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HIGHLIGHTS AND PITFALLS

Staff Sums Up the Impact of 1934 Act Filing Delinquency on Extant Forms S-3 and S-8—Form Eligibility vs. Ongoing Use

These days, we frequently hear from readers wondering about the impact of late 10-Q/K filing on the issuer's outstanding S-3/S-8 registration statements. This is a subject we have addressed more than once, in pieces, but the Staff went deep at the recent Northwestern Law School Securities Regulation Institute Q&A Session (augmented at PLI's *SEC Speaks*). The Staff explained when existing S-3/S-8s must be terminated, and when counsel may exercise judgment to continue an offering.

Registration Form Eligibility vs. Ongoing Use of Prospectus

Form Eligibility. 1933 Act Rule 401 requires that the form and content of a registration statement and prospectus conform to the applicable registration statement eligibility, etc. requirements at (i) the initial filing date (see Rule 401(a)), and again at (ii) the filing date of each Section 10(a)(3) update (see 401(b) and the *Telephone Interpretations Manual* (July 1997) at B.53), but not at the filing date of any other post-effective amendment (see Rule 401(c)). [As our readers may recall from their second week of *Securities* in law school, 1933 Act Section 10(a)(3) generally provides that the information in a prospectus (used more than nine months after the effective date) cannot be more than 16 months old.]

Forms S-3 and S-8 are carved out of the S-K 512(a)(1) undertaking that requires filing a post-effective amendment for §10(a)(3) update purposes (or, for a "fundamental change"—see pg 4), so long as the relevant updating information is contained in (post-effective) 1934 Act filings (which S-3 and S-8 incorporate by reference). In lieu of a separate §10(a)(3) post-effective amendment, the annual 10-K is the equivalent of filing an immediately effective post-effective amendment of the issuer's extant S-3s and S-8s. (See the TIM, at B.55 and our March-April 2005 issue at pg 7.) Thus, at the time of the 10-K filing/§10(a)(3) post-effective amendment, the eligibility requirements for Form S-3 or S-8, as applicable, must (again) be met.

S-3 General Instruction I.A.3 sets forth the registrant eligibility requirements to "use" (which, in this context, apparently means file/effect, not ongoing use after effectiveness) Form S-3, including being current in 1934 Act filings (including any proxy statements) for the 12 months preceding filing of the registration statement, and timely in filing 1934 Act reports for the portion of the calendar month before filing the S-3 and the preceding 12 months (see our November-December 2005 issue at pg 11). [Once the issuer files a registration statement, the Staff doesn't require eligibility to be assessed again at the effective date, so that a 1934 Act delinquency occurring after filing an S-3 but before effectiveness doesn't *per se* affect whether the Staff will accelerate effectiveness. *E.g.*, where, after a new S-3 is filed but before it becomes effective, a 10-Q or a non-safe harbor 8-K is filed late, it wouldn't even be necessary to request an S-3 eligibility waiver. On the other hand, if an issuer's situation *improves* after the filing date, making it S-3 eligible at the time of effectiveness, the Staff says it allows eligibility to be measured then (*e.g.*, an issuer that originally filed an S-1 but reaches $75 million float when its stock price spikes, may file a pre-effective S-3 amendment to the S-1).]

S-8 General Instruction A.1 requires being current in 1934 Act reports for the 12 months preceding the filing of the registration statement (which, as our readers will recall, becomes effective automatically upon filing); there is no timeliness requirement for S-8s.

Ongoing Use of Prospectus. After a 1934 Act delinquency occurs, until the §10(a)(3) update or deadline, the Staff generally allows issuer/counsel to decide whether the issuer's outstanding S-3 and S-8 prospectuses remain usable (for S-3 shelf takedowns, etc. and S-8 stock options exercises, etc.), *i.e.*, are valid under Section 10(a); the Staff believes it would not be knowledgeable of the issuer-specific facts and circumstances that

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go into this determination. The determination would be based, in part, on compliance of the prospectus with applicable 1933 Act rules (see Section 10(a)(1)), including Rule 408 which, as our readers will recall, requires any material information as may be necessary to make the information in the prospectus not (materially) misleading (see our March-April 2005 issue at pg 9).

The issuer's determination would, of course, also include assessment of the risk of 1933 Act Section 12(a)(2) liability, *i.e.*, material untrue statement or omission, as well as Rule 10b-5, *i.e.*, *scienter* fraud. (This assessment may be different in the S-8 context, where the offerees generally are closer to the issuer than S-3 investors but, on the other hand, may include many who aren't sophisticated.) The risk assessment may be based, in part, on the issuer's ability to supplement the prospectus (see below) to assuage the disclosure gaps resulting from the 1934 Act filing delinquency.

Late 10-Q

Rule 12b-25's five-calendar day extension for Form 10-Q doesn't provide a grace period for ongoing use of an already effective S-3 or S-8; both during the five-day period, and after if the delinquency continues, it is for issuer/counsel to determine whether to continue outstanding S-3 and S-8 offerings.

