using only (A) financial measures calculated in accordance with GAAP and (B) operating measures or other measures that are not non-GAAP financial measures; or (ii) operating and other statistical measures (such as unit sales, "same store sales," numbers of employees, numbers of subscribers or numbers of advertisers).

Under these rules, the term "GAAP" refers to generally accepted accounting principles in the United States, except that (i) in the case of foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. GAAP, the term "GAAP" refers to the principles under which those primary financial statements are prepared, and (ii) in the case of foreign private issuers that include a non-GAAP financial measure derived from or based on a measure calculated in accordance with U.S. generally accepted accounting principles, "GAAP" refers to U.S. generally accepted accounting principles for purposes of the application of these rules to the disclosure of that measure. *Id.*

Pro forma financial information presented pursuant to Article 11 of Regulation S-X (*e.g.*, required disclosures relating to certain acquisitions or divestitures) is not subject to these rules.

[116] *Id.*; see also SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures (Jan. 15, 2010). In January 2010, the staff of the SEC's Division of Corporation Finance released new Compliance and Disclosure Interpretations on the use of non-GAAP financial measures that clarified and, to some extent, relaxed the SEC's policy on the use of non-GAAP financial measures. The Compliance and Disclosure Interpretations superseded the frequently asked questions on non-GAAP financial measures that were adopted by the SEC in June 2003.

[117] A foreign private issuer is exempt from the requirements of Regulation G if (i) the securities of the issuer are listed on a securities exchange or quoted in an inter-dealer quotation system outside the United States; (ii) the non-GAAP financial measure is not derived from or based on a measure calculated and presented in accordance with U.S. GAAP; and (iii) the disclosure is made in a written communication that is released outside the United States prior to or contemporaneously with its release in the United States and is not otherwise targeted at persons located in the United States. The exemption does not become unavailable because the information appears on the issuer's website (so long as the website is not available exclusively to, or targeted at, persons located in the United States) or, following the disclosure or release of the information outside the United States, the information is included in a submission by the issuer on a Form 6-K.

We believe that a press release should not be viewed as "targeted at persons located in the United States" solely because it is in the English language. As a result, the earnings press releases of most foreign private issuers, whose primary financial statements are prepared under non-U.S. GAAP, need not comply with Regulation G.

Non-GAAP Financial Measures in Press Releases and Other Public Disclosures

Whenever a company subject to Regulation G publicly discloses material information that includes a non-GAAP financial measure (other than in SEC filings that are covered by Item 10(e) of Regulation S-K as discussed below), it is required to accompany that disclosure with a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP[118] and a quantitative reconciliation of the two measures (with an exception applicable to forward-looking information).[119]

Regulation G contains an antifraud provision prohibiting the publication of any non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion, contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading.[120] However, non-compliance with Regulation G does not in itself affect any person's liability in a private cause of action under the antifraud provisions of Exchange Act Section 10(b) or Rule 10b-5 thereunder. An issuer that fails to comply with Regulation G could be subject to an SEC enforcement action under Regulation G and, if warranted by the facts and circumstances, an enforcement action under Exchange Act Section 10(b) and Rule 10b-5.[121]

Regulation G also permits the public presentation of non-GAAP financial measures orally, telephonically, by webcast or broadcast or by similar means without requiring the additional disclosure, provided that the most directly comparable GAAP financial measure and the required reconciliation are provided on the registrant's website at the same time, and the location of

[118] As general guidance with respect to this requirement, the SEC has stated that "(1) non-GAAP financial measures that measure 'funds' generated from operations (liquidity) should be balanced with disclosure of amounts from the statement of cash flows . . . and (2) non-GAAP financial measures that depict performance should be balanced with net income, or income from continuing operations, taken from the statement of operations." SEC Release No. 33-8176 (Jan. 22, 2003), 68 Fed. Reg. 4820, 4823 (Jan. 30, 2003) n.26. The SEC has clarified that (i) with respect to the use of EBITDA as a performance measure, it would require a reconciliation to net income (as opposed to operating income) and (ii) only non-GAAP financial measures derived from GAAP net income may properly be characterized as EBITDA or EBIT. See SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Questions 103.01 and 103.02 (Jan. 11, 2010).

[119] The required reconciliation must be quantitative for historical non-GAAP financial measures presented and quantitative, to the extent available without unreasonable efforts, for forward-looking information. Rule 100(a)(2) of Regulation G. With respect to forward-looking non-GAAP financial measures, the SEC expects the issuer to: (i) disclose the fact that the most directly comparable GAAP measure is unavailable; (ii) provide reconciling information that is available without unreasonable effort; and (iii) identify information that is unavailable and disclose its probable significance. SEC Release No. 33-8176 (Jan. 22, 2003). For example, this exception could apply if an issuer believes it can accurately forecast its quarterly operating results, but not the amount of a potential restructuring charge. See Steven E. Bochner & Eric John Finseth, The Earnings Release and Disclosure Reform, Insights, Dec. 2003, at 10.

