

**DISCLOSURE UPDATE:  
PUBLIC COMPANY  
DISCLOSURES IN A  
DANGEROUS WORLD**



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& Legal Issues Conference  
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# Summary of Topics

- Update on SEC Disclosure Guidelines
  - Including Non-GAAP; Climate Change
- Recent Developments in Securities Litigation
- Recent Developments in SEC Enforcement
- Public Company Disclosure Tips
- Questions

# Update on SEC Disclosure Guidelines

- New Interpretations Regarding Non-GAAP Financial Measures
- SEC Statement on Climate Change
- SEC Comments and Process

# Non-GAAP Financial Measures: Generation Non-GAAP

- SEC rewrite of Compliance & Disclosure Interpretations (“C&DIs”) in January 2010
  - [www.sec.gov/divisions/corpfin/cfguidance/shtml/](http://www.sec.gov/divisions/corpfin/cfguidance/shtml/) under “Non-GAAP Financial Measures”
- First revisiting of interpretations of Regulation G and Item 10(e) of Regulation S-K since adoption of Regulation G
- New culture of non-GAAP openness?

# Main Changes in C&DIs

- may *exclude the impact of recurring items* (must not be labeled as “non-recurring”)
- may present measures *not used by management* in evaluating the business
- may present *reconciliation on a net-of-tax basis* (so long as tax effect of each reconciling item, and manner of calculating tax, is disclosed)
- may now use *Adjusted EBITDA*

# Other Changes

- No More “Shadow Disclosure”?
- Summary Cheat Sheet
  - See the “Generation Non-GAAP” summary table in written materials that lists in bullet point format the now-current requirements pertaining to the use non-GAAP financial measures (also available at the Small Public Company Forum website: [www.smallpubcoforum.com](http://www.smallpubcoforum.com))

# Climate Change Disclosure: A Change in the Political "Climate"

- Recent Developments from 2009
  - Pending legislation
  - EPA "endangerment finding" and mandatory reporting
  - State and regional initiatives
  - International initiatives
  - NY Attorney General 2007 lawsuit against energy companies
  - Some measure of success in private litigation

# Climate Change Guidance: Overview

- No new rules: SEC guidance in February 2010 designed to provide SEC view of existing disclosure requirements as they may apply to climate change matters. (Release No. 34-61469.)

# . . . Climate Change Guidance: Overview

- Guidance is a reminder that regulatory, legislative and physical developments arising from climate change, and any business and market outcomes from those developments, could have a significant effect on operating and financial decisions.

# Climate Change: What Were We Supposed to Have Been Doing?

- Specific reminders of potential obligations under:
  - ***Business Description***—effects of compliance with federal, state and local environmental laws and regulations (see Item 101(c)(1)(xii))

# . . . Climate Change: What Were We Supposed to Have Been Doing?

- ***Litigation***—judicial or administrative proceedings arising under regulations or laws designed to protect the environment (see Item 103, Instruction 5)
  - Material to business or financial condition
  - Involves claims or sanctions in excess of 10% consolidated current assets
  - Potential governmental/administrative sanctions of \$100,000+
  - No exception for ordinary litigation incidental to business

# . . . Climate Change: What Were We Supposed to Have Been Doing?

- Specific reminders of potential obligations under:
  - ***MD&A***
    - How to assess materiality of uncertainties or trends? (likelihood + magnitude)
    - Consider sufficiency of controls & procedures
    - When drafting, address difficulties of assessing uncertainties
  - ***Risk Factors***

# Climate Change: More Reminders

- Have your doubts? Be mindful of the broader purpose: “it is appropriate that these doubts be resolved in favor of those the statute is designed to protect.”
- Can't find an affirmative obligation to disclose? Remember Rules 408 and 12b-20: “...such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.”

