FENWICK & WEST LLP

Corporate and Securities Law Update

Regulation FD Enforcement Actions

MAY 24, 2005

Regulation FD was adopted in October 2000 to deter public companies and their executives from disclosing material nonpublic information to market participants other than in public forums. Since then, the SEC's program of enforcement actions has been designed to make the application of the rules clear and to underscore the central importance of Regulation FD through significant corporate and individual penalties. This memorandum summarizes the fact patterns of those actions to present the application of Regulation FD in practical terms.

Regulation FD prohibits public companies from selectively disclosing material, nonpublic information to securities analysts, broker-dealers, investment advisors and investors before disclosing the same information to the public. Inadvertent disclosures of material information must be cured with a public release of the information within 24 hours. Regulation FD does not prohibit companies from engaging in private one-on-one meetings or non-public conferences with investors and analysts, and these remain common practices. However, SEC enforcement actions underscore the burden on the company representatives in those situations to limit the information discussed to only what is publicly available or not material.

The published enforcement actions and reports involved the following fact patterns:

- efforts to induce analysts to lower their published expectations about financial results to be consistent with expectations that the company had meant to convey in prior public disclosures (both Raytheon and Motorola);
- disclosure of a company's improved outlook for the current quarter, during an investor conference that was closed to the public (Siebel Systems);
- disclosure of a major new contract, where the company spokesperson was of the impression that the contract information was effectively disclosed on the company's website (Secure Computing);
- selective disclosure through a combination of statements, demeanor and general expressions of concern for business prospects (Schering-Plough); and
- selective reaffirmation of earnings guidance (Flowserve).

These SEC cases illustrate the real-life situations in which the SEC has chosen to apply Regulation FD. They do not represent a startling expansion of Regulation FD. The fact situation and the important details of the Regulation FD violations are summarized in the annexes to this update. *We recommend that company executives, investor relations personnel and legal staff read the fact patterns as illustrations of how Regulation FD issues may arise.*

These cases also underscore a few lessons about Regulation FD compliance:

- Most, if not all, guidance given about the likelihood of achieving earnings expectations will be regarded as material information;
- A company spokesperson in private conversation with investors and analysts must know precisely what information has and has not been publicly disseminated;
- Investor conferences are not public forums unless the conversations are webcast or otherwise immediately available to the public;
- Posting information on a company's website is not yet regarded as adequate disclosure of that information. If a website posting is to be part of a

company's disclosure procedures, the information needs to be appropriately posted in a location on the website that would be intuitively obvious to investors;

- Code words and body language can be as troublesome as specific disclosures;
- Disclosure policies should be followed; and
- Investor Relations personnel have an important gatekeeper function in enforcing Regulation FD compliance.

Adjusting Analysts' Earnings Expectations – Raytheon Company
(http://www.sec.gov/litigation/admin/34-46897.htm)
November 25, 2002

Raytheon's stock price dropped in 1999 and 2000 following warnings that earnings would not match analyst expectations. Subsequent to these earnings shortfalls, Raytheon's ability to meet consensus earnings estimates became a benchmark for its performance.

On February 7, 2001, Raytheon conducted an earnings call that was open to the public in which it disclosed expected eps for 2001 of between $1.55 and $1.70. In 2000 Raytheon had generated two-thirds of its earnings in the second half of the year, and it expected a similar pattern in 2001. Shortly after the earnings call Raytheon reviewed analysts' expectations and found that analysts had not adopted the seasonality anticipated, but not expressly disclosed, by the company for the distribution of expected earnings in 2001. The First Call consensus for first quarter earnings per share was $.31, which was higher than the company's expectation of $.28 earnings per share.

