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The Evolving Landscape Of 'Corporate Access'

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For years, sell-side brokerage firms have arranged, for compensation, meetings between managers of publicly-traded corporations and institutional investors. This practice is commonly referred to as "corporate access." Recently, however, corporate access has attracted an increasing amount of attention. According to media reports, as part of its ongoing insider trading crackdown, the U.S. Securities and Exchange Commission (SEC) has warned investment banks about the need to ensure that such meetings do not result in the improper exchange of privileged information.[1] And earlier this year, the *Financial Times* ran a series of articles on corporate access,[2] which reported that many chief executives were unaware that their brokers charged investors, such as hedge fund and mutual fund managers, up to $20,000 for such meetings.[3] Shortly thereafter, the *FT* revealed that the United Kingdom's Financial Services Authority would review whether the practice violates U.K. rules prescribing the acceptable uses of client commissions.[4]

Given the prohibitions on selective disclosure of material information in the United States and other jurisdictions, regulators are likely to inquire increasingly into what makes these meetings so valuable. Company management, if they are truly unaware that their time is being allocated on the basis of payments to their bankers, might also ask whether the practice is consistent with their bankers' fiduciary duties.

This article first describes the contexts in which these meetings typically transpire. Next, it addresses these questions by reviewing some of the legitimate reasons for the practice of brokered access to company management. This article then assesses the legal risks attendant to such meetings, and concludes with some proposed "best practices" for managing potential legal risks.

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Background

"Corporate access" generally refers to the practice of brokers arranging meetings between investors and corporate management, often at the CEO or CFO level but sometimes with companies' Investor Relations personnel. These meetings can, for the most part, be divided into three categories. The broadest and most public interactions are investor conferences, in which corporate management is invited to make presentations to a large number of analysts and investors. Next are smaller group meetings, typically arranged by broker-dealers for a select group of investor clients, perhaps as part of a targeted investment strategy or a tour of a specific geographic region. Finally, brokers facilitate one-on-one meetings between investors and corporate management, which can take place at the investors' offices, on site at the company, or at "breakout" sessions at conferences.

The practice of paying for one-on-one meetings is common. A recent study reflected that over a quarter of U.S. and U.K. investors allocated more than half of their commissions to corporate access.[5] Nevertheless, the *FT* quotes an official of the U.K. Investment Management Association as saying that a "rudimentary straw poll of corporate communications advisers and chief executives indicated that many of them weren't aware that investors and potential investors were paying to see them."[6]

Legitimate Purposes

One question that follows is: What justification exists for the significant sums spent on corporate meetings? As the discussion and examples below demonstrate, there are several legitimate reasons investors pay for corporate meetings. There are also noteworthy risks, as laid out in the following section.

First and foremost, the meetings provide a venue for investors to assess the quality of management teams. Investors may assess management's knowledge, philosophy and worldview, temperament, management style, and level of engagement. Investors can seek to answer questions such as: Is the management team thoughtful about various industry-specific and macroeconomic risks to the company, or does it seem complacent? Will it prioritize the maximization of shareholder value, or will it run the company for its own self-aggrandizement? These are subjects of particular interest to longer-term, fundamental value investors.

Second, corporate access meetings can provide the opportunity to discuss information that, standing alone, is nonmaterial (and thus, as explained below, does not implicate insider trading laws), but that may nonetheless factor into an investment thesis. The following hypothetical illustrates this point: A new product of Company X, a large electronics company, has sold poorly, and the publicly reported revenue and profit contribution from that product are not material to the company's performance. Based on her research, an analyst believes that sales are anemic because potential buyers are awaiting the outcome of a standards war between Company X's product and a competing format. The analyst is predicting, based on her observation of the shelves at various electronics retailers, that a second company is slowing or ceasing production of its product that is on the same format as Company X's

product, which (if true) would leave Company X as one of a very small number of sellers on its side of the standards war. The analyst is further predicting that Company X will win the standards war and that the product in question will become a significant profit maker for Company X. In a meeting with Company X's CEO, she asks the CEO if he is committed to continuing to produce, market and sell the product. The CEO says he is. This response, while nonmaterial in and of itself, forms one key part of the analyst's thesis on Company X.

