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SEC ADOPTS REG FD BARRING SELECTIVE DISCLOSURE, AND, WHETHER YOU LIKE IT OR NOT, YOU'LL HAVE TO DEAL WITH IT

After much debate and lobbying, the Securities and Exchange Commission adopted Regulation FD (for "fair disclosure") on August 10th. The Regulation takes effect on October 23, 2000, when many companies will be in the process of releasing their 3rd quarter results.

Reg FD is designed to provide a level playing field for all investors, large and small. The SEC does not want companies to selectively disclose significant information to the stock market by using securities analysts as information conduits. Corporate developments or expectations that are arguably material are supposed to be communicated to all investors transparently and simultaneously. If a company has been providing selected analysts with "guidance" as to expected future results, under Reg FD that company must now provide that guidance to all investors.

According to the SEC this Rule will "end the practice of selective disclosure, whereby officials of public companies provide information to Wall Street prior to making the information available to the general public." In announcing the Rule's adoption, SEC Chairman Arthur Levitt said, "High quality and timely information is the lifeblood of strong, vibrant markets. It is at the very core of investor confidence. Regulation FD will bring all investors, regardless of the size of their holdings, into the information loop – where they belong."

Notwithstanding these optimistic statements, it has been reported in the *Wall Street Journal* and other sources that some companies, in response to Reg FD, are planning on limiting their investor communications, including refraining from one-on-one conversations with analysts and others in the investment community. However, by taking such a position a company runs the risk of frustrating, and even alienating, its investors, which will not improve the market's evaluation of the company or its stock.

Many analysts and institutional investors fear that Reg FD will create an environment in which companies either refrain from disclosure or "flood the market" with an endless stream of press releases. Are these fears real?

So, what should a public company do? What questions should you be asking to better understand this new Rule and its effect on your company? These and many other questions are being raised throughout the corporate, financial and legal communities. Before you can even ask the right questions, let alone participate in this new disclosure arena, however, you will need to have an appreciation of what Reg FD is all about.

HOW DOES REG FD WORK?

In very general terms, Reg FD requires that if a public company or one of its senior officials intentionally, or even unintentionally, discloses material nonpublic information to a shareholder, or a securities market professional such as an analyst, broker, or investment adviser or manager, the company must provide that same information to the public. The finer points of the Rule are discussed below. The Rule and the SEC's Release adopting the Rule can be found at the SEC's website (<http://www.sec.gov/rules/final/33-7881.htm>).

To whom does the Rule apply?

The Rule applies to issuers who have a class of securities registered under Section 12 of the Securities Exchange Act of 1934, or who are required to file reports under Section 15(d) of that Act, including closed-end investment companies. It does not apply to any other investment company or to any foreign government or foreign private issuer. For example, it does not apply to Canadian public companies.

What does the Rule require?

Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to a defined group of persons, it must make public disclosure of that information:

- simultaneously, if the disclosure is intentional, and
- promptly, if the disclosure is non-intentional.

Disclosure to what persons triggers the issuer's obligation to make public disclosure?

Disclosure to any of the following triggers the issuer's Reg FD disclosure duties:

- broker or dealer, or an associate of a broker or dealer,
- investment adviser, an institutional investment manager that filed a report on Form 13F with the SEC for the most recent quarter ended prior to the date of the disclosure, or a person associated with either of the foregoing,
- investment company, hedge fund or an affiliated person, or
- holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information being disclosed.

- However, Reg FD specifically does *not* apply to an issuer's disclosure:
- to a person who owes a duty of trust or confidence to the issuer (that is, "temporary insiders" such as an attorney, investment banker, or accountant),
- to a person who expressly agrees, orally or in writing, to maintain the disclosed information in confidence,
- to a rating agency, provided the information is disclosed solely for the purpose of developing a credit rating and those ratings are publicly available, or
- in connection with certain of the issuer's registered public offerings of securities.

Also, according to the SEC's Release adopting the Rule, Reg FD does not apply to disclosures to the news media or government agencies or to ordinary course business communications with customers and suppliers.

Whose comments on behalf of an issuer trigger Reg FD's disclosure obligations?

A "person acting on behalf of an issuer" can trigger an issuer's disclosure obligations. That can be any:

- senior official of the issuer, such as a director, executive officer, investor relations or public relations-officer, or other person with similar functions,
- in the case of a closed-end investment company, a senior official of the issuer's investment adviser, or
- any other officer, employee, or agent of the issuer who regularly communicates with any broker or dealer, investment adviser, institutional investment manager, investment company, or with holders of the issuer's securities.

