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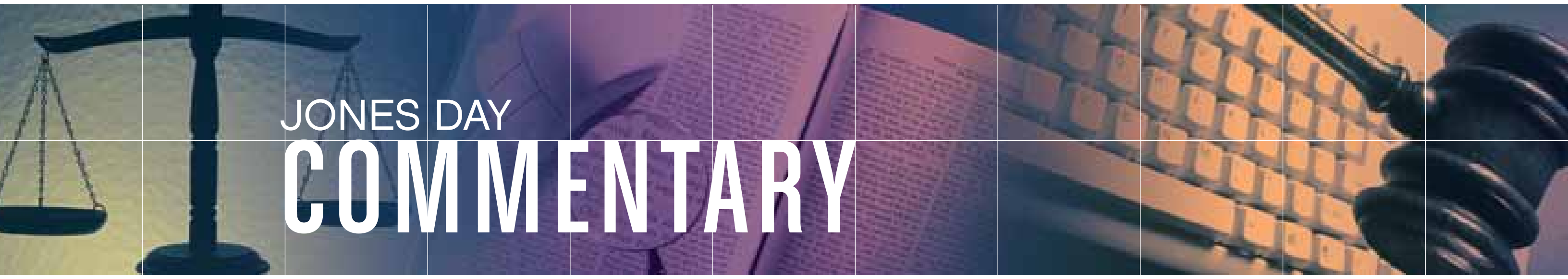

SEC ACTION AGAINST OFFICE DEPOT HIGHLIGHTS REGULATION FD PROHIBITION ON "INDIRECT GUIDANCE"

In the third Regulation FD enforcement action in the last 13 months, on October 21, 2010, the Securities and Exchange Commission brought enforcement actions against Office Depot, Inc. ("Office Depot") and its now former CEO and CFO.[1] In this action, the SEC alleged that Office Depot, the CEO, and the CFO violated Regulation FD in June 2007 by selectively releasing information designed to guide the analysts to reduce their quarterly earnings estimates.[2]

REGULATION FD

Regulation FD prohibits individuals acting on behalf of issuers from disclosing material nonpublic information to securities analysts, institutional investors, and certain others without disclosing the information

1 On the same day, the SEC issued settled administrative proceedings against the company, Sec. Exch. Act Rel. No. 63152; its CEO, Stephen A. Odland, Sec. Exch. Act. Rel. No,. 63513, who resigned shortly after the SEC's action; and its former CFO, Patricia A. McKay, Sec. Exch. Act. Rel. 63514. The SEC also filed a complaint in federal district court for purposes of assessing a financial penalty against the company. *SEC v. Office Depot, Inc.*, No. 9:10-cv-81239-KAM (S.D. Fla. Oct. 21, 2010).

2 Unrelated to violations of Regulation FD, the action also claimed that Office Depot overstated its net earnings, resulting in a failure to file timely and accurate reports with the Commission; to make and keep books, records, and accounts that reflected the transactions and dispositions of its assets; and to maintain a system of internal controls sufficient to provide reasonable assurances that transactions are properly recorded. The SEC claimed that these failures constituted violations of Section 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and related rules.

to the general public. In adopting Regulation FD, the SEC noted the increased risk associated with private discussions about earnings estimates with analysts. The release also specifically noted that selective communication of anticipated earnings, whether express or "through indirect 'guidance,' the meaning of which is apparent though implied," will likely be a violation of Regulation FD.

OFFICE DEPOT SENIOR MANAGEMENT ATTEMPTS TO STEER ANALYSTS

The SEC found that Office Depot's then-CEO and then-CFO determined in early 2007 that Office Depot could not sustain the significant growth it had enjoyed in 2005 and 2006. The executives agreed to temper analysts' expectations, and the CEO and CFO began publicly warning investors in February, April, and May of 2007. Ten days prior to the close of Office Depot's second quarter, the CEO and CFO discussed how to encourage analysts to lower their estimates. In particular, the CEO suggested to the CFO that Office Depot could talk to analysts and refer them to recently released disappointing earnings announcements from comparable companies that were affected by the slowing economy. In addition, the CEO suggested that Office Depot point out on these analyst calls what the company had disclosed earlier in 2007. The SEC claimed that the executives agreed to this approach because it would result in the analysts lowering their estimates.

Based on talking points prepared for the calls, the director of investor relations at Office Depot subsequently made one-on-one calls to analysts and conveyed to them the information regarding comparable companies and the previously disclosed public information about Office Depot as per the CFO's instructions. After being apprised of the results of the initial calls, the CEO encouraged the calls to continue, and the director of investor relations made a second round of calls relaying the same talking points to additional analysts and to Office Depot's top 20 institutional investors.

By the end of the second round of calls, 15 of the 18 analysts contacted had lowered their estimates, bringing the consensus down from $0.48 to $0.45. This significant revision caused Office Depot's stock to drop 7.7 percent on substantial trading. Six days after the analyst calls began, Office Depot filed a Form 8-K publicly disclosing that its earnings would be negatively affected by continued soft economic conditions.

As a result, the SEC issued a cease and desist order against the company and, in the related civil action, obtained a civil money penalty of $1 million. The former CFO and the CEO each agreed to settle the enforcement action by paying a $50,000 civil penalty and to cease and desist from causing violations of Section 13(a) and Regulation FD.

THREE NOTEWORTHY ASPECTS OF THE *OFFICE DEPOT* ACTION

The SEC action is noteworthy in three respects, beyond signaling that Regulation FD remains an enforcement priority. First, it highlights Regulation FD's reach to indirect guidance: the SEC did not allege that Office Depot explicitly told analysts that it would not meet earnings estimates. Instead, the SEC asserted that Office Depot breached Regulation FD when it signaled its own disappointing results by referencing public statements from comparable companies about how the slowing economy had negatively affected their earnings and reminders about other public statements regarding the assumptions underlying the company's own economic model. The action pointedly highlights the release's reference to the prohibition on "indirect guidance," which has the same result as direct guidance.

Second, consistent with the SEC's approach in other recent enforcement actions,[3] the actions against the CEO and the

3 *See*, *e.g.*, *SEC v. Citigroup Inc.*, Civil Action No. 1:10-CV-01277 (D.D.C. July 29, 2010); and Sec. Exch. Act. Rel No. 21605 (charging Citigroup with misleading disclosures and naming the CFO and head of investor relations in related proceedings).

CFO highlight the SEC's continuing focus on enforcement against senior executives who are alleged to have directed lower-level executives to engage in violative conduct. Here, the SEC apparently did not take action against the director of investor relations, who spoke individually with the analysts, or the director's immediate superior, who participated in the drafting of the talking points. On the other hand, the SEC brought actions against the CEO, who proposed to the CFO the use of indirect guidance and monitored its execution, and the CFO, who agreed to the approach, participated in the drafting of the talking points, and monitored the execution.

Finally, in both the complaint and the cease and desist order, the SEC specifically highlights Office Depot's lack of written Regulation FD policies or procedures and its lack of formal training.

WHAT TO DO NOW

As mentioned in our prior *Commentary*,[4] companies should consider whether it is appropriate to have written Regulation FD policies and procedures and formal, periodic training sessions, as well as to take other steps to reduce the risk of missteps in dealing with analysts. The *Office Depot* action further underscores these points and confirms the SEC advice that indirect guidance can be just as informative to analysts as direct guidance. Likewise, providing selective indirect guidance can also be just as harmful to the corporation and the individual officer as providing direct guidance.

4 *Jones Day Commentary*, "SEC Renews Focus on Regulation FD," March 2010, *available at* http://www.jonesday.com/sec__renews__focus/.

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