Rule 12b-25(d) prohibits filing an S-3 during the 12b-25 extension period. However, an S-8 may be filed/effected during the 10-Q extension period. [Because, as discussed above, the Staff allows measuring S-3 eligibility, where better, at the effective date instead of the filing date, it may be possible to file an S-3 prior to the original due date (of 10-Q/K) and effect the S-3 when the 10-Q/K is delinquent (or even after the 10-Q is filed late, *i.e.,* not timely), although the Staff may have serious "comments" if it reviews the S-3.]

The 10-Q doesn't involve a §10(a)(3) deadline (a Q updates parts of the prospectus, but not the audited financials). But, a 10-Q filed after the 12b-25 extended deadline will impact S-3 eligibility come §10(a)(3) time.

Supplementing the Prospectus. As mentioned above, issuer/counsel may derive comfort for ongoing use (both antifraud and §10(a)(1)-wise) by supplementing outstanding S-3/S-8 prospectuses during the pendency of a 1934 Act delinquency. For S-3s, the supplement could be filed per Rule 424. For S-8s, the supplement could be distributed without filing (as our readers will recall, S-8 prospectuses aren't filed—see our November-December 2001 issue at pg 5). Most often, however, the supplement would be contained in an 8-K, *i.e.,* an Item 2.02 (earnings release) or 7.01 (Reg FD disclosure) *furnishing* specifically deemed by the issuer to be incorporated by reference even though not filed (see 8-K General Instruction B.2) or an Item 8.01 (Other Events) *filing* (which would be incorporated by reference). The 8-K route may assuage possible Reg FD concerns arising from selective disclosure of material non-public information in the supplement (disclosures made in the context of Rule 415(a)(i)–(vi), *i.e.,* ongoing, offerings are not excluded from FD), even though the disclosure here is not intended for FD-covered persons, *e.g.,* brokers and analysts (see our July-August 2000 issue at pg 1).

Late 10-K

During the 12b-25 grace period for 10-Ks (15 calendar days), the issuer is also able to make the call on using the prospectus, but the Staff says it's generally a "lot harder" than with a late 10-Q (as would be the feasibility of the supplement solution, in that what's missing here includes the annual audit). Even if the issuer fails to file its 10-K by the extended deadline, ongoing use remains the issuer's call until the §10(a)(3) deadline. (This Staff position seemingly supersedes H.80/M.17 of the TIM, which cut off ongoing use at the extended deadline.) Thus, an LAF that misses its extended 10-K deadline on March 16, 2007 theoretically would be able to continue to use extant S-3 and S-8 prospectuses until April 30 (the §10(a)(3) deadline). [An issuer that misses the 12b-25 Form 10-K extended deadline would actually be better off, with regard to its extant S-3s and S-8s, waiting to file its 10-K until April 30 (allowing ongoing use up to the absolute §10(a)(3) deadline). But, we doubt anyone would defer their 10-K just for that reason.]

S-3. If the 10-K is filed within the 15 days, there is no ongoing currency or timing delinquency. If filed after the 15 days, the issuer once again becomes current in its 1934 Act filings but, at the time of the (late) 10-K filing/§10(a)(3) update, the issuer is not timely (and can't be for 12 months); an effective S-3 would no longer be available for takedowns, etc. and a new S-3 can't be filed until the timeliness requirement is once again met. If the 10-K is not filed by April 30, outstanding S-3s become stale under §10(a)(3). To continue a registration after losing S-3 eligibility, the issuer would be forced to file a post-effective amendment (or a new registration statement) on S-1 (*e.g.*, where there is a registration covenant). [Keep in mind that per Rule 457(p), unused registration fees may be rolled forward (for up to five years) into new registration statements—see our January-February 2001 issue at pg 4.]

S-8. With S-8s, on the other hand, because the ultimate 10-K filing (whether during or after the 15-day extension) reinstates currency, the post-effective amendment effected by 10-K filing by April 30 fully revives the issuer's S-8s. If the 10-K is not filed by April 30, S-8s would terminate, but the Staff says that, even where the 10-K is filed after April 30, it will (for "policy" reasons) allow S-8s to, in effect, be resurrected, *i.e.*, without filing new S-8s.

Rule/Form 12b-25

Rule 12b-25 requires all late Q/K filers to file Form 12b-25, and is due no later than one business day after the due date of the delinquent form. (These days, a public announcement usually would accompany, or precede, a 12b-25 filing.) Form 12b-25 contains a box to be checked if (among other things) the delinquency will be cured by the extended deadline. If not, don't check that box; it says "will be filed." As mentioned above, Rule 12b-25(d) provides that an issuer is "not eligible to use" (an S-3) during the 12b-25 extension period. But, here again, "use" apparently speaks to form eligibility rather than ongoing use of an extant S-3.

