

SEC PROPOSED RULE CHANGES ON CORPORATE DISCLOSURE

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APRIL 17, 2002

On April 12, 2002, the Securities and Exchange Commission (the "SEC") issued two releases (the "Releases") that propose new measures intended to improve the financial reporting and disclosure system by requiring certain companies to file their annual and quarterly reports more quickly, to disclose information about where their reports may be electronically available, and to disclose certain significant insider transactions on a current basis. In the first Release,¹ the SEC proposes rule changes that would:

- Accelerate filing of quarterly and annual reports by domestic reporting companies that have a public float of at least \$75 million; and
- Require those companies to disclose in their annual reports where company filings may be accessed, including whether they provide access to their Forms 10-K, 10-Q and 8-K on their websites, at the same time they are filed with the SEC.

In the second Release,² the SEC proposes amending Form 8-K to require certain companies to disclose, on a current basis:

- Directors' and executive officers' transactions in the company's equity securities, including derivative securities;
- Directors' and executive officers' arrangements for the purchase and sale of the company's equity securities; and
- Loans of money to directors or executive officers made or guaranteed by the company or an affiliate of the company.

The rules proposed in the first Release are subject to public comment on or before 30 days after publication in the Federal Register. The rules proposed in the second Release are subject to public comment on or before 60 days after publication in the Federal Register. The SEC may, after the applicable comment period, adopt the proposed rules or adopt modified rules or make additional proposals based on the comments received.

¹ SEC Release No. 33-8089, 34-45741 (April 12, 2002).

² SEC Release No. 33-8090, 34-45742 (April 12, 2002).

The proposed rules are modified versions of some, but not all, of the measures announced by the SEC in a news release on February 13, 2002 (the "News Release"), which was described in our memorandum dated February 28, 2002.

The primary differences between the measures proposed in the Releases and those described in the News Release include:

- Limiting the accelerated filing of annual and quarterly reports to domestic reporting companies that have a public float of at least \$75 million;
- Substituting the requirement that companies post reports on their websites with a requirement that companies with a public float of at least \$75 million disclose in their annual reports *whether* reports are available on their websites; and
- Expanding the types of directors' and executive officers' transactions and arrangements that companies must report on Form 8-K.

The Releases do not address other measures that, according to the News Release, the SEC is also evaluating as part of a broader regulatory agenda. For example, the Releases do not address other categories of information, discussed in the News Release and our prior memorandum, that the SEC may also require to be disclosed on Form 8-K. Nor do the Releases discuss shortening the reporting deadlines under Section 16(a) for certain insider trading activities. The SEC's continued evaluation of these other measures, as well as other reforms designed to improve the financial and reporting disclosure system, may result in additional SEC proposals.

**SHORTENED DEADLINES FOR
FILING OF ANNUAL AND QUARTERLY
REPORTS**

In the first Release, the SEC proposes to require certain domestic reporting companies to file their annual and quarterly reports more quickly than currently required by the disclosure rules. The SEC proposes that these companies file (i) annual reports on Form 10-K within 60 days after the end of their fiscal year, rather than the current requirement of 90 days and (ii) quarterly reports on Form 10-Q within 30 days after the end of their first three fiscal quarters, rather than 45 days. The SEC proposes to make conforming deadline changes for transition reports that those companies must make if and when they change their fiscal year.

The proposed shortened filing deadlines would apply only to domestic reporting companies that:

- have a public float of at least \$75 million as of a date (selected by the company) within no more than 60 and no less than 30 days before the end of the company's last fiscal year;
- have been subject to the reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act") for at least 12 calendar months preceding the filing of the report; and
- previously have filed at least one annual report on Form 10-K.

The proposal does not require changing the filing deadlines for annual, quarterly or transition reports of other companies, including small business issuers that file on Forms 10-KSB and 10-QSB.

