

Corporate and Securities Law Developments NEWSLETTER

JULY 16, 2004

SEC Continues to Pursue Regulation FD Enforcement Aggressively

Asserts First Disclosure Controls and Procedures Violation

The Securities and Exchange Commission has again demonstrated its intent to aggressively enforce Regulation FD. In a complaint filed on June 29, 2004, the SEC alleges that Siebel Systems, Inc., its CFO, and its investor relations director violated Regulation FD by privately giving institutional investors a more positive view of the company's prospects than had been previously disclosed to the public and failing to publicly disclose the private statements.¹ Notably, Siebel had previously settled a Regulation FD case, and the complaint charges that Siebel violated a cease-and-desist order in the earlier case. In addition, in a novel application of new Rule 13a-15 under the Securities Exchange Act of 1934, the SEC charges Siebel with failing to maintain adequate disclosure controls and procedures with respect to the company's compliance with Regulation FD. Siebel and the individual defendants are defending the action.

I. Regulation FD

Regulation FD regulates communications between public companies and investment professionals. Regulation FD prohibits a company from intentionally disclosing material nonpublic information to specified types of market professionals, such as securities analysts, broker dealers, and investment advisers, or to securityholders, unless the company publicly discloses the information simultaneously. In addition, if a company non-intentionally discloses material nonpublic information to persons covered by Regulation FD, the company must publicly disclose the information as soon as reasonably practicable after relevant company personnel learn of the disclosure of material nonpublic information, 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.² A

¹ See *SEC v. Siebel Systems, Inc.*, Litigation Release No. 18766 (June 29, 2004), available at <http://www.sec.gov/litigation/litreleases/lr18766.htm>.

² See Rule 100 of Regulation FD, 17 C.F.R. § 243.100.

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disclosure is non-intentional if the company was not aware (and was not reckless in not being aware) that the information was material or that the information had not previously been publicly disclosed. A company may, however, privately disclose material nonpublic information if the recipient is obligated to keep the information confidential.³

II. Overview of the Siebel Case

In November 2002, the SEC and Siebel settled a previous SEC charge relating to Regulation FD.⁴ The SEC entered an order finding that Siebel had violated Regulation FD and Section 13(a) of the Exchange Act and requiring Siebel to cease and desist from future violations. Siebel paid a \$250,000 civil penalty without admitting or denying any wrongdoing. The charge was based on positive statements about Siebel's prospects made by the chief executive officer of Siebel at an invitation-only investment conference that was not webcast or otherwise made public.

In the present case, the SEC alleges that Siebel's chief financial officer made positive statements at two separate private events with investors regarding the company's business activity levels and transaction pipeline that materially contrasted with Siebel's recent public disclosures. In addition, the SEC alleges that, even after the settlement described above, Siebel did not adopt a formal policy regarding compliance with Regulation FD or have formal training for the executives responsible for ensuring the company's compliance with Regulation FD.

A. *The SEC's factual allegations*

The SEC complaint alleges that in April 2003, Siebel executives made private statements about the company's prospects at an investor conference that were materially different from its public disclosures. On April 4, Siebel warned

that first quarter earnings would be less than the company had forecast as a result of "deals that slipped." Siebel's CEO also stated that "there is clearly less business activity right now than there was three months ago." On April 23, Siebel announced its first quarter results and guidance for the second quarter and held a conference call to discuss its announcement. According to the SEC's complaint, the CEO was negative on the conference call. For example, the CEO stated that "... we are not in an expansive stage of the business cycle yet." However, the company also projected on the conference call that its second quarter software license revenue would be between \$120 million and \$140 million, which was greater than its first quarter software license revenue. This projection was conditioned on the performance of the overall economy and did not address whether the projection for the second quarter was due to the "deals that slipped" in the first quarter.

On April 28, Siebel's CEO spoke at an investor conference that was webcast to the public. In that speech, he reiterated how tough the market was and that Siebel's performance was linked to that of the overall economy. In addition, he avoided answering questions regarding Siebel's pipeline and whether the projections for the second quarter were due to first quarter deals that had slipped into the second quarter.

At the investor conference on April 28 and over the following two days, Siebel's CFO and director of investor relations held several one-on-one meetings with institutional investors. On April 30, they participated in three one-on-one meetings with investors and a private dinner sponsored by Morgan Stanley attended by several institutional investors and Morgan Stanley research and sales personnel. At one of the one-on-one meetings with Alliance Capital Management, the CFO allegedly stated that the pipeline was now "growing" and that there were some \$5 million deals in Siebel's

³ See Rule 100(b)(2)(i), (ii), 17 C.F.R. 243.100(b)(2)(i), (ii).

