



# Help Needed on Disclosure of SEC Probes

By Russell G. Ryan

As a securities lawyer and former member of the Securities and Exchange Commission (SEC) staff, I get two recurring questions from directors and officers of public companies facing SEC investigations. The first is whether they must publicly disclose the investigation, and the second is when they can stop disclosing it.

Despite the frequency of these questions, the answers are rarely easy. An SEC probe is almost always “nonpublic,” meaning the agency and its staff will not even acknowledge its existence unless and until it results in formal charges against somebody. Moreover, the disclosure laws don’t explicitly require companies to announce that they are under investigation.

It is no secret that many SEC investigations never lead to any charges of wrongdoing. According to the SEC’s recent annual reports, the agency opens nearly a thousand new investigations each year, but about half of them are eventually closed without any charges being filed. (Ed. Note: For a discussion on how to respond to SEC investigations, see David P. Hoffman, “Audit Committee Under a Microscope: Responding to Fraud Allegations,” *Directors Monthly*, August 2006.)

Even in cases that result in charges, public companies often pay monetary sanctions that are clearly immaterial to their overall financial prospects, and they sometimes pay no monetary sanction at all. In any event, especially in the ever-changing enforcement environment of the post-Enron era, it is nearly impossible to predict the ultimate result of an SEC investigation when a company is first confronting the dis-

closure issue.

For these reasons, many companies are loath to disclose an incipient SEC investigation and thereby invite the negative publicity and strike suits that often follow. Nevertheless, most securities lawyers agree that the nature and potential impact of some SEC investigations could be “material” to a company’s prospects and therefore may warrant public disclosure. The difficulty is in determining which investigations are material and when they become so.

The challenge gets no easier as the investigation progresses. For example, if a company chooses to disclose the investigation from the outset, what subsequent developments in the investigation will require an updated disclosure? And if the company has not heard from the SEC staff for an extended period of time, when can the company safely conclude that the investigation has been closed without charges, thereby allowing the company to stop disclosing it in future SEC filings?

## Help May Be On The Way

Fortunately for those who confront these challenges, the SEC may soon provide long-needed guidance, and even Congress may be poised to provide some relief. In a speech in February, SEC Commissioner Paul Atkins acknowledged that “there simply isn’t clear guidance for public companies” regarding disclosure obligations in the context of SEC investigations. He promised to work with the SEC staff “to provide clear guidance for companies that will enable them to make the right disclosure decisions and provide some level of comfort with respect to subsequent lawsuits.” (The full text of Commissioner Atkins’s speech to the U.S. Chamber Institute for Legal Reform is available at <http://sec.gov/news/speech/spch021606psa.htm>.)

As Commissioner Atkins perceptively noted, companies today “typically err on the side of extreme caution” and may “have a default instinct to disclose” investigations due to “fear that failure to disclose will open the floodgates

**Director Summary:** Often when directors find out they are the subject of an SEC investigation, they are concerned about disclosure: must they publicly disclose the investigation? While the laws do not require disclosure, more guidance is needed in this area. The author states that such guidance may be forthcoming from the SEC.



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to subsequent private litigation.” But he also cautioned that this prevailing mindset may actually risk misleading investors through premature disclosures of investigations and of tentative settlements with the SEC staff, particularly high-dollar settlements that have not yet been considered or approved by the Commissioners themselves.

**Ratcheting Down the Anxiety**

The SEC guidance promised by Commissioner Atkins could go a long way toward easing the anxiety of executives and lawyers who wrestle with disclosure issues in the context of ongoing SEC investigations. But such guidance should also address the related question of when a company may stop disclosing an SEC investigation that no

longer appears to be active. It should also address the agency’s obligation to help companies determine when probes have ended.

Under current SEC policy, when an investigation terminates without any charges, the agency’s enforcement staff must notify only a limited number of people in only a limited number of circumstances. In many cases, however, the subjects of the investigation must affirmatively request this notice from the SEC staff—a step most are reluctant to take for fear of arousing renewed interest in an otherwise forgotten investigation.

Happily, Congress has an opportunity to provide needed relief to companies facing this conundrum. A bill currently pending before the House Committee on Financial Services—H.R. 4618—would require the SEC staff to provide subjects of SEC investigations with written notice of the status of the investigation at least once every four months, as well as to notify them within 10 days of the completion of the probe.

While the specific time frames contemplated by the House bill may need further consideration, the basic concept of the legislation is laudable. If the bill becomes law in tandem with promised disclosure guidance from the SEC, executives and their lawyers could have one less thing to worry about when dealing with SEC investigations. ■

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**A Dozen\* Easy Steps to Guarantee That a Board’s Becoming Dysfunctional is Not Left to Chance**

**By Norman R. Augustine**

1. Select, without considering ethical qualities, a CEO with an enlarged ego
2. Permit the CEO (with the enlarged ego) to personally select all new board members
3. Never meet with only outside directors present, and do not periodically evaluate CEO performance
4. Do not have the board prepare its own agenda
5. Devote as little time to preparation for meetings as possible and keep meetings short
6. Do not ask tough questions, and certainly don’t keep asking them until they are answered
7. Minimize time spent on strategy and leadership succession in order to free time for compliance procedures
8. Do not visit field operations, read media coverage or analysts reports, or review hot-line calls

9. Do not routinely meet alone with Internal or External Auditors, the Ethics Officer, or the General Counsel
10. Do not run-to-ground anomalies and other troublesome indicators
11. Do not have either a presiding director or a separate chairman
12. By-pass the CEO and give direction to employees
13. Help create conflict within the board by nominating as many special-interest directors as possible...do unto others before they do unto you.

(And then prepare for an increase in D&O premiums.)

\* A baker’s dozen!

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