A significant effect of the proposed change with respect to Form 10-K would be to increase the amount of time a company would be required to defer a shelf takedown or an offering that relies on incorporation by reference unless it files its definitive proxy statement for its annual meeting of shareholders or includes certain information in the Form 10-K that it typically omits from the Form 10-K in reliance on incorporation by reference to its definitive proxy statement. Specifically, most companies incorporate by reference in the Form 10-K certain information, such as information on executive compensation and related transactions, that will be contained in a subsequently filed definitive proxy statement. Form 10-K permits this incorporation by reference so long as the definitive proxy statement is filed within 120 days after the end of the fiscal year. A shortened deadline for filing a company's Form 10-K would, therefore, in most cases increase the period of time between the filing of the company's Form 10-K and the filing of the company's definitive proxy statement. Under current SEC Staff interpretations, however, a company cannot complete a public offering of securities by taking down from an effective shelf registration statement or using a new registration statement that relies on incorporation by reference during this period of time between the filings. The Staff is aware of this effect of the proposed change, but has not yet proposed, in the first Release or otherwise, to take mitigating action.

The SEC expects that the proposal, if adopted, would have a delayed effectiveness date in order to give companies time to comply with the shortened filing deadlines. The SEC expects to make the proposal, if adopted, effective for affected companies as of the end of their first fiscal year ending after October 31, 2002.

**DISCLOSURE ABOUT ELECTRONIC
ACCESS TO REPORTS**

The first Release also proposes that companies that would be subject to the accelerated filing requirements described above be required to give investors more information about

where company reports may be electronically accessed. Specifically, the SEC proposes that these companies disclose in their annual reports:

- That the public may read and copy the company's filings at the SEC's Public Reference Room, and may access information electronically filed on the SEC's website;
- The company's website address, if it has one;
- Whether the company makes available free of charge on its website, if it has one, its reports on Forms 10-K, 10-Q and 8-K as soon as reasonably practicable after, and in any event on the same day as, those reports are electronically filed with or furnished to the SEC;
- If the company does not provide its own website access in this manner, the reasons why it does not do so, including, if applicable, that the company does not have a website;
- If the company does not provide its own website access in this manner, one or more other locations where investors may access the filings electronically immediately upon filing, if any, and whether there is a fee for such access; and
- Whether the company voluntarily will provide electronic or paper copies of its filings free of charge upon request.

These requirements would not obviate the need for a company to file reports with the SEC or otherwise affect a company's reporting requirements with the SEC.

The SEC observed that some companies currently provide website access to their reports by establishing hyper-links between their own websites and websites of third-party services that maintain the company reports. In those cases, the SEC encourages companies to hyper-link directly to their reports, or to a list of their reports, rather than hyper-link just to the third party service's home page. The SEC further noted that because filings on the SEC's own EDGAR website are currently posted after a 24-hour delay, hyper-linking only to the EDGAR system would not allow a company to state that it provides website access to its reports as soon as reasonably practicable after, and in any event on the same day as, those reports are filed. Nor does the EDGAR website currently qualify as a location where investors may access a company's filings electronically immediately upon filing.

The proposed requirements technically apply only to companies that are also subject to the accelerated filing requirements described above. Furthermore, the requirements, if adopted, would not require any company to establish a website if it does not currently have one. However, the SEC expressly encourages companies to make their SEC filings "as broadly available to the public as possible." To that end, the SEC particularly encourages *every*

reporting company to make its filings available to investors, free of charge, on its Internet website, if it has one, as soon as reasonably practicable after, and in any event on the same day as, such material is electronically filed with or furnished to the SEC.

**CURRENT REPORTING OF DIRECTORS' AND
EXECUTIVE OFFICERS' TRANSACTIONS**

The second Release proposes to expand the types of information that companies must report on Form 8-K to include certain significant transactions with or by company directors and executive officers. Under a proposed new Item 10 to Form 8-K, companies with a class of equity securities registered under Section 12 of the Exchange Act must report:

- Directors' and executive officers' transactions in company equity securities, including derivative securities transactions and transactions with the company;
- Directors' and executive officers' arrangements, by contract, instruction or written plan, for the purchase or sale of company equity securities intended to establish an affirmative defense against insider trading liability pursuant to Exchange Act Rule 10b5-1(c); and
- Loans of money to directors and executive officers made or guaranteed by the company or an affiliate of the company.

