# THE PRICE OF SILENCE

## INVESTOR RELATIONS PROFESSIONALS MUST REIN IN CORPORATE OFFICERS

### BY STEVEN M. HECHT, ANTHONY O. PERGOLA, AND KHIZAR A. SHEIKH

Despite high-profile corporate scandals and the subsequent rigorous regulatory enforcement in recent years, the enforcement of Regulation FD by the Securities and Exchange Commission is still very much a work in progress. Recent rulings have broadened interpretation of Reg FD, as well as the cast of possible culprits, and should serve as a warning for all to be vigilant in any matters regarding securities regulation.

In one of the most striking cases of the past year—one sure to make investor relations and other corporate communications professionals sit up and take notice—the SEC settled an enforcement action against **Flowserve Corp.**, its chief executive officer and its director of investor relations for violating Regulation FD and Section 13(a) of the Securities Exchange Act of 1934, 15 USC § 78m(a).

In the Flowserve case, the director of investor relations was found to have violated Reg FD because he stayed silent during a private meeting in which the company's CEO reaffirmed earnings guidance for a select group of research analysts.

The action is significant for being the first settled enforcement action brought against an investment relations professional under Regulation FD. In addition, it is the first settled enforcement action alleging a violation based upon the mere reaffirmation—rather than modification—of earnings guidance. Flowserve underscores the SEC's view that investor relations and other corporate communications personnel should play a heightened role in ensuring compliance with federal securities laws and also illustrates the cautious manner in which any discussion of earnings guidance should be handled in a nonpublic forum.

Regulation FD was promulgated more than five years ago to ensure a level playing field for all investors by giving previously disadvantaged small investors equal access to material nonpublic information released by public companies. Generally, Regulation FD prohibits a public company from disclosing any material nonpublic information regarding the company or its securities to a securities professional or a stockholder if the holder may trade in the securities on the basis of the information.

On the morning of Nov. 19, 2002, just over a month before the close of its quarter, Flowserve invited several securities analysts to a private retreat to discuss the company's general business condition. At one point, the CEO was asked about previous earnings guidance, which had been disclosed 28 days earlier. Instead of heeding a corporate no-disclosure policy, he reaffirmed previous guidance. The next day, that reaffirmation information was released publicly by an analyst who attended the retreat, and the company's stock price soared on heavy trading volume. Only 53 hours after the retreat did the company finally disclose publicly that it had met with certain analysts and reaffirmed guidance.

The SEC eventually settled with the company, its CEO and its director of investor relations, finding each liable under the regulation for intentionally and selectively disclosing material, nonpublic information.

This is a rather extreme result, as the CEO—not the investor relations director—made the disclosures, and the SEC generally holds the CEO to a higher standard than other officers.

Moreover, one would expect the CEO to have known the company's policy on earnings guidance reaffirmation without having to be lectured on the spot by the investor relations person. Should the director of investor relations really be held liable for failing to throw himself in front of the CEO and put his hands over the CEO's mouth?

The SEC's stern message in this case should be heeded by public companies and their communications professionals alike. Here's what we now know:

- Investor relations and corporate communications personnel now have an important gatekeeper role in ensuring Regulation FD compliance. Even silence can be interpreted as joining a statement about earnings guidance; speak up if there's a problem with what another corporate officer is saying (even if he is the CEO).
- Companies must be careful even if merely reaffirming earnings guidance. Merely reaffirming earnings guidance can be a problem; don't think that your statements are above regulatory oversight just because you are not modifying previously announced earnings guidance.
- Corporate executives and investment relations personnel should cooperate fully with the SEC. The SEC was unhappy with what it saw as a lack of cooperation during its investigation (both the CEO and the director of investor relations had denied that a reaffirmation of earnings guidance even occurred at the private meeting with analysts). Being cooperative and forthright with the SEC can go a long way toward fair treatment.
- Private meetings between senior management and analysts can be trouble. Management must be well aware of Regulation FD and know that every person in the room, and not just the CEO, is charged with adhering to the securities regulations. ■

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