Third, meetings may provide an opportunity to discuss information that is public but esoteric. Imagine, by way of example, that Congress passes a piece of highly complicated legislation that is expected to significantly impact a given industry. The legislation, once adopted, is of course "public" in every sense of the word, but the company may be more familiar with its intricacies, as they apply to the company itself, than even the most sophisticated institutional investors. There may be value to investors in obtaining a forum in which to ask questions such as: Where are the provisions in this bill that will affect you most? How do you understand them to operate in practice? Will this put your non-U.S. competitors at a structural advantage? A conversation of this nature can proceed entirely without reference to any nonpublic fact.

Fourth, meetings provide investors with an opportunity to ask probing follow-up questions—sometimes in the nature of cross-examination—that they otherwise would not have an opportunity to ask. Corporate management teams say many things publicly about many aspects of their businesses, including their business plans and long-term expectations. Investors have a legitimate interest in testing the credibility and the quality of management's assumptions and trying to understand the biggest risks to those plans. Having a forum in which to raise questions of this nature—to get one's own questions answered, rather than having to listen to the questions of others (which are presumably of lesser interest)—may be of value.[7]

Fifth, investors may not want to pose questions at all, but rather to suggest a given course of action. For instance, a shareholder may prefer that a company holding significant cash increase its dividend rather than making one or more acquisitions. As described below, company management may be prohibited from responding to such suggestions under Regulation FD (and it may be critical to the investor to set clear ground rules, in order to avoid becoming restricted from trading the issuer's securities). Even in light of those constraints, however, it might be of value to investors to be able to provide suggestions, especially if they have finished building their position in the company in question.

Sixth, meetings may provide an investor with an opportunity to inquire about a management team's view of its competitors. Being industry experts, they may be well-placed to opine on which other companies are likely to do well, and which are not.

Legal and Regulatory Risks

While there are legitimate purposes for corporate access, there are pitfalls that participants must avoid. In the United States, the laws that generally apply are §10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, which are used to prosecute insider trading; Regulation FD, also promulgated by the SEC; and state laws and federal rules governing the breach of fiduciary duties. Also relevant to many institutional investors, the U.K.'s FCA appears to be examining the issue of corporate access from at least two different perspectives. First, the FCA has used its own insider dealing laws, which differ significantly from the rules in the United States, to discipline market professionals for allegedly disclosing or trading after obtaining too much information during corporate access meetings.[8] Second, the FCA recently stated it is contemplating enforcement actions against firms that it believes may be improperly using "soft dollars" to pay for corporate access, irrespective of whether an insider dealing violation has occurred.[9] This section addresses these issues in turn.

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Insider Trading/Rule 10b-5. Insider trading is a potential issue if material nonpublic information is disclosed in a corporate meeting. Most U.S. insider trading cases are pursued as a violation of Rule 10b-5, which prohibits the use of "any device, scheme, or artifice to defraud." Rule 10b-5 reaches trading by insiders on the basis of material nonpublic information, and by those who obtained such information via a "tip" from an insider. As insider trading is a species of fraud (at least in the United States), the government must typically show a breach of duty to the company, as well as a personal benefit to the tipper to prove tipper-tippee liability.

