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SEC Reminds Insiders to Think About What They Say and How They Act in Private

Recently settled SEC enforcement proceedings against Schering-Plough Corporation and its former chief executive have emphasized the need for public company executives to watch what they say and to think about their demeanors in one-on-one and other non-public meetings. Though the cases do not create new law, they represent the most significant SEC actions to date relating to nonverbal communication that violates Regulation FD. This follows a series of other Regulation FD enforcement actions over the past year that have focused on more explicit statements about material non-public information.

Summary of Regulation FD

In 2000, the Securities and Exchange Commission adopted Regulation FD, or Reg FD, in response to concerns relating to the fairness of ‘selective disclosure’ by public companies of material information. Reg FD changed the way public companies approached communications with broker-dealers, analysts and other members of the investment community by requiring disclosure to the public of any material nonpublic information shared with such market participants. Subject to limited exceptions, the Reg FD rules require simultaneous public disclosure of any intentional selective disclosure of such information and public disclosure of non-intentional selective disclosure before the later of 24 hours or the opening of the next day’s trading.¹ Although several years have passed since the adoption of Reg FD, it has received renewed exposure in recent months.

The Schering-Plough Cases

On September 9, 2003, the SEC announced that it had filed two settled enforcement proceedings charging Schering-Plough Corporation and its chief executive officer, Richard J. Kogan, with violations of Reg FD. The SEC charged that Kogan met privately with analysts and portfolio managers of four institutional investors and “through a combination of spoken language, tone, emphasis and demeanor, Kogan disclosed negative and material nonpublic information” regarding Schering-Plough earnings prospects. Specifically, Kogan stated in one meeting that Schering-Plough was going to take a ‘hard hit’ in earnings in 2003 and in another meeting he stated that 2003 would be a ‘tough’ year with regard to earnings. Immediately after these meetings, two of the analysts downgraded their ratings on Schering-Plough and three portfolio managers heavily sold Schering-Plough stock. Kogan had not prepared scripts for these meetings. Statements made by Kogan in these question and answer meetings materially differed from the information contained in Schering-Plough’s quarterly report and went materially beyond any information contained in Schering-Plough’s public filings. No subsequent public disclosure of Kogan’s statements was ever made.

These facts alone would likely have been enough to find that Kogan committed violations of Reg FD. However, it is important to note that the facts also indicate that: one of the portfolio managers based his decision to downgrade Schering-Plough’s stock, in part, on the “tone and lowered confidence level” he inferred from the meeting; another analyst “inferred a negative tone from the meeting”; and yet another “analyst’s downgrade [of Schering-Plough’s stock] resulted, in part, from Kogan’s ‘downbeat’ demeanor at the meeting.” In finding that Kogan and Schering-Plough violated Reg FD the SEC stated that “Kogan’s statements, *demeanor* and general expressions of concern for Schering-Plough’s prospects

¹ For a more detailed description of Reg FD, please contact Howard Berkenblit at hberkenblit@zag-sw.com to receive a complimentary copy of the August 2000 Sullivan & Worcester LLP client advisory entitled “New SEC Rules to Prohibit ‘Selective Disclosure’.”

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during private meetings amounted to selective disclosure and prompted significant selling off in Schering-Plough stock.” (emphasis added). Commenting on the case, the Associate Director of the SEC’s division of enforcement stated “[p]roviding guidance to a select few through a combination of spoken language, tone, emphasis and demeanor, is precisely the kind of unfair advantage the SEC wants to prevent.”

Compliance Suggestions

In light of the observations of the SEC in the Schering-Plough proceedings, executives should consider the following tips for avoiding violations of Reg FD:

- ***Identify authorized persons and subject matter.*** Clearly identify which individuals are authorized to talk to investors and analysts on behalf of the company. Set clear limits on the scope of communications during private conversations with analysts and other market participants. Appoint a company official to review any proposed disclosures which are in the ‘gray area’ of materiality. Have more than one company representative present during all private meetings to ensure an accurate account in the event material non-public information is inadvertently disclosed.
- ***Review existing company disclosure policies and update if necessary.*** Take the time to re-educate employees as to their responsibilities under Reg FD and related company disclosure policies. Sensitize personnel as to materiality issues, both in general terms and in terms of company-specific issues. Make sure employees know who is authorized to speak on behalf of the company.
- ***Be prepared.*** Prepare a script prior to your meetings and limit question and answer sessions which may lead to non-intentional disclosure of material nonpublic information. Try to anticipate questions and plan appropriate responses. Take the time before engaging in any meeting to know what information is already publicly available. If ambiguities arise as a result of deviating from the script, a press release clearing up the ambiguities should be promptly issued.
- ***Be careful of what you say.*** Always exercise great caution in providing specific comments to analysts and investors. For example, Reg FD could be violated if you expand on public earnings estimates with revealing words such as ‘aggressive’ or quantify a word used publicly such as adding the word ‘significant’ to describe previously reported anticipated losses. Avoid providing comments on analyst reports (aside from correcting factual errors), particularly as to the accuracy of their earnings estimates.
- ***Be careful of how you communicate.*** Tone, emphasis and demeanor can lead to inferences of material nonpublic information. If you are not feeling well, alert your audience to that fact in advance of the meeting so that fatigue or illness is not mistaken for a ‘downbeat’ demeanor. Nonverbal expressions that serve as indicators of differences from public statements should be avoided. Be aware of how you are coming across to your audience and try not to react without thinking carefully before you speak or make an expression.
- ***Impose analyst blackout periods.*** Towards the end of each quarter, discussions with analysts become more risky and the chance of management to give an inadvertent signal as to how the quarter is progressing increases.

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While Richard Kogan’s verbal statements alone probably would have constituted violations of Reg FD, the SEC’s discussion of Kogan’s tone, emphasis and demeanor indicates that the SEC is looking beyond statements and into body language and other non-verbal communication when assessing Reg FD violations. In finding Kogan violated Reg FD, the SEC cited one of its other recent actions, noting that “[i]ssuers may not evade the public disclosure requirements of Regulation FD by using ‘code’ words or ‘winks and nods’ to convey material nonpublic information during private conversations.” The

Schering Plough and Kogan proceedings emphasize the importance of being well prepared for any meetings with market participants and highly aware of what you say, as well as how you say it.

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