Recognizing that analysts had not fully anticipated the seasonality expected by the company, Caine, the company's CFO, called 11 of the 13 sell-side analysts covering Raytheon. In these communications Caine indicated that the analyst's Q1 expectations were "*aggressive*" or "*very aggressive*", that the business for the year "*will be back-end loaded*" and that "*you should expect our earnings profile to be about the same as it was in 2000 – that is, we expect about one-third of our eps in the first half of the year. I notice that you are WAY above that.*"

After these communications each of the 11 analysts lowered their Q1 earnings estimates (by amounts ranging from $.01 to $.10 per share) and raised their second half estimates. Interestingly, although of no apparent effect on the case, the analysts generally left the total eps for the year unchanged. After the conversation with Caine, at least one analyst participated in the firm's "morning call" with its sales force and noted the lowered Q1 expectations, and one or more members of the sales force sent emails to clients highlighting this change. On that day there was heavy trading by this firm's clients in Raytheon's shares and the price of its class B and class A shares dropped six percent and three percent, respectively.

The SEC found that the information conveyed to the analysts was material and that Raytheon and Caine had violated Regulation FD.

Adjusting Analysts' Earnings Expectations – Motorola Inc.
(http://www.sec.gov/litigation/investreport/34-46898.htm)
November 25, 2002

On January 11, 2001 Motorola reported its fourth quarter results and its first quarter expectations. This call was webcast and a transcript was posted on the Motorola website. In that call, Motorola predicted first quarter sales of $8.8 billion and eps of $.12. Six weeks later, on February 23, 2001, Motorola issued a press release, stating: "*as a result of significant weakness in first-quarter order input across its business segments, the company does not expect to achieve the first-quarter 2001 sales guidance of $8.8 billion or the earnings guidance of 12 cents per share given on January 11, 2001.*" According to the SEC, on that same day Motorola's President and Chief Operating Officer explained in a webcast conference call that Motorola's PCS was "*experiencing significant weakness in orders and sales versus our expectations at the beginning of the quarter.*" He also stated that the semiconductors business was "*experiencing lower sales and significantly lower orders. All markets are down compared with the same period last year.*" Motorola did not define the terms "significant," "significantly," and "down" in the February 23 release or on the February 23 call and never indicated that it was using those terms in a specific manner or to convey particular quantitative information.

In the days following February 23, Motorola's IR Director observed that while analysts had lowered their estimates for the quarter, they had not done so sufficiently. Consequently, between March 6 and March 12, 2001, he contacted 15 analysts and told them that when Motorola used the term "significant" it meant changes of 25% or more. Set forth below is a partial transcript of one such call between the IR Director ("IRD") and an analyst ("A") at a major financial institution:

> IRD: *I want to review for you the things that we said on that conference call. I've had conversations with a number of analysts over the last several days to review things we said on that conference call because I don't believe that in your case, or in the case of some other people, you've adequately taken into account the things that we've said.*
>
> A: *Okay.*
>
> IRD: *Let me begin by reminding you what our guidance was at the beginning of the quarter. At the beginning of the quarter we guided people toward $8.8 billion in sales.*
>
> A: *Yes, yes.*
>
> IRD: *And earnings per share of 12 cents.*
>
> A: *I remember, yes.*
>
> IRD: *Right. Now your current model is showing sales of $8.375 billion.*
>
> A: *Yes.*
>
> IRD: *So it's only a 5% decline from our original guidance.*
>
> A: *Correct. Yes.*
>
> IRD: *Now I think the things that we said segment-by-segment would indicate a much larger level of decline than that.*
>
> A: Okay.
>
> IRD: *Let's review them. All right. In our Personal Communications Segment, in January we gave guidance that that segment would have lower sales and operating profits than the first quarter of 2000.*
>
> A: *Yes.*
>
> IRD: *And lower than in the fourth quarter of 2000.*
>
> A: *Yes.*
>
> IRD: *All right. Two weeks ago we said that orders and sales in this segment were expected to be significantly lower than the guidance at the beginning of the quarter.*
>
> A: *Hmm.*
>
> IRD: *Now when Motorola uses the word significantly, maybe you're not familiar with this, but it's longstanding approach that we have, we are referring to a rate of change of 25% or more.*
>
> A: *Okay.*
>
> IRD: *Okay so.*
>
> A: *From the guidance down.*
>
> IRD: *From the guidance at the beginning of the quarter which was already lower than the guidance from the year before. So your model for that segment is – and let me go to that right now – your model for that segment is showing 2 billion 830 million, that's only down twelve and one-half percent.*
>
> A: *Yes.*
>
> IRD: *Okay.*
>
> A: *Thank you.*

