

INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

ASPEN PUBLISHERS

Volume 22 Number 3, March 2008

SECURITIES DISCLOSURE

The Earnings Release: Legal Requirements and Best Practices

The number of legal and compliance issues involved in earnings announcements has increased substantially since the enactment of the Sarbanes-Oxley Act. Both quarterly earnings press releases and accompanying conference calls are now subject to a myriad of requirements and best practices.

by **Steven E. Bochner and Richard Cameron Blake**

Increased regulation following the enactment of the Sarbanes-Oxley Act of 2002 has substantially increased the number and complexity of legal issues surrounding quarterly earnings disclosures. These legal issues include required submissions to the Securities and Exchange Commission (SEC), the regulation of disclosure of non-GAAP financial measures, the requirement to establish (and certify as to) disclosure controls and procedures, expanded audit committee involvement, and Regulation FD developments that impact communications with investors and analysts. These

Steven E. Bochner is a member, and Richard Cameron Blake is a senior associate, of Wilson Sonsini Goodrich & Rosati in Palo Alto, CA. The authors thank and acknowledge Eric John Finseth, who co-authored a previous version of this article with Mr. Bochner, that was included in the December 2003 issue of *Insights*, as well as Jose F. Macias, who provided helpful comments.

changes have required public companies to adapt and modify the processes and timelines associated with the traditional earnings announcement.¹

Background

Until several years ago, the quarterly earnings press release and accompanying conference call were not highly regulated activities. Though always subject to general antifraud provisions, these disclosures were not a part of the periodic reporting regime under the Securities Exchange Act of 1934 (Exchange Act) with its detailed regulations governing content and timing. In recent years, however, as a result of governance and disclosure reform, the earnings release process has become the focus of increasing regulation.

Generally speaking, the federal securities statutes and rules do not explicitly require the release of information concerning financial results until the associated SEC periodic report (*i.e.*, Form 10-K or Form 10-Q) becomes due, currently between 40 to 45 days following the end of the fiscal quarter and between 60 to 90 days following the end of the fiscal year, depending on the market capitalization and length of time a company has been subject to Exchange Act reporting rules.² Information concerning financial results is often considered old news by the time these filing deadlines are reached. A combination of market demand for timely information, investor relations considerations, concerns over liability and the listing requirements of The Nasdaq Stock Market

(Nasdaq) and the New York Stock Exchange (NYSE), have prompted issuers to provide information concerning financial results much earlier than actually required under the federal securities laws.³

Earnings Release Triggers Form 8-K

Earnings Release Required to Be Furnished to the SEC

In March 2003, just eight months following the adoption of the Sarbanes-Oxley Act, the earnings release became a regular part of the reporting requirements under the Exchange Act for the first time.⁴ Using Section 409 of the Sarbanes-Oxley Act, which broadly mandates that public companies disclose on a real-time (“rapid and current”) basis such information as the SEC determines is useful or necessary for the protection of investors, the SEC amended Form 8-K to require that public companies that issue earnings releases furnish them to the SEC on a Form 8-K.

Item 2.02 does not require a public company to release earnings in advance of a quarterly or annual report. If such an announcement is made, however, a Form 8-K is triggered. The requirement applies whether the mode of disclosure is oral, such as by conference call or Web cast, or in writing, such as a press release, of material nonpublic information regarding its results of operations or financial condition for a completed quarterly or annual fiscal period.⁵ In other words, until an issuer elects to release financial results, no Form 8-K is required under Item 2.02. Once triggered by the release of financial results (such as, but by no means limited to, the typical quarterly earnings release), the Form 8-K must be furnished to the SEC within four business days.

Generally No Additional Form 8-K for Related Conference Call

Provided the press release is furnished on Form 8-K prior to the related conference call

and/or Web cast, an SEC “safe harbor” in Item 2.02 provides that these oral disclosures generally will not trigger an additional Form 8-K requirement as long as the call is done in a manner that is publicly accessible (as also would be required by Regulation FD) and occurs within 48 hours of the earlier press release.⁶ To satisfy the safe harbor, any additional financial or statistical information that is to be presented orally during the call that was not set forth in the press release also must be posted to the issuer’s Web site prior to the call or the call must be simultaneously Web cast.⁷ During the conference call, the issuer must mention where on its Web site the slide deck may be accessed. Subsequent disclosures concerning historical results that do not meet these requirements would trigger a new Form 8-K, such as the release of material information at an investors conference or shareholder meeting later in the quarter.

Many issuers prepare a written investor presentation “slide deck” that is part of the conference call Web cast that serves as an outline for management’s prepared remarks.⁸ Provided that the safe harbor requirements described above are met, including that the presentation slide deck is provided on the issuer’s Web site prior to the earnings conference call, the issuer need not furnish the slide deck in an additional Form 8-K, even though the slide deck may contain additional information regarding the quarter than was disclosed in the earnings press release.

Form 8-K Is Triggered by Historical Information

Item 2.02 of Form 8-K is triggered by the release of material, nonpublic information concerning a completed fiscal period rather than one in progress or yet to come. Accordingly, a press release or conference call that provides or resets guidance for a future period would not trigger the Item 2.02, unless material, historical information that was not previously disclosed also is provided.

A “preannouncement,” generally denoting an announcement of anticipated financial results in advance of the ordinarily scheduled date for the earnings release, may present a pitfall for the unwary. If a statement concerning anticipated results is made during the course of the fiscal period that it concerns, it would be in the nature of forward-looking guidance and would not trigger the Form 8-K requirement. On the other hand, if a “preannouncement” is made after the end of a completed fiscal period to disclose the anticipated financial results that the issuer expects to be able more definitively announce in the normally scheduled full earnings release (and thus on first reaction might deceptively appear to be forward-looking rather than historical in nature), the information nonetheless relates to a completed fiscal period and the disclosure would therefore trigger the Form 8-K requirement of Item 2.02.

