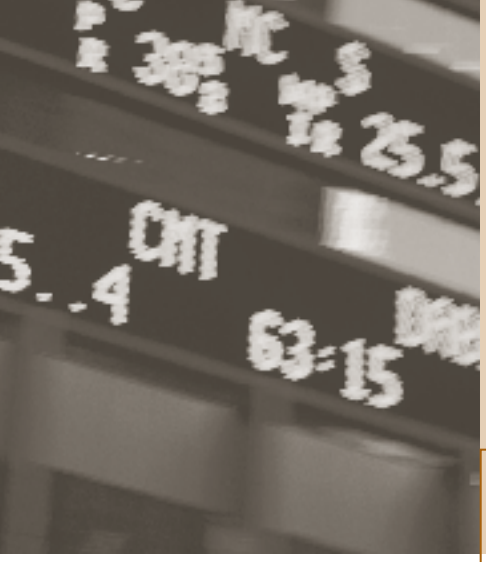

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CORPORATE AND SECURITIES
LAW UPDATE

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Siebel Takes Round Two in Regulation FD Disputes with SEC

Court Dismisses SEC Complaint For Failing to State a Claim

On September 1, 2005, in the first litigated case applying Regulation FD, the US District Court for the Southern District of New York dismissed the SEC's claims that Siebel Systems, Inc., aided and abetted by its CFO and its investor relations (IR) director, had violated Regulation FD.[1] The court criticized the SEC's "overly aggressive" application of Regulation FD, which included "excessively scrutinizing vague general comments" made by Siebel's CFO during a series of nonpublic meetings with institutional investors and analysts, and warned that such an approach to enforcement could have "a potential chilling effect" on disclosure of information, while providing "no clear guidance for companies to conform their conduct in compliance with Regulation FD." The SEC has not announced whether it will appeal the district court's decision.

Undoubtedly, the court's decision in this matter will be welcomed by executives of public companies, who have become increasingly concerned that the SEC's enforcement of Regulation FD has strayed beyond the SEC Enforcement staff's initial promise not to second guess companies on close questions of materiality. But, while the Siebel decision may help alleviate some of the anxiety over whether innocent changes in wording during a private meeting will be construed as violations of Regulation FD, this case is primarily about materiality, which is determined on a case-by-case basis, and should not be viewed as altering the steps companies should take to comply with Regulation FD.

Analysis of the Court's Decision

Alleged Violations of Regulation FD

In a complaint filed on June 29, 2004, the SEC asserted that Siebel violated Regulation FD when its CFO, in private discussions, allegedly gave institutional investors and analysts a more positive outlook on the company's business activity levels and sales transaction pipeline than had been previously disclosed to the public.[2] This was the second time the SEC charged Siebel with violating Regulation FD. In a November 2002 settlement, without admitting or denying any wrongdoing, Siebel consented to the entry of an SEC order finding that it had violated Regulation FD and Section 13(a) of the Exchange Act and requiring it to cease and desist from future violations. In connection with that settlement, Siebel paid

1. Regulation FD prohibits issuers from selectively disclosing material nonpublic information to securities market professionals or holders of the issuer's securities who are reasonably likely to trade on the basis of the information.
2. As discussed below, the SEC also charged Siebel with violating Rule 13a-15 under the Securities Exchange Act of 1934 ("Exchange Act").

a $250,000 civil penalty. In its more recent enforcement action, the SEC sought not only injunctive and monetary relief against Siebel, but also a court order requiring that the company comply with the SEC's 2002 cease and desist order. The SEC also sought injunctive and monetary relief against the CFO, Kenneth Goldman, and the IR director, Mark Hanson, for aiding and abetting Siebel's violations.

In assessing whether Siebel's private disclosures were material and nonpublic, the court compared each of Goldman's privately made comments to public statements made by Siebel's CEO in appearances during the prior three weeks. The table on page six summarizes the private and public statements juxtaposed by the SEC and the court, together with the SEC's claim as to why the four private disclosures were material and thus violative of Regulation FD. The table also provides the court's reasoning in determining that Goldman's private statements did not contain material nonpublic information and therefore did not violate Regulation FD.