An officer, director, employee or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to the issuer will not be considered to be acting on behalf of the issuer, and, therefore, their unauthorized disclosure of material nonpublic information will not trigger the issuer's Reg FD disclosure obligations.

When must an issuer make public disclosure of material nonpublic information under Reg FD?

If the information was intentionally disclosed, the issuer must make simultaneous public disclosure. A selective disclosure of material nonpublic information is intentional when the person

making the disclosure either knows, or is reckless in not knowing, that the information being communicated is both material and nonpublic.

Therefore, in the event of a selective disclosure attributable to a mistaken determination of materiality, liability will arise only if no reasonable person under the circumstances would have made the same determination. The circumstances in which disclosure is made will be very important. The SEC pointed out that it would distinguish between a materiality judgment made in the context of a prepared written statement and one made in the context of an impromptu answer to an unanticipated question. The SEC would more likely assert recklessness in the prepared written statement context.

In the case of a non-intentional disclosure, the issuer must make public disclosure promptly, which means as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange, even if the issuer's securities are not listed on that exchange) after a senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser) learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic. For example, if a non-intentional selective disclosure of material nonpublic information is discovered by a senior official after the close of trading on a Friday, the issuer must make public disclosure prior to the commencement of trading on the New York Stock Exchange on the following Monday, even if its stock trades only on the NASDAQ.

How must an issuer make public disclosure under Reg FD?

An issuer has considerable flexibility in determining how to make required public disclosure under Reg FD. It may make the disclosure by furnishing to or filing with the SEC a Form 8-K disclosing the information, or it may elect instead to disseminate the information through another method or combination of methods of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public (for example, a press release).

What changes were made to Form 8-K in connection with the SEC's adoption of Reg FD?

An issuer may voluntarily elect to satisfy its disclosure obligation under Reg FD by filing a Form 8-K.

Existing Item 5 in Form 8-K has been amended to permit a registrant, at its option, to file a report under Item 5 disclosing the nonpublic information required to be disclosed by Reg FD.

Also, a new Item 9 (Regulation FD Disclosure) was added which reads as follows:

“Unless filed under Item 5, report under this item only information the registrant elects to disclose through Form 8-K pursuant to Regulation FD.”

A registrant's report under Item 5 or Item 9 will not be deemed an admission as to the materiality of any information in the report that is required to be disclosed solely by Reg FD.

The SEC has drawn a distinction between Item 5 (as amended) and new Item 9. You “file” a report under Item 5 but you “furnish” such a report under Item 9. The information in a report “furnished” pursuant to Item 9 shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, except if the registrant specifically states that the information is to be considered “filed” under the Exchange Act or incorporates it by reference into a filing under the Securities Act or Exchange Act.

Does a failure to comply with Reg FD create a Rule 10b-5 violation?

No, a failure to make a public disclosure required by Reg FD will not, by itself, be deemed to be a violation of Rule 10b-5. However, it will not be surprising if plaintiffs’ lawyers cite Reg FD violations as “evidence” of a Rule 10b-5 violation.

Will a Reg FD violation affect an issuer’s ability to use short form registration statements or an “insider” shareholder’s ability to resell her stock using Rule 144?

A failure to make a public disclosure required solely by Reg FD will not affect whether:

- an issuer is deemed to have filed all material required to be filed pursuant to Section 13 or 15(d) of the Exchange Act in a timely manner, for purposes of determining its eligibility to use the short form registration statement on Forms S-2, S-3 and S-8 when registering its securities under the Securities Act, or
- there is adequate current public information about the issuer for purposes of Rule 144 which allows the holder of restricted securities or an affiliate of an issuer to sell their securities.

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**SOME QUESTIONS TO CONSIDER IN DETERMINING
HOW YOUR CORPORATE COMMUNICATIONS
PROGRAM SHOULD OPERATE UNDER REG FD**

With a general understanding of how Reg FD works – in principle – let’s now look at some of the questions that are being raised about how it will work in “the real world.”

- ***What is “material nonpublic” information?***

Reg FD does not define these terms. Will the SEC and the courts rely on existing definitions of those terms established in the case law? According to the SEC in its release adopting Reg FD:

Information is material if “there is a substantial likelihood that a reasonable shareholder would consider it important” in making an investment decision. To fulfill the materiality requirement, there must be a substantial likelihood that a fact “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” Information is nonpublic if it has not been disseminated in a manner making it available to investors generally.

In response to requests by some commentators that the SEC provide interpretive guidance as to the types of information likely to be considered material, the SEC provided the following as examples:

- > 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.