Furnishing versus Filing the Form 8-K

An issue to consider is whether to furnish or file the Form 8-K.⁹ A furnished Form 8-K is publicly available, but is not automatically incorporated by reference into certain Rule 415 continuous offering registration statements that the issuer may have, such as resale registrations on Form S-3. A filed Form 8-K, on the other hand, is subject to automatic incorporation into and consequent potential liability in connection with such registration statements. An issuer may be advised or required to file (rather than furnish) the Form 8-K in order to ensure a registration statement in use does not contain a material omission such as important information concerning the recently completed quarter. Absent such considerations, however, it is better to furnish than to file the Form 8-K insofar as liability under Section 18 of the Exchange Act does not apply to a Form 8-K that is merely furnished. It is nonetheless important to note that the antifraud provisions of Rule 10b-5, which prohibits the making of a material misstatement or omission or the commission of a manipulative act, would apply irrespective of whether the Form 8-K is furnished or filed.

Regulation of Non-GAAP Financial Measures

Regulation G and Item 10(e) of Reg S-K

Any public financial disclosure by a public company that includes a non-GAAP number, be it oral or written, is now subject to the requirement of Regulation G (Reg G) that such non-GAAP number be accompanied by and reconciled to the most closely comparable GAAP number. If the non-GAAP number is set forth in a document filed with the SEC, then the additional requirements and restrictions set forth in Item 10(e) of Regulation S-K apply.¹⁰

Reg G and Item 10(e) were enacted pursuant to Section 401(b) of the Sarbanes-Oxley Act to prevent misleading disclosure using non-GAAP information, such as attempting to mask disappointing financial results by excluding certain charges that would otherwise be required under GAAP. Notwithstanding several high-profile SEC enforcement actions highlighting their misuse,¹¹ non-GAAP disclosures can serve to enhance disclosure and period-to-period comparability when used in a transparent manner. For example, they can provide investors with an understanding of the core operating results of an issuer, which results are often required under GAAP to include various nonoperating charges that might not reoccur. In fact, such an analysis is required in periodic reports and registration statements under Item 303 of Regulation S-K, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” if necessary to an understanding of the company’s financial statements.¹² Consistent with such considerations, Reg G and Item 10(e) regulate, but do not preclude, most non-GAAP disclosures.

Definition of “Non-GAAP Financial Measure”

Reg G and Item 10(e) apply to any “non-GAAP financial measure,” essentially a numerical measure of financial performance, financial position, or cash flows that excludes amounts

that are included (or includes amounts that are excluded) under the most directly comparable GAAP number. Non-GAAP financial measures do not include operating or other statistical¹³ measures (such as unit sales or numbers of employees, subscribers, or advertisers), or ratios or statistical measures calculated using solely (1) GAAP numbers and/or (2) operating or other measures that are not non-GAAP numbers. Unlike Item 2.02 of Form 8-K, Reg G and Item 10(e) apply whether the financial disclosure relates to historical or forward-looking information.

GAAP Comparison and Reconciliation Requirement

The core requirement of both Reg G and Item 10(e) is that the non-GAAP number in question be accompanied by and reconciled to the most closely comparable GAAP number. And even if compared and reconciled to GAAP, both rules prohibit the issuer from making public a non-GAAP number that, taken together with the accompanying information, contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP number not misleading (*i.e.*, a Rule 10b-5 style provision).

Accommodation for Oral Disclosures

Reg G incorporates some practical relief for oral disclosures, recognizing that a verbal reconciliation might be ineffective and confusing on an earnings call. Accordingly, issuers that disclose non-GAAP numbers orally, by conference call or by Web cast, may satisfy the Reg G reconciliation requirements by posting the requisite GAAP information and the reconciliation on the issuer's Web site. However, in order to satisfy this requirement, the posting must have occurred by the time of the presentation, and the location on the Web site must be disclosed during the presentation.

As a practical matter, many of the non-GAAP numbers an issuer might want to present in the

conference call will already have been set forth, and compared and reconciled to GAAP, in the related earnings release. As to such non-GAAP numbers, the issuer typically will satisfy the requirement for oral non-GAAP disclosures by posting the earnings press release on the issuer's Web site prior to the call. However, if the issuer contemplates presenting any other non-GAAP numbers during the call that have not already been compared and reconciled in the press release, then comparison and reconciling information for such additional non-GAAP numbers will need to have been posted on the Web site prior to the call.

Accommodation for Forward-Looking Reconciliations

Reg G also provides relief for certain forward-looking non-GAAP information if the GAAP equivalent information and reconciliation is not available "without unreasonable efforts." For example, this could occur when a company believes it can accurately forecast its core operating results for the quarter, but not the size of a possible restructuring charge. In such a case, the issuer must disclose that fact, provide any reconciling information that is available without unreasonable effort, identify the information that is unavailable, and disclose its probable significance.

Equal or Greater Prominence; the Reasons Why Non-GAAP Numbers Are Used

As mentioned, the requirements of Item 10(e), which go above and beyond those of Reg G, apply to any document filed with the SEC. Even for earnings releases that are furnished on a Form 8-K rather than filed, however, Item 2.02 of Form 8-K requires compliance with Item 10(e)(1)(i).

Item 10(e)(1)(i) requires that the GAAP comparison numbers in an earnings release must be set forth with equal or greater prominence to the non-GAAP numbers. For instance, if an issuer announces GAAP and non-GAAP earnings per

share in its press release, it should report the GAAP earnings per share prior to the non-GAAP earnings per share. The issuer also should avoid highlighting non-GAAP achievements in the title or subtitle to its press release (e.g., “Company Achieves Record Non-GAAP Earnings”).

