Cahill

April 30, 2021

SEC Charges AT&T and Individual Executives With Violations of Regulation FD

On March 5, 2021, the Securities and Exchange Commission ("SEC") charged AT&T, Inc. ("AT&T" or the "Company") and three executives in its Investor Relations Department (the "IR officers") with violating Regulation Fair Disclosure ("Regulation FD") under the Securities Exchange Act of 1934.[1] The Complaint alleges that, in March and April of 2016, the IR officers conducted one-on-one telephone conversations with approximately 20 securities analysts, during which the IR officers disclosed internal smartphone revenue trends to the analysts in order to "'walk the analysts down'" from their first quarter 2016 revenue estimates. The Complaint alleges that this information was material to investors and that the information was disclosed solely to analysts, rather than to the public. To date, there has been no settlement in this matter.

In recent years, the SEC rarely has pursued cases solely for alleged Regulation FD violations.[2] The conduct alleged in this enforcement action, however, appears to be uniquely flagrant, as discussed below. After filing the Complaint, the Director of the SEC's New York Regional Office stated in the Press Release that this "selective disclosure . . . is precisely the type of conduct Regulation FD was designed to prevent."

Regulation FD Background

Regulation FD prohibits selective disclosure of material nonpublic information ("MNPI") from publicly traded companies to individual market participants, including: (1) brokers or dealers, (2) securities analysts and other investment advisers, and (3) holders of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information.[3] The Regulation is intended to ensure that all market participants have the same access to a public company's material information.

When a publicly traded company (or a person acting on its behalf) intentionally discloses MNPI to one of the aforementioned individuals, Regulation FD requires simultaneous disclosure to the public.[4] If a company

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[1] Complaint and Jury Demand, *SEC* v. *AT&T et. al.*, No. 1:21-cv-01951 (S.D.N.Y. Mar. 5, 2021), available at https://www.sec.gov/litigation/complaints/2021/comp-pr2021-43.pdf ("Complaint"); *see also SEC Charges AT&T and Three Executives with Selectively Providing Information to Wall Street Analysts* (Mar. 5, 2021), Securities and Exchange Commission, available at https://www.sec.gov/news/press-release/2021-43 ("Press Release"). Unless otherwise specified, quoted statements in this memorandum are taken from the Complaint. Additionally, because AT&T has not filed an answer to the Complaint, all statements of fact drawn from the Complaint are treated as allegations rather than facts for the purposes of this memorandum.

[2] *See* Andrew Edgecliffe-Johnson & Anna Nicalaou, *SEC charges AT&T and investor relations employees over calls to analysts*, Financial Times (Mar. 5, 2021), available at https://www.ft.com/content/80cd2b96-af49-4030-bdf3-76e97aa628bb (identifying that, including the complaint against AT&T, the SEC has brought just two cases in the previous eight years solely for alleged violations of Regulation FD).

[3] 17 C.F.R. § 243.100(b)(1).

[4] 17 C.F.R. § 243.100(a)(1).

unintentionally discloses MNPI, the public company must thereafter "promptly" disclose the information to the public.[5] The regulation defines "promptly" to mean "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange)."[6] Regulation FD requires that the curative public disclosure be made in the form of either: (1) a Current Report on Form 8-K disclosing the information, or (2) any other method which is "reasonably designed to provide broad, non-exclusionary distribution of the information to the public."[7] However, if the employee selectively discloses MNPI "in breach of a duty of trust or confidence" owed to the company, the employee is no longer acting on the company's behalf, and the company has not violated Regulation FD.[8]

Commentators have suggested that Regulation FD creates a chilling effect on companies, such that companies are less willing to provide valuable information.[9] In advance of the SEC adopting Regulation FD in 2000, then SEC Commissioner Laura Unger pointedly stated that commenters and securities lawyers had warned that a chilling effect would occur, which led Commissioner Unger to question whether information would reach the market if companies were less inclined to "talk to analysts, the financial press or shareholders."[10] Commissioner Unger was the sole dissenting vote against Regulation FD, primarily relying on the argument that the "chilling of corporate communications . . . would outweigh the benefits of eliminating opportunities for trading on non-public material information by a select few."[11]

