

Client Alert

October 22, 2010

For more information, the full text of the SEC's Complaint is available at

<http://www.sec.gov/litigation/complaints/2010/comp21703.pdf>

SEC Enforcement Action Targets Implied "Signals" to Analysts

On October 21, 2010, the Securities and Exchange Commission ("SEC") announced an enforcement action against Office Depot and its CEO and CFO alleging violations of Regulation FD when Office Depot selectively signaled to analysts and large institutional stockholders to lower their quarterly earnings estimates by initiating one-on-one telephone calls in which only publicly-available information was discussed. This Regulation FD enforcement action is the third brought by the SEC in a year and emphasizes the SEC's renewed focus on selective disclosure.

This Client Alert discusses the alleged violations and provides practical considerations for public companies to consider regarding internal Regulation FD policies and procedures.

The Alleged Regulation FD Violation — Implied Signals

As set forth in the SEC's Complaint, at the request of the CEO and CFO, Office Depot representatives initiated one-on-one telephone calls near the end of the quarter to all 18 analysts covering the company and several large institutional stockholders. During the calls, using talking points approved by the CFO, representatives pointed out recent public earnings announcements by other comparable companies and reminded the analysts of the company's statements earlier in the quarter about expected earnings. The telephone conversations were carefully scripted to include only publicly available information but were made to cause the analysts to lower their estimates, which in fact happened.

The SEC's Perspective

The SEC's view of implied signals to analysts should come as no surprise in light of the statements in its 2000 adopting release for Regulation FD: "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. . . . This is true whether the information about earnings is communicated expressly or through indirect 'guidance,' the meaning of which is apparent though implied."

In its press release and Complaint against Office Depot and its CEO and CFO, the SEC emphasized several points:

- The CEO and CFO had discussed how to encourage analysts to revisit their analyses of the company.

- Office Depot did not regularly initiate these types of calls to all analysts covering the company.
- The calls were planned by and made at the order of the CEO and CFO.
- While the calls were being made, some analysts had complained about the lack of public disclosure on the topic, which was reported to the CFO.
- 15 of 18 analysts did in fact lower their earnings estimates.
- The market reaction showed a 7.7% drop in stock price from the time the calls began until Office Depot filed a Form 8-K publicly disclosing that its earnings would be “negatively impacted due to continued soft economic conditions.”
- Office Depot had no written Regulation FD policies or procedures in place at the time and had never conducted formal Regulation FD training, although its general counsel had occasionally distributed guidance and updates on Regulation FD.

Although the SEC acknowledged that Office Depot did not directly state that it would not meet analysts’ expectations, the Director of the SEC’s Miami Regional Office made it clear that “[t]alking Wall Street down from its earnings projections whether done expressly or through signals is prohibited.”

This is not the first time the SEC has taken action against executives for non-verbal or implied disclosures of material, non-public information, especially when it concerns earnings guidance regarding a soon-to-be-completed quarter. Although the executives carefully scripted the talking points to include only public information and may have been attempting to work under the “mosaic” theory of disclosure where analysts may sift through and assemble otherwise immaterial pieces of information to reach material conclusions (also endorsed in the 2000 adopting release for Regulation FD), these actions were insufficient. In this case, the intent of one-on-one calls to analysts made at the end of the quarter was likely too obvious to avoid an SEC enforcement action, which was simultaneously settled without admitting or denying the findings and allegations.

Takeaways

As noted by the SEC in the 2000 adopting release for Regulation FD, private discussions with analysts are inherently risky from a Regulation FD perspective. If the company desires to correct misinformation, an appropriately timed and carefully worded press release or Form 8-K may serve as better vehicle to inform analysts and the markets when compared to one-on-one telephone calls. For Office Depot, the result was the same: a 7.7% drop in the stock price with an additional 4.7% drop the day after the Form 8-K was filed. The difference was that the recipients of the selectively disclosed signals were able to avoid most of the losses while the company and its top two executives became the target of an SEC enforcement action, which could have been avoided.

Practical Considerations

As a pragmatic matter, this enforcement action should cause public companies to reexamine their Regulation FD compliance policies and procedures with respect to private communications with analysts with a view towards ensuring that comments regarding public information do not become implied signals as to non-public earnings estimates.

Editors:

Jennifer Martella
+1 415 984 3839
jennifer.martella@bakermckenzie.com

Lewis Popoff
+1 734 622 0251
lewis.d.popoff@bakernet.com

If you have any questions regarding the information in this Client Alert, please contact the current Baker & McKenzie LLP attorney with whom you work, or any of the following:

Chicago
One Prudential Plaza
130 East Randolph Drive
Chicago, Ill 60601
Tel: 312 861 8000
Attn: Craig A. Roeder
Attn: Christopher M. Bartoli

New York
1114 Avenue of the Americas
New York, NY 10036
Tel: 212 626 4100
Attn: Jeffrey E. Cohen
Attn: Thomas J. Rice

Washington DC
815 Connecticut Avenue, N.W.
Washington DC 20005-4078
Tel: 202-452-7000
Attn: Marc R. Paul
Attn: Pamela Dayanim

Palo Alto
660 Hansen Way
Palo Alto, CA 94304
Tel: 650 856 2400
Attn: Matthew R. Gemello

Miami
Mellon Financial Center
1111 Brickell Avenue, Suite 1700
Miami, FL 33131
Tel: 305 789 8900
Attn: Roy J. Larson

Dallas
2300 Trammel Crow Center
2001 Ross Avenue
Dallas, TX 75201
Tel: 214 978 3000
Attn: Amar Budarapu
Attn: Roger Bivans

Houston
Pennzoil Place
711 Louisiana, Suite 3400
Houston, TX 77002 2746
Tel: 713 427 5000
Attn: Jonathan B. Newton
Attn: William D. Davis II

San Francisco
Two Embarcadero Center, 11th Floor
San Francisco, CA 94111-3909
Tel: 415 576 3000
Attn: Shane M. Byrne

San Diego
12544 High Bluff Drive, Third Floor
San Diego, CA 92130
Tel: 858 523 6200
Attn: Maria P. Sendra