Regulation G does not apply to non-GAAP financial measures contained in disclosures specifically subject to the SEC's rules regarding communications in connection with business combinations, which are comprised of Rule 425 under the Securities Act (communications in connection with a business combination in which stock consideration is being registered under the Securities Act), Rules 14a-12 (solicitations before furnishing a proxy statement) and 14d-2(b)(2) (communications relating to a tender offer) under the Exchange Act and Item 1015 of Regulation M-A (disclosure relating to fairness opinions and the underlying analyses).

However, related communications not specifically captured by the business combination communications rules would be subject to Regulation G, such as (i) communications to shareholders generally after the meeting of target company shareholders that approves a business combination or after the completion of a tender offer; (ii) communications about an all-cash business combination if made by an acquiror to its shareholders who are not voting; or (iii) where the acquisition is of a closely held target and therefore implicates neither the tender offer or proxy rules under the Exchange Act nor the registration requirements of the Securities Act.

[120] Significantly, the SEC has indicated that issuers should consider whether a change in the methodology for calculating or presenting a non-GAAP financial measure from one period to another, without a complete description of the change in methodology, complies with this antifraud provision. SEC Release No. 33-8176 (Jan. 22, 2003).

[121] *Id.*

the website is also included in the public presentation.[122] In the case of a foreign private issuer that is exempt from the requirements of Regulation G with respect to earnings webcasts or conference calls, no additional steps need be taken. Foreign private issuers should, however, continue to take into account best practices and the views of the SEC to avoid selective disclosure of material information and to monitor the content of these oral presentations in light of the antifraud provisions of the U.S. federal and state securities laws.

While the matter was not expressly addressed by the SEC in adopting Regulation G, we believe that any disclosure containing non-GAAP financial measures made during a webcast or conference call (*e.g.*, to discuss earnings) by means of slides that are not distributed or made available electronically or in hard copy should be viewed as disclosure "orally . . . or by similar means" within the meaning of the "oral disclosures" requirements of Regulation G. Under this view, the required comparable GAAP measure and quantitative reconciliation need not be set forth in the slides themselves, provided that each requirement applicable to "oral disclosures" has been satisfied.

By contrast, if slides or other written materials are distributed or made available electronically or in hard copy to participants during a webcast or conference call and contain non-GAAP financial measures, we believe that the most directly comparable GAAP measures and the required reconciliations must be presented in the slides or other written or electronic materials and should be presented in close proximity to the non-GAAP financial measures.

[122] The SEC encourages issuers to provide website access to this information for at least a 12-month period and has suggested that this information may appear on the website or page that the issuer normally uses for its investor relations function. *Id*. We believe that a hyperlink to a list of a company's reports on the SEC's EDGAR website will satisfy this requirement, provided that a document filed with or furnished to the SEC and appearing on the EDGAR website contains the required information.

Requirement to Furnish Earnings Releases on Form 8-K

In accordance with Section 409 of the Sarbanes-Oxley Act, the SEC adopted Item 2.02 of Form 8-K, which requires U.S. domestic issuers to *furnish*[123] any public announcement or release (including any update of an earlier announcement or release) that discloses material nonpublic information regarding the company's results of operations or financial condition for a completed quarterly or annual fiscal period (such as the typical quarterly earnings release)[124] to the SEC within four business days of being issued and to comply with the requirements of Item 10(e)(1)(i) of Regulation S-K in connection with any non-GAAP financial measures contained therein.[125] Item 10(e)(1)(i) imposes two further requirements in addition to those imposed by Regulation G. First, the comparable GAAP measure must be presented with equal or greater prominence. Second, there must be a statement either in the earnings press release or in the related Form 8-K regarding management's belief as to why the non-GAAP financial measure is useful to investors (and, if material, regarding the additional reasons for which management uses the non-GAAP financial measure).[126] Under Item 2.02, the Form 8-K must also disclose the date of the announcement or release, briefly identify it and attach the text as an exhibit.

Unlike information filed with the SEC, information "furnished" to the SEC is not subject to liability under Section 18 of the Exchange Act or automatically incorporated by reference into shelf registration

[123] Because Item 2.02 only requires that the information be furnished (and not filed), an issuer's failure to comply in a timely manner will not affect its eligibility to use a short-form registration statement. SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 105.03 (Jan. 11, 2003); SEC, Compliance and Disclosure Interpretations, Form 8-K, Question 106.05 (Apr. 2, 2008).

[124] It bears noting that this requirement is only triggered upon the disclosure of material nonpublic information concerning a completed quarterly or annual fiscal period. Public announcements or releases regarding future periods would not require an issuer to furnish an additional Form 8-K under Item 2.02, unless the disclosure contained historical information not previously furnished.

