TO OUR CLIENTS AND FRIENDS:

One of the recent areas of concern for the Securities and Exchange Commission has been “selective disclosure” – the release of material nonpublic information to selected persons, such as securities analysts or institutional investors, before making the information widely available to the marketplace.

On August 10, 2000, the SEC adopted “Regulation FD” to address this perceived problem. Regulation FD endeavors to eliminate the selective disclosure of material nonpublic information without “chilling” the free flow of information in the marketplace.

Regulation FD becomes effective October 23, 2000. Companies should use this time before the effective date to prepare for the impact of the new rule. Companies that fail to prepare for the consequences of the new rule could find themselves, through their outmoded disclosure policies, exposed to unnecessary risks.

The attached memo, In Pursuit of Fair Disclosure: The SEC Adopts Regulation FD, by Ronald R. Levine, II, Peter H. Schwartz, and Michelle H. Shepston,* contains two parts – a brief summary of Regulation FD and a few practical considerations for companies to consider.

Please do not hesitate to contact the authors, or any other member of the DGS Finance and Acquisitions Group, to discuss issues relating to Regulation FD.

Regards,

DGS FINANCE AND ACQUISITIONS GROUP

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SUMMARY OFREGULATION FD

General Rule

Regulation FD (the “Rule”) states that “[w]henever any issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any [recipient covered by the Rule], the issuer shall make public disclosure of that information . . . .” Depending upon how the selective disclosure occurred, the issuer must either “simultaneously” or “promptly” make disclosure to the public.

Which Companies are Subject to the Rule?

The Rule applies to companies registered under Section 12 of the Securities Exchange Act of 1934 (the “Exchange Act”) or required to file reports under Section 15(d) of this Act, including closed-end investment companies. The Rule does not apply to foreign private issuers, foreign sovereign debt issuers, or open-end investment companies.

Which Company Personnel are Subject to the Rule?

The Rule applies to communications by an issuer and by those “acting on behalf of” an issuer. Persons considered acting on behalf of the issuer are limited to “senior officials” of the issuer (i.e. directors, executive officers, investor or public relations officers, or other persons with similar duties) and any other “officer, employee, or agent” of the issuer who commonly communicates with the enumerated parties or with the issuer’s shareholders. This latter definition could implicate even junior level investor or public relations, finance and/or treasury personnel who participate in corporate communications. If, however, the disclosure of material nonpublic information by any of these persons breaches his or her duty of confidentiality to the issuer, the issuer will not be held responsible for the disclosure.

Which Recipients are Covered By the Rule?

The Rule applies to disclosures made to:

- brokers or dealers;
- investment advisers;
- institutional investment managers;
- investment companies;
- any affiliates of these groups; and
- communications to the issuer’s security holders “under circumstances
where it is reasonably foreseeable that the person will purchase or sell the issuer’s securities on the basis of the information.”

Notably, the Rule does not apply to discussions with the media or to those disclosures to customers, suppliers, strategic partners, and government regulators made in the issuer’s ordinary course of business.

**Which Disclosures are Covered By the Rule?**

The Rule applies only to the selective disclosure of “material nonpublic” information.

**“Material” Information**

As under other SEC rules, materiality presents a difficult issue under the Rule. The Securities and Exchange Commission (“SEC”) acknowledges this difficulty, but refuses to adopt a “bright-line” test or exclusive list of material subjects. Instead, the SEC relies on the traditional case law definitions, which hold that information is material if “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision. It must be probable that the reasonable investor would view the fact as substantially altering the “total mix” of available information. With respect to uncertain or predictive statements, materiality turns on the likelihood that the event will occur, balanced against the magnitude of its effect should it occur.

Materiality determinations in the context of financial statements were made more uncertain by SEC Staff Accounting Bulletin No. 99 (August 12, 1999) (“SAB 99”). In SAB 99, the SEC eschewed materiality determinations based primarily on numerical rules-of-thumb or thresholds. Instead, materiality must be judged in light of the “surrounding circumstances” and the “total mix” of available information. Quantitatively small misstatements or omissions may be deemed material based on the intent of management, the location of the misstatement in the financial statements, the effect of the misstatement on the overall financial picture and the presence of other misstatements or omissions. Although expected market reaction to the release of misstated information may be considered, such potential reaction by itself is “too blunt an instrument to be depended on” in making materiality determinations. These vague standards provide little guidance and instead impose upon companies and their auditors the onerous burden of predicting which small misstatements or omissions may later be deemed material based on new information and the lucidity of hindsight.

