Complaint Regarding Apparent Violations of Regulation FD by Walgreen Co.

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I. Introduction

This complaint summarizes Walgreen Co.'s ("Walgreen" or "the company") apparent violations of Regulation FD. Walgreen has held private meetings with sell-side analysts and investors in which the company has apparently disclosed material, nonpublic information concerning a potential corporate tax inversion. These disclosures provided material information to well-connected and influential shareholders, and after both meetings, there were spikes in Walgreen's trading volume and share price. While this was going on, the vast majority of regular shareholders were kept in the dark about crucial developments. We therefore call upon the Commission to conduct a full investigation and to take remedial action.

In 2012, Walgreen Co. announced a planned acquisition of Alliance Boots GmbH ("Alliance Boots" or "AB"). Both companies heralded the deal, which would progress in two steps, as transformational. The companies completed the first step in August 2012 and have indicated that they intend to complete the acquisition in early 2015. The structure of the transaction was called into question in February 2014, when rumors began to spread that Walgreen and Alliance Boots were considering negotiating a change to the second step of the deal to enable an inversion, a reincorporation overseas that would result in significant tax savings. Such a move would require significant restructuring of the post-merger entity. Both companies faced a pressing need to shore up profits as they reported lackluster earnings in spring 2014.

Publicly, Walgreen Co. executives denied that the company was considering an inversion. However, even as the company was publicly denying that it might reincorporate overseas, top executives were holding private meetings with sell-side analysts and hedge fund shareholders in which they discussed the possibility of a tax inversion and commented on what obstacles existed to structuring the second step to enable an inversion. The dissonance between private and public statements from the company continued until three weeks after the second private meeting, when an executive confirmed that the company was seriously considering such a move. This incomplete public disclosure – nearly three months after the company first privately disclosed that it was considering an inversion – does not cure the original violations.

These meetings appear to have violated Regulation FD by creating an uneven playing field, in which favored analysts and well-connected and influential investors received material information before the market and may have profited from this information.

II. CtW Investment Group

The CtW Investment Group works with pension funds sponsored by affiliates of Change to Win – a federation of unions representing over five million members – to enhance long-term shareholder value through active ownership. These funds invest over $250 billion in the global capital markets and are substantial investors in Walgreen.

III. Facts

A. Background information on the transaction

In June 2012, Walgreen publicly announced, providing comprehensive details in its 8-K filings, that it had entered into an agreement with Alliance Boots GmbH and Gibraltar-based AB Acquisitions Holdings Limited ("GibCo") to acquire a 45% stake in Alliance Boots GmbH as well as an option to acquire the remaining 55% of the company with an exercise period beginning in 30 months' time.[1] In exchange, Walgreen paid consideration of $4.025 billion in cash and 83,392,670 shares of Walgreen stock.[2] On August 2, 2012, Walgreen closed the first step of the deal.[3] Walgreen shares were trading at $36.27, resulting in consideration worth $7,049,652,141.

The company now possesses an option to buy the remainder of AB from GibCo. Per the purchase agreement, Walgreen will pay "£3.133 billion in cash, payable in British pounds sterling, and 144,333,468 shares of Common Stock" if it exercises the option.[4] The option is exercisable for a six month period beginning February 2, 2015. Walgreen has consistently indicated that it intends to exercise this option.

Based on the current share price and exchange rate, the second step is valued at $15,734,438,274, up from $10,530 million when the deal was announced. The total value of the deal is $31,452,667,125, which includes the assumption of Alliance Boots' debt, presently worth $8,708,429,100.

B. Corporate tax inversion

In recent months, it has become apparent that Walgreen and AB are considering re-structuring the second step of the transaction. In particular, management of both companies has stated that they are considering undertaking a corporate tax inversion. An inversion would have the effect of re-domiciling Walgreen in a foreign country so that the group's worldwide effective tax rate is significantly lower. At an investor conference in late April, Walgreen management confirmed that the company was seriously considering an inversion.[5] An inversion would require a major revision to the original transaction because of the significant changes required to meet legal requirements for an inversion . Walgreen shareholders must hold less than 80% of the combined entity to qualify for the tax benefit. Even if the

