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COMMUNICATING WITH SECURITIES ANALYSTS AND THE MARKETPLACE

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The reality of public company life is that public companies must maintain an open line of communication with analysts and the marketplace. Securities analysts play an important role in gathering and disseminating information about publicly-held companies. As the U.S. Supreme Court has noted, securities analysts "ferret out and analyze information" by meeting with and questioning corporate officers and others who are insiders" [a]nd information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities." Investors and other market participants have come to rely on analyst recommendations for an understanding of a company's business and prospects, with the result that analyst reports can have a significant impact on stock price. That having been said, as the SEC made clear in its statements in support of Regulation FD, communications with analysts and others can raise a series of legal and regulatory concerns.

The purpose of this memorandum is to alert corporate officers to some of the potential issues raised by corporate communications. While this memorandum provides some basic information for corporate officers to consider before dealing with analysts, it cannot possibly cover the multiplicity of situations that can arise. Corporate officers therefore should seek the advice of counsel if there are any doubts as to the legal implications of specific communications.

Communications with analysts, whether in the course of quarterly teleconferences with analysts to discuss the quarter then ended or one-on-one discussions or other exchanges, could lead to liability in at least five circumstances:

- First, a corporate officer's statements to an analyst may give rise to liability if it was materially false or misleading when made.
- Second, disclosure of material non-public information selectively, as opposed to broad public dissemination, could violate Regulation FD.
- Third, a corporate officer, in hindsight, may be deemed a "tipper" of material, nonpublic information and held liable under the laws prohibiting insider trading for tipping one or more analysts.
- Fourth, a company may become sufficiently involved with an analyst report so as to become responsible for misstatements in, or omissions from, the report.
- Finally, a company may become subject to an obligation to update information in an analyst report that was correct when provided, but which subsequently becomes misleading.

The penalties for violations can be severe. The corporate officer may be subject to civil or criminal penalties or be barred from serving as an officer or director of a public company. The company may be subject to civil penalties or damage awards in private actions.

The various theories of liability, which to a certain extent overlap, are discussed below. Part H of this memorandum sets forth a series of recommendations that public companies should consider in formulating their policies and procedures for corporate communications.

A. Disclosure Duties Generally

In the absence of special circumstances, public companies are under no general obligation to disclose material information. As the Supreme Court has stated, "[s]ilence, absent a duty to disclose, is not misleading." When a company chooses to speak, however, it has a duty under the principal antifraud provisions of the U.S. securities laws, Section 10(b) and Rule 10b-5 promulgated thereunder,[1] to do so in a way that is truthful and not misleading.

In *Basic Inc.* v. *Levinson*, the Supreme Court held that a company engaged in preliminary merger negotiations violated Rule 10b-5 by denying the existence of such negotiations. The Court adopted a probability/magnitude test of materiality and held that disclosure is required only when a particular development is material and there is a duty to disclose. This duty may arise when (i) a company voluntarily speaks in a manner reasonably calculated to influence the investing public and the statement made is false or misleading or failure to disclose additional information makes a statement misleading, (ii) a company responds to a line item disclosure requirement in a document or report filed with the SEC, (iii) a company is trading in its own stock, (iv) a prior statement made by the company that is still alive in the marketplace had become materially false and misleading or (v) rumors are attributable to, or have leaked from, the company.

The Court indicated that a company could answer inquiries concerning unusual market activity with a "no comment" response. The availability of this option, however, depends partly on the prior practices of the company and, in part, on the absence of any other duty to disclose.

The "no comment" response was addressed by the SEC in a September 2000 enforcement action against a German company for making a series of denials of ongoing merger negotiations, followed some weeks after it first issued denials with a "no comment" response. The SEC cited its general antifraud rules and the *dicta* of *Basic v. Levinson* that when a public company denies the existence of merger negotiations, or voluntarily makes partial disclosure of information, it is then under a duty to disclose materials facts necessary to make the statements not misleading. The SEC further cited cases addressing the duty to update, which stand for the proposition that public companies have a duty to correct statements made by corporate representatives that they learn were misleading or inaccurate when made.

The SEC order made clear that the "no comment" response is not appropriate if the company has issued prior statements which were inaccurate when made (*e.g.*, express

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[1] Rule 10b-5 prohibits, in connection with the purchase or sale of any security, the making of any untrue statement of a material fact or the omission of a material fact or the omission of a material fact that would render any statements made not misleading.

denials of ongoing merger negotiations). Thus, when, the company in question began issuing "no comment" responses after a month of regular public denials, the "no comment" responses were too late and, at that point, inappropriate.

