



# **Evolving Best Practices: The New Form 8-K Rules**

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## Overview of Presentation

- Setting the Stage for the New Form 8-K Rules
- Areas of Particular Focus
  - Material Agreements (Item 1.01)
  - Exit or Disposal Activities (Item 2.05)
  - Change in Accountants (Item 4.01)
  - Appointment and Termination of Principal Officers and Directors (Item 5.02)
- Practice Recommendations
  - Disclosure Controls and Procedures
  - Managing the Process
  - Implications for Insider Trading

## Setting the Stage for the New Form 8-K Rules

- A Step Towards Current Disclosure
  - SEC response to Section 409 of Sarbanes-Oxley
  - Expansion of Form 8-K items
  - Shortened filing periods
  - No Form 8-K required for:
    - ▶ Ordinary course contracts
    - ▶ Changes in outlook or guidance
    - ▶ Non-binding letters of intent

## Setting the Stage (cont'd)

- Legal Backdrop for Form 8-K Disclosures
  - Basic v. Levinson (“Silence, absent a duty to disclose, is not misleading”)
    - ▶ Still applies to material information that does not trigger a Form 8-K
    - ▶ Duty to disclose arises frequently
      - MD&A known trends and uncertainties requirement
      - Disclosure necessary to make concurrent public statements not misleading (Rule 10b-5 and Rule 12b-20)
      - When insiders or the company are buying or selling
  - How do new Form 8-K requirements affect the landscape?
    - ▶ If a Form 8-K event occurs, there IS a line item duty to disclose
    - ▶ Must disclosure go beyond the expressly required information?

## Areas of Particular Focus: Material Agreements

- Item 1.01: *Entry into a Material Definitive Agreement*
  - Disclosure triggered by:
    - ▶ Entry into any material definitive agreement not made in the ordinary course
    - ▶ Any material amendment to such an agreement
  - Agreement must be enforceable
    - ▶ Non-binding letters of intent do not trigger Form 8-K
    - ▶ Disclosure must be made even if subject to stated conditions, such as customary closing conditions
  - Exhibit requirements
    - ▶ Not required to file as an exhibit to the 8-K (but “encouraged”)
    - ▶ Must file with the next periodic report

## Areas of Particular Focus: Material Agreements (cont'd)

- Definition of “Material Agreement” imported from Item 601(b)(10):
  - Contracts not made in the ordinary course that are material to the company
  - Exceptions: Certain contracts are deemed not to be in the ordinary course
    - ▶ Contract upon which the business is substantially dependent
    - ▶ Acquisition or disposition of property, plant or equipment for consideration exceeding 15% of fixed assets, or
    - ▶ Material lease
      - These must be disclosed UNLESS immaterial in amount or significance.

## **Areas of Particular Focus: Material Agreements (cont'd)**

- Definition of “Material Agreement” (cont'd):
  - Management contract or compensatory plan, contract or arrangement in which a director or executive officer participates
    - ▶ Any agreement with a “named executive officer”
    - ▶ Agreements with other executive officers UNLESS immaterial in amount or significance
    - ▶ Exceptions include non-discriminatory plans (e.g., ESPP)
  - Non-shareholder approved equity compensation arrangements
    - ▶ For any employee
    - ▶ UNLESS immaterial in amount or significance

## Areas of Particular Focus: Material Agreements (cont'd)

- Compensation-Related Events
  - Determination of “named executive officers”
  - Employment offer letters
  - Setting or increasing salary
  - Option grants
    - ▶ Standard form of option agreement
      - If it has been previously filed, no Form 8-K triggered
      - If not, probably triggers Form 8-K
    - ▶ Non-standard form of option agreement => Form 8-K
  - Adoption of plan or award subject to shareholder approval
  - Cash bonus plans
    - ▶ Establishment of performance formula
    - ▶ Award determination/payout
  - Severance Agreements



## **Areas of Particular Focus: Material Agreements (cont'd)**

- **Material Contracts Generally**
  - Remember the “ordinary course of business” exception
  - Timing of filing the contract as an exhibit
  - Automatically renewable contracts

## Areas of Particular Focus: Exit or Disposal Activities

- Item 2.05: *Costs Associated with Exit or Disposal Activities*
  - Disclosure triggered when:
    - ▶ Decision is made by:
      - Board of directors
      - Board committee
      - Authorized officer (if no board action is required)
    - ▶ The company:
      - Commits to an exit or disposal plan
      - Otherwise disposes of a long-lived asset
      - Terminates employees under a “plan of termination”
    - ▶ Under which material charges will be incurred
    - ▶ Key concepts
      - “Final determination” regarding the course of action
      - SFAS No. 146 criteria

## **Areas of Particular Focus: Exit or Disposal Activities (cont'd)**

- **Required Disclosures Include:**
  - Date of commitment to the course of action
    - ▶ Board vs. officers
  - Facts and circumstances leading to the expected action
  - Estimate of amounts or range of amounts expected to be incurred
    - ▶ Breakdown by each major type of cost
    - ▶ Cash component
    - ▶ Subsequent amendment to 8-K if estimate not currently available

## **Areas of Particular Focus: Exit or Disposal Activities (cont'd)**

- **Examples**
  - Employee lay-offs
  - Discontinuation of a line of business
  - Closing of a facility

## Areas of Particular Focus: Change in Accountants

- Item 4.01: *Changes in Registrant's Certifying Accountant*
  - Impact of Sarbanes-Oxley Section 404
  - Disclosure triggered if auditor:
    - ▶ Resigns
    - ▶ Indicates that it declines to stand for re-appointment after completion of the current audit, or
    - ▶ Is dismissed
  - Engagement of new auditor is a separate reportable event

