FENWICK & WEST LLP

CORPORATE & SECURITIES LAW UPDATE

Frequently Asked Questions About Regulation FD

Updated September 20, 2000

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What is the purpose of Regulation FD?

The Securities and Exchange Commission adopted Regulation FD to eliminate selective disclosure of material non-public information by public companies to securities market professionals and to stockholders that are likely to use the information in buying and selling securities.[1] The regulation was designed by the SEC to promote "fair disclosure" of this information to the public at large.

Who does Regulation FD apply to?

Regulation FD generally applies to all Nasdaq and exchange listed companies that are incorporated in the United States.

What disclosures are covered by Regulation FD?

Regulation FD generally applies to statements that include material non-public information about a public company:

- made by the company's senior officials or by any other officer, employee or agent who regularly communicates with securities market professionals or the company's security holders (such as investor relations staff);
- to securities market professionals or to holders of the company's securities who are likely to use the information in buying and selling the company's securities.

By limiting the types of communications covered by the rule to those made to securities market professionals and to stockholders who are likely to use the information in buying and selling the company's securities, the SEC attempted to exclude ordinary course communications with suppliers, customers, strategic partners and other business associates of the company, as well as communications made to the press and to governmental agencies. There are a few types of communications that are specifically excluded from the rule.[2] However, the general rules regarding insider trading and selective disclosure of material non-public information would still apply to communications with third parties that are excluded from Regulation FD. Regulation FD does not change a company's duty to disclose material developments as they occur, or to project future results, unless the company discloses that information to a securities market professional or to a stockholder who is likely to use the information in buying and selling the company's securities.

[1] Securities market professionals include securities analysts, broker-dealers, investment advisers, certain institutional investment managers, investment companies, hedge funds and affiliated or associated persons.

[2] Regulation FD does not apply to: (i) communications to a person who owes the company a duty of trust or confidence, such as an attorney, investment banker or accountant; (ii) communications to someone who expressly agrees to keep the information confidential; (iii) communications to a credit rating agency in order to develop a credit rating, if the agency's ratings are publicly available; and (iv) communications in connection with most offerings of securities that are registered with the SEC under the Securities Act of 1933.

How does a company make a disclosure under Regulation FD?
If a public company discloses material non-public information to a securities market professional or a security holder of the company that would be covered by Regulation FD, it must also make public disclosure of the same information.

- If disclosure is intentional, then the public disclosure must be made simultaneously.
- If disclosure is unintentional, then the public disclosure must be made within 24 hours after a "senior official" of the company learns of the disclosure and knows that the information disclosed was both material and non-public. For this purpose, any executive officer, director, investor relations officer or public relations officer, or employee that performs similar functions, is a "senior official."[3]

A disclosure is "intentional" under this rule if the person making the disclosure knows, or is reckless in not knowing, that the information being disclosed is both material and non-public.

How does a company know whether disclosed information is "material"?
The most difficult part of complying with Regulation FD will be in making decisions about whether information is "material." Unfortunately, Regulation FD does not provide a bright line test. Instead, the SEC will rely on existing definitions of materiality, which have been developed through case law.

Currently, information would be considered material if there is a substantial likelihood that:

- a reasonable stockholder would consider it important in making an investment decision about the company; or
- the information would have been viewed by the reasonable investor as having significantly altered the total mix of information that is available about the company.

The SEC has suggested that companies look at the following types of information, among others, to evaluate their materiality:

- earnings information;
- mergers, acquisitions, tender offers, joint ventures or changes in assets;
- new products or discoveries or developments regarding customers or suppliers;
- changes in auditors or auditor notification that the company may no longer rely on its audit report;

[3] Companies should make sure that each of these individuals, including members of its Board of Directors, is aware of these responsibilities, so that they know to report immediately to the company if they learn that a material non-public disclosure has been made.

- events relating to the company's securities, such as defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders and sales of additional securities; and
- bankruptcies or receiverships.

However, this list is not exclusive, so companies will need to look at every event and every piece of information that they disclose to determine if the event or information could be considered "material" and therefore should not be disclosed non-publicly.[4]

Given the subjective nature of this analysis and the volatility of the public markets, this standard of materiality will subject companies to second-guessing by others based on the market's reaction to the selectively-released information. To address some of these concerns, the SEC has made it clear that liability under Regulation FD will arise only when a company's personnel know, or are reckless in not knowing, that the selectively disclosed information is both material and non-public. Therefore, a company would not be liable under Regulation FD because it makes a mistake in judging whether a piece of information is material, unless it is reckless in coming to that conclusion.[5] If a company acts in good faith to comply with Regulation FD, it generally should not be considered to have acted recklessly. However, a pattern of so-called mistaken judgments about materiality would call into doubt whether a company was in fact acting in good faith.