In the SEC's view, the company's private disclosures, described in the table on page six, contrasted materially with the company's prior public statements. However, the court found that the SEC was relying on a hyper-technical reading of Regulation FD, stating:

> It would appear that in examining publicly and privately disclosed information, the SEC has scrutinized, at an extremely heightened level, every particular word used in the statement, including the tense of verbs and the general syntax of each sentence. No support for such an approach can be found in Regulation FD itself, or in the Proposing and Adopting Releases. Such an approach places an unreasonable burden on a company's management and spokespersons to become linguistic experts, or otherwise live in fear of violating Regulation FD should the words they use later be interpreted by the SEC as connoting even the slightest variance from the company's public statements.

Rather than focusing on the precise words that Goldman used and how they differed from those used by the CEO in his prior public statements, the court indicated that the appropriate comparison was of the substance of the public and private remarks.[3]

Court's Assessment of Materiality

The court's opinion includes several significant statements relating to the "materiality" of the private comments cited in the SEC's complaint. First, the court discounted the SEC's reliance on the effect of Goldman's disclosures on the market for Siebel's stock. The SEC sought to demonstrate materiality by pointing out that at least four of the attendees at the private meetings bought Siebel stock almost immediately after their meetings, and that Siebel's stock rose 8%, on roughly twice its average daily trading volume, on the day following a dinner at which some of the private disclosures were made. Nevertheless, the court, while acknowledging that stock movement is a relevant factor to be considered in making materiality determinations, noted that stock movement by itself is not sufficient to establish materiality. The court then concluded:

> The actions taken by those in attendance at Mr. Goldman's speaking engagements, although a relevant consideration, do

3. The court also was critical of the SEC's selective references to Siebel's public statements in claiming that Goldman's private comments contained material nonpublic information not included in the public statements. The court noted, for instance, that "[t]he SEC selectively cites, in its pleadings, to isolated portions of Siebel Systems' public statements in support of its conclusory allegation that Siebel Systems failed to publicly disclose material information which Mr. Goldman privately disclosed." The court rejected the Commission's effort to limit judicial review to the public statements cited in its complaint, concluding that "[s]ince the SEC relied on the non-disclosure in the public statements, as an integral component in the framing of its complaint, the full content of the statements, as oppose[d] to the limited portions the SEC selectively decided to include in the complaint, is properly considered by the Court."

not change the nature or content of Mr. Goldman's statements. The regulation does not prohibit persons speaking on behalf of an issuer, from providing mere positive or negative characterizations, or their optimistic or pessimistic subjective general impressions, based upon or drawn from the material information available to the public. The mere fact that analysts might have considered Mr. Goldman's private statements significant is not, standing alone, a basis to infer that Regulation FD was violated.

To support its conclusion, the court relied on the SEC's acknowledgement when it adopted Regulation FD that the new rule did not displace the so-called mosaic theory. The mosaic theory recognizes that analysts, because of their "combination of persistence, knowledge, and insight," may regard information as significant, even though it would not be material to a reasonable investor.[4]

Second, the court found it significant that none of the statements the SEC identified as violating Regulation FD fell within the seven categories of information characterized in the Regulation FD adopting release as more likely to be considered material, and thus requiring careful review.[5]

Third, the court seemed to dismiss the notion that the omission from a private statement of a qualification that was included in a prior public statement could trigger a violation of Regulation FD. One basis for the SEC's assertion that Goldman's private disclosures included material nonpublic information was that his forecasts of positive financial performance were not conditioned, as were the CEO's public forecasts, on the positive performance of the economy as a whole (which, Siebel had stated publicly, showed no signs of improving). In the SEC's view, the private statements thus conveyed a more optimistic tone than did the public remarks. The court rejected this distinction as immaterial, a conclusion that may have been influenced by the fact that the omitted qualification (general economic performance) was so generic in nature.

Alleged Failures to Maintain Disclosure Controls and Procedures

This case also marked the SEC's inaugural use of Rule 13a-15 under the Exchange Act in an enforcement action. Adopted in August 2002, Rule 13a-15 requires issuers to maintain disclosure controls and procedures designed to ensure (1) the proper handling of information required to be disclosed in Exchange Act filings; and (2) that management has the information it needs to make timely disclosure decisions. Here, the SEC charged Siebel with failing to maintain adequate disclosure controls and procedures with respect to the company's compliance with Regulation FD. In support of its claim, the SEC alleged that Siebel failed to provide formal training or adopt a formal policy regarding compliance with Regulation FD; did not memorialize the statements Goldman made in private meetings with institutional investors and analysts; and failed to make any corrective public disclosure within the time periods required by Regulation FD following Goldman's alleged selective disclosures.