Further, Item 10(e)(1)(i) requires the issuer to set forth (in addition to the GAAP comparison and reconciling information), either in the earnings release itself or elsewhere in the Form 8-K, the reasons why management believes the non-GAAP numbers provide useful information to investors and, to the extent material, the additional purposes, if any, for which management uses the non-GAAP numbers.¹⁴ In a series of frequently asked questions regarding Reg G, the SEC suggested that such disclosure may be misleading, both in filed documents and in a Form 8-K furnishing an earnings release, if it does not include disclosure regarding:

- “the manner in which management uses the non-GAAP measure to conduct or evaluate its business;
- the economic substance behind management’s decision to use such a measure;
- the material limitations associated with use of the non-GAAP financial measure as compared to the use of the most directly comparable GAAP financial measure;
- the manner in which management compensates for these limitations when using the non-GAAP financial measure; and
- the substantive reasons why management believes the non-GAAP financial measure provides useful information to investors.”¹⁵

Following the release of this FAQ, a number of companies have received comment letters from the SEC requiring them to expand their Item 10(e) disclosure in earnings release Forms 8-K.¹⁶ The SEC also has used the comment letter process to urge companies to stop distributing separate non-GAAP income statements with their earnings press releases.¹⁷

If Filed Rather Than Furnished, Special Prohibitions Apply

Finally, for non-GAAP information in documents filed (as distinct from furnished) with the SEC, Item 10(e) imposes prohibitions on:

- presenting non-GAAP numbers on the face of the financials or accompanying notes;
- using titles or descriptions for non-GAAP numbers that are confusingly similar to those of GAAP numbers;
- excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures (other than “plain vanilla” formulations of EBIT and EBITDA¹⁸);
- adjusting a non-GAAP number to eliminate or smooth items identified as nonrecurring, infrequent, or unusual when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years;¹⁹ and
- presenting non-GAAP numbers on the face of any pro forma information required by Article 11 of Regulation S-X (usually concerning significant acquisitions).

Although these prohibitions are not specifically incorporated by Item 2.02 of Form 8-K for furnished earnings releases, many of them are advisable in any event in order not to fall afoul of the general prohibition in Reg G and Item 10(e) on the misleading use of non-GAAP numbers.

Coming Attractions

- **Subprime-related securities litigation**
- **Navigating debt repurchases**

Forward Looking Statements and the Duty to Update

Issuers often use the quarterly earnings release to provide information on the company's future plans and prospects. Such forward looking statements can take the form of quantitative guidance on projected earnings and other operating results,²⁰ or qualitative statements about the issuer's strategies and initiatives. Since adoption of the Private Securities Litigation Reform Act of 1995, Section 21E of the Exchange Act has provided a safe harbor, with some exceptions, to issuers who comply with specified requirements when making forward looking statements.²¹ Specifically, the forward looking statement must be identified as such and must be accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward looking statement.²² Such information typically is included in a "forward looking statement disclaimer" that is now common place in earnings releases.

Many issuers, however, provide a "one-size-fits-all" forward looking statement disclaimer in their earnings and other press releases. For instance, rather than specifically identifying forward looking statements, they merely indicate that the release contains non-historical statements that are forward looking, which may be identified by words such as "anticipate," "expect," and "may." Rather than specifically identifying meaningful corresponding risk factors, the issuer using a boilerplate disclaimer may just identify general risks that are recycled press release by press release, or may merely refer a reader to the issuer's periodic filings without identifying the risk factors in the press release itself.²³ These approaches are not recommended, as recent case law suggests that specific, rather than general, disclaimer language is important. For instance, in *Asher v. Baxter International, Inc.*,²⁴ the Seventh Circuit held that it may be impossible to determine whether an issuer's cautionary statements in a press release

are "meaningful" at the motion to dismiss stage of litigation. In his opinion, Judge Easterbrook noted disapprovingly that the cautionary language in Baxter's forward looking statement disclaimer in its press releases "remained fixed even as the risks changed." Judge Easterbrook's opinion in *Baxter* emphasizes that non-boilerplate forward looking safe harbor disclaimers are as important as ever.

Issuing forward looking guidance also raises the question whether there is a duty to update the guidance if subsequent events render previous forward looking statements inaccurate as of a subsequent date. Federal courts have struggled with this question and have reached divergent positions.²⁵ An unpublished case in the Ninth Circuit suggests, however, that publicly disclaiming a duty to update in connection with providing forward looking statements can help keep such a statement from remaining "alive."²⁶ Such a disclaimer could be as simple as

The statements in this press release are made as of the date of this press release, even if subsequently made available by [Company] on its Web site or otherwise. [Company] does not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.

Disclosure Controls and Procedures

Applicability to Earnings Releases

Rules adopted in 2002 under the Exchange Act now require issuers to maintain, and their CEOs and CFOs to design, evaluate, and report on the effectiveness of, "disclosure controls and procedures" (DCP), essentially the totality of the issuer's information gathering, processing, and reporting processes designed to ensure the accuracy and timeliness of all information in the reports the issuer either files or submits to the

SEC under the Exchange Act.²⁷ Certifications by the CEO and CFO to such effect are required to be filed as exhibits to the issuer's annual and quarterly reports filed under the Exchange Act and carry with them the risk of personal liability.²⁸ However, because the definition of DCP covers not only reports filed, but all reports submitted, to the SEC, the CEO and CFO are therefore required to design the issuer's DCP in a manner that ensures not only the accuracy of all information in the issuer's Forms 10-Q, Forms 10-K, and other filed reports, but also of the information presented in the issuer's earnings releases furnished on Form 8-K.²⁹ The effect of these rules is to require issuers to change a sometimes ad hoc, poorly documented, and hurried earnings release process to one requiring considerably more care, planning, and deliberation.