How does a company satisfy the public disclosure requirements of Regulation FD?

A company can make public disclosure required under Regulation FD by:

- filing a Form 8-K;
- distributing a press release through a widely disseminated news or wire service; or
- any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude people from gaining access.

Regulation FD was designed to give a company disclosure flexibility. It does not require use of a particular method of disclosure, but allows companies to choose methods that are

4 The SEC has recently provided guidance on applying materiality thresholds to the preparation of financial statements and the performance of audits on financial statements. See SEC Staff Accounting Bulletin No. 99 (August 12, 1999). This guidance included the SEC's view that financial management and the company's auditors must consider quantitative and qualitative factors in assessing an item's materiality – materiality cannot be reduced to a numerical formula.

5 The SEC has said that a person would be considered reckless only if no reasonable person under the circumstances would have made the same determination. As a result, the SEC has said that the circumstances in which a selective disclosure is made may be important – for example, a statement made in connection with a prepared written statement could be treated differently from one made in response to an unanticipated question.

reasonably calculated to make effective, broad and non-exclusionary public disclosure, given the particular circumstances of the company.

For example, a company may choose to disclose material information during a conference call or at a conference if it gives the public notice of the call or conference, grants the public access to the call or conference and the call or conference will be widely attended. Notice of the call or conference should be made in a way that provides broad public access to the notice, such as by issuing a press release containing the notice or otherwise getting the notice widely distributed through the media. The company should also consider publishing the notice on its website and sending out email alerts to people who have requested them (but for now this alone is not sufficient notice).[6] A company may provide access to the call or conference by permitting the public to attend in person or permitting people to listen through a telephone or computer connection, including a webcast. The company does not need to allow the public to ask questions or actively participate in the discussion – "listen only" access for the public is enough. However, access must be provided to the live presentation – making only a replay of the call available is not sufficient.

How should a company handle its quarterly earnings call in light of Regulation FD?
We encourage companies to make sure their earnings calls satisfy the "public disclosure" requirements of Regulation FD that are discussed above. To do this, a company should consider using the following model, which is based on suggestions made by the SEC:

- Provide adequate notice of a scheduled conference call to discuss the announced results, giving investors both the time and date of the conference call and instructions on how to access the call. For now, we recommend that this notice be provided at least a few days before the scheduled call by way of press release or other means of widespread dissemination and by posting the information on the company's website. Over time, a company may be able to eliminate the press release altogether and rely on the website posting alone. We do not generally believe that including this information in the earnings release is sufficient, since that release is usually made only an hour or so before the call.
- Issue a press release, distributed through regular channels, containing the company's quarterly financial statements and management's commentary.
- Hold the conference call in an open manner, permitting investors to listen by telephone or through a webcast.

[6] The SEC currently believes that merely posting material information on the company's website is not enough to satisfy the public disclosure requirements of Regulation FD. However, as technology evolves and more investors have access to and use the Internet, it is likely that some companies whose websites are widely followed by the investment community will be able to rely solely on a website posting to meet their Regulation FD disclosure obligations.

It is not clear from the Regulation FD adopting release how much information a company must include in its press release in order for material statements that are not included in the press release but are made during the earnings call to be considered "publicly disclosed." If the earnings call itself is widely attended (after notice and access are provided in accordance with the guidelines we have suggested), then it would appear that all of the material non-public information that is discussed during the call should be deemed publicly disclosed. However, if the earnings call is not widely attended, then it is uncertain whether the information that is made available only on the conference call should be deemed publicly disclosed.

In the adopting release, the SEC indicates that if information is provided in a press release, which is followed by a conference call structured in the manner we have suggested, a company "can use the press release to provide the initial broad distribution of the information, and then discuss its release with analysts in the subsequent conference call, without fear that if it should disclose additional material details related to the original disclosure it will be engaging in a selective disclosure of material information." Based upon this statement, it would appear that the press release itself must include disclosures that are related to the matters that are disclosed on the conference call in order for those matters to be considered to have been publicly disclosed. The SEC does not explain what it means by "related to," so it is not clear how specifically connected a statement made during the conference call must be to the statements that are included in the press release. It is also possible that the conference call, in combination with other methods of disseminating the information, could satisfy the public disclosure requirements of Regulation FD if together these methods result in broad distribution of the information. However, given the uncertainty related to this issue, we would generally suggest that if non-material information, such as projections, will be discussed on a conference call that will not be widely attended, then a summary of that information should be included within the text of the press release. Even if the conference call will be widely attended, a company should consider putting in its press release the key pieces of material non-public information that it will discuss on the conference call.