Prior to making the calls to analysts, the IR Director had contacted a member of the company's legal staff about the appropriateness of the calls under Regulation FD. Apparently of the belief that there was a recognized pattern of Motorola's using the word "significant" to refer to changes of 25% or more, the counsel concluded that the calls would not represent the delivery of either "material" or "nonpublic" information and thus would not violate the rule. The SEC said counsel's determination was "erroneous in both respects." However, it did not take action because it found that counsel and the IR Director had acted in the good faith belief that the conduct was consistent with the rule. The SEC hastened to add that counsel's blessing for disclosure would not uniformly excuse the release of material, nonpublic information in other instances.

Disclosure at an Investor Conference – Siebel Systems
(http://www.sec.gov/litigation/admin/34-46896.htm)
November 25, 2002

On October 17, 2001 Siebel Systems held a public conference call to announce third quarter results. In this call, the CEO stated:

Since September 11, we have faced an . . . environment for information technology that has been as difficult as any in the history of the information technology industry. Things have been tough. We think that they will continue to be quite tough in the short term. We have an exceptionally soft market for information technology . . . . Spending for tech products and services continues to slide. We expect things will be quite tough through the remainder of the year.

Following this call, the company's stock price fell 19%.

After October 17, the company's outlook brightened somewhat. Just under three weeks later, on November 5, 2001, the company's CEO appeared at a major brokerage firm's investor conference. The following is a partial transcript of a conversation between the moderator of the conference and the CEO:

> Moderator: . . . *the software that you sell gives you a good window into sales pipelines . . . you've been pretty good in seeing what's going on in the overall economy and what that means for the software sector. I wonder if you could give us an update of what you're seeing after September, maybe how the economy is looking and how the software business is looking during the month of October. Are customers still paralyzed or are we getting back to normalcy?*
>
> A: . . . *[T]he business decisions appear to be quite normal right now, and so we're pretty optimistic about what we're seeing at this time. People are engaging . . . people are engaging in software evaluations, . . . software selection, . . . vendor negotiations, procurement, installations, . . . contracts are getting signed, . . . they're expanding their existing previous appointments, so right now it appears we're seeing a return to normal behavior in IT buying patterns.*
>
> Q: *Would you, how would you characterize the sort of sales activity levels and linearity throughout . . . the quarter?*
>
> A: *I think the linearity of this Q4 will be about what we saw in Q4 of the previous two years. It was, the behavior of the market appears normal. . . .*
>
> * * * *
>
> Q: *They're still evaluating, they're just slowing down actual signing contracts?*
>
> A: *They were slowing it down significantly in Q3. Right now, it appears to be, the processes appear to be back to more of a normal rate. It's not, it's not a depressed rate . . . as deals are moving through the pipeline. . . .*
>
> Q: *I think there were a lot of concerns that Q4 the bottom could just fall out, that the business we saw in September was just a hint of what we're going to see this quarter. It sounds like from what you're saying that business is getting back more to normal. Before September 11th that the bottom is not, does not appear to be falling out.*
>
> A: *I think that was a legitimate concern, and I shared that concern, and I think I communicated that concern quite clearly in our [third quarter] conference call. I mean if we had seen continued geo-political dislocation, it could have been a nightmare out there in Q4. The good news is we're not seeing that. So, that's, that is a relief for everybody.*

It was clear to the SEC that participants in the conference immediately traded the company's shares on that day, or advised their clients of the more favorable outlook on that day, enticing them to trade. Siebel's stock price rose by over 16% on the day of the conference in heavy volume.

The SEC noted that the CEO was of the mistaken impression that the conference was webcast. However, the company's IR Director, who helped arrange the CEO's attendance at the conference but didn't know the CEO intended to disclose the more favorable outlook, was aware that the event was not available to the public. The SEC said that this fact pattern amounted to the company's intentional disclosure under Regulation FD. It enjoined the company from further violations.