As proposed, the deadline for filing a Form 8-K reporting any of the above transactions depends on the size of the transaction and the presumed significance of the information to investors:

- Transactions and loans with an aggregate value of \$100,000 or more, other than grants and awards pursuant to employee benefit plans, must be reported within two business days;
- Transactions and loans with a smaller aggregate value, grants and awards pursuant to employee benefit plans, and Rule 10b5-1 arrangements generally must be reported by the close of business on the second business day of the following week; and
- Transactions and loans with an aggregate value of less than \$10,000 do not need to be reported until the aggregate cumulative value of those unreported events for the same director or executive officer exceeds \$10,000.

The date of a reportable event would be the date on which the parties enter into an agreement or other arrangement.

A significant effect of the proposed changes to the current reporting requirements would be that affected companies would have to disclose, on an accelerated basis and via electronic filing, purchases and sales of a company's equity securities by its directors and executive officers. While substantially similar information is currently reportable by directors and officers under Section 16(a) of the Exchange Act, those Section 16(a) reports need not be filed electronically and, therefore, may be less readily accessible to investors. Moreover, they currently have longer filing deadlines than those under proposed Item 10 to Form 8-K and, in some cases, permit insider transactions to remain undisclosed until 45 days after the end of the fiscal year (a delay of up to 410 days between a reportable transaction and filing). If adopted, Item 10 would therefore provide investors more timely and readily accessible information concerning transactions that may reveal directors' and executive officers' views as to the company's prospects.

Moreover, unlike Section 16(a) of the Exchange Act, proposed Item 10 would also require disclosure of directors' and executive officers' arrangements under Exchange Act Rule 10b5-1 and their receipt of money loans made or guaranteed by the company or its affiliates, as well as disclosure of certain derivative securities transactions not now reportable under Section 16(a). The SEC believes that these categories of information, which relate to both the market for company equity securities and directors' and executive officers' relationships to the company, are of significant informational value to investors and should be reported on a current basis.

If the proposed changes to Form 8-K are adopted, the SEC will issue a finding that it is not in the public interest to impose any sanction on a company, notwithstanding a violation of the requirements of new Item 10, if it can demonstrate that it designed and followed procedures and systems to assure Item 10 compliance and that it corrected any violation by filing a current report as promptly as reasonably practicable.

The SEC expects that the proposed changes to Form 8-K, if adopted, would become effective 60 days after publication of the final rule, with an additional 60 days before a company would be obligated to report within two business days transactions in derivative securities with an aggregate value of \$100,000 or more. For the first 60 days after the effective date, transactions in derivative securities, regardless of their aggregate value, would be reportable by no later than the close of business on the second business day of the week following the week of the transaction. Upon effectiveness, companies would be required to report not only subsequent transactions, arrangements and loans, but also all previously entered into Rule 10b5-1 arrangements and loans.

Certain of the proposed disclosure requirements described above appear to be inspired by the recent Enron bankruptcy, such as the accelerated disclosure of company stock purchases and sales by directors and executive officers. However, other requirements, such as the accelerated filing deadlines for annual and quarterly reports and increased disclosure about web-accessible filings, do not appear to be Enron-related but instead are part of a continuing effort by the SEC to ensure that the federal public company reporting system is sufficiently extensive and timely to provide needed transparency.

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If you have any questions concerning the Releases, please contact Vincent Pagano (vpagano@stblaw.com), John Lobrano (jlobrano@stblaw.com), Risë Norman (rnorman@stblaw.com) or Frank Marinelli (fmartinelli@stblaw.com) of our firm at (212) 455-2000.

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