

## **SEC MOVES REGULATION FD ENFORCEMENT INTO UNCERTAIN TERRITORY**

The Securities and Exchange Commission on March 24, 2005 settled enforcement proceedings citing Flowserve Corporation's Chairman, President and CEO C. Scott Greer, and Director of Investor Relations Michael Conley with violating Regulation FD and Section 13(a) of the Securities Exchange Act of 1934.

In doing so, the SEC moved the enforcement of Reg FD into a more uncertain area in terms of how far into the quarter or year a company can reaffirm, in a nonpublic venue, previously released financial guidance before it becomes material information. Moreover, this case coupled with others clearly demonstrates that the SEC considers the investor relations officer to be the "Chief Compliance Officer" when it comes to Reg FD.

Without admitting or denying the Commission's charges in a lawsuit filed in the U.S. District Court for the District of Columbia, Flowserve and Greer were fined \$350,000 and Greer personally will pay a \$50,000 civil penalty. Conley was not fined.

The Commission charged that Flowserve (with a December 31 fiscal year end) publicly issued earnings guidance early in 2002 and, in July of that year, lowered its EPS guidance. It again lowered its guidance in September, which the company reaffirmed in its Form 10-Q filed on October 22, 2002. That range represented a decline of more than 30% in its EPS estimates since the beginning of the year.

On November 19, 2002, Greer and Conley met privately at their Irving, Texas headquarters with analysts from four investment and brokerage firms. This was six weeks before the end of the fiscal year. During the meeting, one of the analysts asked about the company's EPS guidance for the year. According to SEC charges, before Greer answered the analyst's question, Conley did not caution Greer by reminding him that, according to the company's disclosure policy, earnings guidance was effective on the date given and would not be updated until the company publicly announced updated guidance. In fact, the SEC said Conley remained altogether silent while Greer reaffirmed the previous guidance issued on October 22.

According to the SEC, "Having heard the exchange between Greer and the analyst, Conley was silent and said nothing to explain Greer's statements." Moreover, the commission said Conley also failed to reiterate the Company policy as to earnings guidance.

The following day, an analyst who attended the meeting issued a report through First Call saying that Flowserve had reaffirmed its earnings guidance. On November 21, Flowserve's stock price closed 6% higher than the previous close and trading volume increased 75% to 658,300 shares from 379,500 the previous day. After the market closed on November 21, Flowserve furnished an 8-K to the SEC saying it had "reaffirmed its full-year 2002 estimated earnings per share."

The SEC found that Flowserve "through its CEO, Greer, intentionally and selectively disclosed material, nonpublic information to securities market professionals when, on November 19th, 2005, Greer disclosed Flowserve's continued confidence in its earning guidance during a private meeting with selected analysis." The SEC press release noted that the Commission also considered the lack of cooperation, stating specifically that Greer and Conley denied a reaffirmation occurred at the meeting.

The SEC said this was the first Reg FD case involving a reaffirmation of earnings guidance by an issuer and the first settled enforcement action against a Director of Investor Relations for violating this rule.

One of the key issues raised by the Flowserve case is how far into the reporting period a company can reaffirm, in a nonpublic meeting, previously released earnings guidance without it constituting material information and therefore in violation of Reg FD. In September 2000, following the issuance of FD as a proposed rule, then SEC General Counsel David Becker participated in a webcast where he was asked how far into the quarter a company could reaffirm earlier guidance before it becomes a material disclosure. He was reluctant to be too specific but said that by mid-quarter a company should have a fairly good idea of how the quarter was going, much better than when it first issued the guidance.

After that webcast, there was a significant increase in the number of companies that issued mid-quarter news releases either updating earlier guidance or reaffirming it. Some of these were accompanied by fully accessible conference calls.

With respect to this issue, following is found in the *NIRI Standards of Practice for Investor Relations*, January 2004, Appendix A, Sample Disclosure Policy). under the section, "Providing Earnings Guidance to Analysts and Investors:"

"It is the company's policy to update the range of estimates should it become likely that the range will change materially. That update will be done in a widely disseminated news release. The company may confirm (publicly) its earlier guidance during the quarter so long as it has not changed materially. However, as the quarter progresses, once the company has a clearer fix on the financial or business related results for the quarter, it will no longer comment on its previous earnings guidance without first issuing a news release providing an update for the quarter."

In view of the Flowserve case, some companies may decide not to reaffirm earlier guidance unless they do so publicly and simply say, in response to query, that it is the company's policy not to comment on earnings guidance in nonpublic meetings.

An alternative would be for a company, in advance of a nonpublic meeting, to issue a release saying that company officials will be meeting with analysts and investors in a series of meetings over the next few days and, if asked, the company intends to reaffirm its earlier guidance that it expects to achieve earnings per share for the quarter (or fiscal year) within a range of \_\_\_.

Given the SEC's emphasis on the role of the investor relations officer with respect to ensuring company compliance with Reg FD, it is important for senior management to see that the IRO has a seat at the table, that the IRO participates in meetings with analysts/investors and that the IRO actively advises company officials on FD matters. That means the SEC expects the IRO to stop a company official from responding to a question if, in the IRO's judgment, it would be inconsistent with the company's disclosure policy and or in violation of Reg FD. If an official makes a statement that the IRO believes was an inadvertent disclosure of material, nonpublic information, then the company should issue a news release and/or furnish an 8-K to the SEC, within 24 hours of the time the statement was made, containing that information.

In a March 24 Dow Jones Newswire story on this case, Judith Burns quoted Paul R. Berger, Associate Director of the SEC's Division of Enforcement saying, "Earnings guidance 'takes on a

little bit more solidity' when it comes near the end of a quarter or year." The article went on, "Many companies provide earnings guidance and Berger said he hopes the SEC's lawsuit against Flowserve doesn't cause companies to clam up."

*This column is derived largely from a NIRI statement on this topic.*