Putting It All Together:
How Recent SEC Rules and Regulations Combine to Create a New Disclosure Environment

Stephen D. Poss, P.C.
Goodwin Procter LLP

Dallas, May 17-18, 2001
An important note:

These materials, and the oral presentation accompanying them, are for educational purposes only and do not constitute legal advice or create an attorney-client relationship. Consult an attorney about your particular facts and circumstances.

The materials and presentation are simplified for educational purposes and are not a complete statement of the law.

The views expressed in this presentation do not necessarily represent the views of Goodwin Procter LLP or its clients.
Synergy

“The interaction of elements that when combined produce a total effect that is greater then the sum of the individual elements”
<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 1995</td>
<td>Private Securities Litigation Reform Act</td>
</tr>
<tr>
<td>October 1998</td>
<td>Plain English Effective</td>
</tr>
<tr>
<td>August 1999</td>
<td>SAB 99 on Materiality</td>
</tr>
<tr>
<td>November 1999</td>
<td>SAB 100 on Restructuring Changes</td>
</tr>
<tr>
<td>December 1999</td>
<td>Audit Committee Rules</td>
</tr>
<tr>
<td>December 1999</td>
<td>SAB 101 on Revenue Recognition</td>
</tr>
</tbody>
</table>
The Elements:

April 2000  --  Interpretive Release on use of Electronic Media

October 2000  --  Reg. FD and Rules 10b5-1 and 10b5-2

February 2001  --  Auditor Independence
The Effect:

New Disclosure Environment

A New Risk Landscape

- More disclosure being made
- In a more complex regulatory environment
- Observed by more sophisticated plaintiffs’ lawyers and regulators
Why Should You Care?

- The Reform Act did not halt the advance of securities class action suits
- More than 230 issuers sued in 2000
- Probability of getting sued has increased
- Average settlement has doubled to more than $11 million
- More mega-settlements
- More sophisticated plaintiffs
- More suits filed by experienced plaintiffs’ Lawyers
What Happens if You do not Adapt to this New Disclosure Environment?

“When Bad Things Happen to Good Companies”
We Will Focus Today Particularly on the Interplay of:

SAB 99
Reg. FD
Safe Harbor Disclosures
SAB 99 on Materiality

• “The magnitude of a misstatement is only the beginning” of materiality analysis
• Quantitative threshold no substitute for a “full analysis of all relevant considerations”
• “Qualitative factors” must be considered
New Focus

Will a misstatement, even if quantitatively small, effect benchmarks important to the market?

- Marks a change in earnings or other trends?
- Hides a failure to meet analysts’ estimates?
- Changes income into a loss?
- Affects compliance with regulations, loan covenants or contractual requirements?
- Will increase management compensation?
- Conceals unlawful transaction?
One Size Doesn’t Fit All

Materiality analysis must consider the nature of the company and its trading history

• Has the issuer experienced “demonstrated volatility” in response to certain types of disclosures?
• Would management or the auditors expect that the misstatement would cause a significant market reaction?
• Is it in an important segment?
SEC Reg. FD

Requires simultaneous public disclosure of material information
Defines all “guidance” on projected financial results as likely to be material
Impact of Reg. FD

guidance out in the open
more pre-releases
more public forward-looking statements
a sea-change in corporate communications
and . . .
a dramatic increase in risk of liability for securities fraud
The Safe Harbor

Part of the 1995 Private Securities Litigation Reform Act

Designed “to enhance market efficiency by encouraging companies to disclose forward-looking information”

Provides meaningful protection from lawsuits and liability . . .
if you are rigorous in complying with the statute’s requirements

The problem: many issuers get it wrong
The Basics:

- In a private securities fraud lawsuit alleging untrue statements or omission of a material fact:

  “a person . . . Shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that

  (A) the forward-looking statement is

  (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

  (ii) immaterial

15 U.S.C. § 78u-5(c)
Key Elements:

- "forward-looking"
- "identified"
- "accompanied"
- "meaningful cautionary statements"
- "could cause"
- "differ materially"
What are forward-looking statements?

The Reform Act says they include, among other things:

(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss per share, capital expenditures, dividends, capital structure, or other financial items);

(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;

(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
What are forward-looking statements?

(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);

(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or

(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission;

15 U.S.C. § 78u-5(i)
How do you “identify” forward-looking statements?

- by key words
- by general subject matter
- by specific subject matter

The more specificity the better
What does it mean to “accompany” the forward-looking statement with a meaningful cautionary statement?

Written forward-looking statements:
the cautionary statement should be in the same document
Oral forward-looking statements:

may be accompanied by “an oral statement” that the cautionary disclosures are

- “contained in a readily available written document, or portion thereof”
- the document or portion must be identified
- the factors in the cross-referenced document must actually relate to the oral forward-looking statement
- the cautionary statements in the cross-referenced document must satisfy the same standard as for written forward-looking statements
- the cross-referenced document must be “readily available”
Disclosure Tune-up

Match all guidance with specific cautionary statements

Check all cross-references to make sure they match with oral forward-looking statements

Check all cross-references from written forward-looking statements to make sure you are not relying on the cross-referenced cautionary statements as your only Safe Harbor protection
Warnings:

If you see a written cross reference, it is probably not an effective Safe Harbor statement.

Watch for conversion of oral forward-looking statements to written form.

The cross-reference for oral statements only works if the risk factors in the cross-referenced document actually relate to the oral forward-looking statements.
Apply the SAB 99 materiality standards to all forward-looking statements and all risk factors disclosures.

Live by the sword . . .
if you thought it important enough to mention in the press release or speech, it is probably “material” enough to warrant Safe Harbor protection.

Update, update, update . . .
if your Safe Harbor disclosures have not changed recently they are probably defective.
Be both specific and general in risk factors disclosure
Final checks: Play the name game