In addition, given the larger audience that these press releases and calls will have, it is more important than ever to include protections against liability for any forward-looking statements that are included in the press release or made during the conference call.[7]

[7] Under the Private Securities Litigation Reform Act of 1995, a company can avoid liability for forward-looking statements in a securities fraud action if it takes the following actions: (i) for a written communication, the 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; and (ii) for an oral communication, the communication includes a cautionary statement that identifies the forward-looking statement as such, mentions that actual results could differ materially from those projected in the forward-looking statement and states that additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statement is contained in a readily available document (such as a Form 10-K or Form 10-Q filed with the SEC).

Will Regulation FD change the way companies communicate with analysts?
The answer to this question depends on what a company's practices were prior to the adoption of Regulation FD. If a company provided guidance to an analyst, whether through a conference call that was not open to the public or though one-on-one conversations, and that guidance included material non-public information, then the company will need to change its practices. Of course, the difficult question will be determining what information is considered material.

In adopting Regulation FD, the SEC expressed special concerns regarding selective disclosure to securities analysts:

> *"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 non-public 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 though 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."*

However, the SEC also confirmed that a company is not prohibited from disclosing a non-material piece of information to an analyst, even if that piece of information helps the analyst complete a "mosaic of information" that, taken together, is material. For example, if a company informs the public that it expects its research and development expenses to increase by 5% during the next year, we would generally say that it would not be a material disclosure to give an analyst a supporting detail about this expected increase, such as how the number of the company's research and development employees will change over this period.

It is often difficult to distinguish between material information and a non-material fragment of a "mosaic of information." Therefore, a company will need to be very careful about what it discloses in its private conversations with an analyst. See below for a few guidelines that a company may want to keep in mind when having a private discussion with an analyst.

What practical guidelines should a company consider following to avoid violating Regulation FD, particularly in connection with its communications with analysts?
There are a number of other things a company should consider doing as Regulation FD goes into effect:

- Make sure that you have a written corporate policy that limits the people who are authorized to speak with securities market professionals and stockholders and that prohibits selective disclosure of material non-public information. Company spokespersons would likely include the CEO, COO, CFO, VP of Investor Relations and/or the public communications officer. Make sure that the rest of your employees are aware that these authorized people are the only ones who may communicate with securities market professionals and stockholders on behalf of the company.[8]
- Make sure that your policies reflect the guidance you have received from counsel and others regarding any changes that should be made in response to Regulation FD. Make sure any changes to your policies are circulated to your employees.
- Make sure that you have reasonable processes in place regarding the preparation of press releases, scripts, speeches, letters to stockholders, website postings and other communications that are distributed to the public, especially those that contain material non-public information. At least one of the persons who is authorized to speak to securities market professionals should review these documents prior to their use or distribution. Allow sufficient time for review and comment by your internal and external legal counsel.
- Prepare a script of what you are willing to discuss in non-public meetings with analysts or other securities market professionals, what questions analysts are likely to ask and what information you will not provide. Make sure that all the people who will be communicating with analysts have a copy of the "script" or "talking points" and are aware of the restrictions under Regulation FD. Be consistent in what you tell analysts and others. Being prepared for the discussion should help you to avoid inadvertent disclosures of material information. If appropriate, discuss your "script" or "talking points" with your internal or external legal counsel.
- Consider requiring a discussion with at least one other person who is authorized to speak to securities market professionals on behalf of the company following disclosure to a securities market professional or stockholder of any information that was not part of the "script" that was prepared in connection with that conversation. This could assist in identifying possible inadvertent disclosures of material non-public information.
- Make sure that you take advantage of the safe harbor protections for forward-looking statements in all written and oral communications. Identify the forward-looking statements, warn that actual results could differ materially from those

[8] In footnote 90 of the Regulation FD adopting release, the SEC indicated that the existence of an appropriate policy, and a company's general adherence to it, might often be relevant to determining the company's intent with regard to a selective disclosure.

projected in the forward-looking statements and include meaningful risk factors related to achieving the results projected in the forward-looking statements.