## **Areas of Particular Focus: Change in Accountants (cont'd)**

- Required Disclosure Is in Reg. S-K Item 304
  - “Disagreements” between management and auditors
    - ▶ Within two most recent fiscal years and stub period
    - ▶ Interpreted broadly
    - ▶ Includes any difference of opinion concerning any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure
    - ▶ Irrespective of whether resolved to the former auditor’s satisfaction
      - Not necessary for there to have been an argument, merely a difference of opinion
      - However, does not include initial differences of opinion based on incomplete facts or preliminary information that were later resolved upon obtaining additional facts or information

## **Areas of Particular Focus: Change in Accountants (cont'd)**

- Reg. S-K Item 304 (cont'd)
  - Other Item 304 reportable events
    - ▶ Internal controls
  - Oral communication suffices to trigger
  - Letter from the former auditor as to whether it agrees with the company's disclosures
    - ▶ Coordination with the auditor on tight timeframe

## Areas of Particular Focus: Change in Principal Officers or Directors

- Item 5.02: *Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers*
  - Disclosure triggered if:
    - ▶ A director
      - Retires
      - Resigns
      - Is removed
      - Refuses to stand for re-election
    - ▶ Additional disclosures required if:
      - Director resigns or refuses to stand for re-election due to:
        - ▶ Disagreement with the company on any matter relating to the company's operations, policies or practices
        - ▶ Disagreement is known to an executive officer
      - Director is removed for cause



## **Areas of Particular Focus: Change in Officers or Directors (cont'd)**

- **Item 5.02** (cont'd)
  - Disclosure triggered if (cont'd):
    - ▶ Director is appointed or elected to the board
      - Except by shareholders at a meeting
      - Includes
        - ▶ Appointment by the Board to fill a vacancy
        - ▶ Election through a written consent of shareholders (if permitted)
    - ▶ Principal Officer
      - Retires
      - Resigns
      - Is terminated from that position
    - ▶ Principal Officer is appointed
      - May postpone until public announcement

## **Areas of Particular Focus: Change in Officers or Directors (cont'd)**

- **Definition of “Principal Officer”**
  - Principal executive officer
  - President
  - Principal financial officer
  - Principal accounting officer
  - Principal operating officer (typically COO or President)
  - Any person performing similar functions

## **Areas of Particular Focus: Change in Officers or Directors (cont'd)**

- When has a director resigned or refused to stand for re-election, or a principal officer resigned or been terminated?
  - ▶ Oral v. written communications
  - ▶ Preliminary discussions v. final decision
  - ▶ Company's decision v. director's decision not to stand
  - ▶ Current notice of a resignation or termination to occur on a specified future date
- Did the director have a disagreement with the company?
- What is the effective date of a director appointment?
  - ▶ When the Board "appoints" the director OR
  - ▶ When the director accepts the appointment

## Practice Recommendations

- Disclosure Controls and Procedures: Reasons to Reconsider in the New Form 8-K World
  - Form 8-K items require new and different processes from other periodic reports
    - ▶ Shorter filing periods
    - ▶ Not just a date on a calendar
    - ▶ Long list of triggering events
  - Potential Rule 10b-5 liability
    - ▶ Limited safe harbor for certain items
  - Potential liability under Section 13
    - ▶ Failure to timely file a report required by Section 13(a)
    - ▶ Rule 13a-15 requires issuers to maintain DCP, and evaluate, with the CEO and CFO, their effectiveness
      - Note SEC DCP claim against Siebel
      - Conclusion of CEO/CFO required in periodic reports

## Practice Recommendations (cont'd)

- Reasons to Reconsider DCP (cont'd)
  - Potential liability under Section 13 (cont'd)
    - ▶ Failure to adequately disclose required information about controls and procedures in Forms 10-K/10-Q
    - ▶ Rule 13a-14 CEO/CFO certification
      - Must certify that they are responsible for establishing and maintaining DCP, have designed DCP to make sure material information is made known to them, have evaluated the effectiveness of DCP as of the end of the last quarter and have presented their conclusions
  - Loss of S-3 eligibility for certain items

## Practice Recommendations (cont'd)

- Document the DCP Process
  - Under CEO/CFO supervision, Disclosure Committee to design, monitor and evaluate process
  - Gatekeepers report to Disclosure Committee / General Counsel / Compliance Officer
    - ▶ Consider Audit Committee involvement
  - How much documentation?
    - ▶ Enough to describe process
    - ▶ Important to design a process that can be adhered to in practice

## Practice Recommendations (cont'd)

- Develop Notification and Triggering Mechanisms
  - Identify / modify gatekeepers
    - ▶ Material contracts
      - Generate list of relevant contracts
      - Review signature authority / legal sign-off
      - Develop systems to track entry, amendment and termination
      - Consider disclosure obligations of counterparties
      - Notice provisions for termination
    - ▶ Financial obligations
      - Develop systems to track creation, amendment and acceleration of obligations
      - Notice provisions re: default
    - ▶ Impairment decision
      - Review decision-making authority
    - ▶ Exit or disposal activities
      - Review decision-making authority

## Practice Recommendations (cont'd)

- Develop Notification and Triggering Mechanisms (cont'd)
  - Assign responsibility and educate personnel (including officers and directors) as to reporting responsibilities
  - Disclosure Committee
    - ▶ SEC recommended use of a Disclosure Committee
    - ▶ Consider revising Disclosure Committee charter to include Form 8-K oversight



## Practice Recommendations (cont'd)

- Insider Trading Implications
  - SEC says new Form 8-K items “unquestionably or presumptively material”
  - A further reason to consider Rule 10b5-1 trading plans
- Option Agreements
  - Consider filing standard forms
- Board Appointments
  - Make clear that appointment is not effective until accepted by the director
  - Better yet, clear the appointment before the Board acts