

*The Coca-Cola  
Company Settles  
SEC Charges  
Related to  
Inadequate  
Disclosures*

On April 18, 2005, the Securities and Exchange Commission settled cease-and-desist proceedings against The Coca-Cola Company relating to Coca-Cola's failure to disclose certain end-of-quarter sales practices used to meet earnings expectations. The investigation stemmed from Coca-Cola's implementation of a "channel stuffing" practice in Japan known as "gallon pushing" during the period from 1997 through 1999. The Coca-Cola (Japan) Company, Ltd. ("CCJC") asked bottlers in Japan to make additional purchases of concentrate at the end of a reporting period in order to generate revenue to meet annual business plan and earnings targets. The income generated by gallon pushing in Japan was the difference between Coca-Cola meeting or missing analysts' earnings estimates for eight of twelve quarters from 1997 through 1999. At no time between 1997 and 1999 did Coca-Cola publicly disclose to shareholders the existence of gallon pushing, the impact that gallon pushing had on current income, or the likely impact of gallon pushing on future income.

This enforcement action highlights disclosure issues regarding a practice, which may be known by a wide variety of terms, that may be common in many industries. Executive officers, compliance personnel, disclosure committee members, audit committee members and others involved in public disclosure procedures should consider whether these issues are applicable to their companies. Now that an

enforcement action has brought to light these issues, the SEC may well be inclined to seek broader remedies than those described here for future violations. In addition, this enforcement action reaffirms the continuing importance of disclosure of material geographical results, activities and factors, first highlighted in 1992, in Caterpillar.

**False and Misleading Statements**

In January 2000, Coca-Cola filed a Form 8-K with the SEC which disclosed that Coca-Cola, specifically CCJC, would cease to sell concentrate to bottlers until the bottlers naturally reduced their inventory to optimum levels. The impact on Coca-Cola's earnings for the first half of 2000 was forecast to be between \$0.11 and \$0.13 per share. The SEC found the following false and misleading statements in Coca-Cola's Form 8-K:

- ▶ Coca-Cola describes the concentrate inventory reduction as a joint measure between Coca-Cola and its bottlers where in fact the reduction was actually a sole initiative by Coca-Cola; and
- ▶ Coca-Cola failed to disclose that \$0.05 of the estimated \$0.11 to \$0.13 impact on Coca-Cola's earnings would be attributable to an anticipated reduction of concentrate sales to Japanese bottlers.

**Antifraud Violations**

Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 prohibit making

material untrue statements of fact and misleading omissions of facts in the offer or sale of a security.

The SEC found that Coca-Cola's Forms 10-K and 10-Q for the reporting periods between 1997 and 1999 were materially misleading because they:

- ▶ failed to disclose the existence of gallon pushing and the resulting current and future impacts because there was a substantial likelihood that a reasonable Coca-Cola investor would have taken gallon pushing into account when making an investment decision regarding Coca-Cola; and
- ▶ failed to disclose the impact of past gallon pushing practices in Japan.

#### Periodic Reporting Violations

Rule 12b-20 of the Securities Exchange Act of 1934 requires that periodic reports must contain, in addition to disclosures expressly required by law, such other information as is necessary to ensure that the statements made in the reports are not materially misleading. Regulation S-K Item 303 requires registrants to disclose in the Management's Discussion and Analysis of Financial Condition and Results of Operation (commonly referred to as "MD&A") sections of required periodic filings "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material ... unfavorable impact on net sales or revenues or income from continuing operations." The failure to comply

with Regulation S-K constitutes a violation of Section 13(a) of the Exchange Act. The SEC found that Coca-Cola's Forms 10-K and 10-Q violated:

- ▶ Rule 12b-20, because neither disclosed the existence of gallon pushing and the resulting current and future impacts; and
- ▶ Section 13(a), because neither disclosed the material impact of gallon pushing on current and future income within MD&A.

#### Undertakings

Under the terms of the settlement, Coca-Cola has undertaken to:

- ▶ permanently maintain an Ethics & Compliance Office to ensure that it conducts its business in compliance with its Code of Business and various laws;
- ▶ permanently maintain a Disclosure Committee to assist its Chief Executive Officer and Chief Financial Officer in fulfilling their responsibility for oversight of the accuracy and timeliness of disclosures and require the Disclosure Committee to identify and evaluate items that might need to be disclosed within MD&A;
- ▶ adhere to the guidance set forth in SEC Staff Accounting Bulletin No. 101 on disclosures that are required with respect to the recognition of revenue; and
- ▶ maintain for ten years documentation sufficient to show the preparers of each Form 8-K that is filed with the SEC and those persons who reviewed and approved each Form 8-K.

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