Monday, May 16
3:30–5:00 pm

402 Was It Legal? A Case Study of Corporate Governance Practices

New Manager Track

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ACC Corporate Counsel University

Program 402: Was It Legal?

A Case Study of Corporate Governance Practices.

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The Emerging Duty of Good Faith:

Delaware "Ups the Ante" For Director Liability

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Functions of the Board of Directors

Decision-making

- Authorize actions not in ordinary course of business, such as major or unusual corporate events
- Provide advice and counsel to management
- Set strategic direction

Oversight

- Monitor performance of management
- Review and monitor financial reporting and adequacy of controls
- Establish information gathering and reporting system to bring appropriate information to the Board's attention

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What Do Director's Really Do?

- Studies show Directors give most priority to
  - Corporate strategy
  - Monitoring CEO
  - Monitoring succession planning
  - Monitoring integrity of operations and financial reporting
  - Counseling management
  - Compensation
- Directors tend to be responsive
- Following Enron and Sarbox, emphasis on proactive monitoring, technical compliance and financial reporting

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Duties of Board Members

- Board Members have “Fiduciary Duties” to the company and shareholders
- Multiple parts to these duties
  - Duty of Due Care
    - Prudent man standard
    - Monitoring function (Caremark duties)
  - Duty of Loyalty
    - Duty of candor
    - Avoidance of conflicts
    - Avoidance of self-dealing
    - Corporate opportunity doctrine
  - Emerging Duty of Good Faith

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Duty of Care

- The duty of care requires a director to use due care in making decisions and in performing oversight responsibilities.
- “Due care” is that level of care a prudent person would take in making the decision.

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Requirements of the Duty of Care

- As to decisions, review and consider all pertinent information reasonably available
- As to oversight, ensure information gathering and reporting system is in place designed to bring appropriate information to the Board's attention
- Duty to "Do Something" – Disney/Ovitz Case

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Complying with the Duty of Care

- Attend, prepare for and participate in meetings
- Be adequately informed and prepared
- As sufficient questions; seek documentation
- Corporate Compliance Program

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Reliance on Committees, Management and Experts

- Generally entitled to rely on management or duly authorized committees, within their areas of competence, so long as there is no reason to believe reliance is unwarranted
- Del. Code § 141(e). Generally entitled to rely on advisors (counsel, accountants, investment banks), within their areas of professional expertise and so long as there is no reason to believe reliance is unwarranted
- Continuing oversight – remain informed as to progress
- Duty to inquire of any "red flags"

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Duty of Loyalty

The duty of loyalty requires a director to act in good faith and in a manner reasonably believed to be in the best interests of the corporation, regardless of the interests of the director or a related person or entity.

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When Does Duty of Loyalty Arise?

- Conflict of interest transactions
- Usurpation of corporate opportunity
- Competition with the corporation

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Complying with the Duty of Loyalty

- Exercise power in the interest of the corporation rather than in own personal interest or interest of others
- Make business opportunities available to the corporation
- Avoid competing with the corporation with Disclosure and Consent
- Properly deal with conflict of interest transactions

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Emerging Duty of Good Faith

The emerging duty of good faith focuses on whether a director's actions are so inconsistent with proper behavior that the director could not have been acting in good faith.

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Is the Duty of Good Faith Masquerading as a "Gross Negligence" Standard?

- "Conscious Disregard for Known Risks"
- "Sustained and Systemic Failure to Exercise Oversight"
- "Consciously Not Devoting Attention to Duties"
- "Knowing or Deliberate Indifference by a Director to His or Her Duty to Act Faithfully and With Appropriate Care . . ."

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Examples:

- Abbott Laboratories Derivative Litigation
- Disney (Ovitz) Derivative Litigation
- Levco Alternative Fund
  vs.
  Readers Digest Association

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Effect of a Breach of the Duty of Good Faith

- Business judgment rule may be unavailable
- Circumvents charter exculpation provisions
- Indemnity under charter, indemnity agreements and/or D&O insurance may be unavailable
- Spectre of personal liability
- "Upping the Ante" from Smith v. VanGorkum where similar "neglect" was found to be an indemnifiable breach of duty of care.

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Indemnification of Directors

- Most state laws permit corporation to indemnify Directors (and Officers); some actually require
- Most companies indemnify Directors in order to attract qualified Directors
- Four levels of corporate indemnity:
  - Statutory
  - Bylaws
  - Indemnity Agreements
  - D&O Insurance

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Delaware Statutory Indemnification

Delaware corporation law permits a corporation to indemnify its directors and officers against liabilities incurred if the directors or officers (i) acted in good faith and (ii) in a manner reasonably believed to be or not opposed to the best interests of the corporation or if approved by shareholders, except for deliberate dishonesty, fraud or willful misconduct.

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Exculpation

- Delaware statutory or charter provisions which eliminate or limit liability for monetary damages
- These limitations apply only to liabilities to the corporation and its shareholders
- These limitations do not apply to liabilities to third parties

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Exceptions

- Breach of duty of loyalty
- Intentional misconduct or violation of law
- Acts or omissions that are not made in good faith or that result in personal benefit to the director
- Unlawful dividends

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The Status of Business Judgment Rule:

SOX Requirements for Company Officers and Board to have Effective Internal Controls on Data

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Business Judgment Rule --- Seminal Case

- **Smith v. Van Gorkem, 488 A.2d 858 (Del., 1985)**
  - Delaware court held that for a corporation to gain protection of the business judgment rule, the Board must be fully informed before making a decision.
  - First pro-shareholder decision in Delaware court, and the case defines due care: the board has a duty to be informed.
  - In the class action lawsuit, shareholders of Trans Union sought a rescission of a cash-out merger or, in the alternative, relief in the form of damages.
  - Van Gorkem, CEO of Trans Union and ready to retire, was offered $55/share (stock was trading at $37) in a cash-out merger. $55 was a low-ball offer and the Board did not negotiate a higher price, and based their decision to accept the $55/share offer on one person's representations, without consulting the CFO or an investment banker.
  - The court held that the Board of Directors did not reach an informed business judgment in voting to sell the company for $55 per share (they should have had an Investment Banker on the Board).

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Business Judgment Rule

Insulates a Corporation's Director's against liability for their Board Decisions

- IF they behave reasonably and exercise appropriate judgment.
  - Presumption of protection if three factors are met:
    1) Acted in Good Faith
    2) Had Sufficient Information
    3) Reasonable Belief Decision is in the best interests of the company and no fraud, bad faith or self-dealing has occurred
- IF Presumption is not available, Directors must prove actions were fair

Not available if the Director breaches the Duty of Loyalty or Duty of Due Care

- IF Directors "did their homework", acted sensibly and honestly, they are relieved of liability for decisions that have bad consequences

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Business Judgment Rule

However:

What if Board fails to create independent directors or to establish audit or finance committees?

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Business Judgment Rule: M&A Transaction

Unocal v. Mesa Petroleum

- Directors who adopt defensive measures against a takeover, must have acted on a reasonable belief that a takeover threatened corporate policy and effectiveness. The measures must be reasonable in the context of the threat and made on complete information – not hasty.
- Directors have a fiduciary duty to auction a company in a way that results in the greatest possible value to shareholders.
- Standard is heightened in M&A transactions is heightened because Directors are making decisions where they may have a significant stake (stock options, officers, jobs etc…)
- Result: Establishment of a separate M&A team or committee made up of independent directors or outside consultants to explore M&A offers can help insulate directors from a claim of self-dealing.