For example, an early announcement, or "preannouncement," of quarterly financial results *during* the course of such quarter would constitute forward-looking guidance, which would not necessitate furnishing a Form 8-K under Item 2.02. However, if a preannouncement of quarterly financial results is made *after* the end of a completed fiscal period—and the issuer anticipates confirming or updating those results in its regularly scheduled earnings release—the preannouncement would require the issuer to furnish a Form 8-K under Item 2.02 since the anticipated financial results relate to a *completed* fiscal period. *See* Steven E. Bochner & Eric John Finseth, *The Earnings Release and Disclosure Reform*, Insights, Dec. 2003, at 13-14 n.11; *see also* SEC, *Compliance and Disclosure Interpretations*, Form 8-K, Questions 106.06 (Jan. 11, 2010) and 106.07 (Apr. 24, 2009).

[125] Foreign private issuers are exempt from the requirements of Form 8-K, including Item 2.02 of Form 8-K. Thus, while foreign private issuers generally furnish their earnings press releases to the SEC on Form 6-K, they are not required to comply with the requirements of Item 10(e)(1)(i) of Regulation S-K in their earnings press releases or in the reports on Form 6-K used to furnish those earnings press releases to the SEC.

Because the contents of any earnings press release may affect investment decisions by U.S. investors and therefore result in liability under U.S. federal and state securities laws, however, foreign private issuers should consult with U.S. counsel about the contents of their earnings press releases, notwithstanding that those releases will in many cases not be subject to the requirements of Regulation G. In addition, foreign private issuers that have outstanding shelf registration statements under the Securities Act should bear in mind that Forms 6-K used to furnish earnings releases to the SEC must comply with the full requirements of Item 10(e) of Regulation S-K if they are incorporated by reference into those (or similar) registration statements.

A report on Form 6-K is incorporated by reference into a Securities Act registration statement only if the foreign private issuer so indicates. The SEC staff has stated that a foreign private issuer that wishes to incorporate only a portion of an earnings press release (*e.g.*, the portion that does not contain a non-GAAP measure) has two options. Either it can furnish a single report on Form 6-K, specifying which portion of the release is incorporated and which is not, or it can file two reports, only one of which is incorporated by reference. The SEC staff has stated its preference for the latter approach, noting that the company should consider whether its disclosure is rendered misleading by virtue of having incorporated only a portion of its earnings press release. SEC, *Compliance and Disclosure Interpretations*, Non-GAAP Financial Measures, Question 106.02 (Jan. 11, 2010).

[126] The explanation of the utility of the non-GAAP financial measure should not be boilerplate and should address a number of matters specific to the issuer. However, the explanation need not be included if this information was already included in the issuer's most recent annual report on Form 10-K (or a more recent Form 10-Q) or 20-F, except to the extent necessary to update it.

statements and thereby made subject to the liability provisions of Sections 11 and 12(a)(2) of the Securities Act. Such information remains subject to liability under Exchange Act Section 10(b) and Rule 10b-5 thereunder and to the general antifraud provision of Regulation G.

Similar to Regulation G, an exemption from the obligation to furnish a report on Form 8-K to the SEC under Item 2.02 of Form 8-K is available for material nonpublic information disclosed orally, telephonically or by webcast, broadcast or similar means if:

— the information is provided as part of a presentation that is complementary to, and initially occurs within 48 hours[127] after, a related written announcement or release that has been furnished to the SEC under Item 2.02 of Form 8-K prior to the presentation;[128]

— the presentation is broadly accessible to the public by dial-in conference call, webcast, broadcast or similar means;

— any financial and other statistical information contained in the presentation is provided on the issuer's website, together with any information required by Rule 100 of Regulation G;[129] and

— the presentation was announced by a widely disseminated press release that included instructions as to when and how to access the presentation and the location on the registrant's website where the information would be available.

The simplest means of ensuring availability of the exemption is to:

— include in the press release announcing the earnings webcast or conference call a statement identifying the page on the issuer's website where the webcast or call will be archived;

— ensure that the announcement is "widely disseminated" (which would be the case if the issuer has chosen to satisfy its obligations under Regulation FD by distributing the announcement through a widely circulated news or wire service);[130] and

— ensure that the earnings press release has been furnished to the SEC under Item 2.02 of Form 8-K before the earnings webcast or conference call begins.[131]

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[127] The SEC staff construes the 48-hour requirement literally—i.e., not as equivalent to two business or calendar days. SEC, Compliance and Disclosure Interpretations, Form 8-K, Question 206.01 (Apr. 2, 2008).

[128] The SEC staff has stated that no additional filing on Form 8-K is necessary where an issuer releases its earnings after the close of the market and files the earnings press release as an exhibit to a quarterly report on Form 10-Q the next day prior to its earnings webcast or conference call, assuming the other conditions of the exception from filing are met. SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 105.07 (Jan. 15, 2010); SEC, Compliance and Disclosure Interpretations, Form 8-K, Question 106.04 (Jan. 11, 2010).

