



March 19, 2019

VIA E-MAIL: rule-comments@sec.gov

Mr. Brent J. Fields

Secretary

Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C. 20549-1090

re: SEC File No. S7-26-18
Release Nos. 33-10588; 34-84842
Request for Comment on Earnings Releases and Quarterly Reports

Dear Mr. Fields:

We are writing to comment on the above-referenced request for comment (the "Comment Release") issued by the Securities and Exchange Commission (the "Commission" or "SEC") on December 18, 2018. These comments are provided on behalf of the Business Law Section of the California Lawyers Association (the "Business Law Section") by the Corporations Committee (the "Committee") of the Business Law Section. The Business Law Section is composed of attorneys regularly engaged in advising business enterprises in California; the Committee is composed of attorneys regularly advising California corporations and out-of-state corporations transacting business in California.

In the Comment Release, the Commission requested comments on how to address investor protections while reducing burdens associated with quarterly reports. This letter provides responses to certain questions posed by the Commission in the Comment Release related to earnings releases, supplemental information and semi-annual reporting. We do not address other queries posed in the Comment Release. The Committee thanks the Commission for the opportunity to comment on the Comment Release.

I. SUMMARY

In the Comment Release, the Commission observed that many companies voluntarily issue earnings releases in addition to filing quarterly reports. The Commission noted the overlap between financial information provided in earnings releases and Form 10-Q and queried the value of earnings releases and whether the Commission, in an effort to reduce issuer burdens, should allow for supplemental information to be incorporated by reference into Form 10-Q. The Commission, noting practices in the United Kingdom, also queried whether companies should be permitted to report on a semi-annual basis as opposed to a quarterly basis.

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Overall, we believe that quarterly reports serve an important purpose for many companies, providing transparency and timely, material information to investors, while at the same time allowing companies to raise capital and allowing insiders to trade in their companies' securities on a more frequent basis. For a subset of companies, semi-annual reporting may significantly reduce costs, while still providing important protections to investors. For example, as discussed further below, the subset of companies where semi-annual reporting is implemented may be based on an asset and/or revenue test, combined with not being listed on an exchange.

As it relates to earnings releases, we encourage the Commission to take a flexible approach in any rule changes that it may adopt. Although the type of information included in earnings releases and Form 10-Q may be similar in nature, there can be material differences between the information provided in an earnings release, which is market driven and is generally unique to each company or industry sector, and Form 10-Q. Any rule changes should not explicitly or implicitly discourage (e.g., by requiring earnings releases to be "filed") issuers from providing quarterly earnings guidance. We do not believe that restricting or limiting quarterly guidance will ultimately change the focus on quarterly results (unless issuers cease to provide quarterly information in the first instance). Consistent with a flexible approach, if the Commission adopts rules allowing Form 10-Q to incorporate by reference information from earnings releases, we believe that issuers should be permitted to choose to disclose in one place in the Form 10-Q or to incorporate by reference the information disclosed in the earnings release in order to reduce duplication of information. In all instances where incorporation by reference is permitted, issuers should be permitted to incorporate on a selective basis, rather than being required to incorporate the entire earnings release (including any forward-looking guidance).

II. COMMENTS

Information Content Resulting from the Quarterly Reporting Process

5. Are there meaningful differences between the financial information typically provided in an earnings release and the financial information required by Form 10-Q? What accounts for the differences?

The degree to which there are differences in financial information provided in an earnings release and a Quarterly Report on Form 10-Q varies significantly by issuer. Some issuers choose not to provide any information that they do not plan to include in their Form 10-Q, whereas other issuers provide additional disclosures that they choose not to include in the Form 10-Q. Typically, the additional disclosures include operational data and may include non-GAAP financial measures. On the other hand, we believe that most issuers provide less financial statement information in their earnings releases than in their Form 10-Qs. For example, issuers very rarely, if at all, include all of the information included in the notes to their financial statement in their earnings releases, nor do they typically provide all of the financial information that is included in the period over period discussion in the MD&A.

The difference in type and level of information included in an earnings release versus a Form 10-Q is driven by a number of factors, including longstanding market practice and a desire to keep earnings releases concise and focused on key information, with many companies focused on

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conveying information that they believe investors are most interested in receiving on an expedited timeline. Issuer disclosures in Form 10-Qs are intended to meet specific Commission requirements. Issuers often use earnings releases to provide information sought by analysts and investors in a manner that avoids issues of selective disclosure. That is not to say that the investing community disregards Form 10-Q; many investors and analysts will take and review as much information about a company as is provided to them.

