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Client Alert

A report for clients and friends of the firm July 2002

The SEC Proposes Requirements to Disclose Eleven New Events Within Two Business Days

On June 18, 2002, in Securities Act of 1933 Release No. 8106, the Securities and Exchange Commission proposed requirements for U.S. public companies to report on Form 8-K 11 new events within two business days, rather than within the five business days or 15 calendar days of the events required to be reported under the current items of that Form. The current items that are retained also would be required to be reported within two business days. The proposals would not apply to voluntary reports or to reports filed to comply with Regulation FD. These proposals are in addition to the proposals, discussed in our April client alert, which would require companies to disclose transactions by their officers and directors. See Release 33-8090.

Under a separate proposal, a company's principal executive officer (CEO) and principal financial officer (CFO) would have to certify in the company's annual reports filed with the SEC that they have reviewed the results of the evaluation of the company's procedures for collecting, processing and disclosing in the time periods required the information required in the company's annual and quarterly reports and in its current reports on Form 8-K. See Release 34-46079. These proposals were the subject of a separate client alert earlier this month.

Since they are not required to file reports on Form 8-K, the proposals do not apply to foreign companies. However, the SEC has asked for comment as to whether they should apply similar requirements to foreign companies.

Note: This alert only summarizes what are very complex proposals.

The Proposed Requirements

The Proposals would accelerate the current five-business-day deadline for disclosure about changes in a company's independent accountant and resignations of its directors, and 15-calendar-day deadline for other required disclosures, to two business days, so that there would be a uniform filing period for all of the mandated Form 8-K disclosure items, except for reports of certain insider transactions that could be reported within seven days.

The proposals would reorganize the disclosure items into logical categories. They would require current reports on Form 8-K of 11 new events:

- Entry into a material agreement not made in the ordinary course of business;
- Termination of a material agreement not made in the ordinary course of business;
- Termination or reduction of a business relationship with a customer that constitutes a specified amount of the company's revenues;
- Creation of a direct or contingent financial obligation that is material to the company;
- Events triggering a direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation;
- Exit activities, including any material write-off or restructuring;
- Any material impairment;
- A change in a rating agency decision, issuance of a credit watch or change in a company outlook;
- Movement of the company's securities from one national securities exchange or inter-dealer quotation system of a registered national securities association to another, delisting of the company's securities from an exchange or quotation system, or a notice that a company does not comply with a listing standard;
- Notice to the company from its currently or previously engaged independent accountant that the independent accountant is withdrawing a previously issued audit report or that the company may not rely on a previously issued audit report; and
- Any material limitation, restriction or prohibition, including the beginning and end of lock-out peri-

ods, regarding the company's employee benefit, retirement and stock ownership plans.

The proposals would move two disclosure items that currently are required in companies' annual and quarterly reports to Form 8-K, thus subjecting them to the two-business-day reporting requirement:

- Sales of unregistered equity securities by the company; and
- Material modifications to rights of holders of the company's equity and debt securities.

The proposals also would amend several existing Form 8-K disclosure items, thus subjecting them to the two-business-day reporting requirement to include:

- disclosure regarding the departure of a director for reasons other than a disagreement or removal for cause;
- the appointment or departure of a principal officer, and the election of new directors; and
- disclosure regarding any material amendment to a company's certificate of incorporation or bylaws.

Current Items 1 (change in control), 2 (acquisitions and dispositions), 3 (bankruptcy), 4 (changes in accountants), 5 (other events), 6 (resignations of directors), 7 (financial statements and exhibits), 8 (changes in fiscal year) and 9 (Regulation FD disclosure) would be renumbered, but their substance generally would be substantially the same as that of their current requirements.

Entry into material agreements. Proposed Item 1.01 Form 8-K would require disclosure about any definitive agreement, conditional or unconditional, and any letter of intent or other non-binding agreement or similar document not made in the ordinary course of business or any material amendment to any of the foregoing. In addition, disclosure would be required about specified material agreement with directors, executive officers and security holders and compensatory agreements, even if made in the ordinary course of business. These agreements would be required to be filed as exhibits to the report.

Termination of material agreements. Proposed Item 1.02 of Form 8-K would require disclosure about termination of material agreements, if the termination is material to the company. Negotiations or discussions about terminating the agreement would not be required to be disclosed until the company decides to terminate the agreement or the other party notifies the company that the agreement has been terminated and all of the conditions for termination, except for the passage of time, have been satisfied.