In at least one SEC enforcement action, the SEC has taken the position that the "no comment" response is also inappropriate where the company has made statements that were accurate when made, but became inaccurate, misleading or incomplete as a result of subsequent events (*e.g.*, a denial of merger discussions at a time when none were pending, followed by the initiation of such discussions). For this reason, many companies adopt a "no comment" response to all inquiries related to potential business combinations and the like, as a matter of course.

B. Regulation FD (Fair Disclosure)

Regulation FD became effective October 23, 2000 and was also the subject of a supplement (released October 20, 2000) to the SEC Division of Corporation Finance's Telephone Interpretations Manual.

Regulation FD seeks to prevent selective disclosure to securities analysts and others, whether in the course of meetings with analysts or discussions of analyst reports in draft form with analysts, or through quarterly conference calls open only to analysts and selected institutional investors, by requiring that reporting companies disclose material information through broad, non-exclusionary public means. Regulation FD also requires that whenever a reporting company learns that it unintentionally has made a material selective disclosure, it make "prompt" public disclosure of that information. The reporting company will be able to make the required public disclosure by filing or furnishing the information on Form 8-K or by alternative means of disclosure that will achieve the goal of broad, non-exclusionary distribution of the information.

Regulation FD applies to selective disclosure made by (i) any "senior official" of the issuer, or (ii) any other officer, employee or agent of an issuer who regularly communicates with securities market professionals (broker-dealers, investment advisers, institutional investment managers or investment companies) or with the issuer's security holders. "Senior official" is defined as any director, executive officer, investor relations or public relations officer, or other person with similar functions.

Regulation FD addresses selective disclosure of material nonpublic information, but does not define the term "material." The SEC has stated its view that the majority of cases will be clear cut even though materiality does not lend itself to any bright line tests. It has recommended careful review to determine whether certain types of information or events are material, including: earnings information; mergers, acquisitions, tender offers, joint ventures, or changes in assets; changes in control or in management; changes in auditors; events regarding the issuer's securities; and bankruptcies or receiverships.

Most significantly, the SEC has noted that giving guidance or express warnings concerning earnings or sales figures would likely be material, while more generalized background information would likely be less material. The SEC has emphasized that a covered person engaging in a private discussion with an analyst who is seeking guidance about earnings estimates takes on a high degree of risk. Selective disclosure that

expected earnings are likely to be higher, lower or the same as analyst forecasts would likely constitute a violation of Regulation FD. However, the SEC has also pointed out that materiality is an objective test keyed to the reasonable investor, so that immaterial information the significance of which is discerned only by an analyst will not be implicated under Regulation FD.

Regulation FD applies only to disclosures made to the following categories of persons "outside the issuer":

- broker-dealers and their associated persons;
- investment advisers, certain institutional investment managers (those that report on Schedule 13F) and their associated persons;
- investment companies and private investment companies that are exempt from investment company status under Section 3(c)(1) or 3(c)(7) of the Investment Company Act (which would pick up hedge funds, for example) and persons affiliated therewith; and
- any of the issuer's security holders under circumstances in which it is reasonably foreseeable that the holder will trade on the basis of the information.

The regulation covers persons most likely to receive improper selective disclosure, while generally not covering disclosures to persons who are engaged in ordinary course business communications, disclosures to the media or communications with government agencies.

Regulation FD sets forth four exclusions from coverage:

- disclosures to persons subject to duties of trust or confidence not to disclose the information or use it for trading. This exclusion would cover "temporary insiders" such as attorneys, investment bankers and accountants;
- disclosures to any person who *agrees* to maintain the information in confidence. This agreement may be written or oral, and may be entered into even after disclosure, so long as the recipient of the information does not disclose or trade based on the information;
- disclosures to credit rating agencies; and
- disclosures made in connection with most registered security offerings.

Intentional selective disclosure requires simultaneous corrective action. This requirement in effect means that issuers will not be able to engage in intentional selective disclosure without violating Regulation FD.

Non-intentional selective disclosure requires prompt corrective action. "Prompt" is defined to mean "as soon as reasonably practicable" but no later than the later of 24 hours and the commencement of the next day's trading on the New York Stock Exchange after a senior official of the issuer knows, or is reckless in not knowing, that a non-intentional disclosure of information which is both material and nonpublic has been made. The senior official might become aware of the disclosure as a result of seeing a significant change in the trading price or volume of the company's stock or might learn of a non-intentional disclosure by another employee when an analyst or investor calls for confirmation of the information.