In our experience, issuers also sometimes include different types of information in their earnings releases. This information is not necessarily material. For example, an earnings release might focus on particular customer or contract wins, or provide information about granular product category mix or new product launches—not all of which would be required or expected to be in the Form 10-Q.

6. When a company issues an earnings release that includes much of the information required by Form 10-Q before the form is filed, is the Form 10-Q still useful? Why or why not? How important to investors is the confirmation or interpretation by the Form 10-Q of the information in the earnings release? If investors rely on Form 10-Q as the primary document, is the historical financial information about the quarterly period included in the earnings release useful? Why or why not? Does the fact that Form 10-Qs are filed as opposed to furnished, and include certifications, impact the extent to which investors rely on them? Are there any instances when information disclosed in earnings releases may be useful to investors for purposes of interpreting the content of Form 10-Q? If so, when and how?

Companies face potential liability under the securities laws for misstatements and omissions in their earnings releases, and as with any public statements by companies, disclosures made in an earnings release can have an immediate impact on the trading prices of a company's securities. The market does not wait for "confirmation" of these (or any) disclosures in a Form 10-Q. For these reasons, companies typically do not issue earnings releases without a high degree of certainty that the disclosures in the Form 10-Q will not materially change. In our experience, companies will have substantially completed their disclosure control procedures and the Form 10-Q before issuing of their earnings releases.

Information presented in earnings releases or on earnings calls or at investor events often provides helpful additional color that goes beyond what has been presented in the issuer's filings with the Commission. We believe that issuers should not be effectively discouraged from providing that information (and therefore potentially reducing the total amount of information that investors receive) through requirements, for example, to file all such information and subject such information to Sarbanes-Oxley Act certifications or disclosure controls and procedures or to be subject to enhanced securities law liability for such statements.

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- 8. Some have suggested that the practice of providing quarterly forward-looking earnings guidance creates an undue focus on short-term financial results and thereby negatively affects the ability of companies to focus on long-term results. Is this the case and, if so, are there changes we could make to our rules that would discourage this practice or address this concern? For example, should we require that earnings guidance be filed with or furnished to the Commission? Are there other factors that promote a focus on short-term results? If so, what are they and what is their impact on investors and companies?**

We believe that the Commission should not discourage or address concern about quarterly forward-looking earnings guidance because this practice and the type of information provided is driven by a variety of factors, including the issuer's industry, investor expectations and general market forces. Commission rules currently require issuers to disclose known material trends and uncertainties that are expected to have a material impact on future financial condition and operating performance.¹ These rules do not specifically require an issuer to provide, nor do they prohibit the provision of, earnings guidance, but instead ask the issuer to provide insight on trends that may affect the company's financial performance. We believe that the Commission should not on the one hand encourage forward-looking disclosures and then on the other hand discourage specific quarterly earnings guidance.

Decisions on whether to provide quarterly forward-looking earnings guidance are made on an individual basis at each company, and the reasons for doing so, or not doing so, are similarly varied. We expect that so long as companies are providing financial information on a quarterly basis, there will be forward-looking information about that guidance, whether solely from analysts' expectations about the quarter or from both the company and analysts.

Some companies may prefer not to provide guidance, but receive market pressure to do so in order to meet investor and analyst desire for the information. Other companies may receive that same market pressure, but determine not to provide quarterly guidance, even if it means less investor interest in the stock or less comprehensive analyst coverage (or coverage that is divergent from the company's expectations). Other companies may choose to provide the information to help provide investors with the company's perspective on quarterly expectations, rather than having analyst expectations be the sole datapoint in the market. In that regard, some companies want to provide some guidance to the market in an effort to set market expectations and avoid surprises, which potentially lead to stock price declines and loss of investor confidence.

Even if the Commission were to prohibit (or significantly discourage) companies from providing forward-looking guidance, analysts would likely continue to provide that information, in which case investors would lose the benefit of the company's perspective on future results, and companies would be hamstrung (including under Regulation FD) in correcting or disputing analysts' views. Implementing such a change also would not be likely to reduce a company's focus on short-term results, other than if such a change were to have the effect of eliminating quarterly estimates from all sources, including analysts. As discussed above, even if companies were to eliminate the practice of providing quarterly guidance, analysts would likely continue to

¹ See Regulation S-K, Item 303, Management's discussion and analysis of financial condition and results of operations.

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provide estimates, against which companies would be measured as to whether they missed, met or beat those estimates.

Requiring companies to “file” such information could have a chilling effect for some issuers on providing guidance due to liability concerns. Consequently, investors would receive less information.