[1] Walgreen Co., SEC Form 8-K (June 18, 2012). Attached hereto as Exhibit 1.
[2] *Id*.
[3] Walgreen Co., SEC Form 8-K (Aug. 2, 2012). Attached hereto as Exhibit 2.
[4] Walgreen Co., SEC Form 8-K (June 18, 2012).
[5] Transcript, Walgreen Co. at Barclays Retail and Consumer Discretionary Conference (Apr. 30, 2014). Attached hereto as Exhibit 3. A corporate tax inversion is available to a U.S. company that merges with a foreign company, where at least 20% of the combined company is held by the owners of the foreign company. Typically, an inversion merger is structured so that a newly created foreign holding company acquires both the domestic and the foreign corporations. Shares in the domestic corporation are then cancelled and the shareholders receive a right to shares in the new, foreign holding company. Companies undertaking this move for tax purposes will generally re-incorporate in a low-tax jurisdiction, such as Ireland or Switzerland. As a result, the move can result in dramatically lower tax payments, both because the group's worldwide earnings are no longer subject to U.S. taxation, and because the move enables massive profit shifting via intra-group transactions. In recent months, U.S. firms have made headlines with their aggressive pursuit of mergers with foreign companies for this purpose.

companies negotiate all stock consideration for the second step, current Walgreen shareholders would end up with 82% of the combined entity. Reports from various sources indicate that the company is open to renegotiating the deal to meet the threshold.[6]

Analysts have estimated that an inversion would result in significant savings for the company. Barclays has published the most complete models of potential savings. It estimates that, beginning in FY16, the inversion will result in annual tax savings of $783 million.[7]

These savings are particularly alluring because both companies have had disappointing results in the past year. Alliance Boots reported flat EBITDA this year and faced significant challenges in its core European wholesaling markets.[8] Walgreen has missed earnings expectations for the most recent two quarters.[9] Analysts cite weak fundamentals including reduced prescription drug reimbursement and declines in store traffic.[10] In its most recent earnings release, Walgreen announced that it was withdrawing its estimates of FY16 operating income for the combined company, but provided little other information to shareholders.[11] In this context, there is increasing pressure inside and outside the company to undertake an inversion as a means to make this transaction worthwhile, at a time when the future earnings potential of the combined entity is in question.

C. First private meeting: early February 2014

Prior to February 2014, there was no public discussion of whether Walgreen would consider changing the second step of the transaction to undertake a corporate tax inversion. However, in early February, rumors began to spread that Walgreen and Alliance Boots management were actively discussing whether to do an inversion and what form that inversion might take. News articles and analyst reports make clear that the source of these rumors was a private meeting in London in the first ten days of February attended by representatives of Deutsche Bank, Morgan Stanley, unidentified investors, and management of Walgreen and Alliance Boots. [12]

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[6] Barclays, Walgreen Co.: Investors in the Drivers' Seat; Upgrading to Overweight (June 18, 2014), at 38-39. Attached hereto as Exhibit 4. See also UBS, Walgreen Co.: Tax Inversion Case Studies Suggest Big Upside (Mar. 12, 2014), at 3. Attached hereto as part of Exhibit 14.

[7] Barclays, Walgreen Co.: Investors in the Drivers' Seat; Upgrading to Overweight (June 18, 2014), at 10-12.

[8] See, e.g. Credit Suisse, Walgreen Co.: Alliance Boots Annual Report Provides Rare Update; Reliance on Synergies Increases (May 15, 2014). Attached hereto as Exhibit 5.

[9] NASDAQ, Walgreen Co. Earnings Surprise, http://www.nasdaq.com/symbol/wag/earnings-surprise

[10] Barclays, Walgreen Co.: Short-Term Turbulence Expected (June 26, 2014); Cantor Fitzgerald, Walgreen Co.: Inversion Won't Address Structural Challenges (June 24, 2014). Attached hereto as Exhibits 6 and 7.

[11] Press Release, Walgreen Co., Walgreen Co. Reports Fiscal 2014 Third Quarter Results (June 24, 2014). Attached hereto as Exhibit 8.

[12] The Wall Street Journal's MarketWatch blog reported on the meeting on February 11, 2014: "Shares of Walgreen Co. jumped nearly 6% to an all-time high Tuesday, but the cause for the stock move is somewhat of a mystery as there was no news on the drug retailing giant that hit the wires. Instead, analysts on Wall Street say they are hearing that Walgreen management spoke in bullish tones at an investor conference in London, which was also attended by its international partner, Alliance Boots. Stateside sources at the two brokerages hosting the conference, Deutsche Bank and Morgan Stanley, confirm the meetings were going on this week but had no information on the substance of the discussions." Russ Britt, "Walgreen's record move a mystery; talk centers on