Issuers will be able to comply with the public disclosure requirement of Regulation FD by filing or furnishing the information on Form 8-K. Alternatively, issuers may disseminate a press release through widely circulated news or wire services, or through any other means reasonably designed to provide broad non-exclusionary access, such as a press conference to which the public is granted access and of which the public has adequate notice. Although the SEC encourages issuers to post information on their corporate web sites when they make public disclosure as described above, the SEC has to date resisted suggestions to treat a web site posting as a sufficient means of public disclosure.

Failure by an issuer to comply with Regulation FD could subject the issuer, or an individual at the issuer responsible for the violation, to SEC enforcement action. The SEC has, however, made it clear that Regulation FD is not intended to create new duties under the antifraud provisions of the federal securities laws or in private rights of action, and Regulation FD expressly provides that no failure to make a public disclosure required *solely* by Regulation FD shall be deemed to be a violation of Rule 10b-5. An issuer, however, could face liability under the general antifraud provisions of the 1934 Act if a public disclosure contained material misstatements or material omissions.

Selective disclosure may also create a duty to disclose the information to the public generally under stock exchange regulations. For example, the rules of the New York Stock Exchange state that an issuer should not "reveal information that it would not willingly give or has not given to the press for publication" and that "if in the course of discussions with analysts substantive material not previously published is disclosed, that material should be simultaneously released to the public."

Although Regulation FD only applies to domestic reporting companies, foreign issuers should consider adopting policies and procedures consistent with Regulation FD as a matter of best practices.

C. Insider Trading

When corporate officers or other employees selectively disclose material, nonpublic information instead of disseminating it broadly to the public, they also run the risk of incurring liability under the laws governing insider trading. Liability can result because the law prohibits corporate insiders not only from trading on material, non-public information, but also from revealing such information to third parties, a practice known as "tipping."

Prior to 1980, liability could be imposed on any person who traded while in possession of material, nonpublic information. In 1980, the Supreme Court, in *Chiarella* v. *United States*, held that Rule 10b-5 imposes a duty to disclose or refrain from trading on the basis of material, nonpublic information only when such trading constitutes a breach of a fiduciary duty. In 1983, in *Dirks* v. *SEC*, the Court restated its rejection of the "possession" theory, and extended the fiduciary duty theory of *Chiarella* to tippee liability, holding that the test for determining whether a tippee's trading violates Rule 10b-5 is whether the insider (tipper) breached a fiduciary duty in passing along the nonpublic information.

In *Dirks*, the Court addressed tippee liability involving the receipt by Dirks, a broker-dealer, of information from a former officer of an insurance company, that the insurance company's assets were overstated as a result of fraudulent corporate practices. Dirks investigated the allegations. Neither Dirks nor his employer owned or traded in any of the insurance company's stock, but during the course of his investigation, Dirks discussed the information that he had obtained with certain clients and investors. Some of these individuals thereafter sold their stock in the insurance company.

The SEC investigated Dirks' role in exposing the fraud, and concluded that Dirks was a "tippee" who had aided and abetted securities law violations by repeating the fraud allegations to members of the investment community who later sold their stock in the insurance company. On Dirks' appeal, the Supreme Court rejected the SEC's view. The Court held that a tippee's duty to "disclose or abstain" derived from the tipper's breach of his fiduciary duty; if the insider did not breach his fiduciary duty in making a disclosure, the tippee has no limitations on the use of the information thus received.

The question thus was whether the corporate insider breached any fiduciary duty. While the Court affirmed the principle that corporate fiduciaries may neither profit from personally using undisclosed material information or by giving such information to an outsider for the same improper purpose of personal gain, it held that insider trading liability depended on some direct or indirect "personal benefit" to the insider, or some other indication of a *quid pro quo*. "Absent some personal gain," the Court held, "there has been no breach of duty to stockholders." Since the insider received no monetary or other personal benefit, and was motivated solely by the desire to publicize the fraud, there was no derivative breach by Dirks.

Commentators have interpreted the favorable language and tone of this decision as an indication that personal benefit means primarily a pecuniary benefit, and have concluded that absent some personal financial reward, corporate insiders are shielded from legal liability. *Dirks* itself, though, indicated that the personal benefit need not be monetary, but could be found in a "gift" of information to a friend or in a "reputational benefit that will translate into future earnings." Since "reputational benefit" is such a highly elastic concept, *Dirks* left the door open for the SEC to press a more hard-line position on company-to-analyst disclosures.

In *SEC* v. *Stevens*, the SEC advanced the position that a CEO's disclosure to an analyst of the downward trend in company earnings was made "in order to protect and enhance his [the CEO's] reputation" and therefore constituted insider trading. The problem for corporate officers is that reputational benefits can be alleged in just about

any selective disclosure of information. This case was ultimately settled, and so the court has not ruled on the SEC's strict position. Until the issue is decided by the courts, however, it appears likely that the SEC will continue to prosecute under its broad interpretation of a personal benefit.

