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SEC Proposes New Disclosure Rules for Current Reports on Form 8-K

The Securities and Exchange Commission (the "SEC") has proposed changes to the Form 8-K reporting requirements that are designed to improve the disclosure system for U.S. companies that are subject to the reporting requirements of the Securities Exchange Act of 1934. The SEC believes that such improvements would effectively improve market performance and efficiency.

Form 8-K is the form that companies use to file current reports with the SEC when specific extraordinary corporate events occur. Currently, Form 8-K consists of nine disclosure items, six of which describe specific events that mandate filing Form 8-K. Those six events are a change in company control, the company's acquisition or disposition of a significant amount of assets, the company's bankruptcy or receivership, a change in the company's certifying accountants, the resignation of a company director and a change in the company's fiscal year.

The proposed rules are similar to the rules suggested but not adopted by the SEC in 1998. The response to the 1998 proposals varied greatly, and no consensus was reached. Recent events however have focused attention on the need for more current disclosure and these proposals reflect a consensus that more current disclosure will better serve the marketplace. Specifically, the proposed rules would:

- add new items and events to be disclosed in Form 8-K reports, and
- require that Form 8-K reports be filed within two business days instead of the current five to 15 days.

These requirements would not apply to foreign private issuers that file annual reports on Form 20-F.

The proposed rules are subject to a 60-day comment period. The proposed rules would be prospective only; registrants would not be required to make disclosures under the new rules until their effective date. The SEC expects that if the proposed rules are adopted, they would be effective 60 days after adoption.

The SEC had proposed renumbering the Form 8-K items in a way that avoids re-use of former item numbers. Each Form 8-K item would be designated as a three-digit number containing a decimal point. The following summary tracks the proposed new format.

Proposed New Form 8-K Disclosure Requirements

The SEC's proposed amendments would add 11 new items or events that must be disclosed in Form 8-K reports. They would include:

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Section 1: Registrant's Business and Operations

Item 1.01

Entry into, or material amendment of, a material agreement not made in the ordinary course of business. This item would require disclosure relating to the new agreement or amendment as well as filing of the agreement or amendment. The amendment would have to be filed even if the underlying agreement had been entered into prior to the effective date of the proposed rules, and if the underlying agreement were not otherwise on file, it would be filed with the amendment. The required disclosure would include:

- the identity of the parties to the agreement and a description of any material relationship between any of the parties other than in respect to the agreement;
- a brief description of the agreement;
- the rights and obligations of each party to the agreement that are material to the company;
- any material conditions to the agreement becoming binding or effective; and
- the duration of the agreement and any material termination provisions.

Letters of intent and other non-binding agreements would have to be disclosed. However, the SEC stresses that this proposed disclosure requirement is not intended to alter current law and practice in respect of disclosure of ongoing negotiations.

Item 1.02

Termination of a material agreement not made in the ordinary course of business. The required disclosure would include:

- the identity of the parties to the agreement and a description of any material relationship between any of the parties other than in respect to the agreement;
- a brief description of the agreement;
- a description of the material circumstances surrounding the termination;
- any material early termination penalty incurred by the company; and
- a discussion of management's analysis of the effect of the termination on the company.

Companies would not have to disclose negotiations or discussions regarding the termination of an agreement. If the company is not the terminating party, it would not have to disclose information until it receives a written termination notice from the terminating party. If the material agreement was not previously filed (because it was entered into prior to the effective date of proposed Item 1.01), the material agreement would have to be filed as an exhibit to the report disclosing termination.

Item 1.03

Termination or reduction of a business relationship with a customer that constitutes a specified amount of the company's revenues.

- The SEC has proposed that the threshold for the loss of revenues be 10% or more of the company's consolidated revenues during the company's most recent fiscal year.

- A group of customers under common control or customers that are affiliates of each other would be regarded as a single customer.

- No disclosure would be required if the company is in negotiations or discussions with a customer, or a suspension or reduction of orders occurs, unless and until an executive officer of the company is aware that the termination or reduction has occurred or will occur.

- Required disclosure would include the identity of the customer and management's analysis of the effect of the loss or reduction.

Section 2: Financial Information

Item 2.03

Creation of a direct or contingent financial obligation that is material to the company. This proposal would require a company to disclose information whenever it or a third party enters into a transaction or agreement that creates any material direct or contingent financial obligation to which the company is subject. Disclosure would be required under this proposed item whether or not the company is a party to the agreement. Furthermore, disclosure would be required only when the company or a third party enters into a definitive agreement that is unconditional or subject only to customary closing conditions. The company would be required to file the document creating the obligation and disclose or provide:

- a brief description of the transaction or agreement, including an identification of the parties to the agreement;

- the nature and amount of the company's material direct or contingent financial obligation, including a description of events that may cause the obligation to arise, increase or become accelerated;

- if applicable, the name of any underwriters or placement or other agents for the transaction or any persons performing a similar function in the case of a private transaction, and the amount of any fee or other compensation paid to them, or the name of any lenders or other persons who are the beneficiaries of the obligation; and

- management's analysis of the effect of the direct or contingent financial obligation on the company.

