

## The SEC Expands and Accelerates Form 8-K Reporting

### *Moving Toward Real-Time Disclosure*

By **Robert L. Kohl**  
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On March 11, 2004, the Securities and Exchange Commission (SEC) promulgated final rules that significantly alter the reporting requirements for public companies on Form 8-K. These final rules put into place a series of reforms first proposed in June 2002, and which were given additional momentum by Section 409 of the Sarbanes-Oxley Act of 2002 (SOX), which mandated that the SEC promulgate rules to require disclosure of additional information regarding material changes in the financial condition or operations of an issuer on a "rapid and current basis." Section 409 of SOX provided additional impetus for the SEC to continue its trend toward a theoretical goal of real-time issuer disclosure, a goal furthered by the advent of two-business-day reporting of insider trading. The four-business-day deadline of the new Form 8-K will considerably increase the pressures on issuers and their advisers to create

organized processes which will enable all potential triggering events under the revised form to be identified, evaluated, and processed into appropriate disclosure on an extremely expedited basis.

The proposed 8-K reforms include a number of important new requirements (eight new items in total), as well as expansion of two existing items and the relocation of two items from Forms 10-Q and 10-K into Form 8-K. The new items provide for a four business day filing deadline for most issuers (Form 6-K, for foreign private issuers, has not been amended). All of the new items become effective on Aug. 23, 2004, the date for EDGAR implementation of the new Form 8-K (after which the old form will not be accepted).

#### **SUMMARY OF REVISED FORM 8-K ITEMS**

The following is a summary of the revised list of Form 8-K items, which follow a new three-digit numbering regime:

- **Item 1.01.** Entry into (or Material Amendment of) a Material Definitive Agreement Not Made in the Ordinary Course of Business. This item parallels Item 601(b)(10) of Regulation S-K in its formulation of what constitutes a material definitive agreement, although the agreement itself does not need to be filed as an exhibit until the next periodic report or registration statement is filed. Non-binding agreements such as letters of intent are not required to

be disclosed even if a non-material portion of such letter is binding. However, the signing of a material agreement subject to customary closing conditions triggers the filing and disclosure requirement.

- **Item 1.02.** Termination of a Material Definitive Agreement. This item requires disclosure where such termination is material to the company, other than by expiration on a stated termination date or as a result of all parties completing their obligations.

- **Item 1.03.** Bankruptcy or Receivership. This replaces old Item 3, with minor changes to make the item more readable.

- **Item 2.01.** Completion of Acquisition or Disposition of Assets. This replaces the former Item 2, except that disclosure is no longer required regarding the nature of the business in which the acquired assets were used and whether the company acquiring the assets intends to continue such use. In contrast to the materiality standard in Item 1.01, this item retains the bright-line "significant" assets test in old Item 2 of Form 8-K. The SEC's adopting release implies that an acquisition or disposition agreement may be "material" (and thus reportable under Item 1.01) but not meet the "significant" assets test of Item 2.01.

- **Item 2.02.** Results of Operations and Financial Condition. This replaces Item 12, adopted last year, and is triggered when results of operations are released

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for a financial period that has ended.

- **Item 2.03.** Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant. Filing here is triggered if a company becomes obligated under a direct financial obligation that is material to the company. "Direct financial obligation" is defined by reference to Item 303(a) of Regulation S-K, and includes long- and short- term debt obligations, capital lease obligations, and operating lease obligations. A report need not be filed under this item until the company enters into an agreement enforceable against it, whether or not subject to conditions.

- **Item 2.04.** Triggering Events that Accelerate or Increase a Direct Financial Obligation or an Obligation Under an Off-Balance Sheet Arrangement. Filing under this item is required if a triggering event causing acceleration of a direct financial obligation of the company occurs and the consequences are material. This item uses the same definition of "direct financial obligation" as Item 2.03, except that it adds for purposes of Item 2.04 that such term includes an obligation arising out of an off-balance sheet arrangement that is accrued under SFAS No. 5.

- **Item 2.05.** Costs Associated with Exit or Disposal Activities. This new item requires disclosure when the board of directors, a committee of the board of directors, or an authorized officer or officers (if board action is not required), commits the company to an exit or disposal plan, otherwise disposes of a long-lived asset or terminates employees under a plan of termination described in paragraph 8 of FASB Statement of Financial Accounting Standards No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146). In such a case, material charges will be incurred under generally accepted accounting principles applicable to the company. Disclosure includes estimates of each major cost associated with the action as well as an estimate

of total amounts charged and total cash required.

- **Item 2.06.** Material Impairments. This new item requires disclosure when a company's board of directors, a committee of the board of directors, or an authorized officer or officers of the company (if board action is not required), concludes that a material charge for impairment to one or more of its assets, including, without limitation, an impairment of securities or goodwill, is required under generally accepted accounting principles applicable to the company. There is an exception where the impairment charge is made in connection with the preparation of quarterly or annual financials and will be disclosed in the Exchange Act report for that period.

- **Item 3.01.** Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing. A company must make disclosure under this item if it receives notice from the exchange (or national securities association) with which its securities are listed that it no longer meets the requirements for continued listing, that the exchange has submitted an application under Exchange Act Rule 12d2-2 to delist the company's securities, or that the exchange has taken all necessary steps under its rules to delist the company. Because both initial notice of noncompliance and actual delisting are reportable, it is likely that the delisting process will trigger two separate disclosures under this item. Under this item voluntary delisting or transfer of listing of a company's securities is also disclosable.

- **Item 3.02.** Unregistered Sales of Equity Securities. This replaces Item 701 of Form 10-Q, and adds a *de minimis* exemption for sales of less than 1% of the outstanding class of a security.