In a subsequent action, filed June 29, 2004, the SEC charged Siebel Systems, Kenneth Goldman and Mark Hanson with Regulation FD violations. This complaint describes a pattern of disclosure of material nonpublic information in a private setting, followed by trading in Siebel Systems securities by meeting participants, and significant movement in stock price. The Commission also drew attention to the company's lack of disclosure policy and training. This complaint represents the first time the SEC has charged a company with violation of Rule 13a-15, which requires issuers to maintain adequate disclosure controls and procedures to ensure that management obtains the information required to comply with SEC disclosure requirements in timely fashion.

Disclosure of Significant New Contract – Secure Computing
(http://www.sec.gov/litigation/admin/34-46895.htm)
November 25, 2002

In early 2002, Secure Computing entered into an OEM agreement under which a major networking firm would bundle Secure's software in its systems. The agreement prohibited Secure from announcing the deal without the OEM's consent, and Secure did not disclose the information while the OEM was beta testing the product with selected customers. At some point the OEM began to post technical information about the bundled product on its website for the benefit of its customers. At the OEM's request, on March 6, 2002, Secure posted corresponding technical information on its own website for the benefit of the OEM's sales force and customers, but did not yet announce the deal or link this technical data to its home page.

On March 6, 2002, Secure's President conducted a conference call with a portfolio manager of an investment advisory firm, and Secure's IR Director was also on the line. During the call, Secure's President was asked about the product that had been bundled with the OEM's systems. The President asked the IR Director if he could discuss something posted on the company's website, and the IR Director, not knowing that the President was referring to this otherwise undisclosed information, answered affirmatively. *The President then discussed the OEM deal.*

Shortly after the call, the President received an email from a managing partner of the advisor's brokerage firm asking about the deal. The President emailed back that "*There won't be a[n] announcement/press release until the buyer has some customer references – bottom line though it ain't bad!!!!!*" After that call the President retrieved a voicemail from the IR Director advising him that he had disclosed material, nonpublic information on the conference call. The President then called back to the managing partner and asked him to keep the information confidential. On March 6, Secure's stock price rose eight percent on double the volume from the previous day.

On March 7, trading volume continued to rise steadily and Secure received several investor and analyst calls seeking to determine the reason and inquiring about rumors of the OEM deal. Secure tried to get the OEM's approval to make a press release during that day but couldn't do so (although in seeking permission Secure apparently did not inform the OEM of the prior day's disclosure). Also on the morning of March 7, the President held conference calls with four additional investors, and one of the callers asked about the OEM deal. *The President confirmed the deal but said that it could not be announced until the OEM had completed customer references*. Secure's stock rose an additional seven percent on March 7. After the close of business that day, the company issued a press release on the deal.

The SEC found that the information disclosed privately by the CEO was material and nonpublic. It found that the initial disclosures (March 6) were unintentional under Regulation FD, thus requiring the company to make "prompt" disclosure (with 24 hours). The SEC found instead of making prompt disclosure, the company to disclose the information selectively (on March 7) before issuing the press release. It enjoined the company and the President from further violations of the Regulation.

Guidance Through Language, Tone, Emphasis and Demeanor – Schering-Plough
(http://www.sec.gov/litigation/admin/34-48461.htm)
September 9, 2003

In August 2002, a federal district court ruled that a Schering-Plough patent on its major drug, Claratin, was invalid. Schering-Plough disclosed publicly that it expected the introduction of generic drug competition to have a rapid, sharp and material adverse effect on its results of operations. In late September 2002 Schering management provided Kogan, Schering's Chief Executive Officer, with the Company's preliminary plan for 2003, including internal forecasts for 2003 and the last quarter of 2002 that were below the then-current consensus of analyst estimates for those periods.