Both *Chiarella* and *Dirks* left open the possibility that a person who "misappropriates" confidential information for securities trading purposes, in breach of the duty owed to the source of the information, can be held to have violated Rule 10b-5. In 1997, the Supreme Court held, in *United States v. O'Hagan*, that a lawyer had defrauded his law firm and its client by misappropriating for his own trading purposes material, non-public information regarding a tender offer by the firm's client. Under the misappropriation theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between the insider and the purchaser or seller of securities, the misappropriation theory premises liability on a fiduciary's deception of those who entrusted him with access to confidential information.

At the same time it adopted Regulation FD, the SEC also adopted Rule 10b5-2 to facilitate actions based on the "misappropriation" theory of insider trading. The Rule provides that a person can be liable under the "misappropriation" (i) where the person agreed to keep the challenged information confidential (though the agreement need not be in writing); (ii) where the people involved in the communication had "a history, pattern, or practice of sharing confidences" (which need not be business-related) that resulted in a reasonable expectation of confidentiality or (iii) where the person providing the information was a spouse, parent, child or sibling of the recipient, unless it could be shown that there was no reasonable expectation of confidentiality. The SEC indicated that this non-exclusive definition will apply to both trading and tipping violations.

D. Responsibility for Analyst Reports

It is not unusual for analysts to ask corporate officers to review or correct reports they are preparing. Public companies may wish, within the parameters set forth in Regulation FD, to review draft analyst reports to establish good relations with the authors, to correct errors before they are made public or to provide warning of a critical report. If a company becomes involved in reviewing and correcting draft reports, it may assume a duty to correct such reports if they contain misleading information when released. In addition, a company may become liable for false statements contained in an analyst report in circumstances where it conveyed the suggestion that the analyst's forecasts are accurate or at least in accordance with its view.

The Entanglement Theory

Although a company is under an obligation not to disseminate false or misleading information into the marketplace, it has no duty to correct an inaccurate report issued by an analyst unless it has become "entangled" with the preparation of the report. In that case, the company may be liable for material misrepresentations or misleading omissions. The critical issue is what constitutes sufficient entanglement such that a company can be held responsible for the analyst report.

As a general matter, the courts look for indications that the company expressly or impliedly placed its imprimatur on the misleading part of the analyst report. The case law in this area tends to be heavily dependent on the particular circumstances of each case.

In a case where company officials reviewed a number of reports for factual accuracy but maintained a consistent policy of not commenting upon earnings forecasts, the court found no liability for the company's failure to disclose that its own forecasts were less optimistic. The court noted that a company may assume a duty to correct material errors in analyst reports when officials of the company have, by their activity, made an implied representation that the information they have reviewed is true or at least in accordance with the company's views. In this instance, the company was saved by its policy of not commenting on earnings projections under any circumstances, even when reviewing analyst reports that contained earnings estimates. The court stated, however, that a different result might follow if the company left uncorrected any factual statements that it knew or believed to be false.

One court highlighted a serious conundrum for companies that agree to review drafts of analyst reports. If a company becomes sufficiently entangled with a report, it is obliged to correct material misstatements or omissions as if the report were its own. On the other hand, if in making this correction the company discloses material, nonpublic information to the analyst, it risks insider trading liability, as discussed above. The final result is that review may lead to a Hobson's choice.

Cases often arise where plaintiffs claim to have relied on an analyst report to which a corporate insider provided information. In such cases, the nature of the information provided by the insider is crucial. In one case, the company merely provided raw data, which served as the basis for the analyst's projections. The complaint alleged that the company knew of the report before it was published. The court held that this allegation was insufficient to establish that the company placed its imprimatur on the forecasts, and therefore dismissed the action. In another case, the plaintiff alleged that a corporate spokesman had made certain representations about the company's performance, and had publicly endorsed the analyst report. The court still refused to find liability, holding that the report did not quote the defendants and represented the independent interpretation of the analysts.

Direct quotations of corporate officers generally will be considered statements of the company. Where misleading information in an analyst report is directly attributed to a corporate officer or director, the information will be treated no differently than if it had been issued via a press release directly from the company. But courts sometimes hold plaintiffs to a high degree of proof or specificity in their pleadings. In one case, plaintiffs alleged that they were damaged by analyst reports which contained false or misleading information supplied by anonymous corporate insiders. The court held that the risk of market manipulation by such statements was small, since investors tend to discount unattributed sources and analysts generally monitor the credibility of these sources, and that burdensome litigation would surely ensue if all such unattributed statements could give rise to legal liability. Therefore, the court held that for such an action to survive a motion to dismiss, the plaintiff must adequately allege facts linking the defendant company to the unattributed statements.

