Regulation FD: A Refresher on the SEC Rules Governing Selective Disclosure

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In mid-2000, the SEC adopted Regulation FD to protect investors by creating a level playing field for all investors for access to material, nonpublic information. The SEC's primary concern was that selective disclosure, and the perception of selective disclosure to analysts and institutional investors, of material, nonpublic information, leads to a loss of investor confidence in the integrity and fairness of the securities markets.

What Does Regulation FD Require?

Generally, no ***person acting on behalf of a company*** may make an ***intentional disclosure of material, nonpublic information*** to ***market professionals or shareholders*** unless ***public disclosure*** of such information is made simultaneously. If a person acting on behalf of a company makes a non intentional disclosure of material, nonpublic information to market professionals or shareholders, public disclosure is required promptly (i.e., no later than 24 hours after the disclosure or, if later, the commencement of the next day's trading on the relevant market) after a senior official of the company learns of the disclosure and knows (or is reckless in not knowing) that the information disclosed was both material and nonpublic.

There is no duty to disclose due to merely possessing information. Companies ordinarily have a duty to disclose material, nonpublic information only:

- if they trade, or their insiders trade, on confidential information
- if they previously made inaccurate, incomplete or misleading disclosures
- when statutes, rules or regulations (e.g., disclosures to be contained in periodic and current reports and other documents under the Securities Exchange Act of 1934 as well as those required under stock

exchange listing standards)

Key Concepts under Regulation FD

Who is a person acting on behalf of the company?

Any senior official of a company will be deemed to be acting on behalf of the company. This includes members of the company's board of directors, executive officers and investor relations or public relations officers. Any other officer, employee or agent of the company who regularly communicates with market professionals or shareholders will also generally be deemed to be acting on behalf of the company.

It is crucial to identify and delineate those employees who are authorized to communicate with market professionals and shareholders. Unauthorized employees must understand that they are to refer any communications to these authorized spokespersons.

Companies must educate their executive officers and directors who do not normally speak publicly on behalf of their company that, even though they may believe themselves to be outside the scope of Regulation FD, their communications are, in fact, subject to Regulation FD.

An officer, director, employee or agent of a company who discloses material, nonpublic information in breach of a duty of trust or confidence to the company will not be considered to be acting on behalf of the company **but** may trigger an obligation on the part of the company to make a public disclosure in any event at what may be an undesirable time from the company's perspective.

What is intentional disclosure?

A selective disclosure of material, nonpublic information is "intentional" when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic. In determining recklessness, the SEC will consider whether any reasonable person under the same circumstances would have made the same determination. The wisest course of action is to assume that any communication of material, nonpublic information will be treated as intentional.

Who are the market professionals and shareholders covered by Regulation FD?

Broker dealers and their associated persons, including sell side analysts; investment advisers, institutional investment managers, and their associated persons, including buy side analysts; and investment companies (mutual funds), hedge funds and their affiliated persons are among the market professionals covered by Regulation FD. Proxy advisers, such as ISS (Institutional Shareholder Services, Inc.), which are registered investment advisers, are also clearly covered. Although other proxy advisers such as Glass Lewis & Co., LLC may not be covered as registered investment advisers, the scope of services and activities they engage in make it wise to share material, nonpublic information only upon their agreement to keep the information confidential.

Regulation FD also covers any shareholder or other holder of a company's securities, including its debt securities, under circumstances in which it is reasonably foreseeable that such person would purchase or sell the company's securities on the basis of the information contained in the communications.

The most commonly relied upon exceptions from the simultaneous public disclosure requirements of Regulation FD are communications to:

- a person who owes the company a duty of trust or confidence (i.e., a "temporary insider" such as an attorney, investment banker or accountant)
- persons who have expressly agreed to maintain the communicated information in confidence — an agreement to not violate federal securities laws will not suffice

Regulation FD also does not cover:

- Disclosures made to employees (even though they may also be shareholders)
- Disclosures to the media — but the company will still need to consider whether the disclosure is intended to achieve the goal of effecting broad, non-exclusionary distribution of information to the public
- Ordinary-course business-related communications with customers, suppliers and independent contractors

What constitutes public disclosure?

The public disclosure element of Regulation FD is satisfied by a method or combination of methods that are in fact reasonably designed to effect broad, non exclusionary distribution of the information to the public. Public disclosure can be made by:

- Filing a Form 8 K under Item 7.01 or filing a Form 8-K under Item 8.01
- Issuing a press release, carried through a widely circulated news or wire service such as Dow Jones, Bloomberg, Business Wire, PR Newswire or Reuters -- if a company's press releases are routinely not carried by major business wire services, it will likely need to rely on filing Forms 8 K to achieve broad public dissemination of information
- Making an announcement in a forum to which the public has been granted access (in person or by telephone or webcast), so long as adequate advance notice (including the date, time, subject matter and manner of access to the announcement) has been given. The period of advance notice deemed reasonable will often depend on whether the information is unexpected or critical or time sensitive. In addition, if a company is making disclosure via a webcast or conference call, the SEC has noted that the company should consider making the webcast or conference call available for access at a later time and indicate in the notice of the webcast or conference call, how and for how long the record will be available to the public

On August 1, 2008, the SEC published an interpretive release (Release No. 34-58288) which provided guidance as to the circumstances under which information posted on a company's website would be considered "public" for purposes of evaluating the (i) applicability of Regulation FD to subsequent private discussions or disclosure of the information which had been posted and (ii) satisfaction of Regulation FD's