The Rule does provide some clarity, however, by exempting three types of communications:

- communications made in trust or confidence or subject to a confidentiality agreement such as those made to attorneys, accountants or investment bankers;
- information given to a credit rating agency for purposes of developing a publicly available credit rating; and
statements made in connection with most securities offerings under the Securities Act of 1933, as amended (the “Securities Act”).

Presumptively Material Information

The Adopting Release offers the following categories of presumptively material items, indicating that they should be reviewed carefully to determine whether they are 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 contract);
- changes in control or in management;
- change in auditors or auditor notification that the issuer may no longer rely on an auditor’s audit report;
- events regarding the issuer’s securities—e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and
- bankruptcies or receiverships.

These items are not per se material, nor do they represent an exclusive list of presumptively material issues. Any fact to be disclosed must be evaluated in light of the particular circumstances of the issuer.

“Mosaic” Theory and Informal Issuer-Analyst Contacts

Materiality determinations may become more uncertain within the context of informal issuer-analyst discussions. In the Adopting Release, the SEC attempted to define the outer limits of issuer responsibilities in such circumstances.

The SEC clearly indicates that issuer discussions with analysts regarding earnings forecasts present a “high degree of risk under Regulation FD.” An issuer may not respond to an analyst seeking “guidance” on earnings with any response suggesting that earnings will be higher, lower or stay the same, regardless of whether the suggestion is express or implied. This puts issuers in the unenviable position of trying to discern which non-earnings related disclosures may later be deemed indirect or implied guidance on earnings.
An issuer may not distribute material nonpublic information to analysts by disclosing it in smaller, non-material portions. The Adopting Release states, however, that the issuer may disclose non-material information, “even if, unbeknownst to the issuer, the piece helps the analyst complete a ‘mosaic’ of information that, taken together, is material.” The issuer is not responsible for either predicting or controlling the analyst’s use of non-material information.

Furthermore, the issuer must judge materiality based only upon its probable value to the reasonable investor. Information does not become material for Regulation FD purposes merely because the analyst unveils its obscured importance. The Adopting Release emphasizes that the “focus of Regulation FD is on whether the issuer discloses material nonpublic information, not on whether an analyst, through some combination of persistence, knowledge, and insight, regards as material information whose significance is not apparent to the reasonable investor.”

**Nonpublic Information**

Information is nonpublic where it has not been disseminated and made generally available to the public.

*When Must Public Disclosure Be Made?*

**Timing of Disclosure**

The timing of the required public disclosure depends upon whether the selective disclosure was “intentional” or “non-intentional.” This factor applies to the degree of awareness as to *both* the nonpublic nature of the information and as to its materiality. A disclosure is intentional if the maker of the statement “either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic.” In this case, the issuer must make simultaneous disclosure of the information to the public.

The recklessness standard for “intentional” disclosure seems problematic under the Rule. Recklessness generally involves actions that are so unreasonable and such an egregious breach of the duty of ordinary care, that the actor should have known the true state of affairs. The SEC certainly would consider this a generous standard. The Adopting Release states that “it is unlikely that issuers engaged in good-faith efforts to comply with the Rule will be considered to have acted recklessly.” The Adopting Release also acknowledges that the determination of recklessness will vary depending on the context of the disclosure. Nevertheless, where an issuer recklessly engages in selective disclosure, it is quite improbable that simultaneous public disclosure occurred. Thus, the issuer is immediately and irrevocably in violation of the rule. It is unclear what effect any sort of mitigating “prompt” public disclosure would then have on the issuer’s liability.

If the selective disclosure was non-intentional, the issuer must make “prompt” public disclosure. This requires disclosure “as soon as reasonably practicable” after a senior official of the issuer becomes aware of the disclosure and knows or should know that the information involved was both material and nonpublic. In no event shall the public disclosure take place
Method of Disclosure

An issuer may make adequate public disclosure by filing a Form 8-K reporting such information or by distributing the information through any “method (or combination of methods) . . . reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”

Form 8-K Filing

There are two methods available to an issuer wishing to made a Regulation FD disclosure through Form 8-K. According to the Adopting Release, submission under either method “will not, by itself, be deemed an admission as to the materiality of the information.”

The issuer may “file” a report under Item 5 of Form 8-K, which subjects the issuer to liability under Section 18 of the Exchange Act for any material false or misleading statements within the report. The filed information may be automatically incorporated by reference into subsequent Securities Act filings, thus subjecting the issuer to liability under Section 11 and 12(a)(2) of the Securities Act for material misrepresentations or omissions.