Issues of entanglement can also arise where companies use their web sites to distribute analyst reports to investors. A company policy of not distributing paper versions of an analyst report should extend to web sites. The potential problems that can arise by including analyst reports on web sites is illustrated by a question and answer in an SEC release, in which the SEC indicated that a company that places a preliminary prospectus on its web site and provides direct access via a hyperlink to a research report will be in the same position as if it had included a paper version of the research report in the same envelope that it uses to mail a paper version of a preliminary prospectus to potential investors.

The Post-Publication Adoption Theory

A company may become liable for false statements contained in an analyst report under the "adoption theory," if it adopts, implicitly or explicitly, the statements after they are published, even if management had no role in preparing them. Adoption can occur in circumstances where the company conveys the suggestion that the analyst forecasts are accurate or at least in accordance with its views. Liability for post-publication adoption of third party reports is distinct from the entanglement theory.

In *In re Presstek*, the SEC instituted proceeding against a company that it claimed had issued a false and misleading press release, had distributed a highly promotional financial newsletter published by others that included misleading projections and through its management had reviewed, edited and distributed an analyst report that overstated the company's sales and earnings outlook. The SEC found that Presstek was liable for the projections in the analyst report under both the entanglement theory and post-publication adoption theory, and liable for the misleading projections in the newsletter under the adoption theory. The SEC articulated the view that a company may adopt the contents of a report that it disseminates, particularly when the report is distributed along with other company materials, such as an annual report or copies of press releases. If the company knows, or is reckless in not knowing, that information in the report is false or misleading, it cannot be insulated from liability because management was not actively involved in the preparation of the information.

E. Duty to Correct Inaccurate Reports or Rumors

Where a company has not become "entangled" with the production of a report, it generally does not have a duty to correct inaccuracies in the report. A company, however, can volunteer that a conclusion in a report is inconsistent with the facts, without providing the analyst with more accurate conclusions.

Similarly, public companies generally have no duty to comment on unusual trading activity in their securities or on market rumors, unless the rumors can be attributed to the company or company insiders are trading in the company's shares.

Although the securities laws may not impose a duty to correct market rumors, the principal stock exchanges require listed companies to make public announcements where rumors or unusual trading activity suggests that material information has been leaked.

The only remedy available to the exchanges, however, is to suspend trading in the company stock, a remedy that they rarely pursue. Companies can also take comfort in the fact that violations of exchange disclosure policies generally do not give rise to private actions.

F. Duty to Update Disclosures

When information is disclosed which, though true at the time, later becomes misleading, the antifraud provisions of the securities law may require the company to correct or update these statements. Thus, when disclosures have been made to analysts, which subsequently become misleading, a company may have a duty to update or correct the statements.

Not all statements are such that they remain "alive" over a long period of time, and therefore require subsequent correction. The courts have held that disclosures which have a "forward intent and connotation upon which parties may be expected to rely" must be updated when they become materially misleading in light of subsequent events. Some forward-looking statements, however, may be so general that they are not deemed to be material for purposes of the duty to update. Statements that do not have forward intent would have to be corrected if later discovered to have been untrue at the time they were made.

A case involving Time Warner addressed various scenarios involving the duty to update. Time Warner, after its merger, found itself with $10 billion in debt. Management decided to begin a highly-publicized campaign to find strategic partners who would invest in the company. Faced with impending debt payments, the company was forced to raise capital by issuing additional stock.

Stockholders brought suit, claiming that Time Warner's statements were materially misleading, in that they misrepresented the status of the strategic partnership discussions and failed to disclose other options under consideration for raising capital. None of the statements, the plaintiffs argued, acknowledged the fact that negotiations with strategic alliance partners were not going as well as expected, or that corporate officers were seriously discussing a new stock offering. The court addressed, among other things, two issues involving a duty to update: whether a company has a duty to update optimistic predictions about achieving a business plan when it appears that the plan might not be realized and whether a company has a duty to disclose a specific alternative to an announced business plan when that alternative is under active consideration.

The court rejected the plaintiffs' theory that Time Warner's statements hyping strategic alliances gave rise to a duty to disclose problems in forming such alliances. The court acknowledged the principle that a duty to update opinions and projections may arise if the original forecasts have become misleading in light of intervening events. The court concluded, however, that Time Warner's statements were not sufficiently definite to require later correction. The statements, said the court, "suggest only the hope of any company, embarking on talks with multiple partners, that the talks would go well." The court hinted at the kinds of statement that *would* have created a duty to update: "No

identified defendant stated that" deals would be struck by a certain date, or even that it was likely that deals would be struck at all."