The SEC has mitigated some traditional constraints of Regulation FD for social media. In April 2013, the SEC clarified that Regulation FD applies to social media statements, but such statements likely will be considered public if investors are able to access the information and are informed that the company will make statements of this nature on social media.[12] Researchers focusing on social media usage by public companies have concluded that, prior to the April 2013 SEC guidance, companies were less likely to utilize social media to provide valuable, material information to the public.[13] This research suggests that Regulation FD can have a chilling effect on burgeoning methods of public disclosure in the absence of clear SEC guidance.[14]

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[5] 17 C.F.R. § 243.100(a)(2).

[6] 17 C.F.R. § 243.101(d).

[7] 17 C.F.R. § 243.101(e).

[8] 17 C.F.R. § 243.101(c). If there is corresponding trading and other elements are met, there could be a violation of insider trading law. *See generally* Bradley J. Bondi & Steven D. Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J.L. & Bus. 151 (2011).

[9] *See e.g.*, Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional*, 39 U.C. Davis L. Rev. 1, 26 n.151 (2005) (identifying commentators who suggest that Regulation FD can chill the speech of a publicly traded company or reduce the utility of information that the company announces).

[10] Laura S. Unger, *Speech by SEC Commissioner: Rethinking Disclosure in the Information Age: Can There Be Too Much of a Good Thing,* Securities and Exchange Commission (June 26, 2000), available at https://www.sec.gov/news/speech/spch387.htm.

[11] Laura S. Unger, *Special Study: Regulation Fair Disclosure Revisited*, Securities and Exchange Commission (Dec. 2001), available at https://www.sec.gov/news/studies/regfdstudy.htm#P121_4002.

[12] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Securities and Exchange Commission (Apr. 2, 2013), available at https://www.sec.gov/litigation/investreport/34-69279.pdf.

[13] *See* James P. Naughton, *The Chilling Effect of Regulation FD: Evidence from Twitter*, Harvard Law School Forum on Corporate Governance (June 20, 2019), available at https://corpgov.law.harvard.edu/2019/06/20/the-chilling-effect-of-regulation-fd-evidence-from-twitter/. The full paper, authored by M. Al Guindy, James P. Naughton, and Ryan Riordan, is available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3385180.

[14] *See id.*

The SEC's Allegations Against AT&T and the IR Officers

The SECs allegations in the matter related to investor interest in revenues from AT&Ts sale of smartphones, as well as the rate at which customers upgrade their phones (the "upgrade rate"), a related performance metric. The sale of smartphones is a component of AT&T's "wireless equipment revenue."

For the fourth quarter of 2015 ("4Q15"), AT&T reported that its revenue was $600 million less than analysts' consensus estimate. The Company's CFO stated during its January 26, 2016 4Q15 earnings call that this revenue shortfall was due, in part, to "'lower equipment sales, as customers chose to hold onto their phones longer.'" While speaking at a publicly-webcasted investor conference on March 9, 2016, AT&T's CFO remarked that he "'would not be surprised' to see [the fourth quarter 2015 trend of declining wireless equipment revenue] continue" in 2016. The CFO "gave no quantitative guidance about AT&T's wireless equipment revenue" during the conference, instead stating that he would only discuss the previously reported 4Q15 results. After the investor conference, several analysts began to "publish[] updated revenue estimates."

On the same day as the investor conference, one of the IR officers distributed within AT&T a projection of the Company's wireless equipment revenue and an estimate of the upgrade rate for the first quarter of 2016 ("1Q16"). These estimates were based on the first two months of data from 2016. According to the SEC, AT&T's internal estimates and revenue results were not disclosed publicly until the 1Q16 earnings announcement on April 26, 2016. As of the March 9 investor conference, the analysts' consensus estimate was higher than AT&T's internal revenue estimates.