[129] The SEC staff has stated that an audio file of the initial webcast would satisfy this condition only if: (i) it contains all material financial and other statistical information included in the presentation that was not previously disclosed; and (ii) investors can access it and replay it through the company's website. Alternatively, the staff stated, slides posted on the website at the time of the presentation containing the required, previously undisclosed, material information would also satisfy the condition. In each case, the information must include any material information provided in connection with any questions and answers during the presentation. SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 105.01 (Jan. 11, 2010); SEC, Compliance and Disclosure Interpretations, Form 8-K, Question 106.01 (Jan. 11, 2010).

[130] If an issuer wishes to use a Form 8-K to satisfy its obligations under Regulation FD with respect to an earnings release, the release may be furnished under Item 7.01 of Form 8-K for purposes of, and within the timeframe specified by, Regulation FD and simultaneously under Item 2.02 of Form 8-K for purposes of that item. SEC Release No. 33-8176 (Jan. 22, 2003).

[131] The EDGAR filing system is open to accept filings between the hours of 6 a.m. and 10 p.m. (Eastern time), though filings other than beneficial ownership reports will not appear on EDGAR until 6 a.m. the next business day if filed after 5:30 p.m. (Eastern standard time). The SEC staff has confirmed that, where the earnings release is issued after the close of the market, the conference call or webcast includes material previously undisclosed information (thus precluding reliance on this exception) and such information has not been furnished on a Form 8-K prior to the conference call or webcast, an issuer must file a transcript of the relevant portion of the conference call or slides including the information on Form 8-K. SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 105.07 (Jan. 15, 2010); SEC, Compliance and Disclosure Interpretations, Form 8-K, Question 106.02 (Jan. 11, 2010).

If any material information not contained in, but complementary to the information contained in, the earnings press release is made public orally during the earnings webcast or conference call, the complementary information must be posted on the issuer's website.[132] Although this requirement should not prove difficult to comply with for any material, complementary information planned to be disclosed in the webcast or call, it raises a practical problem if the information is disclosed in response to a question during the presentation. While not expressly addressed by the SEC, this requirement should be satisfied in such circumstances if the complementary information is posted on the issuer's website by the open of business on the business day following the webcast or call.[133] Archiving the webcast or a transcript of the conference call on the issuer's website within that time period will satisfy this requirement. Issuers should note, however, that the SEC "encourages" issuers to provide "ongoing website access" to information not furnished under Item 2.02 of Form 8-K in reliance on this exemption and "suggests" that website access be provided for at least a 12-month period.[134]

Material information made public during the earnings webcast or conference call must be furnished to the SEC under Item 2.02 of Form 8-K within four business days after it is made public if that information was not contained in, and is not complementary to the information contained in, the earnings press release. The SEC has suggested that information may be viewed as complementary to the information contained in the earnings press release to the extent that the issuer merely continues its practices (as in effect prior to March 29, 2003) regarding allocation of information between the earnings press release and the earnings webcast or conference call.[135]

We also believe that material information made public during the webcast or conference call should be furnished to the SEC under Item 2.02 of Form 8-K within four business days after it is made public if that information was not contained in the earnings release and was disclosed in slides or other written materials that were distributed or made available electronically or in hard copy to participants.[136]

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[132] Alternatively, the complementary information could be furnished to the SEC under Item 2.02 of Form 8-K within four business days after having been made public.

[133] The SEC staff has confirmed that the posting must occur "promptly" (but without specifying a deadline) and that a webcast of the oral presentation would be sufficient to meet this requirement. SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 105.02 (Jan. 11, 2010); SEC, Compliance and Disclosure Interpretations, Form 8-K, Question 106.03 (Jan. 11, 2010).

[134] SEC Release No. 33-8176 (Jan. 22, 2003); see also supra Note 122.

[135] The SEC stated, however, that "[we] do not intend this exception to foster changes in practice whereby disclosure is shifted from the written release or announcement to the complementary presentation." SEC Release No. 33-8176, n.58 (Jan. 22, 2003).

[136] Many companies conduct "one on one" meetings with investors or attend analyst conferences throughout the year that may not fall within the "complementary disclosures" exception given the limited timeframe during which the exception is available. If these presentations include only a repetition of information previously furnished to the SEC, no new obligation to furnish the information on Form 8-K should arise, even where the information is provided in a different format (e.g., graphic, rather than numerical presentation). By contrast, a public update of information previously furnished to the SEC under Item 2.02 of Form 8-K must itself also be furnished on that form. See Item 2.02(a) of Form 8-K.

An issue is also raised as to whether a "one on one" meeting constitutes a "public announcement" for purposes of Item 2.02 of Form 8-K. Form 8-K provides no guidance on this point, although in adopting Regulation G, the SEC stated that "whether disclosure is 'public' will . . . depend on all the facts and circumstances." SEC Release No. 33-8176, n.31 (Jan. 22, 2003).