Disclosure Committee; Creation of a Process

An important step in dealing with these requirements is for issuers to adopt DCP for earnings releases appropriate for their particular business, and see that such procedures are carefully followed. The SEC has recommended, but not required, that companies form a "disclosure committee." Such a committee would not be a committee of the issuer's board of directors but rather of certain management personnel central to the information gathering, evaluation and reporting process and would report to senior management including the CEO and CFO. The SEC has suggested that the committee could include the controller, the general counsel, or other disclosure counsel, the principal risk management officer, the chief investor relations officer, and possibly representatives of the issuer's business units. Many companies are adopting smaller committees consisting of senior financial, legal, investor relations and business unit personnel. This committee is then tasked with coordinating with other relevant management personnel, and often reporting to the audit committee or certifying officers. Whether or not a formal disclosure committee is formed, processes and procedures

should be created and documented that include the steps to be followed prior to releasing earnings publicly, as is set forth in the "Schedule of Actions for Earnings' Releases"—Exhibit 1.

Role of the Audit Committee

In addition to creating robust and defensible reporting processes involving management, employees, and the disclosure committee, issuers will want to establish an appropriate role for the audit committee in the earnings release process.

Since 2004, Nasdaq Marketplace Rule 4350(d)(1)³⁰ has required that the issuer's audit committee's charter set forth the committee's purpose of overseeing the accounting and financial reporting processes of the issuer as well as the audits of the financial statements. In light of the requirement that earnings releases be furnished on Form 8-K (which is a report to the SEC), and that the issuer maintain DCP which apply to those earnings releases, the audit committee should exercise an oversight role in the earnings release process.

In a similar vein but more explicitly, since 2004, Section 303A(7)(c) of the NYSE's Listed Company Manual³¹ has required that the audit committee's charter address the duties and responsibilities of the committee, which duties must include discussing the issuer's earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies. The commentary to this section clarifies that the responsibility to discuss earnings releases and guidance may be done generally (*i.e.*, discussion of the types of information to be disclosed and the type of presentation to be made), and need not involve advance discussion concerning each earnings release or each instance in which a company may provide earnings guidance. However, in light of the added responsibilities and scrutiny of boards and audit committees brought about by governance

Exhibit 1—Schedule of Actions for Earnings Release

T = date of earnings release

<i>Actions to be Taken</i>	<i>Responsible Party</i>	<i>General Timeline</i>
Prepare and issue press release and/or Web site posting announcing earnings conference call, including date, time and instructions on how to access the call	Company	Before T-7
Company's disclosure committee, together with finance department, collects and analyzes financial data, coordinates input from CEO, CFO, business unit heads, etc., and helps to coordinate preparation of: <ul style="list-style-type: none"> • draft earnings press release, • conference call script, and • related presentations (if any) 	Company	Before T-4
Distribute first draft of press release, script and related presentations (if any) to working group (auditors, legal counsel, Company internal working group)	Company	T-4
Review and provide comments on press release, script and related presentations (if any) including legal review of: <ul style="list-style-type: none"> • Item 2.02 of Form 8-K furnishing (or filing) requirement; • Regulation G and Item 10(e) of Regulation S-K concerning the use of non-GAAP numbers; • statutory safe harbor for forward-looking statements and duty to update disclaimers; • proper public notice under Regulation FD and Item 2.02 of Form 8-K; and • factual backup, general disclosure and Rule 10b-5 matters 	Auditors, legal counsel, Company internal working group	T-3
Distribute draft of Form 8-K to Company; ensure compliance with: <ul style="list-style-type: none"> • Regulation G and Item 10(e) of Regulation S-K concerning the use of non-GAAP numbers; and • all non-Item 2.02 Form 8-K disclosure requirements (if any) 	Legal counsel	T-3
Incorporate comments and redistribute press release, script and related presentations (if any) to working group; review and provide comments on Form 8-K	Company	T-3
Provide final comments on press release, script, related presentations (if any) and Form 8-K; Company finance department confirms/“ticks and ties” all financial information	Auditors, legal counsel, Company internal working group	T-2
Incorporate comments and redistribute revised press release, script, related presentations (if any) and Form 8-K to working group	Company	T-2
Distribute press release to Audit Committee	Company	T-2

<i>Actions to be Taken</i>	<i>Responsible Party</i>	<i>General Timeline</i>
Hold Audit Committee meeting; Audit Committee to review and approve press release and discuss any other material financial information proposed to be discussed on conference call	Audit Committee	T-1
Update press release, script, related presentations (if any) and Form 8-K based on Audit Committee comments	Company	T-1
Distribute final version of press release, script, related presentations (if any) and Form 8-K to working group	Company	T-1
Send press release to wire service; EDGARize Form 8-K and press release	Company/ legal counsel	T-1
Review press release from wire service and printer proof of Form 8-K	Company/ legal counsel	T
Inform Nasdaq or NYSE of press release (at least 10 minutes in advance of release): <ul style="list-style-type: none"> Nasdaq MarketWatch via online service https://www.nasdaq.net/ED/IssuerEntry.aspx NYSE representative via telephone 	Company	T
Issue press release after market closes	Company	T
Post press release and conference call presentations (if any) to Company Web site	Company	T
Furnish Form 8-K with SEC with press release as exhibit after press release is issued and prior to conference call	Company/ legal counsel	T
Hold conference call typically within 48 hours (permitting investors to listen either by telephonic means or through Internet Web casting so as to comply with Regulation FD)	Company	T
Consider insider trading window implications and timing (e.g., providing notice to insiders when the trading window opens and when the trading window will close again)	Company	T
Consider Reg FD implications, <i>i.e.</i> , that the information presented in the press release, earnings conference call and related presentations (if any), are now the benchmark of publicly available information regarding the Company	Company	T
Press release, conference call Web cast and related presentations (if any) maintained on the Company's Web site for at least 12 months following the call (consider moving to historical/archives section of Web site prior to 12 months)	Company	T

reform, an earnings release process that does not include meaningful audit committee involvement may raise questions.