# Climate Change: What it Means

- Not all companies will need to change their disclosure
- Who will? Manufacturers, emitters of “greenhouse gases,” environmentally-sensitive businesses, or geographically-sensitive businesses

# . . . Climate Change: What it Means

What to consider and do:

- Review disclosure of your peers
- How best to evaluate these risks and need for disclosure? (Disclosure Cmte? Part of Sarbanes/internal audit process?)
- At least annually (and at least cover enumerated items)
- How best to document evaluation? (be prepared)

# SEC Comments Update

- SEC Guidance on Comment Process
  - Division of Corporation Finance – December 2010 Statement on comment process:  
<http://www.sec.gov/divisions/corpfin/cffilingreview.htm>
  - Provides useful guidance on internal SEC review process

# Recent Developments in Securities Litigation

- Case filings are down with a 24% decline in 2009
- Plaintiffs filed more cases long after the date of the alleged corrective disclosure with a median filing lag of 100 days
- Like 2008, in 2009 the financial sector had most lawsuits with 84 filings
- A few notable developments in the case law

## ... Recent Developments in Securities Litigation

- *Merck & Co. v. Reynolds*, 559 U.S. \_\_\_\_ (2010) [in course materials]
  - Class action filed alleging misrepresentation about the health risks associated with Vioxx
  - Lower court dismissed based on statute of limitations argument that plaintiffs had knowledge of facts more than two years earlier when the FDA had issued a warning letter
  - Third Circuit reversed
  - U.S. Supreme Court affirmed the Third Circuit holding that inquiry notice is not sufficient to trigger the two-year statute of limitations

# ... Recent Developments in Securities Litigation

- *Morrison v. National Australia Bank Ltd.*, U.S. No. 08-1191
  - Case argued before the U.S. Supreme Court on March 29, 2010
  - Case under the federal securities laws involving foreign claimants, who purchase stock of a foreign issuer, on a foreign exchange.
  - Second Circuit affirmed dismissal of the lawsuit brought by shareholders of National Australia Bank Ltd. alleging fraud on the part of a Florida subsidiary

## . . . . Recent Developments in Securities Litigation

- *Archdiocese of Milwaukee Supporting Fund Inc. v. Halliburton Co.*, (5th Cir. 2010)
  - District Court denied class certification in case alleging that Halliburton had misled investors by misrepresenting revenue, asbestos litigation expenses and benefits of a merger based on failure to show loss causation
  - Fifth Circuit affirmed noting that plaintiff must show loss causation at the class certification stage by a preponderance of all admissible evidence

## . . . Recent Developments in Securities Litigation

- *In re Williams Securities Litigation*, 558 F.3d 1130 (10th Cir. 2009)
  - Plaintiff offered a leakage theory of loss causation – true financial condition was revealed over time and the stock responded
  - Tenth Circuit affirmed the lower court's summary judgment

## ... Recent Developments in Securities Litigation

- *In re Williams Securities Litigation*, 558 F.3d 1130 (10th Cir. 2009)
  - Expert must: “differentiate between losses cognizable under loss causation doctrine on one hand, and on the other hand, losses attributable to industry-specific stresses, the meltdown in the telecommunications sector and other negative developments unrelated to the alleged fraud.”

## . . . Recent Developments in Securities Litigation

- *Slayton v. American Express Company, et al.*, No. 08-5442-cv (2d Cir., May 18, 2010) [in course materials]
  - Second Circuit affirmed dismissal of amended complaint
  - Court addressed the safe harbor of the PSLRA
  - Arose out of huge losses from CDO investments and Amex's disclosure that: "the worst of the problem was behind it and that total losses on these investments . . . are expected to be substantially lower than in the first quarter"

## . . . . Recent Developments in Securities Litigation

- *Slayton v. American Express Company, et al.*, No. 08-5442-cv (2d Cir., May 18, 2010)
  - Court held that statement contained in the MD&A qualifies as forward looking
  - Court considered the following cautionary statement: “potential deterioration in the high-yield sector. . . could result in further losses in AEFA’s portfolio.”