On February 11, Deutsche Bank released an analyst report that referenced this meeting.[13] The report estimated that such a move would be "~$1.50 to $~2.00 accretive to EPS, driving a 40%-50% increase the year the structure is implemented."[14] Although the report does not provide details about the private conversation on the issue of inversion, it does note that the topic was discussed during this private meeting:

> A new idea that we heard during this trip was the potential for corporate inversion during the second phase of the transaction process of the Walgreens/Alliance Boots merger. Simply put, the transaction gives the company an opportunity to move its corporate domicile to Europe to take advantage of lower corporate tax rates. Walgreens current reported tax rate is about 37%, so there would is an immense financial incentive to take advantage of this structure. Walgreens could conceivably create a patent holding company in Switzerland and lower its corporate tax rate to a range of 7% to 12%.[15]

Morgan Stanley issued a report on February 13 that also referenced the meeting with management and stated that the issue of inversion was one of "debate" between the two companies' management teams.[16]

Trading volume was intense following this meeting. As the chart below shows, the trading volume peaked on Tuesday, February 11 and Wednesday, February 12.[17] The trading volume on the 11th increased by 137% from the 2Q FY2014 average daily trading volume; the trading volume on the 12th increased by 261% from the average daily trading volume.

London meetings," MarketWatch (Feb. 11, 2014). http://blogs.marketwatch.com/health-exchange/2014/02/11/walgreens-record-move-a-mystery-talk-centers-on-london-meetings/ Attached hereto as Exhibit 9.

[13] Deutsche Bank Markets Research, The Precision of a Swiss Watch – With as Many Moving Parts (Feb. 11, 2014). Attached hereto as Exhibit 10.

[14] *Id*. at 7.

[15] *Id*.

[16] Morgan Stanley, Walgreens: These Boots are for Walking: Domiciles, Taxes, and other Takes from Meetings with AB (Feb. 13, 2014). Attached hereto as Exhibit 11.

[17] During the first three months of 2014, three hedge funds dramatically increased their stakes in Walgreen Co. shares. JANA Partners LLC increased its position from 7,347,395 to 12,145,520, a position change of 4,798,125 or 65%. OZ Management LP increased its position from 2,685,820 to 4,766,300, a position change of 2,080,480 or 77.46%. And Viking Global Investors LP increased its position from 11,604,944 to 24,105,841, a position change of 12,500,897 or 107.72%. It is not possible to tell from public filings at what point during this period the hedge funds increased their stake.

Date	Opening Price	High Price	Low Price	Closing Price	Adjusted Close	Trading Volume
2/3/2014	57.33	57.45	55.36	55.57	55.05	10,031,100.00
2/4/2014	55.91	56.03	55.31	55.95	55.42	6,697,700.00
2/5/2014	55.53	57.93	55.27	57.85	57.3	8,101,600.00
2/6/2014	57.98	59.29	57.9	59.22	58.66	6,594,600.00
2/7/2014	59.54	60.96	59.4	60.96	60.38	9,119,700.00
2/10/2014	60.76	60.93	60.14	60.65	60.08	5,031,200.00
2/11/2014	**61.02**	**64.71**	**61**	**64.2**	**63.59**	**16,109,200.00**
2/12/2014	**64.1**	**67**	**63.23**	**65.42**	**64.8**	**24,541,500.00**
2/13/2014	64.48	67.16	64.36	66.39	66.08	11,099,700.00
2/14/2014	66.09	66.82	64.58	64.78	64.48	8,241,700.00

Although the date of the meetings is not public, these figures show that as soon as rumors of the content of these meetings started to leak out, the market reacted dramatically. Not only was the trading volume at a high for the year, but the share price was also driven up, with a 9.5% increase from Monday, February 10 to Thursday, February 13.

Despite the market reaction and analyst commentary revealing otherwise, however, the company insisted publicly that it was not considering an inversion. On February 12, 2014, at a public meeting, Walgreen's VP for Investor Relations, Rick Hans, responded to a question about the possibility of an inversion by emphasizing that Walgreen management's position is "very adamant that we have no plans at all for a tax inversion."[18] During Walgreen's March earnings call, CEO Greg Wasson responded to a question about the possibility of an inversion by emphasizing that the company had "no plans to do an inversion."[19]

As early as February 13, however, Wall Street analysts were publishing reports noting "internal debate" between management at the two companies, indicating that the issue was certainly on the table and being discussed within the company and with certain investors and analysts.[20]