One area that may provide guidance is the statutory and regulatory regime surrounding offers of securities under the Securities Act. In that context, the number of offerees would not affect whether a "public" distribution has occurred, but the sophistication of the investors involved would. Building on those principles, if persons attending the "one on one" meeting were "accredited investors" within the meaning of Rule 501 of Regulation D under the Securities Act or "qualified institutional buyers" within the meaning of Rule 144A under the Securities Act, an argument could be made that a disclosure is not "public" for purposes of reporting on Form 8-K.

As these meetings are typically held with securities analysts and institutional investors, the company would in any event be obligated to make a wider public disclosure under Regulation FD, if it disclosed material information not previously disclosed to the public. Despite this practical result, in adopting Regulation G, the SEC specifically rejected Regulation FD as a precedent for determining when a disclosure is "public." *Id.*

Non-GAAP Financial Measures in SEC Filings

The rules pertaining to the use of non-GAAP financial measures also amended Item 10 of Regulation S-K and Form 20-F to impose more stringent conditions on the use of such measures in other SEC filings.[137] Under these rules, all filings[138] under the Securities Act and the Exchange Act, other than free writing prospectuses[139] and documents filed by eligible Canadian issuers under the U.S.-Canadian multijurisdictional disclosure system, that include a non-GAAP financial measure must also include:

— a presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with GAAP;

— a reconciliation (by schedule or other clearly understandable method), which must be quantitative (subject to the same exception for forward-looking information described above),[140] of the differences between the non-GAAP financial measure disclosed and the most directly comparable financial measure or measures calculated and presented in accordance with GAAP;

— a statement disclosing the reasons why the registrant's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations; and

— to the extent material,[141] a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure that are not disclosed under the preceding bullet point.[142]

Under Item 10(e) of Regulation S-K, filings may also not: (i) exclude charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than EBIT (earnings before interest and taxes) and EBITDA; (ii) adjust a non-GAAP performance measure

[137] These amendments are discussed in greater detail in our memorandum entitled "SEC Adopts Rules to Implement Section 401(b) of the Sarbanes-Oxley Act to Require Furnishing of Earnings Releases on Form 8-K" (Jan. 30, 2003).

[138] Note that these rules pertain to information "filed" with the SEC as opposed to information that is furnished pursuant to Items 2.02 or 7.01 of Form 8-K or on a Form 6-K. See supra Note 96.

[139] SEC, Division of Corporation Finance, Securities Offering Reform Questions and Answers, Questions 10 and 11 (Nov. 30, 2005).

[140] Consistent with Regulation G, these amendments to Item 10 of Regulation S-K and Form 20-F also provide an exception from the quantitative reconciliation requirement with respect to forward-looking non-GAAP financial measures in situations where a quantitative reconciliation is not available without unreasonable effort. Where this exception applies, the SEC expects the issuer to: (i) disclose the fact that the most directly comparable GAAP measure is unavailable; (ii) provide reconciling information that is available without unreasonable effort; and (iii) identify information that is unavailable and disclose its probable significance. SEC Release No. 33-8176 (Jan. 22, 2003); see also supra text accompanying Note 119.

[141] The qualifying phrase "to the extent material" makes clear that issuers need not separately disclose the utility of the non-GAAP measure to investors and management's purpose for using the measure if the latter disclosure would add nothing important to investors. SEC Release No. 33-8176 (Jan. 22, 2003).

[142] In the case of filings other than annual reports on Form 10-K or Form 20-F, a registrant is not required to include information regarding the purpose for which the non-GAAP financial measure is used and the reasons why that financial measure is believed to be useful to investors, so long as: (i) that information was included in the registrant's most recent annual report on Form 10-K or Form 20-F or a more recent filing; and (ii) that information is updated to the extent necessary to meet the applicable requirements at the time of the current filing. *Id.* Reference to filings does not include reports on Form 6-K, which are "furnished" to the SEC, except insofar as they are incorporated by reference into a Securities Act registration statement or prospectus or an Exchange Act report filed with the SEC.

In addition, these amendments to Regulation S-K and Form 20-F, like Regulation G, do not apply to non-GAAP financial measures contained in disclosures subject to the SEC's rules regarding communications in connection with business combinations. *See supra* Note 119.

to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or where there was a similar charge or gain within the prior two years;[143] (iii) present non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes; (iv) present non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X; or (v) use titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.[144]

[143] The Compliance and Disclosure Interpretations on non-GAAP financial measures that were released by the staff of the SEC's Division of Corporation Finance in January 2010 significantly relaxed the views expressed on adjustments for recurring items in the frequently asked questions of June 2003. In the new guidance, the staff states that an item should not be characterized as non-recurring, infrequent or unusual unless it meets specific criteria, but then indicates that "[t]he fact that a registrant cannot describe a charge or gain as non-recurring, infrequent or unusual...does not mean that the registrant cannot adjust for that charge or gain. Registrants can make adjustments they believe are appropriate, subject to Regulation G and the other requirements of Item 10(e) of Regulation S-K." SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 102.03 (Jan. 11, 2010).