The proposed item is intended to cover disclosure of direct obligations such as registered sales of debt securities, private placements and bank loans or credit facilities, and contingent obligations such as guarantees, keepwell agreements, obligations to purchase assets that are unconditional or conditioned on certain events and similar financial obligations.

Like proposed Items 1.01 and 1.02, the disclosure in proposed Item 2.03 has a "materiality" standard rather than a specific financial threshold.

Item 2.04

Events triggering a direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation.

- A "triggering event" includes an event of default, event of acceleration or similar event that has occurred and as a consequence of which either (a) a material direct or contingent financial obligation of the company that is unconditional or subject to no condition other than the passage of time has arisen (including as a result of an increase in an obligation) or been accelerated or (b) a party to the agreement obtains the unconditional right to cause such an obligation to arise or become accelerated, regardless of whether in either case the company is a defaulting party.

- No triggering event would be deemed to have occurred while the company is negotiating or discussing with other relevant parties whether a triggering event has occurred or whether such an event could be cured by waiver, amendment or similar arrangement.

- Disclosure is required when a party to the agreement with the right to do so notifies the company or otherwise declares that the triggering event has occurred.

If a triggering event occurs, the company, regardless of whether it is a party to the agreement under which the triggering event occurs, would have to:

- describe the agreement or agreements under which the triggering event occurred;

- describe the triggering event;

- disclose the nature and amount of the material direct or contingent financial obligation of the company that may arise, increase or become accelerated as a result of the triggering event, including obligations under cross-default, cross-acceleration or similar arrangements; and

- discuss management's analysis of the effect on the company of the triggering event and of the obligation that has arisen, increased or been accelerated.

The company would also have to file as an exhibit a copy of the document under which the company is subject to the material direct or contingent financial obligation. A contingent financial obligation includes: a guarantee, a co-obligor arrangement, an obligation under a keepwell agreement, an obligation to purchase assets and any similar arrangement or obligation that exists or may arise under an agreement.

This proposed new item is intended to subsume all events that currently are reported under Item 3, Defaults Upon Senior Securities, in Part II of Form 10-Q.

Item 2.05

Exit activities including any material write-off or restructuring charge. This proposed item would require disclosure when the board of directors or the company's officer or officers who are authorized to take such action, if board approval is not required, definitively commit the company to a course of action, including a plan to terminate or exit an activity, under which the company will incur a material write-off or restructuring charge under GAAP. Under the proposed item, the company would have to disclose or provide:

- the date on which such commitment was made;
- a description of the course of action and reasons for the write-off or restructuring charge;
- a description of the asset or assets subject to write-off;
- the estimated amount of the write-off or restructuring charge;
- the estimated amount of the write-off or restructuring charge that will result in future cash expenditures; and
- an analysis of the effect of the write-off or restructuring charge on the company, including the segment affected.

In its request for comment the SEC questioned whether it should require disclosure only if the expected charge would represent a certain percentage, such as 1%, 5% or 10%, of the company's assets, equity, revenues or net income.

Item 2.06

Any material impairment. The proposed item would require disclosure when a company's board of directors or the company's officer or officers authorized to make the relevant conclusion, if board approval is not required, conclude that the company is required to record a material charge for impairment to one or more of its assets, including an impairment of securities or goodwill, under GAAP. Specifically, the company would have to disclose:

- the date on which the conclusion was reached;
- a description of the asset or assets subject to impairment and the facts and circumstances leading to the impairment;
- the estimated amount of the impairment charge; and
- an analysis of the effect of the impairment charge on the company, including the segment affected.

In its request for comment the SEC questioned whether it should require disclosure only if the expected charge would represent a certain percentage, such as 1%, 5% or 10%, of the company's assets, equity, revenues or net income.

Section 3: Securities and Trading Market

Item 3.01

A change in a rating agency decision, issuance of a credit watch or change in a company outlook. Under this proposed item, a company would have to file a report when it receives a notice or other communication from any rating agency *to which the company provides information* (other than its annual report or other SEC filings) to the effect that the organization has decided to:

- change or withdraw the credit rating assigned to, or outlook on, the company or any class of debt or preferred security or other indebtedness of the company;
- refuse to assign a credit rating to the company, to any class of its securities, or to any of its indebtedness *after the company has requested the organization to do so;*
- place the company or any class of its securities or indebtedness on "credit watch" or similar status; or
- take any similar action.

