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Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Pierre Servan-Schreiber
Paris
+33.1.55.27.11.30
pierre.servan-schreiber@skadden.com

Shari L. Piré
Paris
+33.1.55.27.11.43
shari.pire@skadden.com

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68, rue du Faubourg Saint-Honoré
75008 Paris, France
Telephone: +33.1.55.27.11.00

Four Times Square, New York, NY 10036
Telephone: +1.212.735.3000

WWW.SKADDEN.COM

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Ad Hoc Guidance Requirements Unaffected by the Amended EU Transparency Directive

Background

In the wake of the current financial crisis, predicting earnings is challenging. The media is flooded with profit warnings. Boards throughout Europe are faced with a difficult question: Must a company post a profit warning as soon as sales slide and financial objectives are shrouded in doubt or can the company wait until it posts its regularly scheduled report? Today, the Market Abuse and Transparency Directives[1] require companies listed on a regulated market to, among other things, communicate to the market in the course of the fiscal year. When and whether interim, out-of-sequence reports are necessary remains a difficult question. The recently approved package of amendments to the Transparency Directive reflect the European Commission's efforts to decrease the culture of short termism pervasive in today's financial markets. Such amendments do not, however, address *ad hoc* disclosure of inside information, and listed companies may nevertheless feel compelled by investor and analyst pressure to communicate when performance slips.

On June 12, 2013, the European Parliament approved amendments to the Transparency Directive (Amended Directive), which are expected to be transposed into French law by the end of 2015. The Amended Directive is comprised of provisions designed to yield responsible business practices and encourage a longer-term focus. Among the changes effected, the Amended Directive will eliminate the obligation to produce interim management statements and quarterly reports.[2] This amendment is expected to reduce the administrative costs associated with such reporting and may help both issuers and the market focus on the longer term.[3] Legislation governing an issuer's obligation to immediately disseminate any significant financial news is not affected by the Amended Directive and is our focus here. First, an overview of the reporting requirements is in order.

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1 *See* Article 6(1) of the Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC which requires certain issuers to provide interim management reports (Transparency Directive) *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0038:EN:PDF. Article 6(2) of this Directive exempts issuers that publish quarterly financial reports from this requirement. See Article 6 of the Directive 2003/6/EC of the European Parliament and the Counsel of 28 January 2003 on insider dealing and market manipulation (market abuse) (Market Abuse Directive) *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0006:20110104:EN:PDF.

2 The Amended Directive also will require disclosure of (i) interests held in financial instruments that could be used to acquire economic interests in an issuer and have the same economic effect as interests held in shares and (ii) payments in excess of $100,000 made to governments by companies operating in the extractive and forestry logging businesses. The changes to the resource extraction disclosure mark the EU's efforts to fight corruption in resource-rich countries and bring EU regulations in line with Dodd-Frank Act disclosure rules adopted in the U.S. last year. By contrast to the applicable Dodd-Frank Act rules, however, the EU reporting requirements apply to large private companies and not just to public companies.

3 Whether issuers will succumb to pressure from investors and analysts and nevertheless continue to publish such periodic information remains to be seen.

Periodic Reporting and Half-Yearly and Yearly Results, Now and in 2015

A company with shares listed on a regulated French market has an obligation to publish information on both a periodic and continuing basis. More specifically, an issuer must post earnings reports explaining material events and transactions that transpired during the relevant period and the impact such events have had on the issuer's financial position at the end of each quarter, at the end of the first semester and at the end of the financial year, and must communicate revenues only at the end of the first and third quarters.[4]

By the end of 2015, however, reporting requirements will change. In an effort to reduce administrative burdens and encourage long-term investing, the European Commission proposed amendments to the Transparency Directive which once in effect, will eliminate the obligation to publish quarterly financial information and maintain only the requirement to communicate half-yearly and yearly financial results.[5] The changes to the reporting calendar transposed into French law and the laws of the other Member States will not prevent issuers from posting quarterly financial information, should they so desire.

Ad Hoc Reporting

In addition to periodic reporting requirements, issuers will continue to have ongoing reporting requirements. Such obligations will not be affected by the Amended Directive. In particular, a listed company must promptly disclose any nonpublic information that relates directly or indirectly to one or more issuers (or to one or more financial instruments) when such information is "sufficiently precise" and which, if made public, is likely to have a significant effect on the price of the applicable financial instruments.[6] This disclosure obligation also applies to any significant change in information previously disclosed. Failure to disclose such "inside information" constitutes a violation of French law, even if such disclosure was accompanied by cautionary language. Although French-listed companies, like their U.S. counterparts, generally include cautionary statements in their reports, under EU law, cautionary language does not obviate the duty to comply with applicable reporting requirements.[7]

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4 Chapter II of the Transparency Directive sets forth the requirements regarding dissemination of periodic information.

