

## **SEC v. Office Depot: SEC Aggressively Enforces Regulation FD**

The recent sanctions of the Chief Executive Officer (“CEO”) and former Chief Financial Officer (“CFO”) of Office Depot, Inc. (the “Company”) for their roles in orchestrating and coordinating an effort by which other executives of the Company communicated material nonpublic information to selected securities analysts and institutional investors serves as a forceful reminder that the Securities Exchange Commission (“SEC”) intends to vigorously enforce the requirements of Regulation FD.<sup>1,2</sup> Regulation FD prohibits issuers or persons acting on their behalf from disclosing material nonpublic information to securities analysts, institutional investors, or other enumerated persons without disclosing that information to the public.<sup>3</sup>

There are at least two aspects of this matter that distinguish it from prior SEC Regulation FD enforcement actions.

- Neither the CEO nor the CFO directly participated in communicating the information that prompted the SEC’s complaint. Rather, they devised a strategy for disseminating information and then delegated the task of communicating it to other executives, chiefly personnel in the Company’s investor relations department.
- The information communicated was not, for the most part, company specific. Rather, the information referenced the general state of the economy and what other comparable companies had said publicly about the impact of a slowing economy on their businesses as a way of suggesting that analysts should review and revise downward their earnings estimates for the Company.

### **I. Background<sup>4</sup>**

In February 2007, during a publicly broadcasted earnings conference call, the CEO and the CFO described the Company’s business model, which contemplated mid to upper teens earnings per share (“EPS”) growth over the long-term. On another public conference call in late April 2007, the Company warned investors that its largest business segments were facing a softening in demand that was continuing into the second quarter.

Shortly following the analysts’ publication of EPS estimates for the Company in late April (when most analysts lowered their estimates), the Company reiterated at a publicly available investor conference that its business model contemplated only mid to upper teens EPS growth over the long-term and that the Company faced a softening demand environment.

Later, on May 31, 2007, the CEO alerted the Company’s board of directors and the executive committee that the Company would not likely meet the analysts’ consensus \$0.48 EPS estimate for the second quarter and

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<sup>1</sup> *Securities and Exchange Commission v. Office Depot, Inc.*, Civ. Action No. 9:10-cv-81239 (S.D. Fla. Oct. 21, 2010); *In the Matter of Office Depot, Inc.* (SEC Admin. Proceeding File No. 3-14094), *In the Matter of Stephen A. Odland* (SEC Admin. Proceeding File No. 3-14095) and *In the Matter of Patricia A. McKay, CPA* (SEC Admin. Proceeding File No. 3-14096). The complaint, and the orders regarding the three SEC administrative proceedings (collectively, the “Orders”), can be accessed via links in the SEC press release on this matter, available at <http://www.sec.gov/news/press/2010/2010-202.htm>.

<sup>2</sup> The CEO has announced his resignation which will become effective November 1, 2010. The former CFO resigned her position in February 2008.

<sup>3</sup> See generally Regulation FD, Rule 100.

<sup>4</sup> As alleged in the SEC’s complaint.

that senior management was discussing a strategy for advance communication to avoid a complete surprise to the market.

In early June 2007, in response to the CEO's May 31, 2007 notice to the board of directors, the CFO instructed the director of investor relations and his immediate supervisor to prepare a draft press release for her review previewing certain second quarter earnings information should the Company later determine to issue one. By mid-June 2007, certain of the Company's preliminary internal estimates forecasted up to \$0.44 EPS for the quarter. However, the CFO and CEO were uncomfortable with issuing a press release because the Company's internal estimates were incomplete at this point.

On June 20, 2007, ten days prior to the close of the Company's second quarter, the CEO and the CFO, both of whom had investor relations experience, discussed how to encourage analysts to revisit their analysis of the Company. The CEO, in an attempt to get analysts to lower their estimates, proposed to the CFO that the Company talk to the analysts and refer them to recent earnings announcements by two comparable companies that had recently publicly announced results which were impacted by the slowing economy. The CEO further suggested that the Company point out on the calls what the Company had said to the market in April and May 2007. The CEO and the CFO jointly decided to adopt this approach.

