

MAYER • BROWN

Top Disclosure Issues for Public Companies

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February 7, 2018

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Speakers



Jennifer Carlson is a Corporate & Securities partner in Mayer Brown's Palo Alto office. Her practice focuses on capital markets, mergers and acquisitions, and general corporate matters. She represents companies, investors, and underwriters in a wide variety of capital markets and finance transactions, including initial public, follow-on, and secondary equity offerings; investment grade, high yield, and convertible debt offerings; venture capital investments; and liability management transactions. Jen also represents buyers and sellers in private and public mergers and acquisitions, tender offers, private equity investments, and other strategic transactions. In addition to her transactional practice, Jen counsels companies regarding securities law compliance, stock exchange listing requirements, fiduciary duties, corporate governance, and other matters.



Philip Niehoff is a Corporate & Securities partner in Mayer Brown's Chicago office. He is a transactional attorney who advises clients across a broad spectrum of securities-related matters. Philip represents issuers and underwriters in public, Rule 144A and private offerings of both equity and debt securities. He also represents issuers and dealer-managers in liability management transactions, including equity and debt self-tenders, exchange offers, and consent solicitations. Philip also advises client companies regarding Securities Act and Securities Exchange Act compliance, NYSE and NASDAQ compliance, corporate governance, and Sarbanes-Oxley Act matters; and he represents investment companies regarding compliance with SEC rules and regulations.

What you say can, and will, get you into trouble

- Exchange Act Rule 10b-5
 - Misstatement of a material fact or
 - Failure to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading
- Liability under Exchange Act Rule 10b-5
 - Government enforcement actions (SEC, DOJ)
 - Private actions (investors)
- Other possible liability: Regulation FD, Regulation G and other problems

What is material information?

- Information is material if:
 - There is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision
 - There is a substantial likelihood that the information would have been viewed by a reasonable investor as having significantly altered the total mix of information
 - The information could reasonably be expected to have a substantial effect on the price of the securities

No general informal duty to disclose material information

- A company retains control over the timing of disclosure of information – the SEC does not require that a company immediately disclose all material information
 - SEC periodic reporting requirement (Form 10-K, Form 10-Q, Form 8-K)
 - Securities offering
 - Company insiders are buying or selling company securities
 - There is a leak attributable to the company or one of its advisers
 - Duty to update or to correct previously disclosed information
 - Exchanges require prompt disclosure of material information

No duty to respond to rumors or market activity

- Except when caused by leaked information
- A “no comment” policy is the safest way to deal with questions from exchanges, analysts or shareholders and provides maximum flexibility to the company
 - If the company denies the rumor, and the denial turns out to be incorrect, the company needs to correct the prior statement
 - If the company denies the rumor and the rumor is in fact false, the company may be under a duty to update the statement if something transpires to make the denial no longer true

May be a duty to correct prior statements

- Prior statement was materially false when made
- May have liability for the pre-correction period, but should not have liability for the after-correction period
- Depends on how vague the original statement was and whether newly discovered information is reliable

May be a duty to update prior statements

- Prior statement was accurate when made but becomes materially false due to new developments
- Prior statement remains “alive” in minds of reasonable investors and relates to fundamental change
- Depends on whether there was an undertaking or lack of undertaking to update
- Depends on which federal circuit you are in

Formal procedures for informal disclosure

- Authorized spokesperson or spokespeople
 - Investor inquiries
 - Social media
 - Marketing material
- Remain consistent
- Need to agree on process for non-SEC required (informal) disclosures
 - Agree use of forward-looking statement disclaimer
 - Disclosure controls and procedures
- Adopt a disclosure policy