[144] These prohibitions will not, however, apply to a non-GAAP financial measure included in a filing of a foreign private issuer, provided that the non-GAAP financial measure (i) relates to the GAAP used in the issuer's primary financial statements included in its filings with the SEC; (ii) is required or expressly permitted by the standard-setter that is responsible for establishing the GAAP used in such financial statements; and (iii) is included in the annual report prepared by the issuer for use in its home jurisdiction or for distribution to its securityholders. SEC, Compliance and Disclosure Interpretations, Non-GAAP Financial Measures, Question 106.01 (Jan. 11, 2010) (providing guidance on when a measure is expressly permitted).

Disclaiming Liability for Forward-Looking Statements

Projections and forecasts about the issuer and other forward-looking statements are by their nature uncertain and may prove to be incorrect, thus raising special liability concerns for an issuer, including, as discussed above, a potential duty to correct or update them when they are no longer true.[145]

The Litigation Reform Act[146] provides some protection to issuers that are subject to the reporting requirements of the Exchange Act, their officers, directors and employees and their underwriters (with respect to information provided by such issuers or derived therefrom) for projections and other forward-looking statements, whether written or oral, that turn out to be inaccurate or materially misleading. The Litigation Reform Act creates a two-pronged safe harbor from liability under the Securities Act and the Exchange Act[147] where: (i) a forward-looking statement is identified as such and is accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement;" or (ii) a plaintiff is unable to prove that the forward-looking statement was made with actual knowledge that it was materially false or misleading.[148] Thus, the first prong of the Litigation Reform Act allows issuers and their officers, directors, employees and underwriters to obtain summary judgment in private civil suits based on false projections because the factual question of whether the projections were made with actual knowledge of their falsity is not determinative of liability.[149] The safe harbor, however, does not apply to statements made in the context of an initial public offering, a tender offer or going private transaction or in financial statements or beneficial ownership reports under §13(d) of the Exchange Act.[150]

The Litigation Reform Act sets forth specific procedures for complying with the safe harbor with respect to oral forward-looking statements. Pursuant to these procedures, it is sufficient for an issuer (or its director, officer or employee) making an oral forward-looking statement to: (i) state that the discussion or presentation will contain forward-looking statements; (ii) state that actual results could differ materially from

[145] Liability for forward-looking statements, like liability for other statements or omissions concerning an issuer, can attach not only in the context of a registered public offering under Sections 11 and 12(a)(2) of the Securities Act, but also in the context of a private placement or secondary market transaction under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 18 of the Exchange Act and Section 17(a) of the Securities Act.

[146] Pub. L. No. 104-67, 109 Stat. 749 (1995).

[147] The safe harbor does not protect against actions alleging fraud under state law, although in some jurisdictions similar results may be obtained under the "bespeaks caution" doctrine developed by the federal courts and adopted by some state courts. This doctrine shields defendants from liability based on projections and other "soft" or forward-looking statements if accompanied by meaningful disclaimers or disclosures of risk; the doctrine generally does not shield those who make statements with knowledge of their falsity. The safe harbor is also limited in that it applies only to private civil suits and does not protect against civil or criminal enforcement actions brought by the SEC or the Department of Justice. The passage of the Securities Litigation Uniform Standards Act of 1998 (Pub. L. No. 105-353, 112 Stat. 3227 (1998)) mitigates the risk of securities fraud actions in state court by requiring most class action securities fraud suits based on state law to be brought in federal court under federal law.

[148] Section 102(c)(1) of the Litigation Reform Act. In order to qualify cautionary statements as "meaningful," issuers should disclose any assumptions on which the projections are based and make the statements specific, prominent, easy to find and specifically tailored to the issuer's business—general boilerplate warnings applicable to any company or industry will not suffice.

[149] See H.R. Conf. Rep. No. 104-369, at 44 (stating that for the purposes of the first prong of the safe harbor "[c]ourts should not examine the state of mind of the person making the statement"). See, e.g., Slayton v. American Express Co., 604 F.3d 758, 773-77 (2d Cir. 2010) (noting that this inquiry is "fact specific" and applying doctrine to facts of the case to affirm dismissal of complaint).

[150] Section 102(b) of the Litigation Reform Act. In these instances, however, "soft" or forward-looking statements and projections accompanied by meaningful disclaimers or disclosures of risk may be protected under the "bespeaks caution" doctrine. See supra Note 147.

those projected in such forward-looking statements; and (iii) refer the audience to a "readily available" written document where the "meaningful cautionary statements" can be found.[151] Documents filed with the SEC or publicly disseminated are considered "readily available."

Despite the significant protections provided by this safe harbor, it does not affect the scope of any duty to update specific forward-looking statements that fall within it.[152]

[151] Section 102(b) of the Litigation Reform Act. The following sample disclaimer (to be made prior to any oral statements or presentations) could be used to satisfy these procedures:

> During the course of my discussion today, I may make statements that constitute projections, expectations, beliefs or similar forward-looking statements. I would like to caution you that the company's actual results could differ materially from the results anticipated or projected in any such forward-looking statements. Additional detailed information concerning the important factors that could cause actual results to differ materially from the information I will give you today is readily available in [provide name and date of most recent document containing a complete forward-looking statement disclaimer, e.g., an annual report on Form 20-F] on page(s) [page numbers] under the heading [name of section]. Copies of this document are [available upon request/on file with the SEC].