Earnings Release as Core Quarterly Disclosure

20. Should information in an earnings release that is submitted on Form 8-K be allowed to satisfy the Form 10-Q requirements? Why or why not, and if so to what extent? What are the potential benefits and drawbacks to investors, companies, and other market participants of the Supplemental Approach or other suggested approach?

We support a flexible approach that would allow issuers to selectively incorporate in a Form 10-Q specified information submitted on Form 8-K. This may benefit some issuers by reducing time and effort in creating and including any duplicate information for both an earnings release and a Form 10-Q. In addition, investors would not be disadvantaged as they could access the information incorporated by reference via a hyperlink, which would provide the detailed financial information that is required by Form 10-Q. However, many issuers may choose not to use an earnings release to comply with disclosure requirements of Form 10-Q since the earnings release is typically an “executive summary” of the issuer’s financial and business performance for the period. By including Form 10-Q compliant financial information in an earnings release, it may no longer be a succinct overview of the issuer’s financial performance, thereby defeating the purpose of an earnings release for investors. By providing a flexible approach, issuers could choose whether using and filing the earnings release to comply with Form 10-Q requirements would be more beneficial than creating both documents with similar information.

22. If we adopt the Supplemental Approach or other suggested approach, should we require the relevant Form 8-K to be filed rather than furnished? Should we further require the relevant Form 8-K to be incorporated by reference into the Form 10-Q, in whole or in part? Should we require a hyperlink from the Form 10-Q to the relevant Form 8-K? Should we require the relevant Form 8-K to include certain disclosures that are otherwise required in Form 10-Q? If so, which disclosures should be required and why?

Currently, information presented in satisfaction of Items 1, 2 and 3 of Part I of Form 10-Q is not deemed filed for purposes of Section 18 of the Exchange Act (unless that information is also used to satisfy Part II of Form 10-Q). We believe information should not be required to be filed simply because an issuer incorporates that information into a Form 10-Q.

27. If an earnings release were used to satisfy the requirements of Form 10-Q, should any financial statements included in an earnings release be subject to auditor review procedures at the time the Form 8-K is filed? Why or why not?

As previously stated, we encourage the Commission to take a flexible approach as to whether the earnings release could be used to satisfy the requirements of Form 10-Q, and in that regard, if an issuer chooses to satisfy the Form 10-Q requirements with the Form 8-K, then those financial statements should be subject to auditor review procedures. However, permitting an earnings

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release to satisfy Form 10-Q requirements may not be practical unless the Commission reduces requirements for financial statements. As discussed below, there may be a category of issuers that qualify for reporting on a six-month basis and for which those interim financial statements would not be required to be reviewed by an auditor.

Reporting Frequency

31. Should we move to a semi-annual reporting model for all or certain categories of reporting companies? Why or why not, and to which categories of reporting companies (e.g., smaller reporting companies, non-accelerated filers, emerging growth companies)? Are there other categories of reporting companies, such as by industry, that we should consider? For example, are there any unique considerations we should give to certain commodity trusts, business development companies, and other collective investment vehicles? Would any other frequency of reporting model be more appropriate for these or other types of companies?

We believe that quarterly reporting in some form may have benefits for many issuers and their investors. Investors in public, and in many cases, private companies are accustomed to receiving quarterly financial information, and transparency and the frequency of information made available is most likely a factor in the strength of the U.S. capital markets worldwide.

Quarterly reporting also may provide greater certainty, and more windows, for insiders to be able to transact in an issuer's securities while not in possession of material non-public information ("MNPI"). The longer period between reporting financial information could cause officers and directors to be in possession of MNPI on a more frequent basis and lead to more difficult judgment calls as to whether an individual can trade, thereby either increasing the risk of insider trading or decreasing the ability of insiders to trade (and thereby potentially making it less attractive to serve in that role). Typically, companies will adopt insider trading policies that generally prohibit officers and directors to trade during periods where it is presumed that MNPI exists. For example, insiders are prohibited from trading in the company's securities during the period immediately prior to the end of a quarter and ending shortly after the release of earnings. Semi-annual reporting could cause uncertainty for insiders as to when it is appropriate to conduct stock transactions.

Notwithstanding the above, there may be a category of companies for which semi-annual reporting makes sense. We note that companies that conduct Regulation A+, Tier 2 offerings are required to file semi-annual reports.² According to "Regulation A+: What Do we Know So Far?", prepared for the Commission Director and Chief Economist of the Division of Economic and Risk Analysis (DERA) and issued on December 6, 2016, the median total assets was \$200,000 for issuers with qualified Tier 2 offerings and 89% of such issuers had revenue of less than \$1.0 million.