As to the company's nondisclosure of its consideration of a new stock offering, the court was less forgiving. The court stated that a company is liable for an omission only when there is a duty to disclose. The court said that "one circumstance creating a duty to disclose arises when disclosure is necessary to make prior statements not misleading." The court went on to say that when a company is pursuing a specific business goal, and announces both the goal and the path it intends to take to get there, it may be obligated to disclose other approaches that are "under active and serious consideration." Thus, Time Warner's announcement of its goal of solving its debt problem through the formation of strategic alliances, and its failure to disclose its consideration of a stock offering, could constitute a violation of the securities laws.

Opinions, projections, analyses and other subjective evaluations such as the statements made by Time Warner concerning potential strategic alliances are often referred to as "soft" information. The Time Warner court held that a company will not be responsible for projections that are not sufficiently definite. But even where the projections are definite, liability will not automatically attach if the projections are not fulfilled. The courts recognize that projections and opinions issued with the utmost diligence and good faith often turn out to be incorrect. Generally, only if disclosures of soft information are made in bad faith or without a reasonable basis will a company be held in violation of securities laws. A corporate officer should be protected where the officer believes the statement, has a reasonable basis for it, and is not aware of any facts which tend to seriously undermine its accuracy. Furthermore, a number of cases indicate that forward-looking statements can be hedged with adequate qualifications or disclaimers so as to preclude reliance by potential plaintiffs.

The same criteria that determine the duty to update statements made directly to the public apply equally to statements made to financial analysts. If forward-looking statements by a company quoted in an analyst report become misleading in light of new circumstances, the company may well be under a duty to update them. If an analyst report contains statements with forward intent that are ratified in some way by the company, the same duty applies.

G. Forward-Looking Statements

In December 1995, Congress passed the Private Securities Litigation Reform Act. Among other things, the Reform Act established a safe harbor for "forward-looking statements" made by eligible issuers, persons acting on such issuers' behalf, underwriters and "outside reviewers." Where a private securities fraud action is based on an untrue statement of material fact or omission of a material fact necessary to make a statement not misleading, an eligible person will not be liable with respect to forward-looking statements so long as either (i) the forward-looking statement is "identified as a forward-looking statement, 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" or (ii) the plaintiff fails to prove that the forward-looking statement, if made by a natural person, was made with actual knowledge that the statement was false or misleading, or, if made by a business entity, was made by or with

the approval of an executive officer with actual knowledge by that officer that the statement was false or misleading.

Although forward-looking statement notes are commonplace in prospectuses, periodic reports and press releases, it is important to remember that oral statements can, and should be, prefaced by an oral warning to have the benefit of the safe harbor protection. It is also important to remember that when oral statements are reduced to writing, for example when the transcript of a speech is distributed or posted on a web site, the now written statements need to be accompanied by the warning appropriate for written (as opposed to oral) forward-looking statements.

H. Practical Recommendations

1. **Avoid selective disclosure.** There should be no selective disclosure of material information. Analysts should not be used as a vehicle to announce material developments. In the event that material information is inadvertently selectively disclosed, the company must disseminate the information broadly and immediately.

2. **Limit the number of people who speak on behalf of the company.** The company's oral statements to analysts and others should be consistent. The best way to ensure such consistency is to limit the number of people who are authorized to speak on behalf of the company. All inquiries from analysts, as well as the financial press, should be directed to one source. The company should identify, and all employees should be aware of, who is subject to Regulation FD and who the designated spokesperson is.

The designated spokesperson should be a member of senior management or have full access to senior management. The person must be fully familiar with the company's historical disclosures and be fully informed of matters relating to the company's business, results, prospects and strategies, as well as current developments affecting the company. The person should also be aware of statements made by analysts and by competitors. Among other things, this will enable the spokesperson to more easily assess the materiality of statements made, or to be made, to ensure compliance (and, if necessary, remedial action consistent with) Regulation FD. Ignorance by a spokesperson who misled or misspoke is not likely to be a defense.

In addition, company employees should be cautioned against disclosing non-public information. Just because employee statements may not be covered by Regulation FD (for example, because an employee is not a covered person or the recipient is not an enumerated person) does not eliminate the risks associated with disclosures of material, nonpublic information. Statements, for example, may constitute unlawful tipping. This policy should extend to statements made concerning the company in Internet chat rooms and bulletin boards.