Since the Nasdaq and NYSE rules have been adopted, audit committee participation in the

quarterly earnings release seems to have become regular practice. One informal survey indicated that the audit committees of almost 90 percent of issuers responding to the survey review each quarterly earnings release prior to dissemination. Of that 90 percent of audit committees,

over 93 percent discuss the earnings release at an audit committee meeting. Of the 10 percent of audit committees that responded that they do not review the quarterly earnings release, 71 percent responded that they are made aware of the issues to be discussed in the earnings release in an audit committee meeting, and an additional 7 percent responded that they are made aware of such issues not in a meeting but in writing.³²

Beyond the Nasdaq and NYSE listing standards, a board's oversight responsibility, as described in Chancellor Allen's 1996 *Caremark* opinion, should be considered in the context of a company's DCP, including the earnings release process.³³

Regulation FD Developments

Additional developments concerning the SEC's Regulation FD (Reg FD) impact earnings disclosure practices.

Nasdaq Disclosure Rules and Regulation FD

In late 2002, the SEC approved changes to Nasdaq rules requiring prompt disclosure of material information in order to harmonize such provisions with Reg FD.³⁴ As a result, Nasdaq issuers may disclose material nonpublic information through any Reg FD compliant means, such as a public conference call or Web cast, not just via a press release as was previously the case. This rule change is a positive development for issuers and investors. The rule recognizes the increasingly important role that public conference calls and Web casts play in the disclosure framework. The rule also allows executives to respond to questions during a public conference call or Web cast following the press release, even if the response would divulge material nonpublic information, without fear of violating Nasdaq rules.

By contrast, even eight years after the SEC's adoption of Reg FD and seven years after the

Nasdaq' harmonization of its rules with Reg FD, the NYSE continues to require disclosure of material nonpublic information only through a press release. In recent annual policy reminder letters to listed companies, the NYSE states:

The SEC provides a variety of mechanisms for dissemination of information in compliance with [Reg FD], including press releases, public conference calls, Web casts, and Form 8-K filings. However, for purposes of maintaining a fair and orderly trading market, the Exchange believes that a press release is the single best way for a listed company to ensure the timely and widespread dissemination of material news.³⁵

This policy requires NYSE listed companies to plan ahead with respect to information disclosed on conference calls, and sometimes results in difficult real-time assessments as to whether a particular statement made in a conference call could be viewed as material:

If a listed company plans to make a material announcement on a publicly accessible conference call or Web cast that complies with Reg FD, the Exchange requires disclosure of the matter in a press release issued no later than the start of the conference call or Web cast. If material news is being released during market hours, a listed company also is required to give the Exchange ten minutes prior notice of the press release. This notification requirement permits an evaluation of the importance of the news and its potential impact on the market. If new material information is inadvertently disclosed during a conference call or Web cast, the Exchange requires a listed company to promptly issue a press release regarding the information. If this new information is disclosed during market hours, the listed company must immediately notify the Exchange as to the new disclosure.³⁶

Issuers should be careful in preparing the quarterly earnings release and conference call script to see that all material nonpublic information about the company that management would like to disclose to investors is included and publicly disclosed in the Reg FD compliant setting of the conference call. Moving forward from the earnings conference call, the issuer's management should be cautious providing material information that was not publicly disclosed in the earnings release and conference call as disclosure of such new information may raise Reg FD issues.

SEC Enforcement Activity and Litigation

In the days following an earnings release conference call, or sometimes later in the quarter, an issuer may speak with analysts and investors one-on-one about its quarterly results and future guidance. SEC enforcement actions and litigation under Reg FD underscore the need for issuers to exercise extreme caution in such private communications.

Body language may result in a Reg FD violation: In an action against Schering-Plough and its former chairman and CEO, the SEC alleged that Schering-Plough violated, and its former CEO caused Schering-Plough to violate, Reg FD in a series of private meetings with analysts and portfolio managers.³⁷ "Through a combination of spoken language, tone, emphasis, and demeanor," the former CEO was found to have communicated in these meetings that "street" earnings estimates for the company had not come down far enough, and to have made a number of other specific financial communications that went beyond prior public communications by the company.

Private conferences and one-on-one meetings can be risky: In an action against Siebel Systems in 2002, the SEC found that the company had violated Reg FD when its CEO disclosed material nonpublic information at an invitation-only technology conference.³⁸ At the conference, the CEO made optimistic comments concerning the

company's business returning to normal, which contrasted with negative statements that he had made during a public conference call several weeks earlier. Less than one year later, the SEC filed suit against Siebel in US District Court for further alleged violations of Reg FD and of the SEC's rules regarding DCP. After pre-announcing results for its first fiscal quarter and publicly discussing the company's challenging business environment in early April 2004, the company's CFO and director of investor relations told investor fund managers in one-on-one sessions in late April 2004 that business was better and the sales pipeline was growing. While the court dismissed the case,³⁹ handing the SEC a very visible Reg FD loss, the SEC made clear that its loss in *Siebel II* was not the end of its Reg FD enforcement activity: "We will continue to bring cases.... There are FD investigations going on right now."⁴⁰

"Ballparking" no longer permitted: In an action against Raytheon and its CFO, the SEC found that the company violated Reg FD in one-on-one calls with analysts by the company's CFO.⁴¹ According to the SEC, the CFO told analysts privately that their estimates were "too high," "aggressive," or "very aggressive." The *Raytheon* case highlights the fact that the historical practice of "ballparking" analysts privately is a violation of law. The case also highlights the importance of involving knowledgeable securities counsel in the disclosure process, including activities such as investor conferences and one-on-one meetings or calls.