Often, no "duty" issue will be implicated at "corporate access" meetings: Company personnel are fulfilling their duty to the company by meeting with investors or potential investors, not breaching it; there will generally be no confidentiality agreement or understanding in place, written or otherwise; and the investors will owe the company no fiduciary duty, absent a control relationship or other special situation. And there typically will be no personal benefit provided to company personnel—while investors may compensate the broker who facilitates the meeting, they generally do not compensate management. In light of the SEC's broad interpretation of what constitutes a personal benefit,[10] however, investors should take special care to ensure that there is no gift or other provision of value to company personnel, or any special relationship—e.g., a family relationship or a strong friendship outside of the work context—between the investor and any company personnel present.[11]

In addition to the "duty" and "personal benefit" questions, the 10b-5 analysis may also turn in part on the number of investors in attendance. When a large number of institutional investors are present, such as at a conference, the risks of an actual 10b-5 violation occurring may be reduced significantly. If sell-side analysts publish the highlights of the meeting, then information contained in that publication will, after sufficient time has passed, likely be considered "public" under prevailing case law even if the sell-side research is not available to retail investors.[12] One-on-one meetings, of course, call for a higher degree of sensitivity because of their nonpublic nature.

Regulation FD. Regulation FD prohibits public companies from selectively disclosing material nonpublic information to analysts, institutional investors, and others without concurrently making widespread public disclosure. The rule reflects the SEC's view that investors should have simultaneous access to a company's material disclosures.

Under Regulation FD, whenever public companies, or certain persons acting on their behalf,[13] disclose material nonpublic information to certain enumerated persons, the company must disclose that information to the public. The company must make the public disclosure (i) simultaneously, in the case of intentional disclosures, or (ii) promptly afterwards, in the case of unintentional disclosures.

The risk that the SEC would allege a Regulation FD violation arising from a conference exists, given that attendance by retail investors at such conferences may be low or nonexistent, and the SEC thus would not view the conference as a public forum. However, similar to insider trading, the risks of violation are higher at smaller meetings than at widely attended conferences. The largest identified number of recipients of an allegedly selective disclosure based on which the SEC brought a Regulation FD enforcement action appears to be 200.[14] In all other instances where the SEC has brought a Regulation FD enforcement action, there have been fewer than 20 recipients, and in most instances fewer than 10.[15] Many market participants have speculated on the question of whether the SEC will seek to assess liability for aiding and abetting a Regulation FD violation,[16] and there exists at least the theoretical possibility that, in the event of such a violation, the SEC would look at whether the broker who sponsored the conference had advance knowledge of the offending disclosure.

Insider Dealing and Improper Disclosure Under U.K. Law. Like the SEC, the FCA is likely to continue to scrutinize corporate access from an insider trading perspective. However,

because the U.K.'s insider dealing laws often cast a broader net than Rule 10b-5, investors must take extra care when meeting with management from U.K.-listed companies. Unlike in the United States, breach of duty is not an element of insider dealing in the U.K. As a result, analysts who ask overly probing questions could arguably be viewed as "encouraging" management to provide inside information in violation of U.K. law, even if management is not being offered any personal benefit as an incentive to violate their fiduciary obligations.[17] Moreover, while U.S. law requires proof of recklessness for a civil insider trading violation, the required mental state for U.K. insider dealing is mere negligence.[18] These distinctions from U.S. law significantly lower the bar for the FCA to bring insider dealing enforcement actions in the corporate access context.

Fiduciary Duties of Brokers. Another risk is that the broker facilitating the meeting may be alleged to have breached its fiduciary duty to the client if they fail to disclose to their client—the company—that they accepted payment from investors. The New York Court of Appeals[19] and the U.S. Court of Appeals for the Ninth Circuit[20] have held that, under certain circumstances, investment banks may owe a fiduciary duty to their clients. A fiduciary duty can include the duty to disclose conflicts.[21] Brokers arranging corporate access meetings should thus be mindful that their corporate clients may already have concerns about the practice, as the *FT* suggested.[22] While we are not aware of any case in which a broker has been sued for failing to disclose corporate access payments, the recent media attention on this subject may trigger scrutiny by the SEC or other regulators in the future.