Forward-looking statements

- Shareholders should not be able to sue because a forward-looking statement was not true so long as the prediction was made in good faith and based on reasonable assumptions
- Private Securities Litigation Reform Act's ("PSLRA's") safe harbor for forward-looking statements requires that the company:
 - Identify the forward-looking statements
 - Include meaningful cautionary language
 - specific language, not boilerplate – don't use a forward-looking disclaimers in instances where no forward-looking statements are present
 - a cross-reference to filed SEC documents that contain the disclaimer is acceptable if the forward-looking statements were made orally
 - Include an undertaking that the company will not update the forward-looking statements, except as required by law

Forward-looking statements (cont'd)

- Forward-looking statements in tender offers, going-private transactions, initial public offerings and financial statements made in accordance with GAAP are not covered by the PSLRA's safe harbor

When disclosing non-GAAP financial information, mind the GAAP

- Non-GAAP financial information – a numerical measure of financial performance, financial position, or cash flows, that:
 - Excludes amounts that are included in the most directly comparable measure calculated and presented in accordance with GAAP, or
 - Includes amounts that are excluded from the most directly comparable measure calculated and presented in accordance with GAAP

Non-GAAP disclosure requirements

- Regulation G requires that, when a company publicly discloses a non-GAAP financial measure (whether in an SEC-filed report or in an earnings call or investor presentation), it must accompany that non-GAAP financial measure with:
 - A presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP, and
 - A quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure
 - For forward-looking information, quantitative reconciliation is required only to the extent it is available without unreasonable efforts on the part of the company

Non-GAAP disclosure requirements

- If a non-GAAP financial measure is made public orally, telephonically, by webcast, by broadcast, or by similar means, then the requirements under Regulation G would be satisfied if:
 - The required information (i.e., the presentation and reconciliation) is provided on the company's website at the time the non-GAAP financial measure is made public, and
 - The location of the website is made public in the same presentation in which the non-GAAP financial measure is made public

Additional requirements for certain types of non-GAAP disclosure

- Item 10(e) of Regulation S-K applies to non-GAAP financial measures that are included in SEC filings and requires that the company include in its filing:
 - a presentation, with equal or greater prominence, of the most directly comparable GAAP financial measure
 - a quantitative reconciliation
 - a statement disclosing why the company’s management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the company’s financial condition and results of operations, and
 - to the extent material, a statement disclosing the additional purposes, if any, for which the company’s management uses the non-GAAP financial measure

Regulation FD - It is illegal to selectively disclose material non-public information

- SEC considers “selective disclosure” by public companies to be a form of insider trading

Example: Private investor conference where the company announces good news

- The “little guy” is not invited and misses an opportunity to buy the stock before the price goes up

Example: Guiding analysts privately prior to the company announcing bad news (for example, earnings miss)

- These analysts tell their customers to sell the stock, ahead of the “crash”

- Regulation FD (fair disclosure) was designed to “level the playing field” and protect market integrity/investor confidence

Regulation FD - Summary of the Rule

- If a public company, or person acting on its behalf, discloses material, nonpublic information to certain types of recipients,
- then the company must publicly disclose the information:
 - simultaneously, if disclosure was intentional, or
 - promptly, if disclosure was not intentional

Regulation FD – Intentional vs. Unintentional Disclosures

- A disclosure is "intentional" if the person making it either knows, or is reckless in not knowing, that the information he or she is communicating is both
 - material, and
 - nonpublic
- Intentional disclosures of material, nonpublic information to covered recipients require simultaneous public dissemination
- Where a company unintentionally discloses material, nonpublic information, it must publicly disseminate the information promptly, which means “as soon as reasonably practicable” but in no event after the later of:
 - 24 hours, or
 - the opening of trading on the next business day, ... after a senior official learns of an unintentional violation

Regulation FD - Coverage of Regulation FD

- Regulation FD applies only to certain types of speakers at a public company:
 - “senior officials” of the company
 - directors and executive officers
 - investor and public relations officers
 - other persons with similar functions
 - other persons directed to make disclosure (by senior officials)
 - any other officer, employee or agent of the company who regularly communicates with market professionals (described below) or security holders
- Speakers not covered by Regulation FD:
 - those who make disclosure in violation of their duty to the company
 - persons (other than senior officers) who communicate with market professionals or security holders on occasion, but not regularly (they remain subject to insider trading laws)