3. **Keep records of disclosure**. The company should brief authorized speakers as to what matters have been publicly disclosed and ensure that speakers do not deviate from previously announced statements without first receiving guidance from other company officials or counsel. A record of communications made by persons who speak on behalf of the company can help ensure consistency of public statements.

4. **Monitor information in the marketplace about the company.** By monitoring information about it in the marketplace, and the reactions by the marketplace to that information, the company will be in a better position to comply with the prompt disclosure obligations of Regulation FD for non-intentional selective disclosures. Since Regulation FD requires disclosure when a senior official knows, or is reckless in not knowing, of a non-intentional selective disclosure, all company employees should be sensitive to selective disclosure and report any such disclosure to the designated spokesperson.

5. **Develop a routine method of broad public disclosure and do not deviate.** A company is not required to have a routine plan for making public disclosure, but having a plan and sticking to it will help demonstrate that the means of public disclosure used in a given circumstance were "reasonably designed" to effect broad, non-exclusionary distribution. The SEC has cautioned companies that deviation from a company's usual practices for making public disclosure may affect its judgment as to whether the method of public disclosure in a given case was reasonable for purposes of determining whether selective disclosure constituted a violation of Regulation FD.

6. **Open analyst calls to the public.** By opening analyst calls to the public, the company will be better positioned to claim that any material information disclosed for the first time on the conference call was disclosed in a manner that complies with Regulation FD. It is also important that the public have adequate notice of when the call will take place. (The SEC has indicated that for a conference following a quarterly earnings announcement, notice of several days is reasonable, while notice may be shorter to report on time-sensitive, unexpected events.) The SEC has recommended a model employing a combination of methods of disclosure for making a planned disclosure of material information, such as a scheduled earnings release, that includes the issuance of a press release, distributed through regular channels, containing the information and the provision of adequate notice, by press release and/or web site posting, of a scheduled conference call to discuss announced results, including time and date of the conference call; instructions on how to access the call and notice as to how, and how long, the public will be able to access transcripts or replays. The public need not be able to ask questions, but should be able to hear the questions asked by analysts and the answers given. Analysts should be encouraged to ask questions on these open calls in lieu of follow up on a one-on-one basis.

7. **Do not confirm an analyst's earnings estimate, even when such confirmation takes the form of statements such as "that is in the ballpark," "that is doable" or "I am not uncomfortable with that."** These statements, however indefinite, imprecise or hedged, nevertheless may lead to liability because these phrases have taken on specific meanings. Confirmation of an analyst's estimate, or confirmation that the estimate is too high or too low, whether directly or indirectly through implied "guidance," could result in a violation of Regulation FD, liability for insider trading or, if the earnings estimate is significantly inconsistent with actual results, liability for the estimate as if it were the company's own statement. An alternative approach is to focus

on the analyst's assumptions. The SEC has stated that a company is not prohibited from correcting errors regarding historical fact that are a matter of public record or from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the company, that piece helps the analyst complete a "mosaic" of information that, taken together, is material.

8. **Plan presentations to analysts in advance.** Statements to be made by company officials should be reviewed in advance by the appropriate personnel, which may include the general counsel and the chief financial officer of the company, as well as outside counsel. The company may try to pre-screen questions or set the agenda in advance of conversations with analysts to determine which information should be addressed publicly and which can be addressed privately.

The company may also want to consider 24-hour embargo or other confidentiality arrangements (e.g., agreement to maintain confidentiality until the information is made public) for one-on-one sessions, to give management an opportunity to review the statements made and make any needed determinations as to materiality. If these sessions occur after the earnings release and before the conference call, if need be, matters that raise selective disclosure issues can be covered the next day in the call before the embargo lapses. Note that for a confidentiality arrangement to provide protection to the company, the recipient must agree to keep the information confidential. It is not sufficient if the recipient agrees to not use the information in violation of the federal securities laws, and it is not necessary that the recipient agree not to trade on the basis of the information.

If there exist areas of sensitivity as to which a "no comment" response is advisable, it may be useful to set ground rules at the outset to avoid questions that may elicit material non-public information. Where, for example, a company has just filed a registration statement or is preparing a proxy statement in connection with a vote on a corporate combination, the analysts should be advised at the outset that because of legal constraints, the company is not in a position to comment on such matters.

9. **Remember that statements with respect to prior public disclosure may constitute selective guidance.** In confirming information previously made public, the company needs to consider whether the selective confirmation itself conveys information above and beyond the initial forecast and whether the additional information is material. This may depend in large part on how much time has elapsed between the original statement and the confirmation, as well as the timing of two statements relative to the company's fiscal period ends. Thus, selective confirmation of expected earnings near the end of the company's quarter is likely to constitute guidance (as it may well be based on how the company actually performed), while investors may have drawn different inferences from the original forecast earlier in the quarter. Materiality of a confirmation may also depend on intervening events.