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Business Judgment: Recent Case Law

Shaev v. Claflin, No. S126648 (Cal. Sept 29, 2004)

- California Supreme Court refused to review ruling that directors of 3Com are protected by the business judgment rule even if some benefit flowed to the directors.
- Involved the board's decision to adjust stock option plans, which the court ruled was done pursuant to an adjustment clause in the 3Com option plans and could be attributed to a rational business purpose.

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Business Judgment: Recent Case Law

Metricom v. Derrickson, 2004 WL 2151336 (N.D.Cal. Feb. 25, 2004)

- Creditor's alleged directors of bankrupt corporation, Metricom, were inappropriately influenced by a controlling shareholder whose interests were adverse to the interests of the creditors.
- Plaintiffs argue directors breached fiduciary duty to creditors by carrying on business when company should have conserved cash to pay its debts.
- "It is undisputed that Plaintiffs have not pleaded facts suggesting that the outside directors were interested."
- Also, Plaintiffs could not prove a breach of fiduciary duty.
- "To rebut the presumption of the business-judgment rule, a shareholder plaintiff assumes the burden of providing evidence that the board of directors, in reaching its challenged decision, breached any one of its triad of fiduciary duties: good faith, loyalty, or due care."

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Business Judgment: Recent Case Law

Walt Disney Co. Derivative Litigation:

- Shareholder suit in Delaware Chancery Court accusing Walt Disney Co.'s board of "rubber-stamping" a $140 million compensation package for Michael Ovitz (hired and fired as President of Disney.)
- The case has great implications, potentially holding directors personally liable for approving extravagant executive compensation packages.
- The judge will be faced with the issues of whether:
  - Ovitz could have been terminated for cause (w/out paying $140 million),
  - the board's decision to terminate Ovitz was protected by the business judgment rule, and
  - if not, whether the directors are individually liable

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Business Judgment: Recent Case Law

In re Freeport McMoran Sulphur S'holder Litigation:

- Delaware's high court found that a two-person independent committee does not overcome the fact that a majority of the board of directors – the real decision makers – was conflicted (case has been remanded).
- The high court ruled that if the special committee did not have any power in the merger decision, then the board is not protected by the business judgment rule.
- In the case, shareholders are:
  - Challenging a merger that they believe undervalued the company
  - Arguing directors aided the breach
- The directors moved for protection from the business-judgment rule arguing the merger was recommended by a Freeport special committee of independent directors, approved by both boards and ratified by a majority of the shareholders of both corporations.

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Business Judgment: Recent Case Law

Dux Capital Management v. Chen, 2004 WL 1936309 (N.D.Cal.)

- Directors breached fiduciary duty to corporation and minority shareholders by rushing into bankruptcy without considering other options, without relying on professional judgment of accountant and bankruptcy attorney, and acting with improper motive or conflict of interest.
- "Where there is even an inference of improper motives or a conflict of interest such as evidence of personal interest in the corporation, the director's decision is not entitled to the presumption of the business-judgment rule. The business-judgment rule also does not apply where the board action dilutes the shareholder's voting rights as to prevent shareholders from effectively exercising their right to vote contrary to the will of the incumbent board."
- "The business judgment rule does not shield actions taken without any reasonable inquiry, with improper motives, or as a result of conflict of interest"

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Business Judgment: Recent Case Law

In re Emerging Communications Inc. Shareholders Litigation, 2004 WL 1043794 (June 2004):

- Two directors and a controlling shareholder held personally liable to minority stockholders.
- The judgment awarded minority stockholders more than three times what they were offered for shares when the majority stockholder took the corporation private.
- 8 Del.C. § 102(b)(7) allows a corporation to excuse its directors from personal liability for breaches of only their fidicuciary duties of due care, but not of their duties of loyalty and/or good faith. Citation: 20 No. 5 ANDCLUAE 1 (2004).

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Board's Must Keep Up With Requirements of Changing Corporate Laws

- Congress enacted the **Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley")** to protect investors by combating corporate crime and improving corporate governance.
- Sarbanes-Oxley requires companies to implement extensive corporate governance policies to prevent and respond to fraudulent activity within the company, including vigilant self-policing to deter and quickly investigate and contain internal financial fraud.
- Sarbanes-Oxley expressly requires publicly traded companies to create anonymous hotlines for the reporting of fraud, to investigate those instances of fraud, and certify that they have disclosed any instances of fraud involving management and other key employees to the Board of Directors.

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Board's Must Keep Up With Requirements of Changing Corporate Laws

- "The bill sets significantly higher standards for corporate responsibility governance. . . . There are also extensive criminal penalties contained in this legislation . . . These provisions, among other things, require the CEOs and CFOs to certify their company's financial statements under penalty of potentially severe punishments."
  *--Senator Sarbanes, 148 Cong. Rec. S7350-04, at *S7351.*
- One of the central themes underlying Sarbanes-Oxley is that public companies need to institute and maintain adequate internal controls to prevent and timely detect fraudulent activities.
- Another galvanizing factor was the rampant destruction of computer evidence that occurred in the Arthur Andersen/Enron case. The Arthur Andersen indictment alleges that "an unparalleled initiative was undertaken to . . . delete computer files"

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SOX Requires "Internal Controls" To Prevent and Detect Fraud

- Section 404 of Sarbanes-Oxley requires companies to institute effective "internal controls."
  - Encompasses more than mere accounting practices
  - The SEC noted that "internal control is a broad concept that extends beyond the accounting functions of a company."
- Under the SEC's rules, the internal controls process must include policies and procedures that:
  - Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the [company's] assets that could have a material effect on the financial statements.
  - Section 302 specifically identifies internal fraud as an event that would require disclosure by senior management. Put simply, an adequate internal control structure must include "controls related to the prevention, identification and detection of fraud."

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SOX Requires "Internal Controls" To Prevent and Detect Fraud

- Insider trading and other internal financial fraud, theft of intellectual property and large-scale misappropriation of customer information are incidents that would require disclosure.
- In order for a CEO or CFO to properly attest that proper internal controls are in place, the executive must certify under 302 that he or she has disclosed "any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls."
- In addition to these 302 requirements, Sarbanes-Oxley places increased responsibility on senior management and the Board of Directors for any misstatements in a company's SEC filings.
  - The board and senior management may be potentially liable for failing to disclose incidents of internal fraud, such as intellectual property theft or misappropriation of customer information.

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SOX – Board Role In Whistleblower Complaints

- Sarbanes-Oxley directly involves the Board of Directors in setting policy for the handling of whistleblower complaints.
  - Section 301 of Sarbanes-Oxley requires the Board's audit committee to "establish procedures for
    - (A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and
    - (B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters."
- Sarbanes-Oxley squarely places the responsibility for the proper treatment of whistleblower complaints at the highest levels of each public company.

