

March 8, 2021

Is the SEC Pushing the Boundaries of Regulation FD?

On Friday, the SEC [brought an enforcement action](#) charging a public company and three of its investor relations personnel with violations of Regulation FD, alleging that the company's IR personnel had fed non-public information to sell-side research analysts in order to bring their consensus revenue views more into line with the company's own internal estimates. The defendants are all contesting the charges, and the case will be litigated in federal court. While some commentators may see this as an instance of the SEC pushing the Regulation FD envelope, our view is this: if the SEC is ultimately able to substantiate its allegations at trial, the case will fall within what is generally understood to be the proper scope of Regulation FD. We explain below the reasons for this view.

The SEC complaint alleges that the individual defendants communicated material non-public information concerning expected declines in smartphone sales in the first quarter of 2016. The decline in revenue was tied to a drop in the rate at which consumers chose to upgrade their phones. According to the SEC, the company expected that this development would cause its Q1 2016 revenue to fall short of Wall Street analysts' expectations. While the company had generally disclosed a decline in smartphone sales in the prior quarter and publicly predicted a continuation of that trend, the company never publicly quantified the expected magnitude of the phenomenon in Q1 2016. The SEC alleges that, in response to this apparent disconnect between the company's internal estimates and the Wall Street consensus, the company carried out a plan to "walk the analysts down." According to the complaint, the investor relations personnel contacted 20 sell-side analysts and in one-on-one conversations conveyed non-public information, including that the company expected a historically low smartphone upgrade rate of 5% or less in Q1 2016. The analysts then lowered their revenue estimates.

The SEC's complaint and the [statement issued by the company](#) in response illustrate some of the risks that arise when public companies communicate with analysts:

- Even when there has been disclosure of a general trend, specific quantification of the impact of that trend in a given reporting period, when analysts have underestimated that quantification, can be material.

If your address changes or if you do not wish to continue receiving these memos, please send an e-mail to Publications@wlrk.com or call 212-403-1443

- While the participants in the conversations asserted they did not believe that material information was transmitted, materiality is legally defined as information that a reasonable investor would want to know before deciding to buy or sell a company's securities.
- Regulation FD investigations always include a comprehensive search for contemporaneous records of the substance of conversations. Such evidence is viewed by the SEC as highly probative of both what was communicated and whether the information was viewed as material at the time. Here, the SEC's complaint quotes emails allegedly sent by the analysts to colleagues and clients recounting what they were told.
- It is an appropriate technique, widely employed and compliant with Regulation FD, to point analysts to publicly available information as a way of encouraging them to reconsider whether their own assumptions are erroneous. Here, the complaint alleges that one of the investor relations personnel falsely told some analysts that the consensus expectation among analysts at the time was a 5% upgrade rate.

As noted above, the SEC's allegations here will be tested through the litigation process. At this stage, reviewing only the allegations in the SEC's complaint, this case appears to reinforce some familiar lessons under Regulation FD: efforts undertaken expressly to "walk down" analysts will draw regulatory suspicion; materiality is judged on an objective standard; specific quantifications of the expected impact of a publicly disclosed trend will be viewed by regulators as providing information distinct from the general trend disclosure; contemporaneous evidence of communications with analysts and their reactions to those communications is critically important; referring analysts to accurate information that is genuinely publicly available as part of a good-faith effort to invite analysts to revisit their assumptions and estimates does not violate Regulation FD; and seeking expert advice about how best to address a perceived disconnect between a company's internal estimates and Wall Street analysts' views can help to avoid potential regulatory scrutiny.

John F. Savarese
Wayne M. Carlin