On September 30, 2002, the same day Kogan was briefed on Schering's forecasts, Kogan and Schering's senior vice president of investor relations traveled to Boston for previously scheduled meetings with institutional investors. That evening and the following day, Kogan met privately in Boston with analysts and portfolio managers at four firms: Wellington, MFS, Fidelity and Putnam. At each of these private meetings, Kogan disclosed specific new information about Schering's prospects that went beyond earlier disclosures and that left the analysts and portfolio managers with the distinct impression that the Company's results would be worse than expected. Portfolio managers sold Schering stock as a result.

At these meetings, Kogan told the analysts that Schering was going to take a "hard hit" to earnings in 2003, or that 2003 would be a "very, very difficult year", which was materially different from the company's earlier public disclosures because it conveyed a definitive, as opposed to a contingent, statement not previously disclosed. Kogan also told the analysts that he did not favor the company repurchasing its own shares, which was materially different than the company's prior public statement that no decision had been made on whether to buy back its shares. Finally, Kogan indicated that Schering's manufacturing costs would increase in 2003 and that no significant cost cuts were planned, which went materially beyond the company's prior public disclosures. At some meetings, in a break with past practice of not commenting on Wall Street analyst estimates, Kogan told the analysts that "the street" had not sufficiently lowered earnings estimates for the just-completed third quarter of Schering's 2002 fiscal year.

Regardless of what Kogan's intentions were in making these disclosures in this manner, analysts picked up on the negative tone of the meetings, and traders sold Schering stock.

The Wellington pharmaceutical analyst told Wellington's portfolio managers the next morning that she was maintaining her buy recommendation on Schering, but noted that Kogan had emphasized that 2003 would be a "tough" year, that the "language" at the meeting was slightly less positive than it had been a few months ago when Wellington representatives met with Schering's chief financial officer, and that she thought the company wanted earnings expectations to be lower. That same day, several Wellington portfolio managers who attended the Kogan meeting sold Schering stock, and at least based his decision, in part, on the "tone" and lowered "confidence level" he inferred from the meeting.

MFS's pharmaceutical analyst, who inferred a negative tone from the meeting, maintained his neutral rating on the stock, and issued a research note in which he described the "takeaways" from the meeting, as "incrementally negative."

The Fidelity pharmaceutical analyst announced in a voicemail to Fidelity portfolio managers that he was downgrading Schering from a "buy" to a "sell." In that voicemail the analyst said, among other things:

> "I am going to downgrade Schering Plough to a sell after our in-house meeting with the CEO. This had been one of my best near term ideas based on the Zetia launch in November and my belief that there was no risk from 2003 guidance until the January conference call, *but the meeting today made me think that 2003 guidance will be worse than expected and could come on the Q3 earnings call in October*. My previous 2003 estimate was $1.38 and I am cutting this to $1.17 based on a lower gross margin assumption, no Clarinex-D revenue, and higher [operating expenses] due to the Zetia and OTC Claritin launch costs. Stock was very weak today after our in-house meeting, underperforming the group by 10%, but there is further downside with a 2003 guidance range of $1.00 to $1.20 [versus] the current consensus estimate of $1.42." (emphasis added).

The Fidelity analyst's downgrade resulted, in part, from Kogan's "downbeat" demeanor at the previous day's meeting and from the amount of time Kogan spent during the meeting discussing the risk to Schering's earnings from the loss of the Claritin patent. In the days following the meeting with Kogan, Fidelity portfolio managers heavily sold Schering stock.

Putnam's pharmaceutical analyst sent a voicemail to Putnam's portfolio managers announcing that he was downgrading Schering to an "underperform" and lowering his earnings estimates for the company. In his voicemail, the analyst said, among other things:

> "I will leave only one or two points on our broadly attended meeting with the CEO. I would describe him as being more difficult to get information from than the norm. While he was not explicit, *the very interesting meeting left us with the impression that numbers for consensus certainly had been too high for the quarter and for 2003. We also learned that they were not convinced that all investors were aware of the revenue hole that Claritin's move to OTC next year will cause*, which is partly why I believe numbers are still coming down." (emphasis added).