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SOX – Board Role In Whistleblower Complaints

- SEC recently issued regulations proving that any public company that fails to comply with section 301 would be subject to severe penalties, including de-listing.
- Provisions of Sarbanes-Oxley make it essential that companies have the ability to respond to allegations of fraud.
  - Sarbanes-Oxley's requirements "are causing many public companies to hire investigators, including computer forensic experts, far more regularly to review allegations of wrongdoing or indications of potential fraudulent activity detected by internal company control structures. Just detecting possible instances of internal fraud is not enough in today's environment; those instances must be properly investigated and addressed."
    -- Greg Schaffer, Director of Cybercrime Prevention and Response for PriceWaterhouseCoopers

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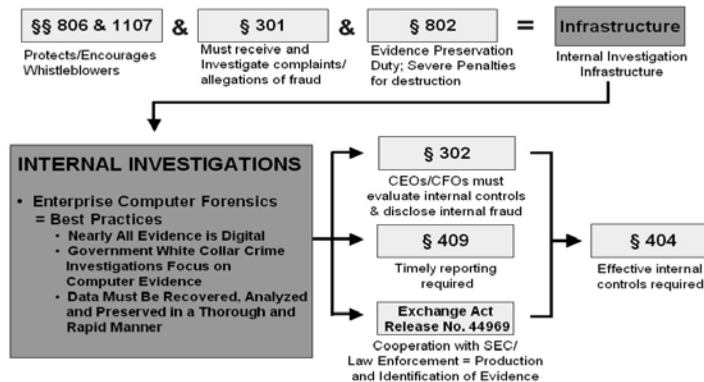
SOX – Board Must Ensure Of Effective Document Retention Capabilities



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SOX Penalties

- Sarbanes-Oxley reserves the most severe sanctions for those guilty of destroying records, including electronic data.
  - Under Section 802 of Sarbanes-Oxley, fines of up to $5 million and imprisonment of up to twenty years can be imposed upon "[w]hoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence" any government investigation or official proceeding.
  - Given the genesis of Sarbanes-Oxley in the Enron/Andersen fiasco, it is not surprising that evidence destruction now carries heavy penalties.
  - US Department of Justice has made it clear that companies that arguably benefit from the illegal conduct of a corporate manager or officer in such a context, even if not directly authorized or sanctioned, would potentially also be held liable for such criminal conduct.

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SEC Recommends A Company become "Self Policing" and "Self Reporting"

- Effective self-policing and cooperation with law enforcement could reduce or even eliminate a corporation's liability for violation of the federal securities laws.
  - SEC's investigation into Seaboard Corporation found that the controller of one of Seaboard's divisions had caused books and records to overstate assets and understate expenses, and had actively concealed such misstatements.
  - Although the SEC ordered relief against the controller, it took no enforcement action against Seaboard, due to the company's prompt and thorough response to the incident, as well as its cooperation with the SEC.
  - The SEC noted that the public at large benefits when "businesses seek out, self-report and rectify illegal conduct."

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SEC Recommends A Company become "Self Policing" and "Self Reporting"

- The SEC, in deciding "whether, and how much, to credit self-policing, self-reporting, remediation and cooperation," established four broad measures for it to assess:
  - Self-policing prior to the discovery of the misconduct . . .
  - Self-reporting of misconduct when it is discovered, including conducting a thorough review of the nature, extent, origins and consequences of the misconduct . . .
  - Remediation . . . modifying and improving internal controls . . .
  - Cooperation with law enforcement authorities, including providing the [SEC] staff with all information relevant to the underlying violations . . .

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SEC Recommends A Company become "Self Policing" and "Self Reporting"

- To cooperate effectively with the SEC and law enforcement, a company must be able to "identify . . . evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law."
  - A network-enabled computer forensic capability enables a company to capture, preserve, analyze and turn over to investigators all of the available digital evidence relevant to an investigation.
  - As a result, this capability enables self-policing, self-reporting, and effective cooperation with law enforcement, thereby strongly supporting a company facing an SEC investigation.

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How Does a Board become Self Policing and Self Reporting?

- Obtain the ability to forensically protect, monitor, collect and examine its electronic data, across the corporate network.
  - Pro-Actively scan your network for bugs, viruses, keywords (e.g. sensitive IP names, pornography, financial exchanges).
  - This ability might have saved Boeing the embarrassment it recently had with its CEO and a female worker.
- Run “fire-drill” mock litigation holds for a certain type of legal claim (i.e. you receive notice of a coming shareholder derivative suit and are asked to preserve all evidence).
- Create A Qualified Legal Compliance Committee --- an optional committee under SOX 307, whose function is to investigate allegations of wrongdoing reported to it and suggest remedies.
  - This is an alternative to the in-house lawyer’s obligation to “report up the ladder of management or resign”.
  - Shifts the responsibility to an independent investigatory team and relieves the lawyer of the burden.

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Disclosure In Corporate Governance--

Duties, Obligations and Requirements for Disclosure

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Overview of Disclosure

- The Rules: SEA Section 13(a), Rule 13a-15, and Regulation FD
- Was it legal? Three case studies
- Best Practices – a few recommendations

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Rule 13a-15

- Every issuer of securities registered under SEA section 12 must maintain disclosure controls and procedures
- Means – controls & procedures designed:
  - To ensure that information required to be disclosed by the issuer in its reports is recorded, processed, summarized and reported, within the time periods specified in the rules and forms.
  - To ensure that information required to be disclosed in its reports is accumulated and communicated to the issuer's management, including its principle executive and financial officers, to allow timely decisions regarding required disclosures.

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Regulation FD

- Regulation FD – prohibits issuers from selectively disclosing material, nonpublic information to certain persons – securities analysts, investment advisors, institutional investors, and a security holder under circumstances in which it is reasonably foreseeable that the person will buy or sell securities on the basis of such information
- When to publicly disclose: Simultaneously if the disclosure is INTENTIONAL, and PROMPTLY if the disclosure in NON-INTENTIONAL
  - What is "PROMPTLY" – As soon as practicable but not more than 24 hours or the beginning of the next days trading on the exchange after a SENIOR OFFICAL learns there has been a non-intentional disclosure
    - SENIOR OFFICIAL – means any director, executive officer, investor relations or public relations officer, or the like
  - What is "INTENTIONAL" – when the person knows, or is reckless in not knowing, that the information is material and non-public.

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Materiality

- Materiality – Reg FD doesn't define it.
- Material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or if the information would significantly alter the total mix of available information. Basic, Inc. v. Levinson, 485 U.S. 224 (1988)
- The SEC has the advantage of 20/20 hindsight

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Was It Legal? – Case Studies

The questions:

- Was the disclosure selective?
- Was the information nonpublic?
- Was the information material?
- Was the disclosure intentional or non-intentional?
- Was timely public disclosure made?

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Hypothetical #1

- Was it selective?
  - Made to analysts without webcast, press release, 8-K or other concurrent broadcast.
- Was it non-public?
  - Information is nonpublic if it has not been disseminated in a manner making it available to investors generally.
  - Sounds like general observations about the economy, not specific comments about the Company's sales pipeline, revenue and profit prospects; BUT, the news did contrast with similar observations made in the Q3 earnings call, AND the more up-beat information was BASED on the CEO's knowledge of actual sales trend / pipeline information.

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Hypothetical #1

- Was it material?
  - Material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or if the information would significantly alter the total mix of the available information.
  - The SEC always has the advantage of hindsight when determining materiality.
  - The Company's stock was at $17.30 before the disclosure. The stock had risen to over $20 per share within hours after the disclosure; trading volume was about double the normal volume; several investors present at the conference either traded or sent messages to others who traded shares.

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Hypothetical #1

- Was it intentional or unintentional?
  - Disclosure is intentional if the person making the disclosure knows, or is reckless in not knowing, that the information being communicated is both material and nonpublic.
  - The CEO didn't know the conference was not being webcast, but the IR Director knew but failed to tell the CEO. Thus, the Company knew, thereby amounting to an intentional disclosure.
  - In the adopting release the SEC observed that "in the case of a selective disclosure attributable to a mistaken determination of materiality, liability will arise only if no reasonable person under the circumstances would have made the same determination."
- Was timely disclosure made?
  - Intentional selective disclosure requires simultaneous publication.

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Hypothetical #1

- The SEC found that the CEO's statements were based on material, nonpublic information and knew or was reckless in not knowing (amounting to intentionally) that it was selectively disclosing material, nonpublic information at the technology conference.
- A $250,000 civil penalty against the company and a cease and desist order.

