

SEC Bans Selective Disclosure of Material Nonpublic Information

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The Securities and Exchange Commission has approved a new regulation which, among other things, prohibits publicly traded companies from intentionally releasing *material* nonpublic information to analysts and institutional investors prior to the disclosure of such information to the investing public. This so-called *ban on selective disclosure* is intended to level the playing field between professional and ordinary investors by requiring corporate management to share information traditionally reserved for analysts and professional investors simultaneously with ordinary investors.

This new regulation will become effective on or about October 23, 2000.

Introduction

Titled Regulation FD (Fair Disclosure), this new regulation requires companies subject to the reporting requirements of the Securities Exchange Act of 1934¹ to provide Wall Street professionals and individual investors with equal access to *material² nonpublic³* information

¹ Including closed-end investment companies but not other investment companies, foreign governments or foreign private issuers. In regard to foreign private issuers, however, the SEC makes clear in Regulation FD that it is currently undertaking a comprehensive review of their reporting requirements and suggested it may extend the scope of Regulation FD's requirements to include these companies.

² Information about a company is generally considered to be *material* if a reasonable investor would consider it to be important in deciding whether to buy, sell or hold securities of the company or in deciding how to vote such securities or if it would reasonably be expected to affect the market price of the securities. It should be noted that both positive and negative information may be material.

³ Information is *nonpublic* when it has not been circulated in a way that would make it generally available to the public.

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when companies *intentionally*⁴ disclose such information. Regulation FD is an issuer disclosure rule that is designed to create duties only under Sections 13(a) and 15(d) of the Securities Exchange Act and Section 30 of the Investment Company Act. It is not an antifraud rule, and it is not designed to create new duties under the antifraud provisions of the federal securities laws or new private rights of action.

In order to comply with Regulation FD, corporate management is advised to issue a press release, broadcast over the Internet or file with the SEC *any intentionally disclosed material information* so as to ensure its dissemination on a broad and nonexclusionary basis.

General Rule of Regulation FD

If a company or its senior official discloses material nonpublic information to securities market professionals or its securityholders (when reasonably foreseeable that securityholders will trade based on the information), the company must *publicly disclose* the information (a) simultaneously, for intentional disclosures, or (b) promptly, for non-intentional disclosures.

Principal Provisions of Regulation FD

Regulation FD is an issuer disclosure regulation. It may be summarized as follows:

- Regulation FD applies solely to communications with (i) securities market professionals⁵ and (ii) securityholders of a company's securities where it is reasonably foreseeable that its securityholders will trade on the basis of the information.
- Regulation FD only applies to communications by the company or persons acting on the company's behalf, which includes senior officials, investor relations professionals and other persons who communicate regularly with securities market professionals and the company's securityholders.
- Regulation FD has four exceptions to its general rule on communications:
 - ❑ communications made to a person who has a fiduciary relationship with the company (such as a lawyer, investment banker or accountant and other *temporary insiders*),
 - ❑ communications made to a person who agrees expressly to maintain the information communicated in confidence,

⁴ Selective disclosure of material nonpublic information is *intentional* when the company or a person acting on its behalf makes a disclosure and either knew prior to the disclosure, or was reckless in not knowing, that the information being communicated was both material and nonpublic.

⁵ The securities market professionals expressly covered by Regulation FD are the following: (1) broker-dealers and their associated persons; (2) investment advisors, certain institutional investment managers (such as those required to report on Form 13F) and their associated persons; and (3) investment companies, hedge funds and affiliated persons. Moreover, the SEC emphasized in the release accompanying Regulation FD that the foregoing categories of securities market professionals include sell-side analysts, many buy-side analysts, large institutional investment managers, and other securities market professionals who are likely to trade on the basis of selectively disclosed information.

- ❑ communications made to an entity which has as its primary business purpose the issuance of credit ratings so long as the information communicated is (a) solely for the purpose of developing a credit rating and (b) the entity's ratings are publicly available, and
 - ❑ communications made in connection with most offerings of securities registered under the Securities Act of 1933.
- Regulation FD distinguishes between intentional and non-intentional disclosures: for intentional disclosures, companies must publicly disclose the same information *simultaneously*; in the case of non-intentional disclosures, the same information must be disclosed *promptly*.⁶
- Regulation FD does not generally apply to communications made in connection with registered securities offerings under the Securities Act of 1933.⁷
- Regulation FD does apply to unregistered offerings (i) in the absence of an “understanding” about confidentiality or (ii) the company discloses material nonpublic information.
- Regulation FD is not applicable to foreign issuers.
- Regulation FD violations will not preclude a company from using a short-form registration on Form S-2 or S-3 or filing a registration statement on Form S-8.
- Regulation FD violations will not impair a securityholder's use of Rule 144.
- Regulation FD makes no provision for private liability under Rule 10b-5 as a result of a selective disclosure violation.
- The SEC may bring an administrative proceeding (seeking a cease and desist order), a civil action (seeking an injunction and/or civil penalties) or an enforcement action (seeking a cease or desist order or an injunction) against a company or person responsible for a Regulation FD violation.