D. Second private meeting: April 11, 2014

On April 13, 2014, the *Financial Times* published an article detailing a private meeting with certain investors and the management of Alliance Boots and Walgreen that occurred on April 11 in Paris.[21] According to the *Financial Times*, the attendees included hedge funds Goldman Sachs Investment

[18] Transcript, Walgreen Co. at Leerink Swann Global Healthcare Conference (Feb. 12, 2014). Attached hereto as Exhibit 12.
[19] Transcript, Walgreen Co. Earnings Call on Q2 2014 Results (Mar. 25, 2014). Attached hereto as Exhibit 13.
[20] Morgan Stanley, Walgreens: These Boots are for Walking: Domiciles, Taxes, and other Takes from Meetings with AB (Feb. 13, 2014). See also UBS, Walgreen Co.: Tax Inversion Case Studies Suggest Big Upside (Mar. 12, 2014); UBS, Walgreen Co.: Post Call: Additional Thoughts on Outlook & Taxes (Mar. 26, 2014); Deutsche Bank, Walgreens: Combinatorial Chemistry – Adjusting WAG Model post F2Q (Mar. 31, 2014). Attached hereto as Exhibit 14.
[21] Ed Hammond, "Walgreens urged to leave US to gain tax benefit," *Financial Times* (Apr. 13, 2014). Attached hereto as Exhibit 15.

Partners, Jana Partners, Corvex and Och-Ziff.[22] The article did not contain specific information about what was discussed and what disclosures were made by management of either company, but did include this description of the conversation on the topic of inversion: "The discussions, held at the Four Seasons hotel in the city's upscale 8th arrondissement, were 'constructive', according to two people with knowledge of the meeting."[23]

Of the four investors cited as present by the *Financial Times*, Jana Partners has been the most aggressive in publicly pressuring Walgreen management. Jana Partners LLC holds 12.1 million shares of WAG, or 1.3% of outstanding shares. Walgreen is Jana's largest holding, representing 9.4% of its portfolio as of its most recent 13F filing.[24] Jana's founder, Barry Rosenstein, has been sharply critical of Walgreen management and supportive of an inversion after his private meetings with the company.[25]

The other investors present are also influential in their own right. They are significant Walgreen shareholders and some are known for their activism. Goldman Sachs Investment Partners is the eponymous hedge fund arm of the investment bank, which is a lead underwriter for Walgreen's debt associated with the first step of the Alliance Boots acquisition.[26] Working together, these hedge funds have significant clout with the company and the ability to pressure management to divulge sensitive information. These off-the-record conversations are problematic in that they give influential and well-connected investors information that is not available to the broader marketplace.

[22] *Id*.
[23] *Id*.
[24] JANA Partners LLC, SEC Form 13F (May 14, 2014).
[25] Saijel Kishan, "Jana Says Firm Is Working With Walgreen After Transaction," *Bloomberg News* (May 14, 2014). Attached hereto as Exhibit 16. In a later interview with *Barron's*, Rosenstein noted the importance of Walgreen to Jana's portfolio and suggested that an inversion would satisfy shareholder demands for better management: "And then, finally, there is the possibility of doing a tax inversion, in which the company would be domiciled outside of the U.S. and benefit from a more favorable tax rate. That wasn't the primary driver for the deal. But we read with interest the recent comments of Ian Read, the CEO of Pfizer, where he said that he viewed minimizing taxes as a fiduciary obligation to his shareholders, and we don't think it is any different in the case of Walgreen." Laurence C. Strauss, "Jana Partners' Favorite Stocks," *Barron's* (May 17, 2014). Attached hereto as Exhibit 17.
[26] Walgreen Co., SEC Form 424(b)(2), Prospectus Supplement (Sep. 11, 2012), at S-56.

In the week that followed, share price increased nearly 4%, from $63.96 on April 11 to $66.44 on April 17. Trading volume was also unusually high during the period in question:

Date	Opening Price	High Price	Low Price	Closing Price	Adjusted Close	Trading Volume
4/7/2014	65.95	66.12	64.59	65.1	64.8	7,521,500.00
4/8/2014	64.82	65.2	63.26	63.82	63.52	7,923,600.00
4/9/2014	63.97	65.9	63.53	65.52	65.22	9,828,900.00
4/10/2014	65.99	66.87	63.08	63.4	63.11	9,934,100.00
4/11/2014	63.3	64.86	62.8	64.26	63.96	8,313,900.00
4/14/2014	65.06	66.23	64.94	65.67	65.36	9,753,100.00
4/15/2014	65.66	66.07	64	66.01	65.7	8,273,500.00
4/16/2014	66.35	66.62	65.76	66.16	65.85	5,529,300.00
4/17/2014	65.99	67.11	65.59	66.75	66.44	6,221,200.00

Walgreen's share price is up 24.62% since the beginning of 2014, compared to 6.75% for the S&P 500.