Resetting guidance may be a Reg FD violation: Finally, the SEC charged Flowserve Corporation, its CEO and director of investor relations with violations of Reg FD when, in a private meeting with analysts near the end of a reporting period, company officials reaffirmed previously given earnings guidance.⁴² In the words of one SEC official, the case emphasizes that "[i]ssuers cannot pick and choose the recipients of material information If issuers disclose material information to market professionals, then Regulation FD

requires that they disseminate the same information to the marketplace.”

Earnings Press Release Checklist

Given the importance of quarterly earnings disclosure, the many people involved in the earnings release and conference call and the myriad legal requirements now affecting such disclosure, maintaining an effective and well communicated process over quarterly earnings disclosure is vital. Furthermore, as discussed above, because earnings reports are submitted to the SEC on Form 8-K, they are subject to the SEC’s DCP requirements, which obligate an issuer to develop processes to see that earnings release information is accurate. Exhibit 1 may be used as a process checklist, to make sure legal requirements are satisfied and to help develop company disclosure controls in this area.

Specifically, when reviewing an issuer’s earnings release and conference call script, counsel should consider the following:

Preparation of Form 8-K: The company or counsel should prepare an Item 2.02 Form 8-K and discuss whether any other recent events at the company trigger additional Form 8-K items. Additionally, counsel should check to see whether the company’s earnings conference call will occur within 48 hours of the earnings release so that the company may avail itself of the safe harbor discussed above.

Reconciliation of non-GAAP numbers: All non-GAAP numbers used in the earnings release, conference call or related presentations must be accompanied by the most closely comparable GAAP numbers and accompanied by a reconciliation of the non-GAAP number to the most closely comparable GAAP number. Most issuers accomplish this by including a non-GAAP to GAAP reconciliation table at the end of the earnings release, clearly following and separate from the GAAP financial tables, if any. Note

that for purposes of the earnings conference call, it is sufficient if the reconciliation of non-GAAP numbers is provided on the issuer’s Web site prior to the call and the location of the Web site is mentioned on the conference call. Care should be taken to confirm that reconciliations are available for all non-GAAP numbers that are not included in the earnings release but are provided in the conference call or related presentation.

Compliance with Reg G and Item 10(e) of Reg S-K in connection with the Form 8-K: As described above, if non-GAAP numbers are provided in the earnings release, the issuer should include, either in the earnings release itself or in the related Form 8-K, the reasons why management believes the non-GAAP numbers provide useful information to investors and, to the extent material, the additional purposes, if any, for which management uses the non-GAAP numbers. This disclosure should be tailored to the issuer’s circumstances.

Forward looking safe harbor compliance: The earnings release, script and related presentation, if any, should specifically identify forward looking statements and include appropriate safe harbor language and tailored (nonboilerplate) risk factors concerning such forward-looking statements in order to satisfy the requirements of Section 21E of the Exchange Act. For example, if the issuer provides earnings guidance for its second fiscal quarter, the release should indicate that it contains forward looking statements, “including earnings guidance for the second fiscal quarter,” and include tailored cautionary language identifying the important factors that could cause actual earnings for the second quarter to differ materially from the guidance.

Duty to update implications: The issuer should consider whether any statements it intends to make may trigger a duty to update (at least in such jurisdictions where such a duty has been recognized) and should disclaim any duty to update the guidance, as described above.

Rule 10b-5 and general disclosure obligations: Counsel should assist issuers in considering whether their earnings release, conference call script and related presentations contain material misstatements or omissions that might be actionable under Rule 10b-5 or whether any statements that have been included could trigger additional disclosure requirements.

Inclusion of conference call information in the press release: The release should specify the date and time for the related publicly accessible conference call to discuss the earnings release, including information as to how to access the call and where on the issuer's Web site the press release and any other related information may be found (such as (i) GAAP comparisons and reconciliations for any non-GAAP numbers to be presented on the call but not found in the press release, (ii) the Web cast of the call, and (iii) if the call is not Web cast, any additional financial and statistical information to be presented during the call but not found in the press release).

Introductory information in the conference call script: At the beginning of the conference call, the safe harbor for forward-looking statements discussed above should be read. In addition, the script should make specific reference to where on the issuer's Web site the press release may be found (along with any additional Web site postings such as (i) GAAP comparisons and reconciliations for any non-GAAP numbers to be presented on the call but not found in the press release, (ii) the Web cast of the call, and (iii) if the call is not Web cast, any additional financial and statistical information to be presented during the call but not found in the press release).

Insider trading window implications: Assuming that company insiders are not aware of other material, nonpublic information regarding the company, such as a pending strategic transaction, the release of financial results will likely trigger the opening of the company's trading window under its insider trading policy. Following the

earnings conference call, the company's insider trading compliance officer should consider notifying company insiders of the exact timing of the start of the trading window, as well as the anticipated timing of the closing of the window. Alternatively, if the trading window is not anticipated to open, despite the announcement of financial results, because of another blackout imposed by the insider trading policy, the company's insider trading compliance officer should notify company insiders of that fact as well.

Conclusion

The number of legal and compliance issues involved in earnings announcements has increased substantially. Counsel should work closely with issuers to see that disclosure controls and procedures are adequate in light of these requirements and that such procedures are followed in the earnings release process.