Statements that the company has "not changed" or "is still comfortable with" prior forecasts are equivalent to confirming a prior forecast. If the company wishes to refer back to a prior forecast without implicitly confirming it, it should state that the prior forecast was as of the date given and is not being updated. The company can always issue a "no comment" response if it does not want to confirm the prior forecast.

10. **Have a system in place to remedy non-intentional selective disclosures.** Non-intentional selective disclosures can be remedied by prompt public disclosure in compliance with Regulation FD or by obtaining a confidentiality agreement from the recipient before the recipient has disclosed the information or traded on the basis of the information. The company needs to have a system in place to quickly evaluate whether remedial action is required.

11. **Remember that selective disclosure violations can occur in a variety of settings.** Senior management needs to be sensitive to the fact that selective disclosure can occur other than in the context of one-on-one discussions, such as at industry conferences and other types of private meetings and break-out sessions. Statements at a shareholders meeting that is open to all shareholders but not to the public at large could also give rise to selective disclosure.

In addition, violations of Regulation FD can be triggered by selective disclosure to persons other than buy- and sell-side analysts, such as money managers, mutual funds and hedge funds, as well as shareholders, if it is reasonably foreseeable that such shareholders will trade on the basis of the information disclosed. If the company is relying on an exception from Regulation FD, be sure that the conditions to the exception have been fully met.

12. **Always invoke the safe harbor for forward-looking statements.** The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements and, in view of the likely increase in the volume of public statements that the company will be making to avoid selective disclosure, the volume of forward-looking statements that the company will be making is also likely to increase. In order to avail itself of the defense provided by the safe harbor, the company must take affirmative action. Thus, the safe harbor for oral forward-looking statements should be invoked at the beginning of any conference call and investor conference. Courts have made references to warnings in giving effect to the safe harbor. One example of such a warning would be:

> Thank you for joining us today. As we conduct the call, various remarks that we make about future expectations, plans and prospects constitute forward-looking statements for purposes of the safe harbor provisions of the Private Securities Litigation Reform Act. It is possible that our actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors, including those identified in our [ ] annual report, our [ ] Form 10-Q and our most recent Form[s] 10-Q.

The company should retain a transcript of each conference call, but it should bear in mind that publishing the transcript, such as placing it on its web site, may give rise to different types of concerns. As far as safe harbor protection is concerned, in contrast to oral statements (as to which warnings may refer to risk factors in documents), written statements may not merely refer to risk factors in other documents. The written statements must contain those warnings directly.

13. **Establish a policy for reviewing analyst reports.** Make clear to analysts that the company's review is limited to reviewing factual information to point out inaccuracies with respect to, or omissions from, recently released public information or to identify recently disclosed factual information that may affect an analyst's model. In any event, an analyst report should not quote any corporate officer, should not directly attribute information to the company and should not state that it is based on information provided by the company.

14. **Do not pass out, or hyperlink to, analyst reports.** Corporate officers should be careful about circulating analyst reports to shareholders or potential investors, as this may constitute an endorsement of the report and its contents. Similarly, as noted above, the company should avoid quoting, citing or hyperlinking analyst reports on its web site. In addition, the company should think twice about including the names of analysts that cover its securities on its web site. Should the company choose to do so, the list should be complete (*i.e.*, it should not simply list those analysts with favorable recommendations), preferably in alphabetical order, with no quotations from, or cites or hyperlinks to, the analyst reports. Any such list should include a disclaimer to the effect that the company does not endorse any statements in any analyst reports.

15. **Remember that a public company generally does not have an ongoing obligation under the securities laws to respond to rumors.** This general rule also applies to disclosure to analysts. Absent a separate duty to disclose (such as following a leak of information into the market or a stock exchange inquiry), a "no-comment" response is perfectly acceptable if it is consistent with past practice.

16. **Finally, remember that even if Regulation FD is adhered to, duties to disclose may nonetheless arise.** Regulation FD did not supplant traditional disclosure rules. A duty to disclose may well arise, for example, when there is unusual trading activity in the market, statements are made that when made are false or statements that are deemed "alive" become incorrect. In addition, it is now standard practice for companies that will not meet earnings expectations to announce that fact. The company needs to address these events with the same vigilance as it does its communications with analysts.

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The recommendations set forth herein are intended to be general in nature. This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Paul Weiss Securities Group, including:

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