E. Disclosure to the Public

Two weeks after the *Financial Times* report and nearly three months after the London meeting, Walgreen's Vice President for Investor Relations, Rick Hans, responded to a question about inversion during a public conference by saying, "We're not aversed of looking at [an inversion], right, for sure. I can't -- why would I be inverse to it. I mean it's been -- it obviously saves people a lot of tax payments, right? We've never been proponent to paying more taxes than we have to. We try to optimize that, increase value."[27] Analyst commentary read these remarks as evidence that the parties were open to an inversion.[28]

IV. Walgreen Co. and its Representatives may have Violated Regulation FD

Regulation FD limits selective disclosure to securities market professionals and holders of a company's securities. The regulation provides:

> Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph(b)(1) of this section, the issuer shall make public disclosure of that information . . . (1) Simultaneously, in the case of an intentional disclosure; and (2) Promptly, in the case of a non-intentional disclosure.[29]

Four elements are necessary to show that a selective disclosure has violated Regulation FD. First, the statement must be made by an issuer or a person acting on behalf of the issuer. Second, the statement

[27] Transcript, Walgreen Co. at Barclays Retail and Consumer Discretionary Conference (Apr. 30, 2014).
[28] See, e.g. UBS, Walgreen Co.: Alliance Boots Adds to Global Footprint (Plus A Tax Inversion Update) (May 6, 2014). Attached hereto as Exhibit 18.
[29] 17 C.F.R. § 243.100(a).

must have been made to persons falling into one of four categories (or their associates): (1) broker-dealers, (2) investment advisors and certain investment managers, (3) investment companies or hedge funds, or (4) "any holder of the issuer's securities under circumstances in which it is reasonably foreseeable that such person would purchase or sell securities on the basis of the information."[30] Third, the statement must have included material, nonpublic information. And, finally, the issuer has not cured the selective disclosure by simultaneous public disclosure or prompt public disclosure (depending on whether the violation was intentional).[31]

In promulgating the rule, the Commission explained its importance in maintaining a level playing field for investors: "many issuers are disclosing important nonpublic information, such as advance warnings of earnings results, to securities analysts or selected institutional investors or both, before making full disclosure of the same information to the general public."[32] The Commission went on to note that, "[w]here this has happened, those who were privy to the information beforehand were able to make a profit or avoid a loss at the expense of those kept in the dark."[33]

The Commission also noted that the regulation would address another problem: "the potential for corporate management to treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors."[34]

This section proceeds as follows. First, it identifies which Walgreen and Alliance Boots officials are covered by Regulation FD. It demonstrates that the February 2014 meeting likely violated Regulation FD. Then, it demonstrates that the April 2014 meeting likely violated Regulation FD. Finally, it argues that the company's public denials may have violated Section 10(b) of the Exchange Act.

A. "An issuer, or any person acting on its behalf"

Regulation FD applies to statements made by "an issuer, or any person acting on its behalf."[35] Walgreen Co. is an issuer, as that term is defined by statute and regulation.[36] The regulation defines a "person acting on behalf of an issuer" as "any senior official of the issuer, . . . or any other officer, employee, or agent of an issuer who regularly communicates with any person described in § 243.100(b)(1)(i), (ii), or

[30] Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881 Exchange Act Release No. 34-43154 (Aug. 15, 2000).
[31] Simultaneous public disclosure is required in the event of an intentional selective disclosure. Prompt disclosure is required in the event of unintentional selective disclosure. The regulation defines "promptly" to mean "as soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day's trading on the New York Stock Exchange) after a senior official of the issuer . . . learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic." 17 C.F.R. § 243.101(d).
[32] Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881 Exchange Act Release No. 34-43154 (Aug. 15, 2000).
[33] *Id*.
[34] *Id*.
[35] 17 C.F.R. § 243.100(a).
[36] 17 C.F.R. § 243.101(b); 15 U.S.C. 78l.

(iii), or with holders of the issuer's securities."[37] The regulation defines "senior official" to include "any director, executive officer . . ., investor relations or public relations office, or other person with similar functions."[38] Thus, Walgreen CEO Gregory Wasson, Walgreen CFO Wade Miquelon, and Walgreen Investor Relations Director Rick Hans are all covered by Regulation FD.