Disclosure under this item would not be required until the rating organization notifies the company that the rating organization has made a decision to take one of the enumerated actions. No disclosure would be required if negotiations are ongoing or if the company appeals the action. However, once good faith negotiations and appeals cease, disclosure would be required.

Item 3.02

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. Changing exchanges would trigger disclosure of the change. In the case of a delisting or threatened delisting, the company would have to file a copy of the delisting notice or notice of non-compliance, if in writing, and disclose or provide:

- the date that it received the notice;
- the listing requirement or standard that the company failed to satisfy or the reason for the delisting as indicated by the exchange or association; and
- a discussion of the company's planned response to the notice and management's analysis of the effect of the delisting or failure to satisfy a listing standard on the company.

Section 4: Matters Related to Accountants

Item 4.02

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. A company would have to file a Form 8-K if and when its audit committee, or the board of directors in the absence of an audit committee, or the company's officer or officers authorized to take such action, conclude that any of the company's previously issued financial statements no longer should be relied upon. Similarly, a company would be required to file a Form 8-K if and when it receives notice from its current or a previously engaged independent accountant that the company should take action to prevent future reliance on a previously issued report related to any such financial statements.

Under this proposed item, the company would be required to file the notice, if it is in writing, and disclose or provide:

- the date on which the conclusion was reached or the company received the notice;
- a description of the events giving rise to the conclusion or notice related to the reliability of the financial statements;
- a statement of whether the audit committee, or the board of directors in the absence of an audit committee, discussed with the independent accountant the subject matter giving rise to the conclusion or notice; and
- a description of management's plans to minimize reliance on the report.

The company would have to provide the independent accountant with the Form 8-K disclosure no later than the business day after it files and request that the accountant furnish a letter to the company as soon as possible stating whether the accountant agrees with the disclosure and, if not, the respects in which it disagrees. Within two business days after it receives a letter from the accountant, the company would have to file that letter as an exhibit by amendment to the relevant Form 8-K.

Section 5: Changes in Control of Registrant

Item 5.04

Any material limitation, restriction, or prohibition, including the beginning and end of lock-out periods, regarding the company's employee benefit, retirement and stock ownership plans. Under the proposed rule, a company would be required to disclose any known event that would have the effect of materially limiting, restricting, or prohibiting participants in an employee benefit, retirement or stock ownership plan from acquiring, disposing or converting their holdings, other than a periodic or other limitation, restriction or prohibition based on presumed or actual knowledge of or access to material non-public information if that plan is broadly available to the company's employees.

The proposed disclosure would not be necessary when a company imposes temporary trading "black-outs" on its senior officers and directors because they possess material non-public information.

Accelerated Disclosure

The proposals would move two disclosure items from annual and quarterly reports to Form 8-K reports (and thereby accelerate reporting of):

- unregistered sales of equity securities (Item 3.03); and
- material modifications to rights of holders of company securities (Item 3.04).

Expanded Disclosure Concerning Officers and Directors

The proposals would amend the existing Form 8-K disclosure item relating to resignation of a director to include disclosure of:

- the departure of a director due to a disagreement, known to a company executive officer, concerning the company's operations, policies or practices (regardless of whether the director provides the company with a letter describing the disagreement) or due to removal for cause

  Under proposed Item 5.02(a), the company would have to summarize and file a copy as an exhibit to the Form 8-K report of any correspondence written by the director to the company about the circumstances surrounding his or her resignation, declination or removal. The company would have to provide the director with a copy of the disclosures no later than the business day following the day that the company files the disclosures with the SEC. The company would have to request the director to furnish the company with a letter addressed to the SEC as soon as possible stating whether or not he or she agrees with the company's disclosures. Finally, the company would have to file the director's letter with the SEC within two business days after receipt as an exhibit by amendment to the relevant Form 8-K.

- the departure (resignation or termination) of a principal officer; or resignation or removal of a director or failure of a director to stand for re-election (other than for reasons covered by 5.02(a))

  Proposed Item 5.02(b) would require disclosure when a principal officer resigns or is terminated from that position. If an officer is removed from one of the stated positions and reassigned elsewhere, disclosure would be required. Unlike the disclosure required if a director resigns under 5.02(a), for disclosures cover by this item, the company would not be obligated to seek the officer's or director's explanation of the departure.