Putnam portfolio managers heavily sold Schering stock in the days following the meeting with Kogan. The day after the meeting, one portfolio manager who had attended the meeting told a Putnam trader who was selling Schering stock for Putnam's portfolio managers:

> "I'll tell you, since I was in the meeting yesterday, I'll be quite clear on the fact that they clearly, *they're going to miss third-quarter. They're going to miss numbers next year. And so, if that's the same message they're giving other people, that's why people are out there selling. It's certainly why we are selling.*"
>
> * * * *
>
> "I'm at a Cowen health care conference, so it's a big buzz down here because, I'll tell you, . . . *no one had any idea why the stock was down yesterday. So there's a lot of speculation going on, because . . . there was no news story, et cetera. So everyone down here is thinking maybe there's a problem with one of their products or something else. So, the larger community, anyone who didn't meet with them over the last couple days, doesn't have a clue as to what's going on*. (emphasis added)."

From October 1 through October 3, 2002, Schering's stock price fell by more than 17 percent, with volume averaging more than four times the typical daily volume. This market reaction was substantially the result of heavy sales of Schering stock by the institutions whose analysts and portfolio managers had met with Kogan that week in Boston. In particular, Fidelity and Putnam each sold more than 10 million Schering shares during that three-day period, accounting for more than 30 percent of the overall market volume for the period.

On October 3, Schering held a previously scheduled meeting with approximately 25 analysts and portfolio managers at its offices in Kenilworth, New Jersey. The meeting was neither webcast nor otherwise accessible to the general public or the media. In a question-and-answer session over lunch, Kogan made comments of similar tenor to those he had made over the past couple of days. Later that day, Schering received press inquiries about whether Kogan had used the word "terrible" in describing 2003 earnings.

Finally, in response to the press inquiries and the heavy trading in Schering stock that week, late on October 3, Schering issued a press release in which it provided 2002 and 2003 earnings guidance that was materially below Wall Street analysts' consensus estimates and materially lower than Schering's previous guidance.

The SEC concluded that Schering violated Regulation FD and Exchange Act Section 13(a), and Kogan caused such violations, by providing guidance that included material, nonpublic information about Schering's earnings prospects during private meetings with institutional investors and analysts, and by failing to make a public disclosure of the information as required by Regulation FD. Kogan's statements, demeanor and general expressions of concern for Schering's prospects during private meetings amounted to selective disclosure and prompted a significant sell-off in Schering stock. Schering and Kogan were free to convey their concerns over Schering's earnings prospects to industry professionals, but Schering had a legal obligation to disseminate that information to the rest of the marketplace in accordance with Regulation FD. Schering failed to do that. As a result, the investing public was placed at a disadvantage relative to those institutional investors privy to the disclosures.

The Commission found that Schering violated, and Kogan was a cause of Schering's violations of, Exchange Act Section 13(a) and Regulation FD. Schering agreed to pay a $1 million civil penalty; Kogan agreed to pay $50,000 as a civil penalty. Both agreed to cease and desist from future violations.

Although Schering's senior vice president of investor relations accompanied Kogan on this trip to meet with analysts and portfolio managers, he was not sanctioned in this SEC enforcement action.

Reaffirming Guidance in Violation of Regulation FD – Flowserve Corporation

(http://www.sec.gov/litigation/litreleases/lr19154.htm)
March 24, 2005

This proceeding is the first SEC enforcement action under Regulation FD charging a violation based on reaffirmation of earnings guidance, and it is the first enforcement action against an investor relations official of a company.

In its Regulation FD adopting release (Rel. No. 33-7881, August 15, 2000), the SEC had this to say on the subject of changing or reaffirming guidance:

> "One common situation that raises special concerns about selective disclosure has been the practice of securities analysts seeking "guidance" from issuers regarding earnings forecasts. When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD. This is true whether the information about earnings is communicated expressly or through indirect "guidance," the meaning of which is apparent though implied. Similarly, an issuer cannot render material information immaterial simply by breaking it into ostensibly non-material pieces."