NOTES

1. See also David Clarke, Paul Sassalos & Kelly Schmitt, "New Disclosure Requirements for Non-GAAP Financial Information," *Insights*, Apr. 2003, at 2. For the sake of brevity, this article does not address the impact of the rules discussed herein on foreign private issuers or investment companies.
2. See General Instruction A of Form 10-Q, General Instruction A(2) of Form 10-K and Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports, Release No. 33-8644 (Dec. 2005). More prompt disclosure of certain material events may be required on a Current Report on Form 8-K independent of the deadlines applicable to "periodic reports" on Form 10-Q and Form 10-K. There also may exist other situations in which an affirmative duty to disclose arises prior to the applicable Form 10-Q or Form 10-K due date. In recent years, the federal Circuit Courts have wrestled with and taken divergent approaches as to whether there may, under certain circumstances, exist a duty to update prior disclosures that, although accurate when made, have since been rendered inaccurate by subsequent events. For discussion of certain Circuit Court cases in this regard, see Steven E. Bochner & Samir Bukhari, "Revisiting the Duty to Update in Light of Regulation FD," *Insights*, Jan. 2002, at 2.
3. Aside from a possibly negative impact on a company's relationship with its investors and the analyst community, delays in the disclosure

of material nonpublic information can increase the risk of trading by company employees in possession of such information prior to disclosure. Such delays also can increase the risk that, prior to disclosure of the material nonpublic information in question, the company's other disclosures may be found to be misleading. As to the listing requirements, Nasdaq Marketplace Rule 4310(c)(16) states: "Except in unusual circumstances, the issuer shall make prompt disclosure to the public through any Regulation FD compliant method . . . of any material information that would reasonably be expected to affect the value of its securities or influence investors' decisions." NYSE Listed Company Manual Section 202.05 states: "A listed company is expected to release quickly to the public any news of information that might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement that the company enters into with the Exchange." Section 202.06(A), "Immediate Release Policy," further states: "The normal method of publication of important corporate data is by means of a press release. . . . Annual and quarterly earnings . . . should be handled on an immediate release basis."

4. Conditions for Use of Non-GAAP Financial Measures, Release No. 33-8176 (Jan. 22, 2003); see also Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Release No. 33-8400 (Mar. 16, 2004) (the Form 8-K Release).

5. The repetition of previously disclosed information would not trigger a Form 8-K requirement. The Form 8-K requirement also does not apply in the case of a disclosure that is made in a Form 10-Q or Form 10-K.

6. The presentation must have been announced by a widely disseminated press release including instructions as to when and how to access the presentation and the location of the information on the issuer's Web site.

7. Although the issuer will typically have posted the relevant press release to its Web site prior to commencement of the analyst call, many times the issuer's script for the call contemplates the disclosure of additional financial and statistical information above and beyond the numbers set forth in the press release, or such information is disclosed during the Q&A portion of the call. In question 24 of its June 13, 2003, Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures (Non-GAAP FAQ), the Division of Corporation Finance indicated that the required additional financial and statistical information must appear on the company's Web site at the time the oral presentation is made, but that a simultaneous Web cast of the oral presentation would be sufficient to meet this requirement. If the issuer has chosen not to conduct such a simultaneous Web cast, and additional financial or statistical information that is not provided in the presentation itself is disclosed unexpectedly in connection with the question and

answer session that was part of the oral presentation, the information may be posted on the Web site promptly after it is disclosed (and the requirements of Regulation FD also must be satisfied). The adopting release suggests that, at a minimum, such posting (of the financial and statistical information or, if a simultaneous Web cast is used to satisfy this requirement, the Web cast) be maintained on the issuer's Web site for at least a 12-month period.

8. See, e.g., Hewlett Packard's "Quarterly Results" link from its Investor Relations Web site, available at <http://lh30261.www3.hp.com/phoenix.zhtml?c=71087&p=irol-reportsOther2008>.

9. See David B.H. Martin & Graham Robinson, "To Be or Not to Be 'Filed'," *Insights*, Sept. 2003, at 16.

10. As to both Reg G and Item 10(e), see the adopting release, Conditions for Use of Non-GAAP Financial Measures, Release No. 33-8176 (Jan. 22, 2003). Neither Reg G nor Item 10(e) apply to non-GAAP financial measures included in disclosure relating to a proposed business combination, the entity resulting therefrom or an entity that is a party thereto, if the disclosure is contained in certain communications that are subject to the SEC's communication rules applicable to business combination transactions. See also David Clarke, Paul Sassalos and Kelly Schmitt, "New Disclosure Requirements for Non-GAAP Financial Information," *Insights*, April 2003.

11. A noted enforcement action by the SEC in this area prior to promulgation of Reg G and Item 10(e) was In the Matter of Trump Hotels & Casino Resorts, Release No. 34-45287 (Jan. 16, 2002).

12. See Regulation S-K Item 303; Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Release No. 33-6835 (May 18, 1989).

13. Although the actual text of Reg G excludes "operating and other financial measures" from the definition of non-GAAP numbers, the textual discussion of Reg G in the promulgating release states that Reg G's definition excludes "operating and other statistical measures," Item 10(e)'s definition likewise excludes "operating and other statistical measures," and the release states that the definitions of non-GAAP financial measure used in Reg G and Item 10(e) are the same [emphasis in each case added]. Presumably this reflects merely a minor oversight in the printed text of Reg G.

14. The requirement for these statements may be satisfied, in the alternative, by including the statements in the issuer's most recently filed Form 10-K (or a more recent filing) and by updating those statements, as necessary, no later than the time the earnings release Form 8-K is furnished.

15. See question 8 of the Non-GAAP FAQ, *supra* n.10.

16. See, e.g., Letter from SEC to Adobe Systems Incorporated dated May 12, 2006 (available at <http://www.sec.gov/Archives/edgar/data/796343/000000000006022693/filename1.txt>).