Soft Money in the U.K. In the U.K., the use of "soft dollars" to pay for corporate access has recently come under fire by the FCA. In the United States, the SEC has interpreted §28(e) of the Exchange Act broadly and has explicitly approved the use of soft dollars for corporate access.[23] In the U.K., however, last November, an official at the FCA threatened "multimillion-pound fines" for firms using client commission dollars to pay for corporate access.[24] Given the global reach of many firms today, this change in position by the FCA may require different practices within a single firm.

Some FCA-regulated companies have reportedly begun to use foreign companies as third-party contractors to obtain corporate access information.[25] Such practices have yet to be approved or disapproved by the FCA. Given the uncertain legal landscape, however, the use of soft dollars to pay for corporate access by FCA-regulated firms, even if through third parties, remains an area of concern.

Best Practices for Participants

In order to mitigate risks and avoid potential pitfalls, participants in corporate access meetings may want to consider the following practices:

• All participants should of course maintain strong compliance and training programs regarding prohibitions on selective disclosure and the handling of potential material nonpublic information. For firms that operate in both the United States and the U.K., these programs should cover the key differences between the sometimes conflicting regulatory regimes in these jurisdictions.

• Investment firms in particular may want to monitor communications and trading in and around corporate access meetings. In the event that a corporate meeting appears to have coincided with a significant change in the firm's investment strategy, counsel will want to inquire about the reasons for the shift.

Insider trading is a potential issue if material nonpublic information is disclosed in a corporate meeting.

• Investment firms also should consider developing procedures to remove concerns that the payments are tied to the *quality of information* provided at a meeting. For example, they might set the dollar value in advance of the meeting based on objective factors, such as the number of persons at the meeting or the level of corporate management attending. This can help reduce incentives to compensate brokers based on the quality of information coming out of the meeting, and also minimize the appearance of such incentives.

• Brokers should consider whether there is an obligation to disclose that they are collecting money for providing access. While fiduciary duty law may be unclear, the imperatives favoring disclosure may grow as clients are increasingly sensitized to the issue, particularly in light of the FCA's position.

• Investors should craft soft-dollar policies to ensure that portfolio activity in a U.K.-registered entity does not generate soft dollars or commission-sharing credits that are used to pay for corporate management meetings.

While there may be few clear directives regarding this area, the one thing that appears likely is that scrutiny of the practice of corporate access will increase over time.

1. David Enrich & Dana Cimilluca, "Banks Woo Funds With Private Peeks," *Wall St. J.*, Jan. 11, 2012.

2. Ellen Kelleher, "IMA Probes Corporate Access Payments," *Fin. Times*, Feb. 17, 2013; Steve Johnson, Fears Rise Over Cash for Access, *Fin. Times*, March 3, 2013; Steve Johnson, "FSA Crackdown on Cash for CEO Access," *Fin. Times*, March 4, 2013; Ellen Kelleher, "Fund Managers Silent Over Cash for Access," *Fin. Times*, March 10, 2013; Steve Kelly, "Are Companies Asleep in Investor Relations," *Fin. Times*, March 17, 2013; Steve Johnson, "Panic Over 'Cash for Access' Clampdown," *Fin. Times*, March 24, 2013; Steve Johnson, "Study Highlights 'Cash for Access' Risks," *Fin. Times*, March 31, 2013; Vince Heaney, "A 'Cash for Access' Ban is Fair," *Fin. Times*, April 7, 2013. Hereinafter, these articles are cited as "*FT*" followed by the article date.

3. *FT*, March 3, 2013.

4. *FT*, March 4, 2013. The FSA has since been split into two agencies. The arm that is in charge of enforcing the rules against insider dealing and other forms of market abuse is now called the Financial Conduct Authority, or FCA.

5. Id.

6. *FT*, March 3, 2013. Though they might not expect payments of such explicit nature, many corporate executives would presumably anticipate that banks would look to their most favored clients in allocating meetings. These executives would also rationally *want* to meet with the largest potential investors, all else being equal, in order to achieve maximum scale per hour in their investor-relations outreach efforts.