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Hypothetical #2

- Was it selective?
  - The meetings were private audiences.
  - Adopting release: Issuers may not evade the public disclosure requirements of Regulation FD by using "code" words or "winks or nods" to convey material nonpublic information during private conversations.
- Was it non-public?
  - The statement about there being a hard hit to earnings contrasted with the Company's earlier, public disclosures because it conveyed a definitive rather than a contingent outcome.
  - The comment about the CEO not favoring a buy back also contrasted with the Company's earlier statements that indicated a stock buy-back was a possibility but no decision either way had been made.
  - Body language, demeanor and mood conveyed negative messages that were inferred by the recipients of the messages and affected their decisions.

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Hypothetical #2

- Was it material?
  - Market reaction: from October 1 through October 3 before the press release the stock fell 17% from about $21.32 to $17.64, and average daily trading volume was up to 4 times the norm; and many of the meeting participants traded.
- Was it intentional or unintentional?
  - Intentional means when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic. Not clear whether the disclosure is unintentional.

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Hypothetical #2

- Was timely disclosure made?
  - If non-intentional, then disclosure must be made as soon as reasonably practicable but in no event after the later of 24 hours or the commencement of the next day's trading on the NYSE. The meetings were held September 30, and October 1 & 2.
  - In response to market activity, the Company issued a press release on October 3 providing guidance for the remainder of 2002 and 2003. So even in non-intentional, the disclosure was not timely.

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Hypothetical #2

- The SEC found that through a combination of spoken language, tone, emphasis, and demeanor the CEO selectively disclosed negative and material, nonpublic information regarding the Company's earnings prospects.
- The Company and the CEO signed cease and desist agreements and the CEO paid a $50,000 civil penalty.

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Hypothetical #3

- Was it selective?
  - Private event for security analysts.
- Was it nonpublic?
  - The Company had already publicly announced the guidance; what was the new information? The reaffirmation of the prior guidance is itself new information.
- Was it material?
  - Within 2 days the Company's stock had risen 6% with the largest spread being 9%, and trading volume was up 75%.

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Hypothetical #3

- Was it intentional or unintentional?
  - The Company had disclosure guidelines that provided specific responses to certain questions – If asked about "comfort" with prior guidance the required response was "although business conditions are subject to change, in accordance with Company policy, the current earnings guidance was effective at the date given and is not being updated until the Company publicly announces updated guidance."
- Was timely disclosure made?
  - After the market closed on November 21 the Company filed an 8K affirming the prior guidance. Too little, too late.

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Hypothetical #3

- The SEC found that by reaffirming prior guidance the Company and its CEO intentionally and selectively disclosed material, nonpublic information to securities professionals.
- The Company and the CEO signed cease and desist agreements and the Company paid a $350,000 fine and the CEO paid a $50,000 fine.

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A Few Best Practices

- Disclosure Committee
- Charter
- Disclosure Guidelines
- Membership
- Meetings
- Plan for, and train executives how to respond to FAQ's, in situations where a possibility for selective disclosure exists
- Analyst conferences, meetings with analysts and investors
- Others

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CODE OF FEDERAL REGULATIONS

TITLE 17--COMMODITY AND SECURITIES EXCHANGES

CHAPTER II--SECURITIES AND EXCHANGE COMMISSION

PART 240--GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

SUBPART A--RULES AND REGULATIONS UNDER THE SECURITIES EXCHANGE ACT OF 1934

REGULATION 13A: REPORTS OF ISSUERS OF SECURITIES REGISTERED PURSUANT TO SECTION 12

OTHER REPORTS

Current through April 27, 2005; 70 FR 21920

§ 240.13a-15 Controls and procedures.

<For compliance date(s) of amendments to section, see 68 FR 36636; 69 FR 9722; 70 FR 1506; 70 FR 11528.**>**

(a) Every issuer that has a class of securities registered pursuant to section 12 of the Act (15 U.S.C. 78l) their than an Asset-Backed Issuer (as defined in § 229.1101 of this chapter), a small business investment company registered on Form N-5 (§ § 239.24 and 274.5 of this chapter), or a unit investment trust as defined by section 4(2) of the Investment Company Act of 1940 (15 U.S.C. 80a-4(2)) maintain disclosure controls and procedures (as defined in paragraph (e) of this section) and internal control over financial reporting (as defined in paragraph (f) of this section).

(b) Each such issuer's management must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, the effectiveness of the issuer's disclosure controls and procedures, as of the end of each fiscal quarter, except that management must perform this evaluation:

(1) In the case of a foreign private issuer (as defined in § 240.3b-4) as of the end of each fiscal year; and

(2) In the case of an investment company registered under section 8 of the Investment Company Act of 1940(15 U.S.C. 80a-8), within the 90-day period prior to the filing date of each report requiring certification under § 270.30a-2 of this chapter.

(c) The management of each such issuer, other than an investment company registered under section 8 of the Investment Company Act of 1940, must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, the effectiveness, as of the end of each fiscal year, of the issuer's internal control over financial reporting. The framework on which management's evaluation of the issuer's internal control over financial reporting is based must be a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment.

(d) The management of each such issuer, other than an investment company registered under section 8 of the Investment Company Act of 1940, must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, any change in the issuer's internal control over financial reporting, that occurred during each of the issuer's fiscal quarters, or fiscal year in the case of a foreign private issuer, that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

(e) For purposes of this section, the term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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(f) The term internal control over financial reporting is defined as a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the financial statements.

17 C. F. R. § 240.13a-15

17 CFR § 240.13a-15

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CODE OF FEDERAL REGULATIONS
TITLE 17--COMMODITY AND SECURITIES EXCHANGES
CHAPTER II--SECURITIES AND EXCHANGE COMMISSION
PART 243--REGULATION FD

Current through April 27, 2005; 70 FR 21920

Authority: 15 U.S.C. 78c, 78i, 78j, 78m, 78o, 78w, 78mm, and 80a-29

§ 243.100 General rule regarding selective disclosure. (17 C. F. R. § 243.100)

(a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in § 243.101(e):

(1) Simultaneously, in the case of an intentional disclosure; and

(2) Promptly, in the case of a non-intentional disclosure.

(b) (1) Except as provided in paragraph (b)(2) of this section, paragraph (a) of this section shall apply to a disclosure made to any person outside the issuer:

(i) Who is a broker or dealer, or a person associated with a broker or dealer, as those terms are defined in Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a));

(ii) Who is an investment adviser, as that term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); an institutional investment manager, as that term is defined in Section 13(f)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(f)(5)), that filed a report on Form 13F (17 CFR 249.325) with the Commission for the most recent quarter ended prior to the date of the disclosure; or a person associated with either of the foregoing. For purposes of this paragraph, a "person associated with an investment adviser or institutional investment manager" has the meaning set forth in Section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)), assuming for these purposes that an institutional investment manager is an investment adviser;

(iii) Who is an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or who would be an investment company but for Section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a-3(c)(7)) thereof, or an affiliated person of either of the foregoing. For purposes of this paragraph, "affiliated person" means only those persons described in Section 2(a)(3)(C), (D), (E), and (F) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3)(C), (D), (E), and (F)), assuming for these purposes that a person who would be an investment company but for Section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a-3(c)(7)) of the Investment Company Act of 1940 is an investment company; or

(iv) Who is a holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information.