Alliance Boots is a privately owned company based in Switzerland and is not an issuer. However, to the extent that Alliance Boots executives act on behalf of Walgreen, their statements are covered by Regulation FD. Thus, Stefano Pessina, the executive chairman of Alliance Boots who serves on the Walgreen board of directors (and is not considered an independent director), is a senior official of Walgreen, and his statements to analysts and investors are covered by Regulation FD.

This element appears to be satisfied by the disclosures made at the February meeting and the disclosures apparently made at the April meeting.

B. Statement Made to Covered Analysts and Investors

The second prong of the test is also satisfied for both the February meeting and the April meeting. The disclosures were made to persons covered by Rule 100(b)(1). The audience at the February meeting included sell-side analysts, who fall within the categories of persons to whom selective disclosure may not be made.[39] The meeting apparently included investors, who may also have been covered by Regulation FD.[40] The April meeting was attended by four hedge funds.[41] Hedge funds are included in the categories of persons to whom selective disclosures may not be made.[42]

C. Material, Nonpublic Information That Was Not Cured by Public Disclosure -- The February meeting

With respect to the February meeting, the last two prongs of Regulation FD—the disclosure of material nonpublic information that was not cured by public disclosure—are also met. The reports that have been released about the meeting indicate that the company made disclosures of material non-public information regarding a possible inversion. This conclusion is also supported by the significant spike in

[37] 17 C.F.R. § 243.101(c).
[38] 17 C.F.R. § 243.101(f).
[39] 17 C.F.R. § 243.100(b)(1).
[40] See Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881 an Exchange Act Release No. 34-43154 (Aug. 15, 2000), note 25.
[41] The meeting was attended by Jana Partners, Corvex and Och-Ziff, all independent hedge funds, along with Goldman Sachs Investment Partners. According to Goldman Sachs' website, "Goldman Sachs Investment Partners is an opportunistic multi-disciplinary hedge fund employing an intensive fundamental approach to investing. The Fund seeks asymmetric risk-reward opportunities to achieve equity like returns. The team has cross-market capabilities, with experience capturing synergies across the capital structure in both public and private markets." http://www.goldmansachs.com/careers/why-goldman-sachs/our-divisions/investment-management/gsam.html
[42] 17 C.F.R. § 243.100(b)(1)(iii).

trading volume that accompanied the meeting.[43] Finally, the company did not cure the selective disclosure by simultaneous or prompt public disclosure.

Following the meeting, analysts reported that the topic of a potential tax inversion was discussed for the first time, to their knowledge, at that meeting.[44] They also reported that the issue was one of "debate" between the two companies' management teams.[45] The possibility of a tax inversion was nonpublic information. It was also, at the time the disclosure was made, material to investors.

In its notice promulgating Regulation FD, the Commission explained that it had chosen to rely upon "existing definitions of ['material' and 'nonpublic'] established in the case law."[46] The Commission adopted the definition that material information is information about which "there is a substantial likelihood that a reasonable shareholder would consider it important in making an investment decision," from *TSC Industries, Inc. v. Northway, Inc*.[47] and *Basic, Inc. v. Levinson*.[48] In *Basic*, the Supreme Court considered whether the existence of preliminary merger discussions was a material fact. Applying the above definition of materiality, the Court noted that, "with respect to contingent or speculative information or events . . . materiality will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity."[49] The Court instructed that, "to assess the probability that the event will occur, a factfinder will need to look to indicia of interest in the transaction at the highest corporate levels."[50]

In *Castellano v. Young & Rubicam, Inc.*, the Second Circuit considered whether failed merger discussions were material facts after the discussions had concluded and whether an investment bank's recommendations to a private company concerning its recapitalization were material.[51] The court concluded that a finder of fact could reasonably conclude that both facts were material. The court explained that the former fact was material because a jury could conclude that "a reasonable investor would have viewed [the company's] failed merger negotiations . . . as significantly altering the total mix of information available, given the seriousness of the negotiations and given that after the failure of these negotiations, [the company] considered to explore corporate restructuring options."[52] The latter fact was potentially material, the court ruled, because "such recommendations can certainly rise to the