- Do not give guidance or express comfort about earnings estimates unless it is part of a disclosure that is simultaneously made available to the public at large. Regulation FD does not permit a company to "walk" the analysts up or down.
- Be careful about providing information to analysts in connection with a review of their reports. Many companies refuse to review analyst reports for fear of becoming entangled in the analysts' projections. With Regulation FD, there is now a heightened risk that comments could also be viewed as providing material non-public information to an analyst. Generally, we recommend that, if you decide to review an analyst report, you should only comment on historical, factual matters. Do not make comments on an analyst's projections or model.
- When making any statement to an analyst, other securities market professional or stockholder, ask yourself whether you would want the statement to be the subject of a press release. If the answer is "no", then you should seriously question whether the statement should be made in the first place.
- Be careful about providing information for longer or shorter time frames than the ones you have addressed in public documents or presentations. For example, if in your quarterly earnings call you addressed your expectations over the next year, you should be careful about providing information that goes beyond that time frame.
- Avoid adjectives in public documents.
- Do not comment on rumors.
- Encourage analysts to do independent research by asking them questions.
- Be careful what you post on your website. For now, it is not considered a public disclosure under Regulation FD. Therefore, if a website posting contains material non-public information, you will also need to take some other action to disclose the information to the public, such as issuing a press release, filing a Form 8K or having a conference call that meets the public disclosure requirements. As a result, all website postings should be reviewed by one of the persons who is authorized to speak to analysts on behalf of the company.
- Be careful what you say at industry conferences. Unless the public at large has been invited through a widely-disseminated notice to attend these meetings, they will be considered private and anything you say will be treated as a non-public disclosure. You need to be especially careful if the industry conference occurs at the end of your fiscal quarter.
- Consider adopting an information "black-out" or "quiet period" at the end of your fiscal quarter. During this "black-out" period, do not provide any information (including non-material details) to analysts or others about the quarter, except

through the publication of a press release or conference call that is open to the public. This could minimize the risk that an inadvertent disclosure of material information is made at this sensitive time in the quarter.

- Involve your internal and external legal counsel in making decisions about the materiality of the information that you are providing in private conversations or meetings with analysts and stockholders and in making changes in your practices in response to Regulation FD.
- Consider using a mid-quarter update like the quarter-end earnings announcement, that would be accessible by the public through a conference call or a webcast. In this way, the company would be able to update the analysts as well as the public at large on the status of its quarter without selectively disclosing information. This would reduce the need to have private discussions with analysts.
- Monitor the market reaction to information that is disclosed both publicly and non-publicly. Learning how the market reacts to different disclosures will help you make judgments about materiality in the future. If it appears that a mistaken judgment was made about the materiality of a non-public disclosure, a corrective disclosure will need to be made within 24 hours of the company's realization that the disclosure was material.
- If you are planning to make a Regulation MA disclosure regarding a proposed merger, acquisition or tender offer, keep in mind how Regulation FD may affect that disclosure. For example, if you will have a conference call to discuss the proposed transaction and its likely impact, Regulation FD may require you to provide adequate public notice of and access to the conference call, or to issue simultaneously a press release containing the material information that you will discuss on the call. Regulation MA may also require that you file with the SEC a transcript of the conference call or a copy of the press release.
- Watch how other companies handle these issues over time. Since this law is new, it will be interpreted over time and companies may change their practices in response to these interpretations.

How does Regulation FD affect a company's securities offering or a merger or acquisition transaction?

Statements made in connection with most registered securities offerings, such as those registered on Forms S-1, S-3 and S-4, will be exempt from Regulation FD.[9] Regulation FD provides specific guidance on the duration of the exemption, which is based on when the SEC considers these registered offerings to begin and end. As a result, statements made

[9] When it adopted Regulation FD, the SEC noted that it was in the process of reviewing the existing disclosure system as it relates to communications made during the offering process and that it would be considering selective disclosure concerns for offerings as part of that review process.

during a “road show” related to a registered offering will generally be exempt from Regulation FD.

However, statements made in connection with the following registered shelf offerings are not excluded from the operation of Regulation FD:

- offerings by security holders;
- dividend or interest reinvestment plans;
- employee benefit plans;
- the exercise of outstanding options, warrants or rights;
- the conversion of outstanding securities;
- pledges of securities as collateral; and
- issuances of American depositary receipts.[10]