(b) (2) Paragraph (a) of this section shall not apply to a disclosure made:

(i) To a person who owes a duty of trust or confidence to the issuer (such as an attorney, investment banker, or accountant);

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(ii) To a person who expressly agrees to maintain the disclosed information in confidence;

(iii) To an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available; or

(iv) In connection with a securities offering registered under the Securities Act, other than an offering of the type described in any of Rule 415(a)(1)(i)- (vi) (§ 230.415(a)(1)(i)-(vi) of this chapter).

§ 243.101 Definitions. (17 C. F. R. § 243.101)

This section defines certain terms as used in Regulation FD (§ § 243.100- 243.103).

(a) Intentional. A selective disclosure of material nonpublic information is "intentional" when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic.

(b) Issuer. An "issuer" subject to this regulation is one that has a class of securities registered under Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l), or is required to file reports under Section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)), including any closed-end investment company (as defined in Section 5(a)(2) of the Investment Company Act of 1940) (15 U.S.C. 80a-5(a)(2)), but not including any other investment company or any foreign government or foreign private issuer, as those terms are defined in Rule 405 under the Securities Act (§ 230.405 of this chapter).

(c) Person acting on behalf of an issuer. "Person acting on behalf of an issuer" means any senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser), or any other officer, employee, or agent of an issuer who regularly communicates with any person described in § 243.100(b)(1)(i), (ii), or (iii), or with holders of the issuer's securities. An officer, director, employee, or agent of an issuer who discloses material nonpublic information in breach of a duty of trust or confidence to the issuer shall not be considered to be acting on behalf of the issuer.

(d) Promptly. "Promptly" means as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange) after a senior official of the issuer (or, in the case of a closed-end investment company, a senior official of the issuer's investment adviser) learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.

(e) Public disclosure.

(1) Except as provided in paragraph (e)(2) of this section, an issuer shall make the "public disclosure" of information required by § 243.100(a) by furnishing to or filing with the Commission a Form 8-K (17 CFR 249.308) disclosing that information.

(2) An issuer shall be exempt from the requirement to furnish or file a Form 8-K if it instead disseminates the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public.

(f) Senior official. "Senior official" means any director, executive officer (as defined in § 240.3b-7 of this chapter), investor relations or public relations officer, or other person with similar functions.

(g) Securities offering. For purposes of § 243.100(b)(2)(iv):

(1) Underwritten offerings. A securities offering that is underwritten commences when the issuer

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reaches an understanding with the broker-dealer that is to act as managing underwriter and continues until the later of the end of the period during which a dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated);

(2) Non-underwritten offerings. A securities offering that is not underwritten:

(i) If covered by Rule 415(a)(1)(x) (§ 230.415(a)(1)(x) of this chapter), commences when the issuer makes its first bona fide offer in a takedown of securities and continues until the later of the end of the period during which each dealer must deliver a prospectus or the sale of the securities in that takedown (unless the takedown is sooner terminated);

(ii) If a business combination as defined in Rule 165(f)(1) (§ 230.165(f)(1) of this chapter), commences when the first public announcement of the transaction is made and continues until the completion of the vote or the expiration of the tender offer, as applicable (unless the transaction is sooner terminated);

(iii) If an offering other than those specified in paragraphs (a) and (b) of this section, commences when the issuer files a registration statement and continues until the later of the end of the period during which each dealer must deliver a prospectus or the sale of the securities (unless the offering is sooner terminated).

§ 243.102 No effect on antifraud liability.(17 C. F. R. § 243.102)

No failure to make a public disclosure required solely by § 243.100 shall be deemed to be a violation of Rule 10b-5 (17 CFR 240.10b-5) under the Securities Exchange Act.

§ 243.103 No effect on Exchange Act reporting status. (17 C. F. R. § 243.103)

A failure to make a public disclosure required solely by § 243.100 shall not affect whether:

(a) For purposes of Forms S-2 (17 CFR 239.12), S-3 (17 CFR 239.13) and S-8 (17 CFR 239.16b) under the Securities Act, an issuer is deemed to have filed all the material required to be filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) or, where applicable, has made those filings in a timely manner; or

(b) There is adequate current public information about the issuer for purposes of § 230.144(c) of this chapter (Rule 144(c)).

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ACCA Corporate Counsel University
WAS IT LEGAL?

Philip C. Maynard
Senior Vice President and Chief Legal Officer
FileNet Corporation
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Hypo No. 1

On October 17, 2001 the Company reported third quarter results. The Company's results declined compared to third quarter 2000 and the Company missed analyst estimates. The CEO stated on the call " Since September 11, the environment for information technology has been as difficult as any in the history of the information technology industry. Things have been tough. We think that they will continue to be quite tough in the short term. We have an exceptionally soft market for information technology. Spending for tech products and services continues to slide. We expect things will be quite tough through the remainder of the year." The Company's stock declined 19% after the earnings release.

Three weeks later (early November) the Company participated in a Technology Conference organized by an Investment Banking Firm. The conference was a Q&A format. The investment firm worked with the Company's IR Director to prepare questions, and the IR Director prepared the talking points for his CEO to help ensure that no material, nonpublic information was disclosed at the conference.

In the meantime, the IR Director and the CEO had access to information concerning, among other things, the Company's sales pipeline, deal closure rate, trends in revenue and performance compared to prior periods, which were trending upwards in the fourth quarter. In fact, it looked like the Company would exceed the license revenue that the Company had forecast at the quarterly earnings release three weeks earlier.

The Company always webcasts its analyst conference presentations. This time, however, the investment firm informed the IR Director that the conference would not be webcast, and the IR Director forgot to inform the CEO of this fact.

At the conference the questions and answers were exchanged:
Q: "I wonder if you could give us an update of what you're seeing after September 11, maybe how the economy is looking and how the software business is looking during the month of October. Are customers still paralyzed or are we getting back to normalcy?"
A: "The business decisions appear to be quite normal right now, and so we're pretty optimistic about what we're seeing at this time. People are engaging in software evaluations, software selection, etc. so right now it looks like we're seeing some return to normal behavior."
Q: "There were a lot of concerns that the bottom could just fall out of Q4 after 9-11. Sounds like what you're saying is that business is getting back to normal?"

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A: "I think that was a legitimate concern, and I shared that concern, and I think I communicated that concern quite clearly in the Q3 conference call. If we had seen continued geo-political dislocation, it could have been a nightmare out there in Q4. The good news is we're not seeing that, and I think that's a relief to everybody."

WAS IT LEGAL?

Was it selective?

- Made to analysts without webcast, press release, 8-K or other concurrent broadcast.

Was it non-public?

- Information is nonpublic if it has not been disseminated in a manner making it available to investors generally.
- Sounds like general observations about the economy, not specific comments about the Company's sales pipeline, revenue and profit prospects; BUT, the news did contrast with similar observations made in the Q3 earnings call, AND the more up-beat information was BASED on the CEO's knowledge of actual sales trend / pipeline information.

Was it material?

- Material if there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision or if the information would significantly alter the total mix of the available information.
- The SEC always has the advantage of hindsight when determining materiality.
- The Company's stock was at $17.30 before the disclosure. The stock had risen to over $20 per share within hours after the disclosure; trading volume was about double the normal volume; several investors present at the conference either traded or sent messages to others who traded shares.

Was it intentional or unintentional?

- Disclosure is intentional if the person making the disclosure knows, or is reckless in not knowing, that the information being communicated is both material and nonpublic.
- The CEO didn't know the conference was not being webcast, but the IR Director knew but failed to tell the CEO. Thus, the Company knew, thereby amounting to an intentional disclosure.
- In the adopting release the SEC observed that "in the case of a selective disclosure attributable to a mistaken determination of materiality, liability will arise only if no reasonable person under the circumstances would have made the same determination."

