DechertOnPoint

October 2005 / Special Alert

A legal update from Dechert's Financial Services and Securities Litigation and Financial Services Groups

SEC Dealt Setback in Regulation FD Action

On August 31, 2005, in the first litigated Regulation FD case, the U.S. District Court for the Southern District of New York dismissed a claim by the Securities and Exchange Commission ("SEC") that Siebel Systems, Inc. ("Siebel") had violated Regulation FD.[1] The court also rejected the SEC's charges against Siebel's chief financial officer ("CFO") and its former director of investment relations for aiding and abetting the alleged violations. The SEC is considering appealing the decision, according to recent reports in *The Wall Street Journal*.

Regulation FD was adopted in October 2000 to prohibit public companies from selectively disclosing material nonpublic information to securities analysts, broker-dealers, investment advisers, and investors before disclosing the same information to the public.[2] Inadvertent disclosures of material information must be cured with a public release of the information within 24 hours. Since the regulation's adoption five years ago, and prior to the case at bar, the SEC had brought six enforcement actions alleging violations, one of which involved Siebel.[3] Each of these actions has been settled.

The SEC's claim stemmed from two private events on April 30, 2003: a one-on-one meeting with an institutional investor, and an invitation-only dinner hosted by Morgan Stanley & Co. At the two private events, Seibel's CFO allegedly "made positive comments about [Siebel's] business activity levels and transaction pipeline" that "materially contrasted with negative public statements made by [Siebel] concerning its business in the three weeks leading up to the private meetings."[4] Siebel's CFO also apparently stated at the private events that the company's activity levels were improving, and that there were deals in the pipeline of at least $5 million in value.

According to the complaint, these comments were in material contrast to statements made by Siebel's chief executive officer ("CEO") during an April 23, 2003 earnings call and an April 28, 2003 conference broadcast over the internet, both of which the SEC characterized as negative in tone. At the earlier events, Siebel had announced that it would not meet first-quarter targets.

The SEC contended that Siebel had made four particular comments that violated Regulation FD:

- That the company had some $5 million in deals pending in 2003 second quarter
- That there were additional deals expected in the sales pipeline
- That the sales pipeline was "growing" or "building"
- That Siebel's sales or business activity levels were "good" or "better"

---

1 *SEC v. Siebel Systems, Inc., Kenneth A. Goldman and Mark D. Hanson*, __ F.Supp.2d __, 2005 WL 2100269 (S.D.N.Y. Sept. 1, 2005).

2 *See* SEC's Adopting Release for Regulation FD, "Selective Disclosure and Insider Trading," August 15, 2000, Rel. No. 33-7881, 34-43154, IC-24599, File No. S7-31-99, 65 Fed. Reg. 51716, 51718.

3 *In the Matter of Secure Computing Corp.*, Exchange Act Rel. No. 46895 (Nov. 25, 2002); *In the Matter of Raytheon Co.*, Exchange Act Rel. No. 46897 (Nov. 25, 2002); *In the Matter of Siebel Systems, Inc.*, Exchange Act Rel. No. 46896 (Nov. 25, 2002); *In the Matter of Schering-Plough Corp.*, Exchange Act Rel. No. 48461 (Sept. 9, 2003); *In the Matter of Senetek PLC*, Exchange Act Rel. No. 50400 (Sept. 16, 2004); *In the Matter of Flowserve Corp.*, Exchange Act Rel. No.51427 (Mar. 24, 2005).

4 *Siebel*, 2005 WL 2100269 at *1-2.

The court found that Siebel's April 30 comments about the pending $5 million deals and other pending deals were equivalent in substance to earlier information Siebel had previously publicly announced. The court noted that there is no requirement that a comment be repeated verbatim to be considered equivalent in meaning.

Similarly, the court found that Siebel's comments about its sales in the pipeline "growing" and "building" were included in previously disclosed public forums. The statements "did not add, contradict, or significantly alter the material information available to the public," and therefore did not constitute a violation of Regulation FD.[5] The court also held that Siebel's comments about the company's sales activity levels being "good" or "better" were innocuous because they were merely generalized descriptive labels based on information that was available to the public.

The SEC's charges relied in part on an 8% jump in stock price after the April 30 private meetings. According to the SEC, the rapid rise of the stock's price in the wake of the meetings indicated that Siebel's comments at the meetings were new and material. Siebel stock rose from $8.66 at close on April 30 to $9.34 at close on May 1. Although the court noted that the increase in the stock price was a relevant factor in a materiality determination, the stock movement by itself was not a sufficient factor to establish materiality.