Alternatively, the issuer may limit its liability by choosing instead to “furnish” the information under the new Item 9 of Form 8-K. This approach avoids liability concerns under Section 11 of the Securities Act and Section 18 of the Exchange Act unless the information is subsequently included in SEC filings. All disclosures, whether furnished or filed, remain subject to the antifraud provisions of the federal securities laws.

Other Methods Generally

The SEC’s position on alternative methods of public distribution allows significant flexibility, as it does not specify a preferred means of communication. It may, however, also generate uncertainty as issuers seek to efficiently disseminate information to the public.

The Adopting Release lists as acceptable vehicles of distribution: press releases through widely-circulated news or wire services, announcements at press conferences, or conference calls open to the public. Conference calls may be made accessible by allowing attendance by the public in person, by telephone, or by other electronic communication “(including use of the Internet).” There must be adequate notice to the public of the conference call and of the available methods of attendance.

The SEC, in the Adopting Release, offers a model approach for the scheduled disclosure of material information. The company should first issue a press release of wide distribution, followed by notice of a scheduled conference call. Finally, the conference call should provide an open, public forum in which the disclosed information is discussed. The notice may be given in any manner “reasonably designed” to effect a widespread, comprehensive dissemination of the
information. This model, of course, discusses only the simplest case of planned, intentional disclosure and does not address more difficult situations.

Internet

The internet has become an increasingly popular venue for the distribution of corporate information. It is extremely likely that the internet will become even more heavily utilized in connection with Regulation FD disclosures. Issuers should remain aware, however, that the use of the internet for disclosure purposes raises several important issues.

The SEC indicates that for most, if not all, companies the use of the company’s web site as the sole method of public disclosure is generally insufficient. This may change in the future, but only for the most widely-followed companies. Nevertheless, the internet can serve an integral role in the disclosure process. Certainly, conference calls can be transmitted by webcasting, and news releases and notices of upcoming conference calls can be posted on the issuer’s web site. Some companies have chosen to place transcripts of webcasted conference calls on their web sites as well. Issuers must ensure that their internet use complements a larger disclosure plan that provides comprehensive disclosure to the public.

Liability Issues

Action by the SEC

Violation of the Rule may subject the issuer to an enforcement action by the SEC, which could result in a cease and desist order, injunctions and/or an action for money penalties. Individual persons may be subject to enforcement actions for their role in the issuer violation and may be subject to cease and desist orders or to injunctive action.

No Right of Private Action

Regulation FD explicitly provides no private right of action.

Implications for Liability Under other Securities Laws

The Rule was not intended to expand issuer liability under other provisions of the securities laws. It does not directly extend liability under the antifraud provisions. “No failure to make a public disclosure required solely by [Regulation FD] shall be deemed to be a violation of Rule 10b-5 under the Securities Exchange Act.” Further, it has no effect on Exchange Act reporting status for purposes of Forms S-2, S-3, S-8 or Rule 144. As noted above, it does not apply to communications made in connection with most registered securities offerings.

Potential Collateral Effects of the Rule

The Rule, however, may indirectly affect an issuer’s liability exposure. For example, plaintiffs’ lawyers may attempt to use violations of the Rule as evidence of reckless disclosure policies. Additionally, many discussions that once would have involved only a limited number
of people may now circulate throughout the public. Oral communications may often be committed to writing, thus subjecting them to heightened scrutiny. Further, information placed on a company’s web site, if not carefully monitored, may become stale or inaccurate, thus risking additional liability under the antifraud provisions of the federal securities laws.

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PRACTICAL CONSIDERATIONS

1. FORM A DISCLOSURE TEAM

Companies should consider forming a disclosure team with primary responsibility for formulating and implementing disclosure policies. This committee should consist of, at a minimum, the company’s chief executive officer, chief financial officer, its head of investor relations, and corporate counsel. If the company spokespersons, as described in Point 2 below, are sufficiently few, all spokespersons should be included on the team; if not, participation should be limited to ensure flexibility and responsiveness. The disclosure team will possess primary responsibility for implementing policies and safeguards such as those discussed below.

2. LIMIT COMPANY SPOKESPERSONS

Whether an employee is “acting on behalf of the issuer” hinges on whether that person is a director or officer or whether that person commonly communicates with the public, the investment community, or with shareholders. Companies should limit the number of individuals meeting the latter criteria. Companies should also create, maintain, and broadly disseminate (within the company and the investment community) a list of persons authorized to speak, formally and informally, on its behalf. Individuals authorized to speak for the company should have a thorough understanding of the company’s policies on materiality and disclosure and should understand the consequences of statements made on the company’s behalf.

