

Client Alert

A report
for clients
and friends
of the firm July 2004

The SEC's New Requirements for Current Reports May Require Modifications of Disclosure Controls and Procedures

The SEC's requirements for reporting specified material events on Form 8-K within four business days will become effective on August 23, 2004. Our March 2004 Client Alert addressed the substantive reporting requirements, which include entering into or terminating any material contract. This Client Alert addresses the need for companies subject to these requirements to examine their disclosure controls and procedures to assure that they can report the required information within the specified time period.

Some Suggested Compliance Procedures

The new Form 8-K requirements will have different degrees of impact on different companies. A larger multi-national company may be impacted to a greater degree than a wholly domestic company. Whatever a company's situation, if it has not already done so, it should review its procedures in light of the new Form 8-K requirements.

- **Disclosure Committees.** The SEC has suggested that companies establish disclosure committees to assist in the oversight of their disclosure controls and procedures and many companies have established such committees. The disclosure committee or other persons responsible for oversight of disclosure must become familiar with the new requirements and should examine the company's existing procedures to determine whether modifications are required and, if so, implement those modifications.
- **Education.** Employees at the appropriate levels performing relevant functions should be educated on an ongoing basis as to their responsibilities to provide information to those responsible for the company's compliance with disclosure obligations. This "bottom up" approach could be critical in capturing the necessary information.
- **Assign Responsibility.** The disclosure committee or other appropriate authority should assign clearly defined responsibilities to employees at the appropriate levels to report information necessary to assist in compliance with the new Form 8-K requirements.
- **Internal Communications.** The company should establish means of timely internal communication of the required information to those responsible for the company's disclosure. This may require involving employees at lower levels or with different responsibilities than those involved in existing controls and procedures. For example, companies with decentralized contract functions may have employees in divisions or foreign subsidiaries who are authorized to approve material contracts or who may become aware of events that result in termination of material contracts. Cross-department or cross-function communications procedures also should be reviewed.
- **Review Contracting Authority.** The company should review and consider limiting the number of persons authorized to enter into contracts or engage in other activities that may trigger a Form 8-K filing.
- **Materiality Standards.** Where appropriate, the company should consider materiality standards that would trigger up the ladder reporting. For example, contracts and loan agreements may lend themselves to numerical materiality triggers. However, responsible employees should be cautioned that, when in doubt, they should report the information up the ladder, which will permit the disclosure committee or other authority to exercise more informed judgments.

- **Timing.** Most Forms 8-K will be required to be filed within four business days. The need to obtain the necessary information, draft the required disclosure and have it reviewed by the appropriate individuals both inside and outside the company and then have it prepared for filing on the SEC's EDGAR system demand that the process begin as long as possible before the filing requirement is triggered. For example, up the ladder reporting should begin at an early stage in the negotiation of a material agreement or a financing involving the issuance of unregistered equity securities, when notice is received by the company that a material direct or indirect financial obligation may be accelerated or increased, or when the company begins considering a change in outside auditors.
- **Coordination.** Effective disclosure controls and procedures require coordination between various functions within a company. Such coordination may be even more important with respect to the new Form 8-K requirements, given the short time frame during which the company has to act. For example, most companies announce material events in press releases. Providing information in a press release does not satisfy most Form 8-K requirements. Thus, those responsible for issuing press releases should coordinate with those responsible for meeting the new Forms 8-K requirements.

Disclosure Controls and Procedures

SEC rules require, with limited exceptions, that companies subject to the periodic reporting provisions of the Securities Exchange Act of 1934 must maintain disclosure controls and procedures so that they can record, process, summarize and report the information required in annual and quarterly reports filed with the SEC within the specified time periods. Each reporting company's principal executive officer and principal financial officer must certify in an exhibit to each quarterly and annual report filed with the SEC that they are responsible for establishing and maintaining these disclosure controls and procedures and that they have evaluated the effectiveness of such controls and procedures as of the end of the period covered by the report and reported their conclusions in the report.

Forms 8-K are current reports, not periodic reports, and thus, technically, are not subject to these controls and procedures and certification requirements. However, if a company fails to file a Form 8-K to report required information before the date the company files a quarterly or annual report with the SEC, that information must then be included in the next quarterly or annual report and, thus, would be covered by the required disclosure controls and procedures and the officer certifications.

Up the Ladder Certifications

Many companies require lower level employees to certify compliance with disclosure controls and procedures within their areas of responsibility. Consideration should be given to requiring additional employees to provide these internal certifications to assist in complying with the new Form 8-K requirements. Any such certifications should specifically address the relevant Form 8-K information to be captured within the certifying employee's area of responsibility. At a minimum, these certifications should be obtained before the filing of quarterly and annual reports with the SEC.

Consequences of Failure to Timely File a Form 8-K

A failure to file on a timely basis a Form 8-K reporting certain events requiring subjective judgments to determine whether they are reportable will not result in a per se violation of the anti-fraud provisions of the Exchange Act and will not affect the eligibility of the company to use short form Securities Act registration statements. Nor will the failure to file any Form 8-K affect the eligibility of a company's security holders to sell securities pursuant to Rule 144. If required information is not included in a Form 8-K filed before the company's next quarterly or annual report is filed with the SEC, it must be included in that periodic report for the company's principal executive officer and principal financial officer to be able to provide their required certifications and their report on the effectiveness of the company's disclosure controls and procedures. However, failure to file a required Form 8-K on a timely basis is a violation of the reporting requirements of the Securities Exchange Act of 1934 and could subject the company and others to an SEC enforcement action or proceeding.

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