Was timely disclosure made?

- Intentional selective disclosure requires simultaneous publication.

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THE RESULT: The SEC found that the CEO's statements were based on material, nonpublic information and knew or was reckless in not knowing (amounting to intentionally) that it was selectively disclosing material, nonpublic information at the technology conference. A $250,000 civil penalty against the company and a cease and desist order. SEC v. Siebel Systems, Inc. file No. 3-10949.

Hypo No. 2

In August 2002 the drug Company filed its 10-Q for the second quarter ended June 30, 2002 in which it disclosed an adverse ruling in a major patent litigation, stated it was appealing, that as a result of the ruling generic drugs would be entering the market, and that the introduction of generic drugs would likely have a rapid, sharp and material adverse effect on the Company's results of operations beginning at the occurrence of such an event and extending for an indeterminate period of time thereafter. The Company had also publicly warned that it expected its third quarter earnings to be significantly lower than the comparable period in 2001. The Company had also made a public statement that it was undecided whether to buy back shares.

In September 2002 the Company's management developed internal forecasts that showed earning for the rest of 2002 and for 2003 would be below Wall Street estimates. Shortly after the management meetings discussing the new forecasts, the CEO and the SVP of Investor Relations traveled to Boston for previously scheduled meetings with institutional investors.

During the meetings, the CEO stated that the Company was going to take a hard hit to earnings in 2003. The CEO also stated that he did not favor a repurchase of Company shares. He also stated that 2003 would be a very, very difficult year and that the street had not sufficiently lowered earnings estimates for the third quarter of the Company's 2002 fiscal year to reflect the impact of the entry of generic drugs into the market. He later commented that 2003 will be a real tough year and earnings would be terrible.

Analysts present at the meeting later noted the CEO's downbeat demeanor, and noted that he was more difficult to get information out of and that while he was not explicit, he left the impression that the numbers for consensus were too high.

WAS IT LEGAL?

Was it selective?

- The meetings were private audiences. Adopting release: Issuers may not evade the public disclosure requirements of Regulation FD by using "code" words or "winks or nods" to convey material nonpublic information during private conversations.

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Was it non-public?

- The statement about there being a hard hit to earnings contrasted with the Company's earlier, public disclosures because it conveyed a definitive rather than a contingent outcome. The comment about the CEO not favoring a buy back also contrasted with the Company's earlier statements that indicated a stock buy-back was a possibility but no decision either way had been made.
- Body language, demeanor and mood conveyed negative messages that were inferred by the recipients of the messages and affected their decisions.

Was it material?

- Again, 20/20 hindsight. Market reaction: from October 1 through October 3 before the press release the stock fell 17% from about $21.32 to $17.64, and average daily trading volume was up to 4 times the norm; and many of the meeting participants traded.

Was it intentional or unintentional?

- Intentional means when the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communication g is both material and nonpublic. Not clear whether the disclosure is unintentional.

Was timely disclosure made?

- If non-intentional, then disclosure must be made as soon as reasonably practicable but in no event after the later of 24 hours or the commencement of the next day's trading on the NYSE. The meetings were held September 30, and October 1 & 2. In response to market activity, the Company issued a press release on October 3 providing guidance for the remainder of 2002 and 2003. So even in non-intentional, the disclosure was not timely.

THE RESULT: The SEC found that through a combination of spoken language, tone, emphasis, and demeanor the CEO selectively disclosed negative and material, nonpublic information regarding the Company's earnings prospects. The Company and the CEO signed cease and desist agreements and the CEO paid a $50,000 civil penalty. See: In the matter of Schering-Plough Corporation, Admin. Proc. File No. 3-11249.

Hypo No. 3

At the beginning of 2002 the Company provided guidance that earnings for the year would be between $1.90 and $2.30 per share. In July 2002 the company publicly lowered its guidance to $1.70 to $1.90 per share. Then on September 27, 2002 the Company again reduced its earnings estimate to $1.45 to $1.55 per share, which was reaffirmed in the Company's 10-Q filed on October 22, 2002. Three weeks later, on November 19, the Company hosted a private investor analyst event at its plant facilities. The IR Director did not advise the analysts as to what topics were off limits in the Q&A. At one point, an analyst asked about the Company's earning guidance for the year. The CEO reaffirmed the guidance most recently provided three weeks earlier in the Company's 10-Q.

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WAS IT LEGAL?

Was it selective?

- Private event for security analysts.

Was it nonpublic?

- The Company had already publicly announced the guidance; what was the new information? The reaffirmation of the prior guidance is itself new information.

Was it material?

- Within 2 days the Company's stock had risen 6% with the largest spread being 9%, and trading volume was up 75%.

Was it intentional or unintentional?

- The Company had disclosure guidelines that provided specific responses to certain questions – If asked about "comfort" with prior guidance the required response was "although business conditions are subject to change, in accordance with Company policy, the current earnings guidance was effective at the date given and is not being updated until the Company publicly announces updated guidance."

Was timely disclosure made?

- After the market closed on November 21 the Company filed an 8K affirming the prior guidance. Too little, too late.

THE RESULT: The SEC found that by reaffirming prior guidance the Company and its CEO intentionally and selectively disclosed material, nonpublic information to securities professionals. The Company and the CEO signed cease and desist agreements and the Company paid a $350,000 fine and the CEO paid a $50,000 fine. See: In the matter of Flowserve Corporation, Admin. Proc. File No. 3-11872.

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ABC Company
Guidelines for Corporate Disclosure

I. Introduction

We take seriously our responsibilities under the federal and state securities laws. For this reason, for example, we adopted and have implemented our insider trading policy for the purpose of preventing illegal tipping and insider trading. On August 10, 2000, the United States Securities and Exchange Commission adopted Regulation FD with the intention of limiting the selective disclosure of material, nonpublic information to securities analysts and others. We are adopting these Guidelines for Corporate Disclosure ("Guidelines") for the purpose of assuring that we comply with Regulation FD.

II. Definitions

A. Categories of People Covered by Regulation FD

Because Regulation FD places special responsibilities on certain categories of individuals or otherwise treats them specially, for convenience these Guidelines will use certain defined terms to refer to these categories, as follows:

1. "Market Professionals or Stockholders" – Regulation FD applies special rules to communications with certain categories of individuals referred to in these Guidelines as "Market Professionals or Stockholders." These include:

   - Broker/dealers and their associated persons, including sell-side analysts,
   - Investment advisors, institutional investment managers, hedge funds, and their associated persons, including buy-side analysts,
   - Investment companies (mutual funds) and their affiliated persons, and
   - Any stockholder or other holder of the issuer's securities.

2. "Senior Officials" – Regulation FD defines "Senior Official" to mean any director, executive officer, investor relations or public relations officer or other person with similar functions. The definition of Senior Official is important principally because all Senior Officials are deemed to be "FD Persons" (see below).

3. "FD Persons" – Regulation FD imposes special responsibilities on any "person acting on behalf of an issuer." Regulation FD defines "person acting on behalf of an issuer" to mean any Senior Official or any other officer, employee or agent of the issuer who regularly communicates with Market Professionals or Stockholders. Such persons may include individuals at an outside public relations or investor relations firm. No person who is not an FD Person is authorized to perform the functions of an FD Person.

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4. "Spokespersons" – Not all FD Persons ordinarily will be called upon to communicate with security analysts, institutional investors or representatives of the media. The individuals who ordinarily will be called upon to perform these functions are listed on Exhibit B of the Corporate Disclosure Policy. In these Guidelines, we refer to these individuals as our "Spokespersons."