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[43] The Commission has previously relied upon market movement to support a finding of materiality in cases brought under Regulation FD. See, e.g., *In re: Office Depot, Inc.*, Exchange Act Release No. 63152 (Oct. 21, 2010); *In re: Schering-Plough Corp. & Richard J. Kogan*, Exchange Act Release No. 48461 (Sep. 9, 2003).
[44] Deutsche Bank Markets Research, The Precision of a Swiss Watch – With as Many Moving Parts (Feb. 11, 2014).
[45] Morgan Stanley, Walgreens: These Boots are for Walking: Domiciles, Taxes, and other Takes from Meetings with AB (Feb. 13, 2014).
[46] See Final Rule: Selective Disclosure and Insider Trading, Securities Act Release No. 33-7881 an Exchange Act Release No. 34-43154 (Aug. 15, 2000).
[47] 426 U.S. 438, 449 (1976).
[48] 485 U.S. 224, 231 (1988).
[49] *Id*. at 238 (citing *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (internal quotation marks omitted).
[50] *Id*. at 239.
[51] 257 F.3d 171 (2d Cir. 2001).
[52] *Id*. at 182.

level of materiality when a company forms intentions based on them and undertakes sufficient actions in pursuit of these intentions."[53]

At the time that the disclosure was made, these discussions were material under the standard announced in *Basic* and further explained in *Castellano*. Here, as in *Castellano*, although the information was contingent, the "anticipated magnitude of the event" was immense. Walgreen Co. had touted its acquisition of Alliance Boots as "transformational,"[54] but some analysts questioned the logic of the deal and whether the transaction was overpriced.[55] As noted above, the news of a potential inversion came as both Alliance Boots and Walgreen were failing to meet targets. In the context of recent underperformance by both companies, Walgreen management disclosed that they were considering restructuring the transaction to take advantage of "tax synergies," which analysts later estimated could save the company $783 million annually – roughly one third of Walgreen Co.'s 2013 net earnings. By any standard, this event would involve dramatic change – both structural and financial. As in *Castellano*, the fact that this was a contingent event does not preclude a finding of materiality. Rather, these discussions provided material information about "a company's intention to merger or undertake other restructuring."[56]

The likelihood of the contingent event also weighs in favor of materiality. The possibility of enormous tax savings breathed new life into the proposed second step of the merger, as analysts speculated that inversion could result in significant accretion to EPS. Moreover, the analysts' reports about debate among Walgreen and Alliance Boots executives provide support for a finding that there is "indicia of interest in the transaction at the highest corporate levels."[57] Thus, the strong possibility of significant changes being made to the transactional structure that could create enormous tax synergies dramatically altered "the total mix of information available" to investors.[58] A reasonable shareholder would have considered this information important to any investment decision. Additionally, the spike in trading volume accompanied by a significant increase in share price indicates that investors found this information material and made many significant trading decisions based on this information.

Finally, Walgreen has not cured the selective disclosure.[59] Even assuming that any disclosure was unintentional, there was no prompt disclosure, as that term is defined by Regulation FD.[60] Instead, the company said it was "adamant" that there were no plans to undertake an inversion.[61] When the CtW

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[53] *Id*. at 183.
[54] Chris Burritt, "Walgreen to Buy 45% Stake in Boots for $6.7 Billion," *Bloomberg News* (June 19, 2012); Sten Stovall & Melodie Warner, "Walgreens to Buy Alliance Boots Stake," *The Wall Street Journal* (June 20, 2012).
[55] "Analysts Blasting Walgreen-Alliance Boots Deal as Shares Fall," *The Wall Street Journal* (June 20, 2012).
[56] *Castellano*, 257 F.3d at 182.
[57] *Basic, Inc.*, 485 U.S. at 239.
[58] *Castellano*, 257 F.3d at 182.
[59] The company could also have cured if it had required all participants in the meeting to sign a confidentiality agreement. 17 C.F.R. § 243.100(b)(2). However, given the analysts' written descriptions of meeting discussions, it seems unlikely that they had signed confidentiality agreements.
[60] 17 C.F.R. § 243.101(d).
[61] Transcript, Walgreen Co. at Leerink Swann Global Healthcare Conference (Feb. 12, 2014).

Investment Group sent a letter to the company, specifically requesting that it disclose what was selectively disclosed at the February meeting, the company did not fulfill the request.[62]

D. Material, Nonpublic Information That Was Not Cured by Public Disclosure -- The April meeting

The April meeting may have also involved the disclosure of material nonpublic information, and thus may have violated Regulation FD. The meeting included discussion of an inversion, but the exact disclosures by the company are unclear and merit further disclosure. And, in any case, the company did not cure any selective disclosures by simultaneous or prompt public disclosure.