The SEC explained that the items on this list are not *per se* material nor is the list an exhaustive one. The determination of whether a matter is material is fundamentally a fact specific exercise in light of the facts and circumstances of the particular case; there is no bright line test for materiality.

- ***How can you meet your Reg FD disclosure obligation if you don’t want to file a Form 8-K?***

The Rule permits alternative methods (or a combination of methods) of public disclosure that issuers may choose to achieve the goal of effecting broad, non-exclusionary distribution to the public. Acceptable methods of public disclosure for purposes of the Rule include one or a combination of the following:

- > press releases distributed through a widely circulated news or wire service,
- > announcements made through press conferences or conference calls that interested members of the public may attend or listen to either in person, by telephonic transmission, or by other electronic transmission (including the Internet) as long as the issuer gives the public appropriate notice of the conference call and the means for accessing it, and
- > in appropriate situations, where issuers have websites that are widely followed by the investment community, by posting the information on their website.

It is not clear that an issuer will be fully protected at this time if it relies solely upon posting the information on its website. The SEC has indicated a willingness to consider this approach as technology evolves and more investors have access to and use of the Internet. In a briefing to reporters following the SEC's adoption of Reg FD, SEC General Counsel David Becker noted, "at least right now," a website disclosure, without more, will not be an adequate means of achieving the required distribution. "That doesn't mean we won't be there one day," but "I don't think we're there yet." he stated.

Reg FD does not require the use of one particular method for issuers to make the required public disclosure; rather, it leaves the decision to the issuer to choose methods that are reasonably calculated to make effective, broad, and non-exclusionary public disclosure, given the particular circumstances of that issuer. The SEC noted that, in determining whether an issuer's method of making a particular disclosure is reasonable, the SEC will consider all the relevant facts and circumstances, recognizing that methods of disclosure that may be effective for some issuers may not be effective for others. If, for example, an issuer knows that its press releases are routinely not carried by major business wire services, it may not be sufficient for that issuer to make public disclosure solely by submitting its press release to one of these wire services. The issuer in these circumstances should use other or additional methods of dissemination, such as distribution of the information to the local media, furnishing or filing a Form 8-K, posting the information on its website, or using a service that distributes the press release to a variety of media outlets and/or retains the press release. The SEC noted an issuer's method of making the required disclosure will be judged to see if it was "reasonably designed" to effect broad, non-exclusionary distribution in light of all the relevant facts and circumstances.

- ***How should your teleconferences be handled?***

You will need to give broad notice of your teleconferences. One way to do so is to include the phone number and other relevant information in a press release. Posting the notice on your website is also advisable. You will need to decide whether to open the teleconference to the news media and how to handle the Q and A session. You might want to post a replay of the telephone conference on your website as well as have it available for a call-back replay.

- ***What is "push technology" and can it be used to give notice of teleconferences?***

"Push technology" uses the Internet and email to send notices to anyone who has requested from your website information on newly posted events, news, or SEC filings. In other words, your website can be structured to "push" information out to your audience via email. Your audience must sign up to be "pushed to". This is often referred to as "email alerts" or "opt-in email".

The information itself may not be “pushed” to the audience, rather a hyperlink to the information on your website is instead. This of course has the advantage of drawing people back to your website.

By itself, “push” form of public dissemination for the scheduling of teleconferences may not necessarily provide “effective, broad, and non-exclusionary public disclosure” but could be used *in combination with other methods* of disclosure (such as a press release) to announce your teleconference. As the use of the Internet continues to grow, and where the following of your company becomes significantly internet-based, using push technology may meet the broad disclosure requirements. For example, the “pushed information” may actually be going to information sites that also push and post, greatly expanding the reach beyond the audience directly oriented on your company’s website.

Of course, having such a broad, diverse audience participating in your teleconference raises more questions regarding message, content, delivery, timing and control. There should be no question though that more is better.

- ***How can you handle securities analysts who are seeking “guidance”?***

The SEC noted that there is a common circumstance that raises heightened concerns about selective disclosure, i.e., the practice of securities analysts seeking “guidance” from issuers regarding earnings forecasts. When an officer of an issuer engages in a private discussion with an analyst seeking guidance about earnings estimates, she takes on a higher degree of risk under Reg FD. For example, if an issuer official were to communicate to a single analyst that the company anticipated that its earnings will be higher than, lower than, or even the same as that which other analysts have forecasted, the issuer (in the absence of the required simultaneous or prompt public disclosure) likely will have violated Reg FD. This is true whether the information about earnings is communicated expressly or through indirect “guidance,” the meaning of which is apparent though implied. Similarly, the issuer cannot render material information immaterial simply by breaking the information into ostensibly non-material pieces. At the same time, the SEC noted that issuers are not prohibited from disclosing non-material information to analysts, even if, unknown to the issuer, these pieces help the analyst complete a “mosaic” of information that, taken together, is material, nonpublic information about the issuer.

