

Implicit "Signals" to Analysts Result in Regulation FD Liability

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The SEC's settlement last week of another Regulation FD enforcement action – its third in the past 13 months – reinforces that management of public companies must avoid not only direct earnings-related or other disclosures that violate Regulation FD but also implicit “signals” that may have the same effect.¹ In its most recent action, the SEC alleged that Office Depot, Inc. and its chief executive officer and former chief financial officer violated Regulation FD and Section 13(a) of the Securities Exchange Act of 1934, as amended, by selectively disclosing, albeit indirectly, to analysts and institutional investors that the company would not meet analysts' earnings estimates.

Regulation FD prohibits issuers from selectively disclosing material nonpublic information to securities professionals without simultaneously (or, with respect to non-intentional disclosures, promptly) disclosing the same information to the public. In the two most recent SEC actions before the Office Depot case, the communications involved executives directly referencing company financial information – in an e-mail to analysts providing additional color on earnings release guidance and in a phone call to an investment adviser communicating financial performance below estimates in advance of an earnings release. However, the Office Depot action clarifies that “signals,” or indirect references to company financial information, such as citing recent earnings announcements made by competitors or repeating previous warnings to the market – can also create Regulation FD liability, even if the company does not directly disclose material nonpublic information. The remainder of this client alert describes the specific facts forming the basis for the SEC's action against Office Depot.

In an effort to encourage analysts to revisit their analysis of the company, Office Depot's CEO and CFO decided that the company would make one-on-one phone calls to the analysts in June 2007, near the end of the company's second quarter. The CFO and the company's director of investor relations drafted talking points, which (i) included references to two negative earnings announcements (in light of economic conditions) of comparable companies and (ii) repeated Office Depot's previous warning to investors of softening demand earlier in the year. Although Office Depot did not regularly initiate phone calls to analysts, over two days the company's director of investor relations called all 18 analysts covering the company and almost all of the analysts then lowered their earnings forecasts. Despite the fact that two analysts contacted by the company indicated their surprise at the lack of a press release to disclose the material discussed in the call, the CFO nevertheless instructed the director of investor relations to then call the company's top 20 institutional investors and pass along the same talking points. Six days after the calls to analysts began (and after the company's stock had already dropped almost 8% over significantly increased trading volume), Office Depot filed a Form 8-K to disclose the negative impact of economic conditions on its earnings. At the time of these actions, Office Depot did not have written Regulation FD policies or procedures and had never conducted any formal Regulation FD training.

The charges were settled without admitting or denying the findings and allegations, with Office Depot agreeing to pay a \$1 million penalty and its CEO and CFO each agreeing to pay a \$50,000 penalty. This most recent Regulation FD action, particularly when taken together with the two previous SEC actions, reinforces that public companies should revisit their Regulation FD policies, procedures and training to ensure that company personnel are aware of the scope of communications – even “nuanced” communications – creating liability under Regulation FD.

1 The SEC complaint against Office Depot is available at:

<http://www.sec.gov/litigation/complaints/2010/comp21703.pdf> (October 21, 2010) and the SEC order against Office Depot is available at: <http://www.sec.gov/litigation/admin/2010/34-63152.pdf> (October 21, 2010). (The SEC also charged Office Depot with unrelated accounting violations, as noted in the order.) The SEC order against the Office Depot CEO, who has since announced his resignation, is available at: <http://www.sec.gov/litigation/admin/2010/34-63153.pdf> (October 21, 2010) and the SEC order against the Office Depot CFO is available at: <http://www.sec.gov/litigation/admin/2010/34-63154.pdf> (October 21, 2010). The SEC press release on the Office Depot matter is available at: <http://www.sec.gov/news/press/2010/2010-202.htm> (October 21, 2010). In March 2010, the SEC settled a civil action brought against Presstek, Inc. in which the SEC alleged that Presstek failed to simultaneously disclose material nonpublic information communicated to an investment adviser. Our client alert describing the Presstek matter is available at <http://www.wcsr.com/resources/pdfs/cs031210.pdf> (March 12, 2010). In September 2009, the SEC settled a civil action brought against Christopher A. Black, the former senior vice president and CFO of American Commercial Lines, Inc. (“ACL”), in which the SEC alleged that Mr. Black aided and abetted ACL’s violation of Regulation FD and Section 13(a) of the 1934 Act. Our client alert describing the ACL matter, the first Regulation FD action brought by the SEC since 2007, is available at: <http://www.wcsr.com/resources/pdfs/cs093009.pdf> (September 30, 2009).

Contact Information

If you have any questions regarding the recent SEC action, please contact Sudhir N. Shenoy (<http://www.wcsr.com/SudhirShenoy>), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link:

<http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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