Although the content of the April meeting is unclear, the *Financial Times* report on the meeting establishes that the meeting centered on the question of whether the two companies will undertake an inversion as a part of the second step of the transaction. According to the *Financial Times*, the meeting involved a "constructive" dialogue about a corporate tax inversion.[63] While it is impossible, based on reports, to know precisely what the company said during this meeting, a constructive dialogue typically involves information sharing. When the information shared by the company pertains to a highly anticipated change to a controversial transaction, this information is material for the reasons discussed above.

As with the February selective disclosure of material information, the April meeting was accompanied by a week of heightened trading volume and an increase of nearly 4% the week following the private meeting. This, also, is highly suggestive that some investors were in possession of information upon which they traded.

Three weeks after the private meeting, Walgreen's Vice President for Investor Relations, Rick Hans, publicly confirmed for the first time that the company was seriously considering undertaking a corporate tax inversion.[64] Even if this disclosure is a public disclosure of what was said during the private meeting on April 11, it was too late to satisfy Regulation FD's requirement of prompt or simultaneous public disclosure.[65]

E. The Company's Statements Prior to April Could Have Misled Investors About a Material Fact

As noted above, the company consistently denied that it was considering undertaking an inversion. On February 12, 2014, Vice President for Investor Relations Rick Hans acknowledged the rumors of inversion and dismissed them:

> DAVE LARSEN: I didn't hear anything about tax rate in there. I've been getting some questions today about some financial tax inversion of some sort?
>
> RICK HANS: I really haven't heard anything about that.

[62] See Correspondence between CtW Investment Group and Walgreen Co. Attached hereto as Exhibit 19.
[63] Ed Hammond, "Walgreens urged to leave US to gain tax benefit," *Financial Times* (Apr. 13, 2014).
[64] Transcript, Walgreen Co. at Barclays Retail and Consumer Discretionary Conference (Apr. 30, 2014).
[65] 17 C.F.R. § 243.101(d).

> DAVE LARSEN: You haven't heard anything about that?
>
> RICK HANS: No, I'm teasing. Yeah, this question came up on a recent call at Walgreens. So 4Q, you can go back and look at the transcript, if you like, one of the sell-side, I won't name him here in front of you, asked if we were planning on a tax inversion and both [CEO] Greg [Wasson] and [CFO] Wade [Miquelon] were very adamant that we have no plans at all for a tax inversion.[66]

Then, on Walgreen's March earnings call, in response to a question from an analyst regarding whether Walgreen would consider an inversion, Walgreen CEO Greg Wasson responded: "we have no plans to do so to do so, to do an inversion or redomicile the company. I think what we are focused on frankly is spending the time with our Board and on diligent and so forth to make sure that we put our board and our shareholders into position to make the right decision on step two. And that's what we're focused on. But just to reiterate as I said on last call we have no plans to do an inversion."[67]

As is explained above, these denials appear to have misled investors about a material fact, namely that Walgreen executives were seriously considering an inversion and reviewing plans as well as obstacles that such a move might face. In particular, Wasson's statement in March plainly contradicts what he was telling certain investors in private conversations. In stating that the question before shareholders will be whether to approve "step two," Wasson misleads shareholders by not informing them that the board and executives are considering radical changes to the second phase of the transaction, meaning that the vote that is presented to shareholders will not be on "step two" as that term was understood by shareholders.

"The elements of a private securities fraud claim based on violations of § 10(b) and Rule 10b–5 are: (1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[68] The company appears to have made a material misrepresentation and, given the contradictory statements it was making at the same time, *scienter* may be inferred because the persons making these statements – Hans and Wasson – knew (and in Wasson's case, had shared with certain investors and analysts) and "had access to information suggesting that their public statements were not accurate."[69]

These material misstatements merit investigation to determine whether the remaining elements of a 10(b) violation are present.

V. Conclusion

For the reasons outlined above, the CtW Investment Group requests that the SEC investigate the selective disclosures made by Walgreen senior officials to sell-side analysts and hedge fund investors,

[66] Transcript, Walgreen Co. at Leerink Swann Global Healthcare Conference (Feb. 12, 2014).
[67] Transcript, Walgreen Co. Earnings Call on Q2 2014 Results (Mar. 25, 2014).
[68] *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S.Ct. 2179, 2184 (2011).
[69] *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000).

enforce Regulation FD's strict requirements of public disclosure and investigate the misleading disclosures made to the public by Walgreen executives. Additionally, the CtW Investment Group requests that the SEC seek immediate corrective disclosures, given the rapid transformation underway of this $34 billion transaction.