The court found that the SEC's Rule 13a-15 claim was largely premised on Siebel's alleged lack of disclosure controls and procedures sufficient to prevent a violation of Regulation FD, and, since there was no violation of Regulation FD, dismissed the Rule 13a-15 claim as well.

4. Of course, the mosaic theory does not apply when the piece of information disclosed by a company that enables an analyst to complete the mosaic is itself material and nonpublic.

5. In adopting Regulation FD, the SEC enumerated seven categories that have a higher probability of being considered material, specifically: (1) earnings information; (2) mergers, acquisitions, tender offers, joint ventures or changes in assets; (3) new products or discoveries, or developments regarding customers or supplies (e.g., the acquisition or loss of a contract); (4) changes in control or in management; (5) change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report; (6) events regarding the issuer's securities (e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to rights of security holders, public or private sales of additional securities); and (7) bankruptcies or receiverships. Companies should not, however, assume that information that does not fall into one of the seven categories is not material.

Siebel's Attack on the Constitutionality of Regulation FD

The court did not need to address Siebel's challenge to the constitutionality of Regulation FD on First Amendment and due process grounds.[6] Because the court held that the complaint failed to allege a cognizable cause of action for violation of Regulation FD, it declined to reach the constitutional questions.

Practical Implications of the Case

The Case Does Not Alter the Basic Requirements of Regulation FD

Not surprisingly, the court's decision confirms that the terms "material" and "nonpublic," as used in Regulation FD, are defined as they have been under prior case law. Specifically, citing prior case law, the court explained that information is:

- "nonpublic" if it has not been disseminated in a manner sufficient to ensure its availability to the investing public; and
- "material" if there is a substantial likelihood that a reasonable shareholder would consider it important in making an investment decision.

The determination of whether particular information is "material" or "nonpublic" will continue to be made on a case-by-case basis, in light of all relevant facts and circumstances. Accordingly, executives who speak at private meetings must always be mindful of what information the company has publicly disclosed and develop a firm understanding, in advance of a private meeting, of what additional information, details or elaboration of previously disclosed information is likely to be considered material.

Executives Should Feel More Comfortable That One-on-One Meetings Are Permissible

The Siebel complaint and other recent SEC enforcement actions have led some to question whether there was anything left that could be discussed in one-on-one meetings. The court's opinion clearly confirms that private meetings and telephone calls with investors and analysts are permissible. In order to minimize the risk of violating Regulation FD when conducting private meetings, companies should follow procedures such as establishing ground rules for topics to be covered, scripting officers' remarks in advance, preparing for anticipated questions, and, where possible, having more than one company representative participate in these private sessions.[7]

Companies Remain Well Advised to Adopt Policies, Controls and Procedures Designed to Ensure Compliance with Regulation FD

In the Regulation FD adopting release, the SEC said: "Regulation FD does not expressly require issuers to adopt policies and procedures to avoid violations, but we expect that most issuers will use appropriate disclosure policies as a safeguard against selective disclosure. We are aware that many, if not most, issuers already have policies and procedures regarding certain disclosure practices, the dissemination of material information, and the question of which issuer personnel are authorized to speak to analysts, the media, or investors. The existence of an appropriate policy, and the issuer's general adherence to it, may often be relevant to determining the issuer's intent with regard to a selective disclosure."

6. Siebel's constitutional challenges were based on: (1) lack of SEC statutory authority to promulgate Regulation FD; (2) abridgement of the First Amendment right to free speech; (3) void for vagueness in violation of the due process clause; and (4) unconstitutional application.
7. When it is not possible to have more than one company representative present, the company should have a procedure for prompt "debriefing" of the participating official by the IR or legal departments so as to identify and correct any potentially problematic selective disclosures that may have occurred.

In addition, public companies are required to maintain disclosure controls and procedures (as defined in Rule 13a-15 under the Exchange Act), and, notwithstanding this case, we believe that the SEC will continue to view Rule 13a-15 as requiring controls and procedures necessary to ensure that Form 8-Ks required under Regulation FD are timely filed. Accordingly, we recommend that all companies adopt—and periodically review and update—a written disclosure policy covering topics such as the designation of authorized spokespersons, procedures for forwarding inquiries to the appropriate authorized spokesperson, the company's policy on not commenting on rumors or other market speculation and the dissemination of material nonpublic information (including guidance and guidance updates) using means that comply with Regulation FD (including filing Form 8-K when appropriate). Companies should also take reasonable steps to train personnel regarding the company's policies.