It should be noted that these cross-reference procedures available for oral forward-looking statements may not be sufficient for the purposes of invoking the safe harbor if the oral statements are later put in writing and such writing is not "accompanied by meaningful cautionary statements." Accordingly, where an issuer posts a transcript or audio recording of a conference call on its website, the cross-referenced document containing the meaningful cautionary statements should also be available on the website.

[152] When accompanied by meaningful and specific cautionary language, the courts may, however, consider forward-looking statements "immaterial as a matter of law" under the "bespeaks caution" doctrine and hold that updating the statements is not required. Illinois State Board of Investment v. Authentidate Holding Corp., 369 Fed.Appx. 260, 263 (2d Cir. 2010) (quoting Halperin v. eBanker USA.com, Inc., 295 F.3d 352, 357 (2d Cir. 2002)). Authentidate involved a press release and a conference call in which the company stated its belief that a proposed amendment to cure a breach under a key agreement was imminent. The plaintiff alleged that the company violated a duty to update because the company failed to update these statements when it subsequently learned that the amendment would not be implemented. Although the court agreed that the company had a duty to update these statements, the court relied on the "bespeaks caution" doctrine to hold that the statement in the press release was not actionable because it was accompanied by an explicit warning that there was "no guarantee" the amendment would be made. However, the court found that the boilerplate warning at the beginning of the conference call – that forward-looking statements were "subject to certain risks and uncertainties" – was insufficient to "put investors on notice of the particular risk at issue" and, therefore, that the warning could not be relied on to negate liability under the "bespeaks caution" doctrine. *Id.* The court also noted that the "bespeaks caution" doctrine applies only to forward-looking statements, and found two statements the company made – that "[they] did a few things recently which [they] think put [them] back in compliance [with revenue metrics]" and "management believes it cured [the breach]" – to be "statements of then-present fact," which were not protected by the doctrine. Authentidate Holding Corp., at 264. See supra Part V for a general discussion of the duty to update previous communications.

Conclusion

Management should be very careful in its communications with securities analysts. Under certain circumstances, the disclosure of material information selectively to analysts can violate Rule 10b-5 and thereby generate both SEC sanctions and liability for damages to investors. Pursuant to the tests courts have fashioned to determine "materiality," company officials should be wary of disclosing to analysts, but not to the public generally, any information (such as earnings information) that might affect the company's share price or that a reasonable investor would deem important in deciding whether to buy or sell company securities.

Furthermore, companies should take precautionary measures in advance to avoid selective disclosure. Prophylactic procedures include the scripting of presentations to analysts, the pre-meeting review of the proposed presentation by counsel and officials familiar with the issues to be discussed and a debriefing of the officials after the presentation to verify that no material nonpublic information has been disclosed, as well as a limitation on the number of company officials responsible for giving such presentations. Management should also consider maintaining a "no comment" position if it wants any particular issue to remain confidential. Finally, less formal communications with analysts—if conducted at all—should also be conducted in accordance with procedures designed to minimize inadvertent disclosure of material information and to provide the company with evidence to defend potential allegations of intentional selective disclosure.

When a domestic company discloses material nonpublic information to analysts or other market professionals, or to its securityholders when it is reasonably foreseeable they will trade, the disclosure regime established by Regulation FD requires that the company must make the disclosure broadly to the investing public too. Although Regulation FD does not apply to foreign issuers, foreign issuers should continue to take into account best practices and avoid selective disclosure of material nonpublic information out of concern for potential liability under Rule 10b-5.

Regulation FD requires that if material nonpublic information is inadvertently disclosed to analysts or others to whom selective disclosure is restricted by the regulation, the company must promptly (and, in any event, generally within 24 hours) make public disclosure of that information. Public disclosure for purposes of Regulation FD can be made by filing or furnishing a Form 8-K or by disseminating the information through a method or combination of methods that is "reasonably designed to provide broad, non-exclusionary distribution of the information to the public," such as a press release. The NYSE and Nasdaq also require listed companies to disclose material information promptly to the public through any Regulation FD-compliant method of disclosure. In addition, listed companies must notify the NYSE or Nasdaq of any such information prior to its release to the public in certain circumstances.

Management should also avoid participating to a significant extent in the preparation of analysts' reports to minimize potential 10b-5 liability. Specifically, company officials should not "entangle" themselves with the creation of such reports to the extent that the information they contain can be attributed to the company. Accordingly, any participation by the company should be limited to reviewing the report for factual accuracy (which is all a U.S.-based analyst is permitted by applicable self-regulatory organization rules to request), with care being taken in any event not to comment on any forecasts or other judgmental statements made by the analyst. Similarly, a policy of not commenting on analysts' projections can prevent the company from being required to correct or verify market rumors on the grounds that such rumors cannot be attributed to the company.