Regulation FD - Coverage of Regulation FD (cont'd)

- Regulation FD applies only to certain types of recipients, or listeners (generally shareholders and market professionals):
 - security holders, where the company should foresee that the recipient will buy or sell on the basis of the information
 - brokers, dealers and their associated persons (including sell-side analysts)
 - investment companies, hedge funds and their affiliated persons (including buy-side analysts)
 - investment advisors, institutional investment managers and their associated persons

Regulation FD - Coverage of Regulation FD (cont'd)

- Recipients not covered by Regulation FD:
 - Press and other media, customers, suppliers, regulators, etc.
 - persons owing a duty of trust or confidence to the company, including “temporary insiders,” such as attorneys, investment bankers and accountants
 - persons who have expressly agreed to maintain the confidentiality of the information
 - Can be oral
 - Does not need to include an undertaking not to trade
 - persons receiving information in connection with most registered public offerings (does not include Rule 144A offerings)

Regulation FD - Definition of Materiality

- Regulation FD applies to material, nonpublic information
- Particularly troublesome areas identified by the SEC include
 - one-on-one sessions
 - review of analyst reports
 - reaffirmation or commenting upon previous earning/revenue guidance
 - responding to inquiries about rumors
- However, the SEC declined to provide a “bright line” test or list of material items

Regulation FD - Definition of Materiality (cont'd)

- Instead, the SEC will utilize the tests that have been developed by the courts over the years:
 - substantial likelihood that a reasonable investor would consider the information important in making an investment decision
 - substantial likelihood that the information would have been viewed by a reasonable investor as having significantly altered the total mix of information
 - information that could reasonably be expected to have a substantial effect on the price of the securities

Regulation FD - Definition of Materiality (cont'd)

- The SEC has provided a list of types of information or events that should be reviewed carefully to determine whether they are material:
 - company earnings
 - mergers and acquisitions
 - joint ventures
 - new contracts or customers (or losses)
 - changes in management/control
 - events relating to auditors
 - stock splits, issuances and repurchases
- Form 8-K filing events should also be examined as indicators of “material” information

Regulation FD - Methods of Making Public Disclosure

- Method must be reasonably designed to provide broad, non-exclusionary distribution of information to the public.
- The SEC suggests one or more of the following:
 - press releases distributed through a widely circulated news or wire service
 - filings made with the SEC
 - press conferences or telephonic conferences that members of the public may access (after receiving adequate notice that the conference will be held)
 - other methods that are reasonably designed to provide broad, non-exclusionary distribution of the information to the public
- NYSE requires a press release for material information

Regulation FD - Public disclosure

- Is a mere posting of the information on the company website sufficient?
 - Does a website satisfy the “recognized channel of distribution of information” test?
 - Recent survey said that less than 6% of respondent companies take the position that mere posting is sufficient
 - Google, Microsoft, Expedia and Marathon Oil have all publicly announced that they will publish their earnings releases through their own investor relations website
- Is disclosure through other social media outlets sufficient?
 - Companies must take steps to inform investors about use of Twitter and explain how they use it for disclosure purposes
 - Post Twitter disclosure policy on company’s website
 - Provide note in SEC filings and news releases about use of Twitter, including full URLs for the relevant accounts
 - Provide prominent links to company’s Twitter and other social media accounts on all pages of the company’s IR website
 - Track access to social media posts and compare to regular attendance on mailing lists and conference calls

Regulation FD - Liability Issues

- Policed by the SEC through enforcement actions, which the SEC continues to actively pursue
- No private right of action – may still be liability under Rule 10b-5
- Penalties: cease and desist orders, civil commentary penalties against officers (e.g., \$50,000) and/or company (e.g. \$1 million)
- Where a company official makes an improper disclosure as a result of a mistaken determination of materiality, the SEC has indicated that liability will arise only if “no reasonable person under the circumstances would have made the same determination”