Unlike registered offerings, statements made in connection with unregistered offerings are subject to Regulation FD. Therefore, companies making unregistrered offerings should either publicly disclose the material information that they are disclosing non-publicly or protect against misuse of that information by having those who receive it expressly agree (orally or in writing) to maintain it in confidence.[11] Although Regulation FD permits oral agreements as long as they are express, we would recommend that a company obtain confidentiality agreements in writing. Disclosures made in a proposed merger, acquisition or tender offer transaction sometimes will also be subject to Regulation FD. Statements made by the issuer of securities in a registered merger, acquisition or tender offer are exempt from Regulation FD. The duration of the exemption begins with the first public announcement of the transaction and ends upon the completion of the vote related to the transaction (or in the case of a tender offer that includes the issuance of registered securities, its expiration). However, statements made outside of these time frames, in a transaction that involves the issuance of unregistered securities or in a cash merger or cash tender offer, would be subject to Regulation FD. In addition, it is not clear whether statements made by a target company would be subject to Regulation FD. Regulation MA, which includes safe harbors for written communications made in connection with certain merger, acquisition and tender offer transactions, became effective in January 2000. If a disclosure will be subject to both Regulation FD and Regulation MA, then:

[10] The SEC does not believe that these sorts of offerings should be exempt from Regulation FD for several reasons. If the exclusion for registered offerings covered these offerings, companies could be exempt from the operation of Regulation FD for extended periods of time because these offerings are generally of an ongoing and continuous nature. In addition, companies are generally accustomed to dealing with the impact of public disclosures during the course of these offerings.

[11] This is the case even if public disclosure would impact the availability of the exemption from registration that the company plans to rely upon to issue the securities.

- Regulation FD may require that the disclosure be made in a certain manner, such as by way of press release or by structuring a conference call to satisfy the public disclosure requirements, while
- Regulation MA may require that the company file with the SEC under a particular rule the written communications that are made in connection with the transaction, including a copy of the press release or a transcript of the conference call.

What penalties could be imposed on a company that violates Regulation FD?
The SEC structured Regulation FD as a disclosure rule, rather than an anti-fraud rule. A company will violate the rule only if its non-public disclosure was made intentionally or the company acted recklessly in not realizing that the information it disclosed was material. A violation of Regulation FD could result in an enforcement action by the SEC against the company and, in certain cases, against the person responsible for the violation. An enforcement action by the SEC could involve an injunction or fines, with the related adverse publicity and obligations to disclose these violations. The SEC has made it clear that a violation of Regulation FD will not result in the company's losing its eligibility to use Form S3 or Form S-8, and will not prevent a stockholder from making sales of securities under Rule 144. In addition, disclosures made to comply with Regulation FD will subject a company to the same types of liability that are applicable to other public statements it makes, including liability under Rule 10b-5.

A failure to make a disclosure required solely by Regulation FD will not result in a violation of Rule 10b-5 and will not, therefore, enable one of the company's stockholders to bring a private suit against it. However, selective disclosure of material non-public information by a company official can lead to liability under Rule 10b-5 if the information is provided in breach of the company official's fiduciary duty to stockholders. This would occur if the company official receives a personal benefit from the disclosure, such as an economic gain or a reputational benefit that would lead to future earnings.

In addition, under existing law, a company could incur liability if it fails to make a public disclosure of information when it has a duty to update or correct a prior disclosure.

When does Regulation FD go into effect?
These rules go into effect on October 23, 2000, which is 60 days after the rules were published in the Federal Register.

What are the consequences of filing a Form 8-K to satisfy a company's Regulation FD obligations?
Using a Form 8-K to make a Regulation FD disclosure can expose a company to liabilities that do not apply to statements made by way of press release or by other methods that do not involve filings with the SEC. As a result and because most analysts expect to learn about

material information through a press release or conference call, a company should be careful about using a Form 8-K to make its Regulation FD disclosures.

Filing a Form 8-K solely to satisfy Regulation FD will not, by itself, be an admission by the company that the information included in the Form 8-K is material. A company may choose to file under two separate items of Form 8-K. If a filing is made under Item 5, the information will be subject to liability under Section 18 of the Securities Exchange Act of 1934. It will also automatically be incorporated by reference into the company's registration statements under the Securities Act of 1933 and therefore will subject the company to liability under Sections 11 and 12(a)(2) of the Securities Act of 1933. As an alternative, a company can furnish the information to the SEC by filing under Item 9 of Form 8-K. In this case, the company will not be subject to liability under Section 11 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 for those statements, and the information will not be incorporated by reference into the company's registration statements. However, all disclosures on Form 8-K will be subject to the Rule 10b-5 anti-fraud provisions of the federal securities laws. As a result, if a Form 8-K will be used to satisfy Regulation FD, we would generally recommend that a company "furnish" the information under Item 9. However, if it is necessary for the information to be incorporated by reference into a registration statement that is currently being used by the company or its stockholders to sell securities, a filing under Item 5 of Form 8-K should be made.