Public Disclosure for Purposes of Regulation FD

The public disclosure requirement of Regulation FD may be satisfied by *filing* or *furnishing* the selectively disclosed material information with the SEC on a Form 8-K⁸ or

⁶ The SEC states in Regulation FD that after a senior official at the company learns of the disclosure and knows (or is reckless in not knowing) that the disclosed information was both material and nonpublic the company has until the later of (i) 24 hours or (ii) the commencement of the next day's trading to disclose the subject information.

⁷ Please note the SEC emphasized in the accompanying release that a regularly scheduled conference call is a communication not exempted from Regulation FD merely by virtue of its being made during a company's registered offering. As for the specific categories of offerings which are subject to Regulation FD, various registered shelf offerings under Rule 415 (secondary offerings, dividend plans, employee benefits plans, exercises of outstanding options, conversions and pledges of securities, and issuances of ADRs) are generally covered by Regulation FD. These offerings are of an ongoing and continuous nature, and companies would otherwise be exempt from Regulation FD for extended periods of time if the general exception for registered offerings applied.

⁸ Please note that filing or furnishing a Form 8-K is not an admission as to the materiality of the information contained therein.

disseminating a press release which contains the information through a widely circulated news or wire service. Under the new rules, the SEC will allow a company to *furnish* rather than *file* the Form 8-K. Information that is *furnished* will not be subject to liability for filed information and will not be deemed to be incorporated by reference into any effective Securities Act registration statement.

Alternatively, this requirement may be satisfied if the company uses any other method of disclosure reasonably designed to provide broad public access to the information while not excluding any member of the public from access (such as an announcement at a press conference accessible to the public either by telephonic or electronic access or personal attendance, or Internet broadcast of the conference).

Without more, postings of the information on a company's website will not satisfy the public disclosure requirement of Regulation FD. Yet, under certain circumstances, postings of information on a website, in connection with other methods of disclosure, may satisfy Regulation FD requirements provided that in combination these methods are reasonably designed to provide broad and non-exclusionary access to the relevant information.

Again, it should be noted that Regulation FD does not require a particular means or method of disclosure. Rather, the regulation contemplates that companies will choose whatever form or method reasonably calculated to ensure broad and non-exclusionary public disclosure. As a general matter, the SEC will look to the facts and circumstances at issue when determining whether a particular form of disclosure is sufficient.

Recommendations for Compliance with Regulation FD

First and foremost, Regulation FD is primarily designed to prevent senior company officials from coaching analysts and large institutional investors about earnings estimates and other information deemed significant to the prospective financial performance of the company. Therefore, special emphasis must be paid to situations where nonpublic information is exchanged solely with analysts and large investors.

Therefore, companies should be advised to approach the following situations with caution:

- Private one-on-one meetings with an analyst or investor,
- Follow-up calls with analysts or investors after public conference calls, and
- Industry conferences that are not broadcast or open to the public, particularly where there is a question-and-answer session or any other unscripted session.

While each of the foregoing circumstances is not, by itself, a violation of Regulation FD, there is a high likelihood that material nonpublic information will be disclosed under these or similar circumstances. Accordingly, companies should institute policies that carefully delineate

the types of prohibited communications and the likelihood that the above situations may involve prohibited communications likely to result in violations of Regulation FD.⁹

Moreover, since much of the focus of Regulation FD is directed towards preventing premature disclosure of corporate earnings, the SEC recommended in the accompanying release guidelines when making an intentional disclosure of information. The following guidelines were recommended in the context of preparing a scheduled earnings release:

- Issue a press release containing the information through the company's customary distribution channels,
- Provide sufficient notice by means of a press release or a website posting of a scheduled conference call to discuss earnings (this notice must provide investors with both the date and time of the conference call along with adequate instructions on how to access the call), and
- Conduct the conference call in a way that ensures open access to investors either by telephonic means or Internet broadcast.

⁹ To the extent it is necessary to engage in any meetings or conferences in private, senior company officials should limit communications therein to historical data.