
INSIDE THE SEC

SEC Action under Regulation FD for Implicit Communications

By Louis Lehot, John Tishler and Molly Lateiner

On October 21, 2010, the Securities and Exchange Commission announced enforcement actions against Office Depot, Inc. and two executive officers for violating Regulation FD by selectively conveying to analysts and institutional investors that Office Depot would not meet analysts' earnings estimates.¹

The Complaint

According to the SEC complaint, Office Depot's CEO and then-CFO were concerned that analyst estimates for the then-current quarter were too high. They considered issuing a press release to provide the company's lower internal guidance, but were concerned because internal estimates were incomplete at that point. Instead, they directed employees to conduct one-on-one calls with analysts designed to cause analysts to revise their estimates downward by referring analysts to recent public statements of comparable companies that cautioned of the slowing economy's impact on earnings. The CFO assisted in preparing the following talking points for the calls:

- Haven't spoken in a while, just want to touch base.
- At beginning of quarter we've talked about a number of head winds that we were facing

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this quarter including a softening economy, especially at small end.

- I think the earnings release we have seen from the likes of [Company A], [Company B], and [Company C] have been interesting.
 - On a sequential basis, [Company A] and [Company B] domestic comps were down substantially over prior quarters.
 - [Company C] mentioned economic conditions as a reason for their slowed growth.
- Some have pointed to better conditions in the second half of the year—however who knows?
- Remind you that economic model contemplates stable economic conditions—that is midteens growth.

Office Depot's director of investor relations notified the CFO that an analyst expressed concern over the lack of a press release and indicated that several of his clients were also surprised. Nonetheless, the CFO instructed the director of investor relations to call Office Depot's top twenty institutional investors and relay the prepared talking points to them, which he did.

Six days after the calls to analysts began, Office Depot filed a Form 8-K publicly disclosing, among other things, that its earnings would be "negatively impacted due to continued soft economic conditions."

Between the first day Office Depot began calling analysts to the last market close before Office Depot filed its 8-K, Office Depot's stock dropped 7.7 percent.

SEC Civil Charges and Settlements

The SEC brought and settled on the same day enforcement actions on the Regulation FD violation and an unrelated financial restatement. Office

Depot agreed to settle the SEC's charges without admitting or denying the findings and allegations, and agreed to pay a \$1 million penalty. The CEO and CFO also agreed to settle the Regulation FD charges against them without admitting or denying the findings, and each agreed to pay a \$50,000 penalty.

Implications

This enforcement action is noteworthy because Office Depot and its CEO and CFO were charged not with *explicit* communication of material, non-public information, but with *implicit* communications designed to lead analysts to a conclusion that matched material, non-public information.

This is the first Regulation FD action involving indirect communications since a U.S. District Court dismissed the SEC's complaint against Siebel Systems, Inc. in 2005.² In the *Siebel Systems* case, the SEC alleged that the CEO of Siebel Systems selectively disclosed material, non-public information at private meetings with analysts when the CEO made statements such as "business activity levels were 'good' or 'better' and that its sales pipeline was 'building.'" Such statements were similar to prior public statements made by the CEO, but had somewhat different wording and context, which the SEC alleged were understood by the listeners to convey material, non-public information. The District Court took issue with the SEC's scrutinizing of the particular words, verb tenses, and syntax of the CEO's statements. The District Court also stated that Regulation FD does not prohibit persons speaking on behalf of an issuer from providing "mere positive

or negative characterizations, or their optimistic or pessimistic subjective general impressions, based upon or drawn from the material information available to the public."

This enforcement action signals that the SEC remains committed to applying Regulation FD to implicit as well as explicit statements. A significant difference between the Office Depot action and the Siebel Systems action is the evidence that Office Depot's executives intended for the selective conversations to communicate material, non-public information. No such evidence appears in the SEC's complaint in the Siebel Systems action.

The Office Depot is the third Regulation FD enforcement action brought since September 2009.³ The action is a reminder that companies need to be vigilant about Regulation FD compliance. Public companies should consider adopting written Regulation FD compliance policies, to update such policies and procedures regularly and to conduct periodic Regulation FD training for executives and company spokespersons.

NOTES

1. See *Securities and Exchange Commission v. Office Depot, Inc.*, Civ. Action No. 9:10-cv-81239 (S.D. Fla. Oct. 21, 2010) available at <http://www.sec.gov/litigation/complaints/2010/comp21703.pdf>.
2. *SEC v. Siebel Sys., Inc.*, No. 04 CV 5130 (GBD) (S.D.N.Y. Sept. 1, 2005).
3. See *SEC v. Christopher A. Black*, Case No. 09-CV-0128 (S.D. Ind.), Lit. Rel. No. 21222 (Sept. 24, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21222.htm>. See *SEC v. Presstek, Inc.*, 1:10-CV-10406 (D. Mass.), Lit. Rel. No. 21443 (Mar. 9, 2010), available at <http://www.sec.gov/litigation/litreleases/2010/lr21443.htm>.



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