⁴ *In the Matter of Siebel Systems, Inc.*, Exchange Act Rel. No. 46896 (Nov. 25, 2002).

pipeline. This had not been disclosed in Siebel's public disclosures on April 4, April 23, or April 28. Immediately after the meeting, two representatives of Alliance who had attended the meeting bought shares of Siebel stock for the Alliance funds that they managed and, the next morning, advised a third Alliance fund manager of the CFO's statements; this third fund manager then covered a short position held by the Alliance fund that he managed and then advised a fourth Alliance portfolio manager to do the same, which he did. In addition, the SEC alleges that the director of investor relations, who was responsible for Siebel's compliance with Regulation FD, did not assess whether the CFO had disclosed material nonpublic information and did not counsel him regarding his compliance with Regulation FD.

On the evening of April 30, Siebel's CFO and IR director attended a private dinner hosted by Morgan Stanley, at which, the SEC alleges, the CFO again stated that the company's pipeline was "building." The SEC charges that the private statements "materially contrasted with the public statements" that Siebel's CEO had made on April 4, April 23, and April 28. At least two of the attendees at the dinner bought Siebel stock the next day. The next day Siebel's stock rose 8% and had roughly twice its average daily trading volume over the preceding twelve months. During the day, Siebel received inquiries regarding rumors about what had been said at the Morgan Stanley dinner. Despite questions from the company's general counsel about the need for additional disclosure, the CFO and IR director denied the rumors and claimed to only have repeated what had been previously disclosed to the public. Siebel did not file a Form 8-K or make any other public disclosure regarding the private statements made on April 30.

B. *The SEC's claims*

The SEC's complaint sets forth six claims against the defendants. The first claim charges that, as a result of the CFO's intentional selective disclosure of material nonpublic information,

Siebel intentionally violated Regulation FD. Alternatively, the second claim charges that, even if the disclosures were non-intentional, Siebel violated Regulation FD by not making public disclosure promptly after discovering the non-intentional violation. The third claim charges that Siebel violated the earlier cease-and-desist order, which required compliance with Regulation FD. The fourth and fifth claims charge that the two corporate officers aided and abetted Siebel in the violations mentioned above.

The sixth claim charges that Siebel violated Section 13(a) of the Exchange Act and Rule 13a-15 thereunder by failing to maintain adequate controls and other procedures designed to ensure that information that is required to be disclosed in the reports that the company files or submits under the Exchange Act is communicated to management as appropriate to allow timely decisions regarding required disclosure and is reported in the time specified by the SEC's forms.

III. Analysis

The Siebel complaint demonstrates again that the SEC is prepared to vigorously enforce Regulation FD. That, in the SEC's view, Siebel engaged in a second violation of Regulation FD notwithstanding a prior cease-and-desist order presumably only increases the aggressiveness with which the SEC appears willing to pursue this case. However, the complaint reflects only the SEC's allegations, which Siebel denies, so it is too early to predict the outcome.

In addition, the complaint embodies a novel theory based on Rule 13a-15. This is the first time that the SEC has asserted in a case that failure to comply with Regulation FD is a disclosure controls and procedures violation. Rule 13a-15 requires an issuer to maintain adequate controls and procedures "designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the [Exchange] 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” and “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.” The SEC’s Rule 13a-15 claim appears to run along the following lines: Rule 13a-15 applies to all required Exchange Act forms, including Form 8-K; Regulation FD permits the use of Form 8-K as one method of providing simultaneous public disclosure of material, nonpublic information that is intentionally disclosed to certain investment professionals and securityholders or of publicly disclosing information promptly after a non-intentional disclosure; since Siebel did not avail itself of any other permissible means of providing public disclosure, such as a press release, it was required to submit a Form 8-K; therefore, Siebel’s inadequate controls and procedures to ensure compliance with the public disclosure requirements of Regulation FD violated Rule 13a-15.

To date, many issuers have focused on disclosure controls and procedures as relating principally to ensuring the accuracy and timeliness of their periodic reports on Forms 10-K and 10-Q. While the requirement to maintain disclosure controls and procedures has always also clearly applied to ensuring the accuracy and timeliness of Form 8-Ks, the fact that Rule 13a-15 imports a requirement that disclosure controls and procedures be designed to ensure compliance with Regulation FD will be a new concept to many issuers. In this regard, the SEC’s complaint also relies on the lack of a formal company policy regarding Regulation FD compliance and the lack of formal training relating to Regulation FD for the executives and staff responsible for ensuring

the company’s compliance with Regulation FD. It is not clear from the complaint whether such facts are necessary for a violation of Rule 13a-15 in the Regulation FD context.

The SEC’s claim remains to be tested, both legally and factually. Nonetheless, the assertion of a disclosure controls and procedures violation in connection with Regulation FD only reinforces the importance for issuers of adopting, maintaining, and effectively implementing appropriate internal policies and training programs for compliance with Regulation FD.

If you have any questions, please call your regular Wilmer Cutler Pickering Hale and Dorr LLP contact or any of the following:

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