Customer relationships. Proposed Item 1.03 of Form 8-K would require disclosure if a customer terminates or reduces the scope of its business with the company and the result is a loss of 10% or more of the company's revenue during its last fiscal year. Negotiations and discussions regarding customer terminations would not be required to be disclosed until an executive officer of the company becomes aware that the relationship has been or will be terminated.

Acquisitions or Dispositions of Assets. Proposed Item 2.01 of Form 8-K would require disclosure about material acquisitions or dispositions of assets. The substance of this Item is the same as that of current Item 2 of the Form. The automatic 60-day extension to file any required financial statements would still be available under Item 8.01 of the revised Form 8-K. However, the text of the report would have to be filed within two business days rather than 15 calendar days.

However, the SEC has not proposed to amend Rule 3-05 (b)(4)(i) and (ii) of Regulation S-X, which permits separate financial statements of an acquired business to be filed within 75 days rather than 62 days after the completion of the acquisition. Presumably, the SEC will correct this anomaly when it adopts the proposals.

In addition, the filing of a Form 8-K might be the "first public announcement" of a business combination and require filings under Securities Act Rule 165 and Exchange Act Rule 14a-12.

Bankruptcy or Receivership. Proposed Item 2.02 of Form 8-K would require the same information about bankruptcies or receiverships currently required by Item 3 of the Form.

Creation of Financial Obligations. Proposed Item 2.03 of Form 8-K would require disclosure about material direct or indirect direct or contingent definitive obligations entered into by a company or a third party to which the company is subject, other than certain short-term obligations, such as commercial paper. A discussion of management's analysis of the effect on the obligation or the company also would be required. Thus, a current "mini-MD&A" would be required. A "contingent financial obligation" would include:

- guaranties;
- co-obligor obligations;
- keep well agreements;
- obligations to purchase assets; and
- "any similar arrangements and all other obligations that may exist or may arise under an agreement." (The meaning of the foregoing is not clear.)

Triggering of financial obligations. Proposed Item 2.04 of Form 8-K would require disclosure of events triggering financial obligations, if the effect would be material on the company.

Exit activities. Proposed Item 2.05 of Form 8-K would require disclosure about plans to terminate or exit an activity where generally accepted accounting principles ("GAAP") would require material write-offs or restructuring charges.

Material impairments. Proposed Item 2.06 of Form 8-K would require disclosure about material charges for impairments of assets, including goodwill, under GAAP.

Rating agency actions. Proposed Item 3.01 would require disclosure when any rating agency (any entity whose primary business is issuing credit ratings) to whom the company provides information, other than its annual reports, notifies the company that the agency has decided to:

- change or withdraw the credit rating assigned to, or the outlook on, the company or debt or preferred securities of the company or as to which the company is a guarantor or has a contingent financial obligation;
- refused to assign a credit rating to the company or any of its indebtedness after being requested to do so by the company;
- places the company or any of its securities or indebtedness on a "credit watch" or similar status; or
- takes any similar action.

Discussions with a rating agency before the agency notifies the company of its final decision would not be required to be disclosed.

Securities market actions. Proposed Item 3.02 would require disclosure if a company is notified by a national securities exchange or national securities association (the Nasdaq Stock Market) that is the principal trading market for its common stock that the company does not satisfy that market's listing standards or that the common stock has been delisted. The notice from the market would be required to be filed as an exhibit.

Sales of unregistered securities. Item 3.03 would require disclosure about sales of unregistered equity securities by the company. This disclosure currently is required only in annual and quarterly reports.

Modifications of rights of security holders. Item 3.04 of Form 8-K would require disclosure about material modifications of the rights of security holders. This disclosure currently is required only in annual and quarterly reports.

Actions by independent accountants. Proposed Item 4.01 of Form 8-K would require disclosure about changes in a company's certifying accountants. This disclosure currently is required by Item 4 of Form 8-K.

Non-Reliance on Previously Issued Financial Statements and Related Audit Reports. Proposed Item 4.02 of Form 8-K would require disclosure about determinations by the company that one or more years of its audited financial statements may no longer be relied on, or advice from outside auditors that their reports on those financial statements may no longer be relied on. In addition, the company must provide its independent auditors with a copy of the disclosure no later than one business day after it is filed with the SEC and request them to, as promptly as possible, furnish the SEC with a letter stating whether they agree or disagree (and in what respects) with that disclosure.

Changes in Control. Item 5.01 of Form 8-K would require disclosure about changes in the control of the company. This disclosure currently is required by Item 1 of Form 8-K.