Flowserve Corporation, a calendar-year reporting company, began 2002 forecasting annual earnings per share in the range of $1.90 to $2.30. In July 2002, Flowserve revised its estimate down ($1.70 to $1.90); on September 27th, it did so again ($1.45 to $1.55). On October 22, 2002, it reaffirmed the last guidance in a press release. This last range represented more than a 30% decline in earnings per share estimates since the beginning of the year, which may have been a contributing factor to the finding that a subsequent reaffirmation of the guidance was a Regulation FD violation.

Flowserve had a disclosure policy in place since 1999, amended in 2001, the principal author of which was Michael Conley, Flowserve's Director of Investor Relations. The policy mandated that subsequent to a public announcement of earnings and other guidance, if asked about the Company's level of "comfort" with the guidance, Company spokespersons were to respond as follows: "Although business conditions are subject to change, in accordance with Flowserve's policy, the current earnings guidance was effective at the date given and is not being updated until the company publicly announces updated guidance." Failure to follow this policy during a mid-quarter private update meeting certainly contributed to the Regulation FD violation.

November 19, 2002: Scott Greer, Flowserve's Chief Executive Officer, and Michael Conley, its Director of Investor Relations, met privately with analysts from four investment and brokerage firms. The Commission noted that this meeting occurred 42 days before the end of Flowserve's fiscal year. During a discussion of Flowserve's business, recent acquisitions, debt covenants, and free cash flow, one of the analysts asked about the Company's earnings guidance for the year. Neither Conley nor Greer gave the response required by the Company's policy – that earnings guidance was effective at the date given and would not be updated until the company publicly announced updated guidance. Conley did not caution Greer before Greer answered the analyst's questions. In fact, Conley remained altogether silent. In responding to the question, Greer reaffirmed the guidance that had been issued on October 22, 2002, and provided additional material nonpublic information. Again Conley was silent and did nothing to explain Greer's statements.

November 20, 2002: an analyst who attended the meeting issued a report stating that Flowserve reaffirmed its earnings guidance, and the report was electronically distributed to subscribers of Thomson's First Call.

November 21, 2002: Flowserve's closing stock price was approximately 6% higher than the closing price the day before, and trading volume increased by 75%. Flowserve furnished a Form 8-K that read as follows:

ITEM 9. REGULATION FD DISCLOSURE

> During a conversation this week with securities analysts, Flowserve Corporation reaffirmed its full year 2002 estimated earnings per share, excluding special items, in the range of $1.45 to $1.55, based on average outstanding shares of approximately 52.5 million. The company also reiterated that it is not comfortable at this point projecting more than marginal earnings improvement in 2003, unless markets start to improve. The company went on to say that it believes its markets will improve.

The Commission found it noteworthy that the Form 8-K was furnished after market closed, at 5:16:43 p.m., more than 53 hours after the selective disclosure and nearly 26 hours after dissemination of the analyst's report.

November 22, 2002: Flowserve common stock closed at the same price the day after the Form 8-K filing, and trading volume fell 25%.

In its cease-and-desist order, the Commission found that Flowserve Corporation, through its CEO, Greer, intentionally and selectively disclosed material, non-public information to securities market professionals when Greer disclosed Flowserve's continued confidence in its earnings guidance during a private meeting with select analysts. As a result the Commission found that Flowserve violated, and Greer and Conley each caused Flowserve's violations of, Exchange Act Section 13(a) and Regulation FD. In addition to the underlying conduct, the Commission considered the lack of cooperation afforded the Commission staff. Specifically, both Greer and Conley denied that a reaffirmation occurred at the meeting, which the commission found inconsistent with the Form 8-K disclosure.

Flowserve agreed to a $350,000 civil penalty, CEO Greer agreed to a pay a $50,000 civil penalty, and Greer and Conley agreed to cease and desist from causing future violations of Section 13(a) and Regulation FD.

If you care to discuss the implications of these cases to your Regulation FD compliance practices, please contact any member of your Fenwick & West team. You may also contact Dan Winnike (dwinnike@fenwick.com) or Horace Nash (hnash@fenwick.com) each of whom contributed to the preparation of this update, or send an inquiry to: fwcsu@fenwick.com.

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