We believe it may be difficult to move an entire industry or the entire category of smaller reporting companies, the number of which recently grew as a result of an increase and expansion

² See Rule 257(b) of the Securities Act of 1933, as amended (17 CFR 230.257(b))

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of the qualifying thresholds³, to semi-annual reporting. In the case of industries, the differing size and complexity of companies within one particular industry could vary significantly, making a one-size-fits-all approach challenging.

Rather, the Commission may want to consider specific additional criteria for those companies that would be eligible for semi-annual reporting. For example, semi-annual reporting would only be available for those companies that are not traded or quoted on a national securities exchange⁴, have annual revenues of less than a specified amount and do not incorporate by reference any Commission filings (e.g., the issuer has not filed any Form S-8 or S-3 registration statements).⁵ For this category of company, the cost savings of semi-annual reporting could be meaningful, and at a small enough level of revenue or other activity, quarterly reporting may not produce meaningful information for investors. As noted above, the SEC has already granted certain qualifying issuers the ability to report on a semi-annual basis under Regulation A+. If the Commission were to adopt semi-annual reporting, we believe it should be for a smaller subset of companies than the existing categories of filers (large accelerated, accelerated, etc.). In addition, if the Commission were to conclude that semi-annual reporting companies should also provide quarterly financial information, the Commission instead may consider reduced quarterly disclosure requirements, similar to the modified requirements applicable to Regulation A+ issuers (e.g., financial statements are not required to be reviewed).

34. How would a semi-annual reporting model affect the general use of Form 8-K to report material information? Should we consider any particular additional Form 8-K requirements or triggers under a semi-annual reporting model? If so, what type(s)?

We believe that the implementation of a semi-annual reporting model for a small subset of issuers would not necessarily change the reporting requirements of Form 8-K. These issuers would continue to be required to report as required by Form 8-K, which generally covers developments that would be material to a company. However, the Commission could consider whether the safe harbor for Section 10(b) and Rule 10b-5 of the Exchange Act provided by Rules 13a-11(c) and 15d-1(c) should continue to apply during the period that an issuer relies on semi-annual reporting, at least for certain 8-K items.

35. How would a semi-annual reporting model affect the use of earnings releases? If we were to allow semi-annual reporting, should we require voluntarily published earnings releases, either on a quarterly or semi-annual basis, to be filed rather than furnished? Or, if we were to allow semi-annual reporting, should we require companies to file earnings releases?

Under our proposal, if the Commission were to adopt a semi-annual reporting model, we believe that it should not affect the use of earnings releases since the small subset of issuers that would

³ See Smaller Reporting Company Definition, Adopting Release No. 33-10513 (June 28, 2018), which noted that 2,851, or 38.6%, of the 7,395 registrants that filed a Form 10-K in 2016 reported having a public float of less than \$250 million.

⁴ A “national securities exchange” is a securities exchange that is registered with the SEC under Section 6 of the Securities Exchange Act of 1934, as amended.

⁵ This last requirement would be applicable if the Commission were to adopt semi-annual reporting without changing financial statement staleness rules for registration statements.

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be eligible to report semi-annually are usually the issuers that do not issue earnings releases. If a company does issue a quarterly earnings release, it would need to ensure that it complies with Regulation FD, which requires furnishing to or filing the information with the Commission on Form 8-K or disseminating the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of the information to the public. For reasons discussed above, we believe that the Commission should not require that earnings releases be filed, as opposed to furnished.

If the Commission were to mandate those issuers that are reporting on a semi-annual basis to also file (or furnish) earnings releases on a quarterly basis, it would effectively be retaining the requirements of some form of quarterly reporting for all issuers, thereby reducing the benefits of semi-annual reporting. A semi-annual reporting model should not affect the use of earnings releases, which should continue to be at the discretion of the issuer.

We hope the foregoing is useful to the Commission and Staff in considering changes to Commission rules regarding earnings releases and quarterly reports. Please do not hesitate to contact either of the undersigned if you have any questions on the matters raised herein.

Very truly yours,

/s/ Keith Paul Bishop
Co-Chair, Corporations Committee

/s/ Steven Kelsey Hazen
Co-Chair, Corporations Committee

Drafting Committee:

Katherine J. Blair

Sarah P. Payne

California Lawyers Association Business Law Section Corporations Committee Members:

As of the date of this letter, the Corporations Committee is composed of the members shown below, not all of whom necessarily endorse each and every recommendation and view expressed in this letter. Taken as a whole, however, this letter reflects a consensus of the members of the Corporations Committee.

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