- the appointment of a new principal officer

- the election of a new director (except by vote of security holders at an annual meeting)

Changes to Constituent Documents

The proposed rules would mandate disclosure of any material amendment to a company's certificate of incorporation or bylaws. Proposed Item 5.03 would require a company to disclose such information if the amendment was not disclosed in a proxy statement or information statement filed by the company. This item would be combined with the existing item requiring disclosure of changes in fiscal year.

Material Acquisitions or Dispositions of Assets

Although the proposed rules require disclosure of entry into a material agreement to acquire or dispose of assets, the SEC believes that investors would benefit from continued prompt reporting about the company's completion of its acquisition or disposition of a significant amount of assets. Accordingly, the SEC has proposed in Item 2.01 to retain the current requirement to disclose the closing of a material acquisition or disposition. If the transaction is abandoned after disclosure of the acquisition agreement, termination would be disclosed under the proposed item relating to termination of material agreements (Item 1.02).

The SEC proposes to retain the current test for determining whether an acquisition or disposition involves a "significant amount of assets." Under this standard, companies must disclose only acquisitions or dispositions of assets whose value or cost exceeds 10% of the company's total assets.

Because of the possible incongruence between the retained test and proposed Item 1.01, it is possible that a company could treat an agreement to acquire or dispose of assets whose value or cost is 10% or less of the company's total assets as material. In this circumstance, the company would file a Form 8-K when it enters into the agreement but not when it completes the acquisition or disposition.

Proposed Filing Deadlines and New Safe Harbor

The SEC's proposed filing deadlines would require current reports on Form 8-K to be filed within two business days of a triggering event. The present five business day deadline for disclosure about changes in a company's independent accountants and the resignations of directors, and fifteen calendar deadline for other required disclosures would be accelerated to two business days. This would make uniform the filing period for all of the mandated Form 8-K disclosure items.

These amendments would not affect the filing deadline for disclosures under Regulation FD, voluntary disclosures or the proposed deadlines under recently proposed disclosure rules for insider transactions. In addition, the 60-day period for filing financial statements following material acquisitions would remain in place.

Exchange Act Rules 13a-11 and 15d-11 would be amended to create a safe harbor for a company's late filing of Form 8-K if the company satisfied all conditions for reliance on the safe harbor. In order to satisfy the safe harbor's conditions, on the Form 8-K due date:

- the company must have maintained sufficient procedures to provide reasonable assurances that the company is able to collect, process and disclose, within the specified period, the information required to be disclosed by Form 8-K, and

- no officer, employee or agent of the company knew, or was reckless in not knowing, that a report on Form 8-K was required to be filed and once an executive officer of the company became aware of its failure to file a required Form 8-K, the company promptly filed a Form 8-K with the SEC containing the required information.

A company that fails to file a Form 8-K in a timely manner would not be eligible to use short form registration statements. In addition, a company could not use Form S-8 and its security holders could not rely on Rule 144 unless the company was current in its Exchange Act filings, including Form 8-K. A separate safe harbor would apply for failure to file reports of insider transactions. Proposed amendments to Rule 12b-25 would afford relief with regard to the timeliness of filings and short form eligibility.

Exchange Act Rule 12b-25 would be amended to grant a two-business day extension of the Form 8-K filing deadline to a company that provides proper notice on Form 12b-25 of its inability to file a Form 8-K. The Form 12b-25 would have to be filed one business day after the Form 8-K is due. If the company makes the appropriate representations that it was not able to file in a timely manner without unreasonable effort or expense, then the report would be deemed to be filed on the prescribed due date.

No Inclusion of Waivers of Corporate Ethics and Conduct Rules

The SEC did not propose items that would require disclosure of waiver of corporate ethics and conduct rules and of material change in a critical accounting policy, as suggested in its February 13, 2002 press release. The SEC continues to evaluate these items and solicits public comment on them.

Disclosure of Earnings Results

The SEC did not re-propose requiring companies to disclose annual and quarterly earnings results under Form 8-K.

Impact on Foreign Private Issuers

Foreign issuers that file annual reports on Form 20-F are not subject to the 8-K filing requirements, and instead file Form 6-Ks. The SEC did not propose amendments to Form 6-K to require the disclosure of any specific information or to change the illustrative list of items that registrants may consider material.

Liability

Information on Form 8-K would continue to be considered "filed" for liability purposes, except information provided under current Item 9 in compliance with Regulation FD (proposed Item 6.01).

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This memorandum provides only a general overview of the proposed disclosure rules. It is not intended to provide or constitute legal advice, and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to members of the Paul Weiss Securities Group (see below). In addition, memoranda on related topics may be accessed under Securities Group publications on our web site (www.paulweiss.com).

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