To accomplish the desired objective, talking points were drafted that noted

- o the slowing of the economy,
- o the fact that earnings at two other comparable companies were down,
- o a third comparable company had mentioned economic conditions as a reason for its slowed growth,
- o the possibility that the economy might not improve in the second half of 2007, and
- o that the Company's economic model contemplated stable conditions.

The CEO believed that if the analysts looked at the Company again in light of the talking points, they would come to the point of view that their estimates were too high and likely would lower them.

The SEC complaint states that the communications plan was then carried out over a period of six days by way of telephone calls made initially to all 18 analysts who covered the Company. The CEO and CFO stayed in touch with the director of communications. The CFO emailed analysts' revised estimates to the CEO and reported on the calls being made. The CEO encouraged the calls to continue. After two days of calls, 15 of the 18 analysts had lowered their estimates.

When two analysts asked the director of investor relations about the lack of a Company press release, the CFO's response was to direct the director of investor relations to call the Company's top twenty institutional investors and convey the same information.

Six days after the calls began, the Company filed a Form 8-K publicly disclosing that earnings would be "negatively impacted due to continued soft economic conditions."<sup>5</sup>

In addition to the foregoing matters, the SEC complaint noted that the Company did not have written Regulation FD procedures and had not conducted any formal Regulation FD training prior to June 2007, "although its general counsel had occasionally distributed guidance and updates on Regulation FD."<sup>6</sup>

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<sup>5</sup> Form 8-K filed June 28, 2007 available at <http://www.sec.gov/Archives/edgar/data/800240/000095014407006171/g08169e8vk.htm>.

<sup>6</sup> Complaint at 4.

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The SEC also noted the market trend during the six day-period over which the calls were conducted prior to the filing of the Form 8-K. During that time, the Company's stock dropped 7.7%. On the first day of the calls, the Company's stock closed at \$33.49 per share. This was a decrease of 2.8% from the previous close, on trading volume of almost 7.5 million shares, which was two and half times the average volume for the remainder of that week. On the second day of calls, the stock dropped another 3.5% to \$32.32 per share on trading volume of 7 million shares.<sup>7</sup>

## II. Sanctions

Robert Khuzami, Director of the SEC's Division of Enforcement, summed up the views of the SEC Staff on the matter as follows: "Office Depot executives selectively shared information with analysts and the company's largest shareholders in order to manage earnings expectations... This gave an unfair advantage to favored investors at the expense of other investors and, as today's action shows, is illegal." Eric I. Bustillo, Director of the SEC's Miami Regional Office added, "[t]alking Wall Street down from its earnings projections whether done expressly or through signals is prohibited."

The Company agreed to settle the SEC's charges without admitting or denying the findings and allegations, and consented to the entry of an administrative order requiring it to cease and desist from, among other things, committing or causing any violations and any future violations of Regulation FD. The Company will also pay a \$1 million penalty.<sup>8</sup>

The CEO and CFO also agreed to settle the Regulation FD charges against them without admitting or denying the findings and allegations, and will pay \$50,000 each. As part of their settlements, they each agreed they would not seek, directly or indirectly, reimbursement or indemnification from any source including from any insurance policy, and would not claim any federal, state or local tax deduction or credit, for the payments they will make.<sup>9</sup>

The other executives at the Company who carried out the communications plan were not charged in the SEC actions.

## III. Conclusion

The *Office Depot* matter makes it clear, in case there was any doubt, that the SEC enforcement staff will vigorously pursue prosecutions to ensure compliance with Regulation FD.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com).

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<sup>7</sup> Complaint at 7.

<sup>8</sup> The Company was also charged with books and records violations unrelated to the Regulation FD charges which allegations were also settled by the Company without admitting or denying the findings and allegations.

<sup>9</sup> See the Orders relating to the CEO and CFO at 5 and 6, respectively.