7. The Supreme Court and the SEC have recognized the role played by fundamental investors as "necessary to the preservation of a healthy market." See, e.g., *Dirks v. SEC*, 463 U.S. 646, 658 & n.17 (1983).

8. See, e.g., FSA Final Notice to Andrew Jon Osborne (Feb. 15, 2012) (U.K.-based corporate broker fined based on alleged disclosure of inside information to a hedge fund adviser during a one-on-one conference call that the broker arranged with management).

9. *FT*, March 3, 2013. "Soft dollars" are amounts of money that money managers pay out of their clients' accounts to a broker to cover services the broker provides.

10. E.g., *SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000) (stating, "[t]he 'benefit to the tipper need not be 'specific or tangible.'" (citing *SEC v. Warde*, 151 F.3d 42, 47 (2d Cir. 1998)).

11. See *SEC v. Obus*, 693 F.3d 276, 291 (2d Cir. 2012).

12. Information is considered public when it has been disseminated broadly to investors in the marketplace. *SEC v. Texas Gulf Sulphur*, 401 F.2d 833, 854 (2d Cir. 1968). In addition, information is deemed public, in the Second Circuit, when its import has been impounded into the market price of the given security—even if it has not been disseminated publicly. *United States v. Libera*, 989 F.2d 596, 601 (2d Cir. 1993).

13. Such persons include senior company officials and other officers, employees, or agents of the company who regularly communicate with securities market professionals or security holders.

14. See Joseph A. Grundfest, "Regulation FD in the Age of Facebook and Twitter: Should the SEC Sue Netflix?," 35-36 (Rock Ctr. for Corporate Governance, Working Paper Series No. 131, 2013), available at http://www.niri.org/Other-Content/sampledocs/Joseph-Grundfest-Regulation-FD-in-the-Age-of-Facebook-and-Twitter-Jan-2013.aspx.

15. Id.

16. See, e.g., "Q: What is a broker/dealer's responsibility under Regulation FD if an analyst at the firm obtains nonpublic information?," Inst. Investor (2001), available at http://www.institutionalinvestor.com/Popups/PrintArticle.aspx?ArticleID=1435801.

17. See FCA Code of Market Conduct (MAR 1), §1.4.7 (citing the following example of improperly "encouraging" another to engage in market abuse: "X, an analyst employed by an investment bank, telephones the finance director at B PLC and presses for details of the profit and loss account from the latest unpublished management accounts of B PLC.").

18. See Final Notice to Andrew Jon Osborne ¶¶ 2.4, 2.8 (corporate broker sanctioned by FSA for improper disclosure during call that the broker arranged between management and a large investor, where FSA acknowledged conduct was "not deliberate or reckless").

19. *EBC I v. Goldman, Sachs & Co.*, 832 N.E.2d 26, 30-33 (N.Y. 2005).

20. *Bear Stearns & Co. v. Daisy Sys.*, 97 F.3d 1171, 1177-80 (9th Cir. 1997).

21. See 15 U.S.C. §80b-6 (2012); *Sokoloff v. Harriman Estates Dev.*, 96 N.Y.2d 409, 417 (2001).

22. *FT*, March 3, 2013.

23. SEC Release No. 34-54165, July 2006, at 28 ("Meetings with corporate executives to obtain oral reports on the performance of a company are eligible because reasoning or knowledge will be imparted at the meeting (i.e., reports) about the subject matter of Section 28(e) (i.e., concerning issuers).").

24. *FT*, March 4, 2013. The FCA has suggested that such soft dollar payments may violate the U.K. rules regarding the sorts of research costs that an asset manager can pass along to its clients. See FSA Report, Conflicts of Interest Between Asset Managers and Their Customers: Identifying and Mitigating the Risks, at 8 (November 2012).

25. *FT*, Feb, 17, 2013.

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