As alleged in the SEC's Complaint, AT&T's CFO directed the Investor Relations Department to speak with analysts whose revenue estimates were above AT&T's internal estimates. The Director of Investor Relations relayed this instruction to the IR Officers, informing them that they should "walk the analysts down" to lower the consensus estimate.[15] The IR officers then spoke with 20 different analyst firms between March 9 and April 21, 2016, in order to convince the analysts to lower each firm's estimate. While participating in these calls, the IR officers "intentionally disclosed" MNPI, including the upgrade rate and wireless equipment revenue. Importantly, the SEC further alleged that AT&T's Regulation FD training materials specifically instructed the IR officers that AT&T considered the Company's internal revenue and sales of smartphones to be material to investors.

In the Complaint, the SEC detailed the type and manner of information the IR officers allegedly disclosed. For example, an IR officer allegedly told one analyst that the Company "was expecting record low upgrade rates in 1Q16, and subsequent quarters," which caused the analyst to email the analyst's firm to explain that AT&T "'is saying it will probably see record low upgrade rates for the next 3 quarters.'" On a different call with an analyst, an IR officer allegedly informed the analyst that the upgrade rate would be approximately 5% (a low number compared to the analyst's previous estimate) and that "wireless equipment revenue would decrease by approximately 15% to 20% year-over-year." The SEC alleges that, although the IR officers often represented that the upgrade rates and equipment revenue were derived from the "'consensus' estimate" for AT&T, the information shared with the analysts was actually "AT&T's own internal data for these metrics."

After completing a one-on-one call with one of the IR officers, each analyst released a revised report reducing AT&T's expected revenue. Prior to the revisions, the majority of the 20 analysts predicted equipment revenue would increase in 1Q16. With the revisions, the analysts' individual projections of equipment revenue from 4Q15 to 1Q16 decreased substantially, often changing from predicted increases of 5-15% to decreases of 10-20%.

[15] The SEC did not name AT&T's CFO and Director of Investor Relations as defendants in the matter. The record does not indicate what specific instructions the CFO and Director of Investor Relations provided to the IR Officers.

Because the consensus estimate was reduced, the Company's revenue reported on April 26, 2016 for 1Q16 exceeded the revised analysts' consensus estimate.

The Alleged Violations of AT&T and the IR Officers

The SEC has alleged that AT&T violated Section 13(a) of the Exchange Act through violations of Regulation FD and further that the IR officers aided and abetted these violations. The SEC seeks two forms of relief. First, the SEC requests a permanent restraint against AT&T and the IR officers from engaging in the same or similar conduct alleged in the complaint. Second, the SEC seeks to impose a civil fine against AT&T and the IR officers.

Implications of the SEC's Enforcement Action and Suggested Best Practices

Although the conduct alleged by the SEC is uniquely flagrant – namely the IR officers specifically being told the information was material and yet intentionally disclosing selectively to analysts – there are at least three relevant compliance practices that are worth observing in the area of Regulation FD.

First, public companies should include in-house counsel or compliance personnel on telephone calls and in meetings, to the extent practical, where there is a risk of potential selective disclosure, or, at a minimum, consult with in-house counsel or compliance personnel in advance, especially with respect to earnings calls or other significant matters. The company will be in a better position to make timely curative disclosure if counsel is present during, or had prior awareness of, a conversation in which selective disclosure occurs unintentionally.

Second, public companies should have clear, written policies and procedures in place relating to Regulation FD. The policies and procedures should be written in layperson's language without legalese. These policies and procedures should be accessible to employees and easily understood.

Third, public companies should regularly train and remind employees, particularly those in investor relations, of issues relating to selective disclosure. Training employees on the company's internal guidance regarding selective disclosure will reduce the risk of selective disclosure. Companies should explain that, to the extent that an employee has concerns that selective disclosure has occurred, the employee should elevate promptly such concerns to legal counsel.

Utilizing robust compliance practices, such as those listed above, will facilitate public companies' compliance with Regulation FD requirements.

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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 in it, please do not hesitate to call or email authors Bradley J. Bondi (partner) at 202.862.8910 or bbondi@cahill.com; Geoffrey E. Liebmann (partner) at 212.701.3313 or gliebmann@cahill.com; Kimberly C. Petillo-Décossard (partner) at 212.701.3265 or kpetillo-decossard@cahill.com; or Zachary M. Missan (associate) at 212.701.3577 or zmissan@cahill.com; or email publications@cahill.com.

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