

---

## New Case Shows Importance of Regulation FD Compliance

2010-11-08

On October 21, 2010, the Securities and Exchange Commission filed a settled administrative proceeding against Office Depot, Inc., finding that the Company violated Section 13(a) of the Securities Exchange Act and Regulation FD<sup>1</sup> when its then-CEO Stephen Odland and then-CFO Patricia McKay directed that a series of one-on-one calls be made to research analysts in which the Street's earnings expectations for Office Depot were guided down. Without admitting or denying the Commission's findings, which also included unrelated accounting violations, Office Depot consented to pay a \$1 million civil penalty and to cease and desist from any future violations.<sup>2</sup> The SEC also filed settled actions against Odland and McKay for causing the Company's Section 13(a) and Regulation FD violations. Each agreed, without admitting or denying the Commission's findings, to pay a civil penalty of \$50,000 and to cease and desist from causing or committing future violations.<sup>3</sup> This case provides another reminder that the SEC remains focused on Regulation FD compliance and of the continuing importance to public companies of having in place effective policies, procedures, and training programs to educate officers and employees on the requirements of Regulation FD.

[The SEC's Allegations and Findings: Office Depot's Selective Disclosure](#)

According to the Commission, shortly before the end of the second quarter of 2007, Office Depot selectively disclosed to numerous research analysts and to its largest institutional investors that the Company's earnings per share ("EPS") for the quarter would not meet the Street's current consensus estimate. The selective disclosures were made as a result of a strategy developed jointly by the CEO and CFO after the CEO alerted Office Depot's board that the Company was unlikely to meet analysts' consensus \$0.48 EPS estimate for the quarter. In an effort to close the gap between the Company's internal estimate of \$0.44 EPS and Street expectations, the CEO and CFO jointly decided that the Company would call all 18 analysts who covered Office Depot and refer them to certain data points from which the analysts would likely infer that Office Depot was not on track to meet expectations.

In furtherance of this plan, the CFO, the director of Investor Relations ("IR"), and the IR director's supervisor prepared talking points for the IR director to use in making the calls to analysts. According to the Commission, the talking points began with a reminder that earlier in the quarter Office Depot had "talked about a number of head winds" the Company was facing this quarter, "including a softening economy." The talking points then referred to recent earnings releases by three comparable companies, noting that two of the companies' "domestic comps were down substantially over prior quarters" and that the third company "mentioned economic conditions as a reason for their slowed growth." The talking points closed with a reminder that Office Depot's "economic model contemplates stable economic conditions" resulting in "midteens growth," echoing a similar public statement by the Company earlier in the quarter.<sup>4</sup>

Over the course of two business days, Friday, June 22 and Monday, June 25, the IR director allegedly spoke to each of the 18 analysts and communicated

the content of the talking points. Two analysts lowered their earnings estimates for Office Depot after the first day of calls, and by the end of the second day of calls, 15 of 18 analysts had done so. The calls prompted speculation among some of the analysts that Office Depot was "talking down" analysts' estimates. Throughout the four-day period (Friday through Monday), the IR director provided updates to the CEO and CFO on the calls and analysts' changes in estimates. According to the SEC orders, the CEO encouraged that the remaining analysts be called on Monday, after he received an update indicating that the consensus estimate had only come down to \$0.46 EPS. After the IR director shared with the CFO that some of the analysts he had spoken with expressed surprise that the Company had not issued a press release, the CFO instructed the IR director to call Office Depot's top 20 institutional investors to convey the same information. The IR director did so on June 26, the day after he completed the calls to analysts.

The calls made by Office Depot brought the consensus earnings estimate down from \$0.48 EPS to \$0.45 EPS. In addition, on the first day of calls, June 22, Office Depot's stock closed down 2.8% from the previous close, on trading volume that was two and a half times the average volume for the previous days of that week. On the second day of calls, June 25, the stock dropped another 3.5%. After the market closed on June 28, six days after the Company's first selective disclosure, Office Depot filed a Form 8-K publicly disclosing, among other things, that its earnings would be "negatively impacted due to continued soft economic conditions."