-
17. See, e.g., Letter from SEC to Cisco Systems, Inc. dated March 7, 2006 (available at <http://www.sec.gov/Archives/edgar/data/858877/000000000000006011389/11389filename1.txt>).
18. See question 14 of the Non-GAAP FAQ, *supra* n.10, regarding measures that are calculated differently than those described as EBIT and EBITDA in the adopting release.
19. See questions 8, 9, and 15 of the Non-GAAP FAQ, *supra* n.10, regarding the elimination or smoothing of recurring items.
20. In recent years the focus on short-term earnings or other financial metric guidance has been increasingly criticized. See, e.g., Breaking the Short-Term Cycle, Proceedings of the CFA Centre for Financial Market Integrity and the Business Roundtable Institute for Corporate Ethics, July 2006; Long-Term Value Creation: Guiding Principles for Corporations and Investors, The Aspen Institute, June 2007; Built to Last: Focusing Corporations on Long-Term Performance, A Statement by the Research and Policy Committee of the Committee for Economic Development, 2007.
- Regardless, a National Investor Relations Institute survey published in July 2007 indicates that over 71 percent of public companies surveyed “provide guidance on quantifiable financial performance measurements (such as earnings per share, annual revenue, etc.),” and that 90 percent of companies providing guidance have no plans to discontinue the practice. See NIRI 2007 Earnings Guidance Practices Survey Results (available at http://www.niri.org/news_media_center/lea070604data.pdf).
21. The safe harbor is set forth in Section 21E(c), and the exclusions to the safe harbor are set forth in Section 21E(b).
22. See Section 21E(c)(1)(A). As drafted, the safe harbor applies whether or not an individual or issuer knew the forward-looking statements were false when made. While this safe harbor also applies to issuers making forward looking statements in oral settings, such as an earnings conference call, Section 21E(c)(2) provides an alternative safe harbor for oral statements.
23. In this regard, the company may place undue reliance on the alternative safe harbor requirements for oral statements in Section 21E(c)(2), which permits reference to risk factors set forth in another document.
24. *Asher v. Baxter Int'l, Inc.*, 377 F.3d 727 (7th Cir. 2004).
25. See *supra* n.2.
26. See *Winnick v. Pac. Gateway Exch., Inc.*, No. 02-16060, 2003 U.S. App. LEXIS 17030 (9th Cir. August 15, 2003); see also *In re Burlington Coat Factory*, 114 F.3d 1410 (3d Cir. 1997). While *Winnick* is unpublished and therefore nonprecedential, its instruction is nonetheless useful.
27. See Certificate of Disclosure in Companies’ Quarterly and Annual Reports, Release No. 33-8124 (Aug. 29, 2002). These are the CEO/CFO certifications mandated by Section 302 of the Sarbanes-Oxley Act.
28. Such liability could include penalties for violating Section 13(a) or 15(d) of the Exchange Act and for violating Rule 10b-5.
29. Although DCP by their definition clearly apply to the reports that an issuer files or submits under the Exchange Act, the adopting release does not explicitly state that furnished (as distinct from filed) documents are considered submissions for such purposes. Likewise, the adopting release for Item 2.02 of Form 8-K speaks of the furnishing requirement, but does not explicitly state that furnished material is considered a submission for purposes of DCP. However, informal conversation with the SEC staff has confirmed that an earnings release furnished on Form 8-K would clearly be viewed by the staff as a submission for purposes of the definition of DCP, and that an issuer’s DCP therefore need to encompass the earnings release process and related Form 8-K submissions.
30. See NASD and NYSE Rulemaking: Relating to Corporate Governance, Release No. 34-48745 (Nov. 4, 2003).
31. See *id.*
32. See http://www.thecorporatecounsel.net/survey/Aug05_total.htm.
33. See, e.g., *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996) (“A director’s obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses.”).
34. Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Issuer Disclosure of Material Information, Release No. 34-46901 (Nov. 25, 2002). See also Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Issuer Disclosure of Material Information, Release No. 34-46288 (July 31, 2002).
35. <http://www.nyse.com/pdfs/2007CorpGovLetterDomesticCompanies.pdf>.
36. *Id.*
37. *In the matter of Schering-Plough Corporation and Richard J. Kogan*, Release 34-48461 (Sept. 9, 2003).
38. *In the Matter of Siebel Systems, Inc.*, Release 34-46896 (Nov. 25, 2002).
39. *SEC v. Siebel Systems, Inc. et al.*, mem. dec. (S.D.N.Y. Aug. 31, 2005); see also David F. Taylor, Stewart M. Landefeld and Brendyn P. Ryan, “The Siebel Decision and Regulation FD,” *Insights* (Nov. 2005).
40. See Nicolas Morgan, “The Rise, Fall (And Return?) of Reg FD,” *Forbes*, Aug. 14, 2007.
41. *In the Matter of Raytheon Company and Franklyn A. Caine*, Release 34-46897 (Nov. 25, 2002); *In the Matter of Flowserve Corporation*, Release 34-51427 (Mar. 24, 2005).
42. After the SEC adopted rules requiring that material, nonpublic information concerning a completed fiscal period be furnished on a
-

Form 8-K, it adopted more widespread rules pursuant to Section 409 of the Sarbanes-Oxley Act that dramatically increased the types of events that trigger the filing of a Form 8-K. See Form 8-K Release, *supra* n.4; *see also* Gary Ivey, Michael Reed, and Beth Macdonald, "SEC Expands and Accelerates Form 8-K Disclosures," *Insights*, May 2004. Sometimes, an issuer will take action in connection with its earnings announcement that will trigger a Form 8-K under another item than Item 2.02; for

instance, its board of directors may approve and announce a restructuring under which material charges will be incurred or that would result in a material impairment such that an Item 2.05 or 2.06 Form 8-K is required, or the board may approve a restatement requiring an Item 4.02 Form 8-K. Issuers and their counsel should review the quarterly earnings release and script to ensure that all required Form 8-K items are disclosed properly.

Copyright © 2011 CCH Incorporated. All Rights Reserved.
Reprinted from *Insights* March 2008, Volume 22, Number 3, pages 2-15,
with permission from Aspen Publishers, a Wolters Kluwer business, New York, NY,
1-800-638-8437, www.aspenpublishers.com.