Departures of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers. Proposed Item 5.02(a) of Form 8-K would require disclosure about the departure of a director who resigned or declined to stand for re-election. This disclosure currently is required by Item 6 of Form 8-K.

Proposed Item 5.02(b) would require disclosure about termination of CEOs, presidents, CFOs, chief accounting officers ("CAOs"), and chief operating officers ("COOs") or persons serving equivalent functions, or directors who have not resigned or declined to stand for reelection because of disagreements.

Proposed Item 5.02(c) would require disclosure about the appointment of new CEOs, presidents, CFOs, CAOs, COOs or persons performing similar functions.

Proposed Item 5.02(d) would require disclosure of the election of a new director otherwise than by a vote of security holders. (Similar information is required currently, in some circumstances, by Section 14(f) of the Exchange Act and SEC Rule 14f–1.)

Disclosure would be required about any related party transactions with these new executive officers and directors.

Amendments to certificate of incorporation or bylaws; changes in fiscal year. Proposed Item 5.03 of Form 8-K would require disclosure about changes in the company's certificate of incorporation and bylaws and changes in its fiscal years currently are required to be reported pursuant to Item 8 of Form 8-K.

Lock-out periods. Proposed Item 5.04 of Form 8-K would require disclosure about events that would materially limit, restrict or prohibit, with certain exceptions, the ability of participants in an employee benefit plan to acquire, dispose of or convert their assets in the plan.

Regulation FD Disclosure. Regulation FD disclosure would be made under Item 6.01 of the revised Form 8-K. This disclosure currently may be made under Item 9 of Form 8-K.

Other Events. Voluntary disclosure of material events would be made under Item 7.01 of the revised Form 8-K. This disclosure currently may be made under Item 5 of Form 8-K.

Exhibits. The exhibit requirements would require particular attention due to the need to EDGARize them before they are filed within the two-business-day time limit.

Liability Issues. The SEC has stated that the disclosure made pursuant to the proposals would be subject to the same liability as disclosures on Form 8-K currently are subject, although it would provide some relief for late filings.

Materiality. There is no special materiality standard under the proposals. Accordingly, judicial materiality standards and SEC interpretations will continue to apply, including Staff Accounting Bulletin No. 99.

Timely Filing

Failure to File on Time. The SEC has proposed that a company could not be liable under Sections 13 and 15(d) of the Exchange Act for failure to timely file a Form 8-K under the proposals if:

- on the due date, the company maintained sufficient procedures to provide reasonable assurance that it would be able to collect, process and disclose, within the specified time period, the required information (Note: under separate SEC proposals, CEOs and CFOs will be required to certify with respect to their review of the analyses of these procedures); and
- no officer, employee or agent knew or was reckless in not knowing that the report was required and, once an executive of the company became aware that a report was required, the report was filed within two business days. See proposed Rules 13a-11 and 15d-11.

Applying the knowledge requirement to employees and agents may cast too wide a net to make this a meaningful form of relief in some cases.

Extensions of Time to File. The SEC has proposed to amend Rule 12b-25 to permit a report on Form 8-K to be filed within two business days after the due date, if a Form 12b-25 is filed to report the delay within one business day of the due date.

Under current rules, no extensions of time to file 8-Ks are available.

Reliance on Rule 12b-25 would not preclude a company from using short-form registration statements.

However, if a company relies on the safe harbors under Rule 13d-11 or 15d-11, it would lose its eligibility to use short-form registration statements for a year, and it could not use Form S-8 and its stockholders could not sell shares under Rule 144 until the required Form 8-K was filed. The latter two provisions are curious, since, by definition, the company would not know a report was due, and stockholders using Rule 144 can rely on the company's representations on its Forms 10-K and 10-Q that it has filed all required reports.

Other Potential Liability Exposure

The Note to Rules 13a-11(c) and 15d-11(c) state that the relief provided under those rules has no effect on the company's liability under any other provision of the Federal securities laws, including the anti-fraud and civil liability. (Note: Regulation FD disclosure is exempted from liability under Section 18 of the Exchange Act.)

Other Matters

The SEC also has asked whether it should require disclosure in Form 8-K about waivers of corporate codes of conduct and changes in critical accounting policies. (The SEC separately has proposed disclosure about critical accounting policies and estimates in annual and quarterly reports.)

Conclusion

The SEC expects to have those proposals effective 60 days after adoption. The comment period expires on or about August 23, 2002, so that these proposals could well be in effect before the end of 2002. These proposals, if adopted, will require systems and procedures to capture and disclose the required information in a timely manner.

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