Finally, investor relations executives should remain mindful of the SEC staff's view that IR professionals share in the company's obligation to prevent or mitigate Regulation FD violations.

Conclusion

The SEC may have stretched to reach Siebel's alleged misconduct, which it viewed as too close to the line, coming less than six months after the SEC's first FD enforcement proceeding against the company. Confronted with conduct and a lack of policies and procedures that perhaps suggested that Siebel and its officers "still didn't get it" the SEC may have been motivated to take more aggressive positions on materiality than it otherwise would have. For its part, the court responded with pointed criticism of the SEC's position and cautionary words about the dangers of overly aggressive enforcement of Regulation FD. When these unusual circumstances are stripped away, however, the case provides at least one useful principle: to comply with Regulation FD, private statements need not repeat public disclosures word for word, so long as they do not "add, contradict, or significantly alter the material information available to the general public." Beyond incorporating this guidance into their understanding of Regulation FD, issuers should be cautious about reading the Siebel decision as a turning point in the SEC's enforcement of Regulation FD.

Summary of Statements Made, SEC Claim and Court's Decision

Public Statements	Private Comments	SEC Claim	Court's Decision
"Our guidance and [sic] license revenue for the quarter is 120 to 140 million range. I think that we'll see lots of small deals. We'll see some medium deals. We'll see a number of deals over a million dollars. And I suspect we'll see some greater than five. And now that's what the mix will look like."	Disclosed that there were some $5 million deals in Siebel's pipeline.	Private disclosure about $5 million deals was material nonpublic information because the public statement was in the future tense and forward-looking in nature, but the private statement was in the present tense and a statement of fact.	Private statement was equivalent in substance to the prior public statement. Although the private statement was not literally a word-for-word recitation of the public disclosure, both provided the same information. The private statement "did not add, contradict, or significantly alter the material information available to the general public."
Company did not quantify the expected impact on Q2 sales of deals that "slipped" from Q1. In response to a question regarding the makeup of the pipeline with respect to new versus existing customers: "…every quarter will be some place between 45 and 55 percent of our business with new customers."	Disclosed that new deals were coming back into the pipeline.	Private disclosure was material nonpublic information because public statements did not describe the status of Siebel's pipeline and because private statements indicated that Siebel's increased guidance for Q2 was not simply because of deals that had slipped from Q1.	The public statements clearly indicated that the Q2 pipeline would include new deals.
Reported that Q1 results were poor because the economy was poor and because some deals that were expected to close in Q1 slipped into Q2. Projected total revenues for Q2 in the range of $340-$360 million, which was greater than reported total revenues for Q1. Projected software license revenues for Q2 in the range of $120-$140 million, which was greater than reported license revenues for Q1 and noted that anticipated increase in license revenues was based on an analysis of the pipeline. Indicated there were no indications that the existing poor economy was improving.	Disclosed that the company's sales pipeline was "growing" or "building."	Private disclosure was material nonpublic information because, unlike the company's prior public statements about expected Q2 performance, the private statements were not linked to or conditioned upon the performance of the economy. In addition, the company's private comments about the economy were more "positive" and "upbeat" than the "apocalyptic economic environment" described in Siebel's public statements.	Siebel's public statements clearly demonstrated that it was projecting an increase in revenues in Q2, and that this expectation was based, in part, upon an analysis of the pipeline. Based on this information, a reasonable investor would be aware that the sales pipeline was "growing" and "building."
	Disclosed that the company's sales or business activity levels were "good" or "better."	Private disclosure was material nonpublic information because it forecasted overall positive growth, whereas Siebel's public statements avoided making such a positive affirmation and implied that Siebel's business would only improve in Q2 if the economy improved.	"The terms 'better' and 'good' are merely generalized descriptive labels based on the underlying quantitative information provided publicly [by Siebel]. Given the detailed and specific information revealed in the company's public disclosures, [the private] description of the company's performance and activity level as being 'good' and 'better' imparted no greater information to [the] private audiences than [Siebel] had already disclosed to the public at large."

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