### Lessons from Office Depot's Experience

The Office Depot case reinforces the Commission's warning, first expressed in the Regulation FD adopting release, that private communications with analysts about earnings are a high-risk endeavor under Regulation FD.<sup>5</sup>

According to the Commission, information about earnings has a high probability of being material, even if communicated "through indirect 'guidance', the meaning of which is apparent though implied."<sup>6</sup> Similarly, interpretive guidance published by the Commission Staff makes clear that a selective disclosure late in the quarter confirming earnings expectations stated publicly early in the quarter could reasonably be viewed as communicating different information than the original public statement.<sup>7</sup> As explained by the Staff, this is because a reasonable inference can be drawn that the later confirmation is informed by knowledge of the issuer's actual performance during the quarter.<sup>8</sup>

The nature of Office Depot's communications are a reminder of the risks of attempting to communicate indirectly, including through signaling or coded speech, what Regulation FD would prohibit communicating expressly. The orders do not address whether the communications strategy was designed with the express purpose of avoiding Regulation FD or whether the individuals believed they were not providing material information and could achieve their goal without running afoul of Regulation FD. Regardless, the communications were high risk. This was the case even though the Company did not provide any explicit information about Office Depot's expected second-quarter earnings and even though, to the extent any message about earnings could be inferred from the IR director's comments, the message was largely confirmatory of public statements made by the Company early in the quarter.

In addition, it is significant that, according to the Commission's findings, Office Depot did not have any written policies and procedures on Regulation FD at the time of its violation. And the Company also had never conducted any formal Regulation FD training until June 2007, the month in which the key events occurred.

Finally, the Commission orders note that more than one analyst to whom the IR director spoke during the June 22 and 25 calls expressed surprise that the Company was not issuing a press release containing the information being conveyed in the calls. The implication is that the analysts' reactions should have prompted Office Depot to consider at that point, rather than several days later, whether it was engaged in selective disclosure that should be remedied by public disclosure.

### Conclusion

Ten years after its adoption, Regulation FD remains a focus of enforcement activity by the Commission. Companies should have in place written policies and procedures for complying with Regulation FD and should provide training regularly, including to officers and senior managers, on the prohibitions imposed by the rule. A well-designed policy could have prevented communications with analysts of the type that led to the violation here. Issuers should also consider obtaining legal advice before engaging in communications—such as the analyst calls at issue in this case—that could be problematic under Regulation FD.

---

<sup>1</sup> Regulation FD prohibits issuers from intentionally 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, unless the company publicly discloses the information simultaneously.

<sup>2</sup> See *In the Matter of Office Depot, Inc.*, Exchange Act Rel. No. 63152 (Oct. 21,

2010); *SEC v. Office Depot, Inc.*, Litigation Release No. 21703 (Oct. 21, 2010), available at [www.sec.gov/litigation/litreleases/2010/lr21703.htm](http://www.sec.gov/litigation/litreleases/2010/lr21703.htm).

<sup>3</sup> See *In the Matter of Stephen A. Odland*, Exchange Act Rel. No. 63153 (Oct. 21, 2010); *In the Matter of Patricia A. McKay, CPA*, Exchange Act Rel. No. 63154 (Oct. 21, 2010).

<sup>4</sup> In early May, at a publicly available investor conference, the Company had stated that "its business model contemplated only mid to upper teens EPS growth over the long-term."

<sup>5</sup> *Final Rule: Selective Disclosure and Insider Trading*, Exchange Act Rel. No. 43154, 65 Fed. Reg. 51,716, 51,721 (Aug. 15, 2000) ("Adopting Release").

<sup>6</sup> *Id.*

<sup>7</sup> Division of Corporation Finance: Manual of Publicly Available Telephone Interpretations, Regulation FD, Item 1 (4th supp., May 2001).

<sup>8</sup> *Id.*

## Authors

---

### Thomas W. White

RETIRED PARTNER

☎ +1 202 663 6000



### Jonathan Wolfman

PARTNER

Co-Chair, Corporate Governance and Disclosure Group

✉ [jonathan.wolfman@wilmerhale.com](mailto:jonathan.wolfman@wilmerhale.com)

☎ +1 617 526 6833