3. MINIMIZE “ONE-ON-ONE” CONTACTS WITH ANALYSTS AND SIGNIFICANT INVESTORS

To the extent that authorized company personnel engage in contacts with analysts and others who could potentially subject the company to Regulation FD, companies should strive, to the extent possible, to limit such contacts. Companies can mitigate concerns over selective disclosure by opting to broadly disseminate information. Publicly disclosed information, whether material or not, does not implicate Regulation FD concerns.

4. DOCUMENT AND REPORT ALL CONTACTS WITH ANALYSTS AND SIGNIFICANT INVESTORS

Companies that decide to engage in contacts with analysts and significant investors should promptly document and report those contacts to appropriate compliance personnel. The disclosure team or a similar compliance personnel should review these reports to determine that the contacts were consistent with other company disclosures and did not involve material nonpublic information.

5. MAKE AND REEVALUATE JUDGMENTS ABOUT MATERIALITY

One of the more difficult aspects of the rule is making judgments about the materiality of the information disclosed. The varying standards imposed by the traditional “total mix”
analysis, SAB 99, and the “mosaic” theory make this analysis extremely difficult. What may have reasonably appeared non-material to the company at the time, may be construed by another person to be material in hindsight. Companies should form a materiality policy in consultation with counsel that fits their preferred level of risk and works well with their business model.

6. **MAKE CONSISTENT DISCLOSURES AND USE “SAFE HARBOR” DISCLAIMERS**

   The disclosure team should review all corporate disclosures (*e.g.*, press releases, speeches, analyst calls, web site materials) to ensure that the disclosures are consistent. Inconsistent disclosures made in smaller settings could raise the inference that the persons in those smaller settings received information that was not generally made available to the public. As long as the company reasonably concludes that such discrepancies, if any, could not be construed as involving material information, no other steps need to be taken. Consistency should also limit antifraud liability by reducing the inference that some disclosures were false or misleading.

   Companies should make frequent and appropriate use of safe harbor disclaimers as provided in the Private Securities Litigation Reform Act. Disclaimers should attach to oral and written communications containing forward-looking statements.

7. **DESIGN AND MAINTAIN PROCEDURES THAT ENHANCE INTERNAL REPORTING OF INADVERTENT SELECTIVE DISCLOSURE**

   Companies should design a “quick response” protocol to handle an inadvertent, potentially selective disclosure. This protocol should include both internal processes (*e.g.*, appropriate company contacts, evaluation teams to determine materiality of disclosure), but also involvement of outside counsel, where appropriate. Companies should, if possible, simulate an inadvertent disclosure. The short 24-hour disclosure period imposed by the rule emphasizes the importance of the company maintaining a protocol that enables it to respond promptly and efficiently.

8. **CREATE A PUBLIC DISCLOSURE PLAN**

   At present, the safest method of making a “public disclosure” is by filing or furnishing the information by Form 8-K. Although companies may make supplemental disclosures through press releases, web site postings and other methods, companies should not exclusively rely on these other methods as satisfying the “methods of disclosure reasonably designed to provide broad, non-exclusionary distribution of the information to the public” test without further guidance from the SEC. These other methods, however, may be utilized to allow and facilitate discussion of the filed information. In any case, issuers should create disclosure plans tailored to individual circumstances that provide comprehensive public disclosure.
9. **USE “OPEN CALL” ACCESS FOR ISSUER-SPONSORED CONFERENCE CALLS**

Issuer-sponsored conference calls have been an area of particular concerns for the SEC. To bolster the position that such calls do not involve selective disclosure, companies should provide adequate notice of the call and adequate means for accessing the call to all investors, analysts, and others that follow the company. By providing such broad access, the company could reasonably protect itself against the accusation that the call was used to accomplish selective disclosure.

10. **USE THE INTERNET, BUT WITH CARE**

The SEC recognizes the internet as an important method of public disclosure as it is efficient and cost effective. Issuers, however, must carefully select and monitor the information placed on their web sites. Companies should avoid linking to sites of third parties, especially those of analysts, as this could cause the company to be held responsible for misstatements or omissions contained in the third party’s materials. In addition, the selective inclusion of favorable analyst reports may make the issuer’s web site as a whole misleading. All posted items must be carefully monitored for recency and accuracy. Issuers should date all materials posted on their site, include appropriate cautionary language, and promptly remove outdated materials.

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