While Rule 10b-5 liability can arise from selective disclosure of accurate information, it is important to note that liability can also attach if such disclosure, made selectively to analysts or generally to the public, contains a materially misleading statement or omits a material fact necessary to make the statement made not misleading. Even if a company's statement is accurate when made, if intervening events render the disclosure materially misleading, management may have a duty to update the prior comment.

Finally, management should institute a process for identifying all non-GAAP financial measures contained in any public disclosure by the company, accompanying that disclosure with the most directly comparable GAAP financial measure and quantitative reconciliation of the two measures. To minimize the impact of these rules on public presentations of non-GAAP financial measures disclosed orally, telephonically, by webcast or broadcast, or by similar means, the company should also consider maintaining a reconciliation of these non-GAAP financial measures, for at least a 12-month period, on its website under the section dedicated to investor relations and set forth the location of the website in the public presentation in which the non-GAAP financial measure is used. In particular, for information disclosed in conjunction with the company's earnings conference call, management should furnish the earnings press release to the SEC under Item 2.02 of Form 8-K before the conference call, include a statement identifying where the call will be archived on the company's website and distribute the announcement through a widely circulated news or wire service.

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Please feel free to call any of your regular contacts at the firm or any of our partners and counsel listed under Capital Markets or Corporate Governance in the Practice Area section of our website (http://www.cgsh.com) if you have any questions.

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Guidelines for Communications with Analysts

1. Designate one company executive to communicate with analysts.
2. Make each presentation to analysts on the basis of a prepared text that has been reviewed by senior executives and by counsel.
3. Do not disclose material nonpublic information to analysts unless you disclose the information to the public at the same time; this can be done by permitting the public, on reasonable advance notice, to participate in any call with analysts during which material nonpublic information may be discussed.
4. Refrain from responding to analysts' inquiries in a nonpublic forum unless you are certain that the response does not include material nonpublic information.
5. If you are asked about a matter that is not ripe for disclosure, simply say "no comment."
6. If requested by an analyst to review a research report, do not comment except to correct errors of fact. Do not comment in any way on an analyst's forecasts or judgments, including by saying you are "comfortable" with them, that they are "in the ballpark" or other words to similar effect. Do not distribute analysts' reports or hyperlink to them on the company's website.
7. Avoid favoring one analyst over another.
8. Review public statements to identify any non-GAAP financial measures. If disclosure contains non-GAAP financial measures, include a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP and a quantitative reconciliation of the two measures. To avoid reconciliation of non-GAAP financial measures in public presentations given orally, telephonically, by webcast or broadcast, or by similar means, provide the most directly comparable GAAP financial measure and the required reconciliation on the company's website and include the location of the website in the presentation. If materials distributed (electronically or in hard copy) during a public presentation contain non-GAAP financial measures, provide the most directly comparable GAAP measures and provide the required reconciliations in close proximity to the non-GAAP financial measures.
9. Do not make specific forward-looking statements, unless (a) you set out the assumptions on which the forecast is based, (b) you indicate the factors that could prevent the forecast from being realized, (c) you make the statements to the public at the same time and (d) you are always prepared to evaluate the need to update the statement when circumstances change. The steps contemplated by (a) and (b) can be effected by referring to a filed document that contains the relevant information.

Office Locations

New York
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

Washington, D.C.
2112 Pennsylvania Avenue, NW
Washington, DC 20037-3229
T: +1 202 974 1500
F: +1 202 974 1999

Paris
12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

Brussels
Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

London
2 London Wall Place
London EC2Y 5AU, England
T: +44 20 7614 2200
F: +44 20 7600 1698

Moscow
Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

Frankfurt
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

Cologne
Theodor-Heuss-Ring 9
50668 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

Rome
Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

Milan
Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

Hong Kong
Cleary Gottlieb Steen & Hamilton
(Hong Kong)
Hysan Place, 37th Floor
500 Hennessy Road, Causeway Bay
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

Beijing
Cleary Gottlieb Steen & Hamilton LLP
45th Floor, Fortune Financial Center
5 Dong San Huan Zhong Lu
Chaoyang District
Beijing 100020, China
T: +86 10 5920 1000
F: +86 10 5879 3902

Buenos Aires
CGSH International Legal Services, LLP-
Sucursal Argentina
Carlos Pellegrini 1427, 9th Floor
C1011AAC Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

São Paulo
Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Professor Atílio Innocenti, 165
São Paulo, SP Brazil 04538-000
T: +55 11 2196 7200
F: +55 11 2196 7299

Abu Dhabi
Al Sila Tower, 27th Floor
Abu Dhabi Global Market Square
Al Maryah Island, PO Box 29920
Abu Dhabi, United Arab Emirates
T: +971 2 412 1700
F: +971 2 412 1899

Seoul
Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 04539, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099

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