In rejecting the SEC's argument, the court found that the attendee's actions did not change the nature or content of the April 30 comments:

> "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."[6]

The court criticized the SEC's application of the regulation, writing in the 27-page opinion that the SEC's interpretation of Siebel's statements was inconsistent with the aim of the regulation. While Regulation FD was adopted in order to promote the full and fair disclosure of information to the public, the court noted that the SEC's narrow reading of the regulation "could compel companies to discontinue any spontaneous communications and restrict the dissemination of "relevant investment information."[7] The court further noted that there was nothing in Regulation FD that supported the SEC's approach of scrutinizing "at an extremely heightened level, every particular word used in the statement, including the test of verbs and the general syntax of each sentence."[8]

As the first litigated Regulation FD case, the *Siebel* decision establishes relatively restrictive boundaries for the SEC's enforcement of the regulation. The case is clearly a setback for the SEC in light of its previous commentary indicating that it intended to vigorously enforce Regulation FD.[9] Although public companies should still use the utmost caution in the preparation and monitoring of both private and public statements, the *Siebel* decision indicates that the judiciary may not be as likely to ascribe to the SEC's narrow application of Regulation FD.[10]

Siebel settled a previous case with SEC involving Regulation FD in November 2002.[11] In that case, Siebel paid regulators a $250,000 penalty to settle charges that it violated Regulation FD when its CEO privately discussed information to certain investors. Siebel neither admitted nor denied that it had violated Regulation FD in the 2002 matter.

■ ■ ■

This update was authored by Catherine Botticelli (+1.202.261.3368; catherine.botticelli@dechert.com), Alan Rosenblat (+1.202.261.3332; alan.rosenblat@dechert.com), and Tara Kelly (+1.202.261.3329; tara.kelly@dechert.com).

5 *Siebel*, 2005 WL 2100269 at *9.

6 *Id.* at *11.

7 *Id.*

8 *Id.*

9 Richard H. Walker, Director of Enforcement, Remarks Before the Compliance and Legal Division of the Securities Industry Association, "Regulation FD: An Enforcement Perspective" (Nov. 1, 2000) ("...[Y]ou should understand that the Enforcement Division is not a toothless tiger. We expect issuers and others to conform their conduct to the requirements of the rule, and if they don't, we will take steps to make them do so.")

10 For guidance on avoiding a Regulation FD violation, *see Dechert OnPoint* Special Alert: "*SEC Charges Siebel Systems, Inc. and Two Senior Executives With Regulation FD and Rule 13a-15 Violations*," July 1, 2004.

11 *See In the Matter of Siebel Systems, Inc.*, Exchange Act Rel. No. 46896 (Nov. 25, 2002).

Practice group contacts

If you have questions regarding the information in this legal update, please contact the authors, the Dechert attorney with whom you regularly work, or any of the attorneys listed. Visit us at www.dechert.com/financialserviceslit or www.dechert.com/financialservices.

Sander M. Bieber
Washington
+1.202.261.3308
sander.bieber@dechert.com

Catherine Botticelli
Washington
+1.202.261.3368
catherine.botticelli@dechert.com

Douglas P. Dick
Newport Beach
+1.949.442.6060
douglas.dick@dechert.com

William K. Dodds
New York
+1.212.698.3557
william.dodds@dechert.com

Ruth S. Epstein
Washington
+1.202.261.3322
ruth.epstein@dechert.com

Susan C. Ervin
Washington
+1.202.261.3325
susan.ervin@dechert.com

Joseph R. Fleming
Boston
+1.617.728.7161
joseph.fleming@dechert.com

Brendan C. Fox
Washington
+1.202.261.3381
brendan.fox@dechert.com

David J. Harris
Washington
+1.202.261.3385
david.harris@dechert.com

Robert W. Helm
Washington
+1.202.261.3356
robert.helm@dechert.com

David M. Howard
Philadelphia
+1.215.994.2218
david.howard@dechert.com

Paul Huey-Burns
Washington
+1.202.261.3433
paul.huey-burns@dechert.com

Jane A. Kanter
Washington
+1.202.261.3302
jane.kanter@dechert.com

Stuart Kaswell
Washington
+1.202.261.3314
stuart.kaswell@dechert.com

George J. Mazin
New York
+1.212.698.3570
george.mazin@dechert.com

Jack W. Murphy
Washington
+1.202.261.3303
jack.murphy@dechert.com

John V. O'Hanlon
Boston
+1.617.728.7111
john.ohanlon@dechert.com

Jeffrey S. Puretz
Washington
+1.202.261.3358
jeffrey.puretz@dechert.com

Jon S. Rand
New York
+1.212.698.3634
jon.rand@dechert.com

Keith T. Robinson
Washington
+1.202.261.3386
keith.robinson@dechert.com

Frederick H. Sherley
Charlotte
+1.704.339.3100
frederick.sherley@dechert.com

Patrick W.D. Turley
Washington
+1.202.261.3364
patrick.turley@dechert.com

Brian S. Vargo
Philadelphia
+1.215.994.2880
brian.vargo@dechert.com

David A. Vaughan
Washington
+1.202.261.3355
david.vaughan@dechert.com

Dechert LLP
www.dechert.com

U.S.

Boston
Charlotte
Harrisburg
Hartford
New York
Newport Beach
Palo Alto
Philadelphia
Princeton
San Francisco
Washington, D.C.

U.K./Europe

Brussels
Frankfurt
London
Luxembourg
Munich
Paris

© 2005 Dechert LLP. All rights reserved. Materials have been abridged from laws, court decisions, and administrative rulings and should not be considered as legal opinions on specific facts or as a substitute for legal counsel.