B. Material Information

The focus of Regulation FD is on the disclosure of material information. For purposes of these Guidelines, we use the same definition of "material information" the SEC used in its adopting release for Regulation FD. Information is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision, or if it would significantly alter the total mix of information available to investors. In Regulation FD, the SEC provided a nonexclusive list illustrating the types of information or events that the SEC believes must be reviewed carefully to determine whether they are material, including:

- Earnings information,
- Mergers, acquisitions, tender offers, joint ventures, or changes in assets,
- New products and discoveries,
- Developments regarding customers or suppliers (such as the acquisition or loss of a contract),
- Changes in control or in management,
- Changes in the outside auditor or notification by the auditor that the issuer may no longer rely on an auditor's report,
- Events regarding the issuer's securities, for example, defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders and public or private sales of additional securities, and
- Bankruptcies or receiverships.

The SEC has made clear in another recent release that there are no numerical thresholds that may be used to determine whether information is material. For example, there is no "rule of thumb" that a development that has less than a 5% effect on net income is immaterial *per se*. Materiality must be evaluated by reference to all the relevant circumstances. In this regard, potential market sensitivity to the information is a key consideration.

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III. Administration of the Guidelines

A. Disclosure Committee

We have formed a Disclosure Committee to implement these Guidelines and to address disclosure issues that may arise from time to time. In particular, the Disclosure Committee will administer the Disclosure Guidelines discussed in Section IV below. The Disclosure Committee will meet annually to review the Guidelines or as needed for modification or updating. The Disclosure Committee shall consist of the the Chief Financial Officer, the Director of Investor Relations, Director of Public Relations and the General Counsel. The current members are listed on Exhibit A to theCorporate Disclosure Policy.

B. Materiality Determinations by Disclosure Committee

Whenever questions arise about whether information constitutes material non-public information, our FD Persons will confer with one or more members of the Disclosure Committee. The committee member, in turn, may elect to confer with other members of the Disclosure Committee or to call a meeting of the Disclosure Committee if he or she believes it is appropriate. Committee members also may elect to consult with outside counsel, if necessary.

C. Updating Lists of Senior Officials, FD People, and Spokespersons

The General Counsel (or his or her designee) will be responsible for periodically updating the lists of individuals, such as Senior Officials, FD Persons and Spokespersons.

IV. Disclosure Guidelines

A. Earnings Announcements and Conference Calls

1. Earnings Announcement and Quarterly Outlook

Following the end of each quarter, we will issue a press release to report our results of operations for that quarter and to provide quarter-to-quarter and period-to-period comparisons. We generally will issue this release during the third week following the end of the quarter.

In addition to the historical financial information provided, and except in unusual circumstances at the direction of the Disclosure Committee, each release also will contain projected financial information for the then-current quarter. The projected financial information typically will include our current estimate of such items as, for example, revenues, gross margins, operating expenses and our effective tax rate. Each discussion of these projections will contain appropriate disclosure to the effect that statements about the projections are based on current expectations and that actual results may differ materially. Each release also will

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include a discussion of factors that may cause results to differ and a reference to appropriate risk factor disclosure in a recently filed SEC report, such as a Form 10-K or Form 10-Q.

2. Quarterly Conference Calls/Webcasts

Shortly after we issue our quarterly earnings release, we will make a presentation about the results of operations for that quarter on a conference call and/or webcast. Absent unusual circumstances, each conference call or webcast will begin with prepared remarks by Spokespersons, including a reference to filed risk factor disclosure, followed by a question and answer period.

Absent unusual circumstances, each call will be open to securities analysts, stockholders, the media and other interested parties. We will announce the date and time of the call on our Web site and in a press release inviting anyone who may be interested to listen to the call or have access to the call via the Internet (or otherwise provide a public notice at least two business days advance notice to the public of the time and date of the call, with instructions as to how to access the call). The release or notice will provide dial-in instructions and/or a web site address for the call. Although we will permit anyone who may be interested to listen to the call, we may choose to permit only securities analysts or other designated individuals to ask questions during the question and answer period.

3. Blackout Periods

Absent unusual circumstances, we will not discuss with Market Professionals or Stockholders or otherwise comment on our current or future financial or business performance or prospects during the period beginning approximately two weeks before the end of the quarter and ending after the quarterly conference call. If circumstances are such that the members of the Disclosure Committee feel it is desirable to comment on such matters during this period, we will do so only by way of a press release, as contemplated below.

4. Pre-Release

In some circumstances, it may be desirable for us to provide information regarding our expected financial or business performance (such as regarding our expectations for revenues and net income for a quarter) before we are prepared to issue our quarterly earnings release. For example, such a release might be appropriate when there is a concern that materially positive or negative news may have leaked, or for other reasons. The determination whether to pre-release information about a quarter and what information to include in such a release must be made on a case-by-case basis and will be made by members of the Disclosure Committee, who may seek the advice of outside counsel at their discretion.

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B. Dealing with Market Professionals, Stockholders and Other Inquiries

1. Guidance

To promote compliance with Regulation FD, it is our policy not to provide formal or informal guidance, whether direct or indirect, to Market Professionals or Stockholders with respect to earnings or other material financial projections except as part of our regular, quarterly press releases and subsequent conference calls.

2. Meetings, Telephone Calls or Other Communications with Market Professionals and Stockholders

FD Persons will seek never to disclose material non-public information in meetings, telephone calls or other communications with Market Professionals or Stockholders. Participants in such meetings or telephone calls will include one or more of our Spokespersons, whenever possible. During these conferences, our representatives may present historical information in an organized manner, such as in graphical form, to illustrate trends in our business or in the industry in general. Our representatives also may provide immaterial background information to help Market Professionals or Stockholders fill in elements of a "mosaic" of information, but they should seek never to provide material non-public forward-looking information, particularly financial projections, during any such meeting or other communication. While these Guidelines do not prohibit exchanges of e-mail correspondence with Market Professionals or Stockholders, FD Persons should exercise particular caution in interacting with Market Professionals and Stockholders through e-mail.

3. Analyst Models and Reports

Upon request by a Market Professional or Stockholder, a Spokesperson may elect to review drafts of analysts' models or reports. It is our policy, however, not to comment on analysts' projections or their statements and conclusions about us, other than to correct factual errors by reference to information already in the public domain. In addition, no officer should allow himself or herself to be quoted in an analyst report. Absent unusual circumstances, we do not distribute copies of analyst reports to stockholders or others as part of investor relations kits. If the Disclosure Committee should determine to make an exception to these Guidelines, care should be taken to include a full spectrum of opinions from a broad range of analysts and appropriate disclaimers of the content of the analysts' reports.

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4. Site Visits

We permit Market Professionals or Stockholders to visit our offices and other facilities on a non-discriminatory, appointments-only basis. While our officers may from time-to-time make "road show"-style presentations to Market Professionals or Stockholders, it is our policy to seek never to disclose material non-public information during these meetings. Officers may elect to include product-line managers or other representatives in these meetings, provided that such managers are briefed on their responsibilities under this disclosure policy prior to meetings and a Senior Official accompanies them during the meetings.

C. Investment Bank Sponsored Conferences, Road Shows, Trade Shows and the Press

1. Investor Conferences and Road Shows

As with one-on-one meetings with Market Professionals or Stockholders, FD Persons must proceed with great caution at investor conferences, such as those sponsored by investment banks, and on road shows. Participants in such conferences and road shows should include one or more of our Spokespersons, whenever possible. Such representatives should apply the same disclosure guidelines to these meetings that they would to one-on-one meetings with Market Professionals or Stockholders.