# Recent Developments in SEC Enforcement

- Organizational changes in the wake of failures
  - Enforcement division reorganized
    - Asset Management unit
    - Market Abuse unit
    - FCPA unit
    - Municipal securities and public pensions unit
    - Structured and new products unit

# . . . . Recent Developments in SEC Enforcement

- Organizational changes in the wake of failures, cont.
  - Enforcement division streamlined processes
    - No formal order needed to issue subpoenas
    - Tolling agreements only for special cases
    - Secretary is not only person who can issue formal order
    - Branch chiefs now in the trenches
  - More incentives for cooperation
    - Seaboard policy for individuals
    - Use of cooperation agreements
  - More enforcement activity

# ... Recent Developments in SEC Enforcement

- More Enforcement Activity

	<b>Fiscal 2008</b>	<b>Fiscal 2009</b>
Investigations Opened	233	496
TRO Cases	39	71
Enforcement Actions	Not supplied	664

- Fiscal years ended September 30. Source: Testimony of Robert Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission before the U.S. Senate Committee on the Judiciary, December 9, 2009

# . . . . Recent Developments in SEC Enforcement

- Expansive use of enforcement powers
  - Section 304 claw back used against an individual who was not alleged to have violated the securities laws. *SEC v. Jenkins*
  - Pursuit of CEO and CFO in FCPA matter under the 1934 Exchange Act's control person liability provision in matter where SEC did not allege that either party participated in or had underlying knowledge of the bribes. *SEC v. Nature's Sunshine Products, Inc.*

## ... Recent Developments in SEC Enforcement

- Expansive use of enforcement powers
  - Pursuit of Goldman Sachs for fraud arising out of a 144A transaction
  - Consent decree in November 2009 with former SafeNet officers and accountants for accounting fraud

# . . . . Recent Developments in SEC Enforcement

- Publication of SEC Enforcement Manual
  - <http://www.sec.gov/divisions/enforce/enforcementmanual.pdf>
  - Black box has been opened
  - Manual reflects internal policies

# Public Company Disclosure Tips

- How not to get:



# Tips to Avoid Disclosure Problems

- The basics – do your best on the close calls
  - Financial statements and earnings disclosures
  - Revisit forward looking disclaimers, risk factors and MD&A in light of current conditions
  - Materiality of information – “Reasonable investor”
  - Remember public skepticism and SEC activism (business as usual may not be enough)

# Tips to Avoid Disclosure Problems

- The basics – do your best on the close calls
  - Timing of disclosures
    - Apple Computer – Steve Jobs' illness
    - Goldman Sachs – Wells notice
    - 10-K, 10-Q and 8-K requirements vs. general duty to disclose material information
  - “Don't get caught cheating”
  - Just in case, check your D&O Policy
    - Does it cover SEC investigation expenses?

# . . . Tips to Avoid Disclosure Problems

- Focus on process
  - In light of public scrutiny, it's important to have consistency and proper oversight
  - Disclosure controls - procedures designed to ensure that relevant information gets to the CEO and CFO
    - SEC Rules 13a-15(b) and 15d-15(b)
    - Certifications in 10-K and 10-Q
    - "Internal controls" under Section 404 of SOX are similar, and also may come into play

# . . . Tips to Avoid Disclosure Problems

- Focus on process
  - Make sure disclosure controls are formalized (written and compiled)
    - Internal disclosure committee to review filings, make sure disclosure controls are followed and adjusted if necessary
    - Sub-certifications – do personnel certify results of subsidiaries, divisions, etc. to CEO and CFO?
  - Re-examine whistleblower policies, especially in relation to reporting of financial fraud

# . . . Tips to Avoid Disclosure Problems

- Focus on process
  - Consider a formal Communications Policy [included in course materials]
    - Control flow of information to analysts, media, etc.
    - Reduce the risk of inconsistent or misleading statements
    - Compliance with Regulation FD (prohibiting selective disclosures to analysts)
      - Subject of SEC enforcement activity
    - Consider addressing social networking
      - Can “tweets” be actionable? (Ruby Tuesday CEO)

# . . . Tips to Avoid Disclosure Problems

- Focus on process
  - Review website and make sure disclosures are consistent with public reports
    - Linking to analysts reports and other third party information
    - 2008 SEC release on website disclosure
  - Careful about disclosure of non-GAAP financial measures

# . . . Tips to Avoid Disclosure Problems

- Focus on process
  - Insider trading policy
    - Make sure policy is up to date and policed
    - Insider trading gives plaintiffs and SEC additional basis for actions
    - Watch out for Rule 10b5-1 Plans
    - Impact of margin accounts
    - Are there problematic relationships with hedge funds?

Hopefully, You Can Avoid Being:



# Questions?



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