- ***Should you review an analyst’s report or financial model?***

Generally, you should limit any such review to verifying the facts; there may be those rare instances in which it may be appropriate to question an analyst’s assumptions. However, do not comment on the analyst’s conclusion, particularly his earnings forecast, unless you are prepared to make full and prompt public disclosure of your comments.

- ***Are industry and trade association seminars danger zones now?***

You should assume they are. It is likely that analysts will increase their presence at these events. Therefore, you will have to be careful who you send and what they say.

- ***How do you handle the disclosure of material nonpublic information during negotiations of a business contract?***

This is an area where you should consider using a carefully drafted confidentiality and nondisclosure agreement.

- ***What do you do if you find out after the fact that there has been a non-intentional disclosure of material nonpublic information?***

You must disclose that information as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the NYSE) by means of a broad based, non-exclusionary disclosure, such as a press release.

- ***What are the consequences if you violate Reg FD?***

If you fail to comply with Reg FD, you could be subject to SEC enforcement action for alleged violations of the reporting requirements of the Exchange Act (or, in the case of a closed-end investment company, the Investment Company Act of 1940), and Reg FD. The SEC could bring an administrative action seeking a cease-and-desist order or a civil action seeking an injunction and/or civil money penalties. In appropriate cases, the SEC could bring an enforcement action against an individual at the issuer responsible for the violation.

In the Release, the SEC clarified that Reg FD is not an antifraud rule, and it is not designed to create new duties under the antifraud provisions of the federal securities laws or in private rights of action. On the other hand, the SEC noted that an issuer's failure to make a public disclosure may still give rise to liability under a "duty to correct" or "duty to update" theory in certain circumstances. Further, an issuer's contacts with analysts may lead to liability under the "entanglement" or "adoption" theories, and Reg FD would not provide protection from Rule 10b-5 liability for false or misleading reports made pursuant to the regulation.

Also, Reg FD expressly states that an issuer's failure to comply with Reg FD (i.e., by failing to make timely public disclosures by filing or furnishing a Form 8-K or other appropriate methods) will not affect whether the issuer is considered current or timely in its Exchange Act reports. This is especially important for purposes of an issuer's continuing eligibility to use short form registration statements (Forms S-2, S-3 and S-8) and for purposes of the continuing availability of Rule 144 (relating to resales of restricted and control securities).

MORE QUESTIONS TO PONDER

In addition to the above questions, which have some answers, there are many other questions, such as the following, where there either are no ready answers yet or the answers will vary significantly depending on the facts and circumstances:

- What does an officer, employee or agent have to do to be considered "regularly" communicating with stockholders or securities market professionals?
- Does Reg FD apply if the communication is with someone who is neither a securities market professional or a "holder" of the issuer's securities?
- How will the SEC and the courts interpret "intentional", particularly if a person is accused of acting "recklessly" in not knowing that the information she communicated was both material and nonpublic?
- Should an issuer start publishing its own earnings estimates?

- How can you conduct an analyst meeting and one-on-one discussion? What can and cannot be discussed?
- What are your options for giving guidance with your quarterly earnings release and during a quarter?
- How and when can you address the “street’s” estimates, if at all?
- What does the SEC mean by “no guidance”? Can you “walk the street down”?
- How can you have a meaningful discussion with a “sell side” analyst who has published an earnings estimate for your company? Should you?
- How can you permit an analyst or institutional investor to visit your company or tour the company’s factory? What precautions should you take?
- Will the brokerage and investment banking firms continue to hold their industry forums and investment conferences? Should your company attend? What can you say?
- How does Reg FD affect the “quiet period” at the end of a quarter?
- If you have a Reg FD disclosure obligation should you file a Form 8-K or issue a press release?
- If you file a Form 8-K, should you report under Item 5 or Item 9?
- Should you use the management discussion and analysis (MD&A) section of your Form 10-Q more aggressively to present forward looking information?
- Will your “forward looking safe harbor” provide protection for Reg FD disclosure?
- Even if Reg FD does not apply, are there rules of the stock exchanges or NASDAQ that will require you to disclose?
- Should you consider rewriting your company’s policy of communicating with analysts and others? Do you have such a policy?
- What is your competition doing?

There are many other questions and issues that are likely to arise as a result of Reg FD. As with most securities disclosure matters, you will be best served if you seek the advice of a qualified and experienced securities lawyer and investor relations professional in deciding how to handle disclosure under Reg FD.

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