"public disclosure" requirement. The following conditions must be satisfied for information to be "public" or publicly "disseminated" on a company's website and will depend on the underlying facts and circumstances:

- The company's website must be a recognized distribution channel for information about the company as well as its business, financial condition and operations
- Posting must result in dissemination of information in a manner making it available to the securities marketplace in general
- A reasonable waiting period must have occurred for investors and the securities marketplace to react to the information

Supporting factors include:

- marketplace awareness of the website
- the company's posting pattern/practice
- a website design which leads investors and the market to information efficiently and with easy accessibility
- the extent to which website information is regularly picked up by the market and readily available media
- the steps the company has taken to make its website and the information accessible (including the use of "push" technology)
- whether the company has maintained its website to ensure information is accurate and current

Few companies to date have, however, indicated that they will rely solely upon website disclosure for Regulation FD purposes.

Recently, there has been a shift by the SEC as to the use of social media within the dictates of Regulation FD. In April 2013, the SEC issued a Section 21(a) Report of Investigation (Release No. 69279) in which the SEC affirmed that a company may use social media to disclose material, nonpublic information to investors without violating Regulation FD provided the company makes investors aware in advance of which social media channels it expects to use so that they know where to look for the information or what they need to do to be in a position to receive it. The Report emphasizes the SEC's expectation that a company will rigorously examine the non-exclusive list of factors included in the 2008 guidance to determine whether a particular social media channel is a recognized channel of distribution for communicating with its investors.

Limited access settings will not satisfy the public disclosure requirement. As a result, we recommend that a company always file a Form 8-K in advance of participating in investor conferences hosted by investment banks and company-sponsored "analyst days."

What constitutes material, nonpublic information?

Information is material if there is a substantial likelihood that a reasonable investor would: (i) consider it important in making an investment decision and (ii) view the fact as having significantly altered the "total mix" of information available. Companies must remember that materiality determinations will be assessed by the SEC and courts with the advantage of 20 20 hindsight. Quantitatively small amounts may still be qualitatively material.

Among the factors to consider in making a materiality determination are whether the item under consideration:

- is capable of precise measurement, or is based on an estimate (and the degree of imprecision inherent in the estimate)
- affects the trend in earnings or other key items
- is consequential to meeting analysts' consensus expectations
- changes results from positive to negative
- is significant to a segment
- is consequential to compliance with regulatory requirements or loan or other contractual requirements
- affects compensation
- is intentionally wrong or misleading, or conceals unlawful transactions
- prompts significant market reaction

SEC and stock exchange guidance suggest that the following should be treated with extreme care and are more than likely to be considered material:

- Earnings information
- Mergers, acquisitions, tender offers, joint ventures or changes in assets
- New products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a significant contract)
- Changes in control or in management
- Change in auditors
- Events regarding the company's securities -- e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits, changes in dividends, or public or private sales of additional securities
- Bankruptcies or receiverships

The SEC provides no bright-line test as to what will be considered material information. Each company must make its own judgment based on the totality of facts and circumstances.

What are the Penalties for Regulation FD Violations?

Failure to comply with Regulation FD may give rise to a possible SEC enforcement action, but not a private lawsuit (at least not one based on Regulation FD).

SEC Regulation FD enforcement may take different forms:

- An administrative enforcement action seeking a cease and desist order
- A civil action in federal court seeking an injunction and/or monetary penalties
- An administrative enforcement action against a "control person"

The SEC can take action not only against the company whose information was selectively disclosed but also against the employee(s) responsible for violation of Regulation FD, particularly control persons and authorized spokespersons.

There is no private right of action for Regulation FD violations. However, a Regulation FD violation may enable the plaintiffs' bar to sue a company under other laws. Regulation FD's exclusion from private rights of actions relates only to failure to make Regulation FD required disclosures. Regulation FD does not affect how a company might be liable under Rule 10b 5 or Section 18 of the Securities Exchange Act of 1934, or Section 11 of the Securities Act of 1933.

What are the benefits of adopting Regulation FD policies and procedures?

Regulation FD does not require companies to adopt policies and procedures to avoid violations. However, in the Regulation FD adopting release, the SEC stated that it expected most companies to use policies as a safeguard against selective disclosure of material, nonpublic information.

Companies are required to maintain disclosure controls and procedures to ensure that information required to be disclosed in public reports is recorded, processed, summarized and reported within the required timeframes. Having a written external communications policy (covering Regulation FD issues) can be an important part of a company's disclosure controls and procedures and should be coordinated with other aspects of a company's disclosure procedures such as those relating to the company's Forms 10-K, 10-Q and 8-K.

The SEC also indicated in the Regulation FD adopting release that implementation and adherence to an appropriate policy may often be relevant in determining whether selective disclosure was intentional. Further, recent case law and SEC enforcement actions suggest that establishing and adhering to a formal Regulation FD policy will be among the factors considered by the SEC in determining a company's liability for its employees' conduct.

A well-drafted external communications policy should enable a company to timely consider alternative means of disclosure, develop consistent disclosure practices, reduce the likelihood of inadvertent disclosure and enable officers to say "no" to requests for information that the company does not wish to disclose publicly.

In any event, a company's communications policy must be realistic and reflect achievable behavior. The violation by a company of its own policy can make an already difficult situation even worse.