- **Item 3.03.** Material Modifications to Rights of Security Holders. This new item requires a company to disclose material modifications to the rights of the holders of any class of the company's registered securities and to

briefly describe the general effect of such modifications on such rights, similar to the requirements of Items 2(a) and (b) of Form 10-Q.

- **Item 4.01.** Changes in Registrant's Certifying Accountant. This item is substantively the same as former Item 4 of Form 8-K, requiring disclosure of the resignation, dismissal or engagement of an independent accountant.

- **Item 4.02.** Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review. This new item requires a company to file a Form 8-K if and when its board of directors, a committee of the board of directors, or an authorized officer or officers (if board action is not required), concludes that any of the company's previously-issued financial statements covering one or more years or interim periods no longer should be relied upon because of an error in such financial statements as addressed in Accounting Principles Board Opinion No. 20 (APB Opinion No. 20).

- **Item 5.01.** Changes in Control of Registrant. Except for certain changes that streamline the language of this item, it is substantively identical to the old Item 1 of Form 8-K.

- **Item 5.02.** Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers. Item 5.02(a) requires disclosure when a director resigns or refuses to stand for re-election due to a disagreement or is removed for cause. This broadens the old Item 6 requirement, which only applied if a director departed as the result of a disagreement and provided a written explanation of the reasons for resignation. Now the item is triggered if the reasons for a director's resignation are related to a disagreement known to an executive officer of the Company — on any matter related to the company's operations, policies or practices — or if a director has been removed for cause from the board of directors.

- **Item 5.02(b)** requires disclosure

when the company's principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or any person performing similar functions retires, resigns, or is terminated from that position. The item also requires disclosure when a director retires, resigns, is removed or declines to stand for re-election and the company is not required to provide disclosure under Item 5.02(a). (Disclosures under Item 5.02(c) and (d) are essentially the inverse of Item 5.02(b), and are triggered when the company appoints a new principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or person performing similar functions, or elects a director other than at an annual meeting of security holders.)

- **Item 5.03.** Amendments to Articles of Incorporation or Bylaws; Change in Fiscal Year. This item requires a company with a class of *equity* securities registered under Section 12 of the Exchange Act to disclose any amendment to its articles of incorporation or bylaws if the company did not propose the amendment in a previously filed proxy statement or information statement. A copy of the amendment must be filed with the Form 8-K.

Finally, the SEC adopted a limited safe harbor from Rule 10b-5 for failure to timely file Form 8-K Items 1.01, 1.02, 2.03, 2.04, 2.05, 2.06 and 4.02(a) and also provided that eligibility to file a Form S-3 is not lost for failure to timely file the Form 8-K with respect to these same items. Rule 144 eligibility provisions were also similarly amended.

### **IMPLICATIONS FOR CORPORATE PLANNING AND GOVERNANCE**

The new Form 8-K requirements up the ante for maintaining adequate disclosure controls and procedures, and increase the risk of inadvertent failures to disclose that may affect required disclosure (under Regulation

S-K, Items 307 and 308(c)) in 10-Qs and 10-Ks, as well as SOX Section 302 officer certifications. While the procedures many issuers have put into place in the wake of the Section 302 certification may aid compliance with the new current report requirements, it is likely that they will not be broad enough.

The pressure to compile and disclose information required by the revised Form 8-K in a timely manner calls for a process akin to that required by the new Section 16 filing requirements. The complexity of much of the new disclosure, however, will require a broader and higher-level review process. Just as many issuers have designated one officer as responsible for Section 16 compliance, a single officer should be the gatekeeper for Form 8-K reporting. In-house counsel are perhaps best suited for this function. If an issuer has no in-house counsel, the financial or operations personnel who are chiefly responsible for interacting with outside counsel for the purposes of Exchange Act disclosure should be assigned this function. Where a disclosure committee is responsible for disclosures in quarterly and annual reports, it may be advisable to designate one member of the committee as responsible for initial screening of potential triggering events. This designated member should then surface issues and materiality judgments to finance, legal or operating personnel, or outside counsel and auditors.

In addition to designating individuals to monitor Form 8-K compliance, a company-wide effort to educate relevant employees on the scope and time pressure of new requirements will be required. Finance and legal personnel (again, anyone involved in quarterly and annual reporting) must be the focus of these efforts, but a larger group of officers and employees should also be involved. This is particularly true with respect to any personnel responsible for entering into or monitoring (for amendment or termination)

of material contracts (Items 1.01 and 1.02) and relationships with lenders and other financial institutions (Item 2.03), some of whom may not be accustomed to identifying and framing disclosure issues and may require background education on general securities disclosure.

To facilitate compliance with the new Items 1.01, 1.02 and 2.03 requirements (signing a material contract or amendment, termination of a material contract or entering into a material direct financial obligation), companies may want to limit the number of officers authorized by the board to execute such contracts, amendments, or borrowing or lease agreements; make it a practice to execute such contracts only upon (and not subject to) board approval; and require that all such contracts contain termination provisions effective only upon receipt of notice by designated officers (with a copy to in-house counsel). Finance staff members need to be made aware that if asset impairments or exit or disposal charges are contemplated, such plans must be discussed in advance with in-house counsel or the Form 8-K gatekeeper to determine whether the "materiality" standards for Items 2.05 or 2.06 of Form 8-K are met or exceeded in connection with the contemplated charges. Finally, in-house counsel may want to review by-laws (before the Aug. 23 effective date of the Form 8-K changes) to eliminate the need for routine by-law amendments after that date (as may be required to set the number of directors comprising the board, for example).

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