Regulation FD - Liability Issues (cont'd)

- A company's diligence in training its senior officials will be considered in determining whether there has been intentional or reckless misconduct

Regulation FD - Practical Guidance

- The SEC is serious about Regulation FD
 - Best to broadly comply. Attempts to split hairs with the technicalities of the rule could backfire
- What is “material” – market reaction matters
 - SEC assesses materiality in hindsight
 - Conservative approach
 - Avoid determinations about materiality on the fly
 - When in doubt about whether nonpublic information could be material: avoid commenting
 - If market reacts to disclosure that was originally considered immaterial, re-evaluate and consider prompt public disclosure

Regulation FD - Practical Guidance (cont'd)

- Consider including a knowledgeable FD “traffic cop” in all discussions with investors or analysts
- To the extent possible, presentations should be scripted and reviewed in advance
- Prepare all speakers: list of permissible topics and off-limits topics; follow the script; “traffic cop” intervenes if heading in wrong direction
- If a presentation deviates from the script, the presenter should follow-up with a member of the legal department to determine whether any public disclosures need to be made

Regulation FD - Practical Guidance (cont'd)

- Debrief after investor or analyst conferences or meetings to confirm no material, nonpublic information was disclosed
- Consult with counsel
- Any follow-up to a public statement that might be viewed as material should be made publicly, not in one-on-one conversations; use extreme caution with the analyst “follow-up” call
- Don't reaffirm or comment upon previously issued guidance without making a contemporaneous public disclosure of the same information

Regulation FD - Practical Guidance (cont'd)

- Encourage analysts to ask questions during publicly available conference calls rather than in one-on-ones; address “model” issues publicly
- Extreme care in reviewing analyst models:
 - Permissible: make corrections to historical facts; point out previously disclosed information; provide clearly immaterial information (caution)
 - Never comment on projections/forward-looking information
- Keep investor relations and counsel “in the loop”; involve them in the company’s disclosure controls and procedures

Regulation FD - Practical Guidance (cont'd)

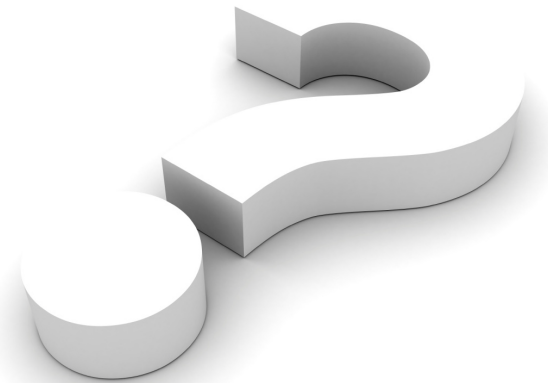
- Following presentations and one-on-one sessions, review updated analyst reports to determine whether internal assessment of information disclosed is consistent with the analyst's assessment
- If a decision is made to respond to a rumor, don't respond privately
- A subset of the disclosure committee should be responsible for following-up on inadvertent disclosure of material non-public information
- Be especially careful when speaking privately with analysts or investors; any indication of earnings/trends can be a problem, including body language/enthusiasm/tone/confidence
 - According to September 27, 2015 WSJ Article, trading volume typically went up around time of private meetings
 - Some companies, such as Morningstar Inc., do not have private meetings

Regulation FD - Practical Guidance (cont'd)

- Public disclosure policy
 - The SEC will consider existence of a formal policy when deciding whether a prohibited disclosure was unintentional or intentional/reckless
 - Policy should limit and define the people who are authorized to speak for the company
 - Policies should be reviewed periodically to determine whether they are working as designed or whether they need to be revised
 - Training and refresher courses should be administered on a periodic basis

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Questions?



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