Much Ado About Nothing?

On September 29, 2010, the Securities and Exchange Commission (SEC) issued a final rule amending Regulation FD to remove the exemption covering disclosures to rating agencies effective October 4, 2010. (17 C.F.R. 243.100(b)(2)(iii)). The amendment was mandated by Section 939B of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

What is Regulation FD?

Regulation FD (for Fair Disclosure) was adopted by the SEC to prevent the selective disclosure of information to analysts and institutional investors at the expense of other investors.

Regulation FD provides that when:

- an issuer, or certain persons acting on its behalf
- discloses material nonpublic information regarding the issuer or its securities
- to securities professionals (including analysts, brokers and investment advisors) or certain stockholders,[1]

  then, the issuer must also disclose the information to the public simultaneously (for intentional disclosures) or promptly (for nonintentional disclosures).

Exemptions from Regulation FD

Rule 100(b)(2)(iii) of Regulation FD provided an exemption for disclosures made to a rating agency solely for the purpose of developing a public credit rating under the theory that such use of the information would not provide it or its customers with an unfair advantage over the rest of the market.

The rule also contains exemptions for disclosures made to:

- attorneys, investment bankers or accountants who owe a duty of trust to the issuer,
- the media or governmental entities, or
- a person or entity who agrees to keep the information confidential.

Section 939B of the Act

Section 939B of the Act directed the SEC to revise Regulation FD within 90 days after enactment of the Act to remove the rating agency exemption. If no other exemption were applicable, an issuer would then be required to make a public disclosure of the content of communications regarding material nonpublic information with a rating agency.

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[1] For the most part, persons who one has reason to believe will trade on the basis of the information.

What Happens Now?

Notwithstanding the amendment, there are several approaches that may provide comfort to issuers and the rating agencies. Regulation FD applies to communications with certain enumerated persons; namely, securities professionals and holders of the issuer's securities who are reasonably likely to trade on the basis of the information. As the rating agencies are neither securities professionals of the kind enumerated in the rule nor securities holders, some have taken the position that communications to rating agencies do not fall within the purview of Regulation FD. Under this approach, the exemption for communications to rating agencies contained in clause (iii) of Rule 100(b)(2) was unnecessary.

If one were to assume that certain communications to the rating agencies were subject to Regulation FD, the repeal of the rating agency exemption does not prohibit the application of other exemptions. Accordingly, issuers and rating agencies may rely on Rule 100(b)(2)(ii), which provides an exemption for disclosure "to a person who expressly agrees to maintain the disclosed information in confidence." In response to the recent amendment, certain rating agencies have indicated an increased willingness to enter into confidentiality agreements.

Much ado about nothing? Perhaps. However, the directive to the SEC to remove the rating agency exemption may well evidence an intent by the legislators to require the public disclosure of material nonpublic information provided to the rating agencies in certain circumstances. It is uncertain whether Congress will be satisfied by the mere repeal of Rule 100(b)(2)(iii) and the continuation of business as usual.

If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

Janette A. McMahan
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/jmcmahan
+1 (212) 446-4754

Kelly A. Schell
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL
www.kirkland.com/kschell
+1 (312) 862-2433