5 Under the Amended Directive, "[t]he home Member State may only under specific conditions require issuers to publish additional periodic financial information on a more frequent basis than the annual or half-yearly reports required by the Directive, namely if, after an assessment of the impacts, it is shown that such additional requirement does not lead to an excessive focus on short-term results and performance of the issuers and to a negative impact on the access of small and medium sized issuers to regulated markets." *See* Memorandum of the European Commission, *Revised Directive on transparency requirements for listed companies (Transparency Directive) – frequently asked questions*, dated June 12, 2013 *available at* http://europa.eu/rapid/press-release_MEMO-13-544_en.htm?locale=en.

6 *See* Article 6(1) Market Abuse Directive. Information that a reasonable investor would likely consider when making investment decisions is information that would be likely to have a significant effect on the prices of financial instruments. *See* Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32003L0124:EN:NOT**.** Information is sufficiently precise when "it indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so and if it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments." *See id.* Information which is likely to have a significant effect on the price of related derivative instruments is covered by this requirement.

7 In the U.S., courts are split on when revised guidance must be provided. While the inclusion of cautionary language is one of many factors, it may not be sufficient to protect a U.S. issuer from liability for failure to revise prior guidance.

What Prior Guidance Must be Updated?

Assessing whether or not information requires disclosure is not always straightforward, especially when management publishes quantitative statements regarding the issuer's financial condition with forecasts and a range of expected revenues and per share earnings. What happens when growth starts to slow down and the financial objectives previously disclosed to the market begin to feel like a reach? Should the board feel compelled to disclose its concerns to the public?

The decision to revise prior guidance requires analysis and comparison of the nature and content of the information communicated to the market and the state of the business in the months following such communication. Neither French law nor market practice create an obligation to update financial estimates on a monthly basis or each and every time performance varies, whether up or down. Such regular and frequent communication with the market could be more confusing than enlightening. In fact, an issuer has no duty to revise previous guidance unless it becomes aware of an event or information that is both precise and material. As a result, an issuer should not feel compelled to issue a profit warning revising prior guidance simply because it establishes that there is a difference. Even information indicating a significant disparity between the objectives previously announced and the likelihood the results for the referenced period will be achieved need not be disclosed, unless and until the board of such issuer has established that such difference is or appears definitive and is, in absolute terms, of material importance.

Similarly, when in the context of making periodic reports, an issuer has regularly disclosed information regarding its business strategy, financial objectives and the degree to which its business and results are affected by macro-economic factors, the market should, in principle, be in a position to assess the impact upon the issuer's situation of any information relating to it or of any change in macro-economic factors likely to have an impact upon such issuer. Accordingly, in such a case the issuer may generally refrain from making any immediate and specific announcement updating any previously issued objectives until the next, regularly scheduled publication of periodic statements. By contrast, if a board reviews revenues evidencing a downward trend and reasonably determines that its expected earnings will actually be materially lower than the estimated range, and that such gap derives from the fact that the issuer insufficiently explained its strategy, failed to consider external economic variables or the affect that such variables would have on the company's results, revised guidance should be published.[8]

The decision is even more difficult to reach when the issuer feels that although the market is in possession of all relevant and material information diverging from previously issued guidelines or estimates, which could or even should have a negative impact on the share price, the market does not seem to draw the appropriate consequences. In such circumstances, management or boards may be tempted to "do something" to alert the market, via analysts and/or journalists, thereby attempting to provoke a "soft landing" of the stock price, which may fall more in line with their own assessment of how the stock should be priced. In general, an issuer should avoid adopting such tactics. An issuer's only duty is to ensure that the market possesses all relevant information. The market's reaction, or absence thereof, is not within an issuer's control, nor should an issuer attempt to influence it unduly.

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8 Doctrine dictates that a difference is of material importance when it derives from a percentage of the financial objectives published by the issuer, percentage of the figures published in the previous year, or the gap in the estimates and amounts realized has emerged rapidly. *See Cadre et Pratiques de Communication Financière L'Observatiore de la Communication Financière available at* http://www.observatoirecomfi.com/index2.php?option=com_docman&task=doc_view&gid=26&Itemid=26.