2. Trade Shows

Although our target audience at trade shows generally does not include Market Professionals or Stockholders, we nevertheless require participants in trade shows to comply with these Guidelines. In particular, it is our policy not to disclose material non-public information at trade shows. To confirm that participants in such trade shows understand and abide by these Guidelines with respect to disclosure of material information, the members of the Disclosure Committee will take such steps as they deem appropriate in the circumstances to ensure that our representatives who participate in trade shows, or their supervisors, as appropriate, are familiar with these Guidelines. In addition, we will issue press releases to announce new products or other material developments prior to or concurrently with any disclosure at a trade show.

3. The Press

Although statements made to members of the press do not fall within the scope of Regulation FD, absent a determination by members of the Disclosure Committee to the contrary based on the circumstances in question, we have a policy of not disclosing material non-public information to individual representatives of the press without first issuing a press release or otherwise making a broadly disseminated announcement. However, it is permissible to disclose material information to members of the press who have agreed (orally or in writing) to

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keep the information confidential while they are preparing an article and until such time as the information can be broadly publicized. It is also permissible to disclose material information to a publication (such as *The Wall Street Journal*) that can assure broad dissemination of the information. Contacts with the news media should be only by one or more of Spokespersons, whenever possible.

D. Disclosure in Periodic SEC Filings

Our policy is to include detailed disclosure in the quarterly “Management's Discussion and Analysis” (“MD&A”) section of our 10-Qs and 10-Ks filed with the SEC that generally covers all material facts and other historical topics that we have covered in our quarterly conference calls, or that we expect to cover in private discussions with investors and analysts. We also endeavor to include in our MD&A a detailed discussion of known trends and uncertainties affecting our business (subject to risk factor disclosure). In addition to providing our investors with additional historical and forward-looking information regarding our business, this approach will increase our flexibility in communicating with Market Professionals and Stockholders in accordance with the guidelines in Section B above.

E. Inadvertent Disclosures

We recognize the possibility of inadvertent disclosure of material non-public information, such as in an informal meeting with a Market Professional or Stockholder. It is our policy to promptly disclose through a press release or through a filing on Form 8-K with the SEC any material non-public information inadvertently disclosed by an FD Person to a Market Professional or Stockholder. Accordingly, when a Senior Official becomes aware of a potential inadvertent disclosure of non-public information that may be material, he or she should confer with a member of the Disclosure Committee to determine whether the information is material. The Disclosure Committee member, in turn, may, in his or her discretion, consult with other members of the Disclosure Committee and/or seek the advice of outside counsel. If the Disclosure Committee members determine that the information is material, they also will determine the appropriate manner of disclosing the information and also may elect to confer with outside counsel in making this determination. Regardless of the means we elect to make the disclosure, we will disseminate the material information before the later of (i) 24 hours from the Senior Official becoming aware of the disclosure or (ii) the next opening of trading on the New York Stock Exchange following the Senior Official’s becoming aware of the disclosure.

V. Securities Offerings

Regulation FD contains limited exemptions for registered, but not unregistered, securities offerings made by companies subject to the regulation. These exemptions are beyond the scope of these Guidelines. Accordingly, it is our policy to confer with outside counsel regarding the Regulation FD implications of registered and unregistered offerings of our securities before engaging in such activities.

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Disclosure Committee Charter

This Disclosure Committee Charter (the "**Charter**") has been adopted by the Chief Executive Officer and Chief Financial Officer (the "**Senior Officers**") of ABC Company Corporation (the "**Company**") and ratified by the Audit Committee of the Board of Directors. The Disclosure Committee (the "**Committee**") shall review and reassess this Charter annually and recommend any proposed changes to the Senior Officers for approval.

I. PURPOSE

It is the Company's policy that all disclosures made by the Company to its security holders or the investment community should be accurate and complete and fairly present the Company's financial condition and results of operations in all material respects, and should be made on a timely basis as required by applicable laws and stock exchange requirements.

The Committee shall assist the Senior Officers in fulfilling their responsibility for oversight of the accuracy and timeliness of the disclosures made by the Company by being responsible for the following tasks, in each case subject to the supervision and oversight of the Senior Officers:

- Design and establish controls and other procedures (which may include procedures currently used by the Company) that are designed to ensure that (1) information required by the Company to be disclosed to the Securities and Exchange Commission ("**SEC**") and other written information that the Company will disclose to the investment community is recorded, processed, summarized and reported accurately and on a timely basis and (2) information is accumulated and communicated to management, including the Senior Officers, as appropriate to allow timely decisions regarding such required disclosure ("**Disclosure Controls**").

- Monitor the integrity and effectiveness of the Company's Disclosure Controls.

- Review and supervise the preparation of the Company's (i) periodic and current reports, proxy statements, information statements, registration statements and any other information filed with the SEC, (ii) press releases containing financial information, earnings guidance, information about material acquisitions or dispositions or other information material to the Company's security holders, and (iii) correspondence broadly disseminated to shareholders and all presentations to analysts and the investment community (collectively, the "**Disclosure Statements**") and review disclosure policies for the Company's corporate/investor relations website(s).

- Evaluate the effectiveness of the Company's Disclosure Controls within 90 days prior to the filing of the Company's Annual Report on Form 10-K and each Quarterly Report on Form 10-Q (collectively, the "**periodic reports**").

- Discuss with the Senior Officers all relevant information with respect to the Committee's proceedings, the preparation of the Disclosure Statements and the Committee's evaluation of the effectiveness of the Company's Disclosure Controls.

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- [Provide a certification to the Senior Officers prior to the filing with the SEC of each periodic report as to (i) the Committee's compliance with its policies and procedures and proper performance of the responsibilities that have been assigned to it and (ii) the Committee's conclusions resulting from its evaluation of the effectiveness of the Disclosure Controls.]

In discharging its duties, the Committee shall have full access to all company books, records, facilities, and personnel, including the internal auditors.

II. Organization

The membership of the Committee shall initially consist of [list officer titles]. Such members may be replaced, or new members added, at any time and from time to time by the Senior Officers. Notwithstanding the foregoing, the Senior Officers at their option may at any time assume any or all of the responsibilities of the Disclosure Committee identified in this Charter, including, for example, approving Disclosure Statements when time does not permit the full Committee to meet.

The Committee may designate two or more officers, at least one of whom shall be an attorney knowledgeable about SEC rules and regulations with respect to disclosure and at least one of whom shall be knowledgeable about financial reporting, who can, acting together, approve Disclosure Statements (other than periodic reports) when time does not permit the full Committee to meet.

One member of the Committee shall be appointed by the Senior Officers as chair. The chair shall be responsible for scheduling and presiding over meetings and preparing agendas. Any question of interpretation of this charter of the Committee's procedures shall be determined by any Senior Officer or, in their absence from any meeting, the chair.

Promptly after the date hereof, the Committee shall meet with the Senior Officers and submit for their approval an initial set of Disclosure Controls, including policies and procedures of this Committee, as well as policies and procedures to test the effectiveness of the Disclosure Controls.

The Committee shall meet as frequently as circumstances dictate to (i) ensure the accuracy and completeness of the Disclosure Statements and (ii) evaluate the Disclosure Controls and determine whether any changes to the Disclosure Controls are necessary or advisable in connection with the preparation of the Company's upcoming periodic reports or other Disclosure Statements, taking into account developments since the most recent meeting, including changes in the Company's organization and business lines and any change in economic or industry conditions.

III. Other Responsibilities

The Committee shall also have such other responsibilities as the Senior Officers may assign to it from time to time.

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