Impact if Blow 12b-25 Filing. An issuer that fails to timely file Form 12b-25 loses the applicable grace period. As discussed above, the ongoing use call would still be available. But, even if the 10-K is filed within 15 days after the original due date, the filing is not timely so S-3 eligibility is lost (for non-timeliness) and outstanding S-3s are no longer available (but, the late filing restores S-8 currency). Similarly, a Q filed less than five days late would result in loss of S-3 eligibility, but not until the 10(a)(3) date.

Impact of Filing 8-K Item 4.02—Non-reliance on Previously Issued Financials

The Staff hasn't taken a hard and fast position that the issuer's determination of non-reliance on the financials in a prior 10-K is tantamount to that filing being delinquent, *i.e.*, so deficient as to be deemed not to have been filed (see our March-April 2005 issue at pg 7), which, if the most recent 10-K, would result retroactively in non-currency and non-timeliness at the last §10(a)(3) date. The Staff says there are "lots of reasons" for a 4.02 determination, so it's up to the issuer to decide whether S-3 and S-8 prospectuses are still good. However, the Staff would expect that, in most such 10-K situations, the offering would be suspended. (Where, however, the non-reliance relates to years-back financials, *e.g.*, options backdating, that may be an easier ongoing use call.) When the subject of the 4.02 is a 10-Q, the §10(a), etc. analysis (as well as use of a supplement) also may be easier: moreover, no (retroactive) §10(a)(3) deadline is implicated.

8-K Delinquency

A missed 8-K deadline technically has the same currency and timeliness effects on S-3/S-8 eligibility/ongoing prospectus use as a delinquent 10-Q/K. Most 8-K items are due within four business days after the trigger event. Some are due sooner, *e.g.*, Item 7.01 is due simultaneous for an intentional selective disclosure and "promptly" for non-intentional disclosure. Item 8.01 is not really *due* at any time, but is voluntary. A failure to "furnish" (per Items 2.02 or 7.01) is not, however, a delinquency for S-3 (and, presumably, S-8) eligibility purposes. (See our May-June 2005 issue at pg 5.) And, specified items covered by the 8-K safe harbor needn't be filed until the 10-Q/K for the quarter in which the 8-K event was reportable, *i.e.,* an event occurring on March 31 apparently needn't be included until the second quarter 10-Q (see 10-Q, Part II, Item 5(a) and 10-K, Part II, Item 9B); moreover, failure to do so when required in the Q/K only causes a "current" delinquency, not a timing delinquency, in that the Q/K is still timely filed (see S-3 General Instruction I.A.3(b)).

As with 10-Q/K, a missed 8-K deadline affects S-3 form eligibility for 12 months (from when the 8-K information is filed), but affects S-8 form eligibility only until the 8-K information is filed. [There is no 12b-25 extension for 8-Ks, but the Staff considers (and, for minor misses, sometimes grants) eligibility waiver requests for any late 1934 Act reports—see our May-June 2006 issue at pg 5.] As for ongoing prospectus use during an 8-K delinquency, usually the 8-K can be filed soon enough. Moreover, the non-reported information may be less material than, *e.g.*, non-reported financial statements.

Suspension of Stock Option Exercises

We have discussed the importance that option plans/grant agreements contain (and the S-8 prospectus adequately disclose) a provision conditioning the optionee's right to exercise on compliance with applicable securities laws. Such a provision would come in handy if filing delinquencies were to force S-8 termination (or suspension of use). (See also the January-February 2007 *NASPP Advisor* at pg 3.)

Extending Options. The issuer may want to consider extending in-the-money options that are about to expire. Under FAS 123(R), the accounting consequence here may be minimal in that, if the extension occurs

before the option expires, there would be a charge only for the incremental fair value of the extended option. (See the January-February 2007 issue of *The Corporate Executive* at pg 7.) Better yet, grants could bake-in such an extension, or a provision tolling the option term during any period that vested options aren't covered by a viable S-8.

Rule 144(c). Rule 144(c)'s "current public information" requires 1934 Act currency for the 12 months preceding the sale (other than 8-K reports). (See our May-June 2005 issue at pg 6.) As we have discussed, 144(c) is seemingly satisfied during the 12b-25 extension period (see Rule 12b-25(d) and the TIM, at C.30); however, if the issuer does not file the 10-Q/K by the extended deadline, the "current public information" requirement is deemed not to have been met even during the extension period. (See our July-August 1998 issue at pg 6.) The unavailability of 144 would prevent same-day sales by affiliate-grantees to fund option exercises and tax withholding on options and restricted stock.

April in S-1 Land??

Posit a non-S-3 issuer with an ongoing S-1. The issuer must effect a post-effective amendment each year by the end of April per Section 10(a)(3). [The first April 30 may not be a §10(a)(3) deadline (see below). But, even there, the 10-K filed by March 31 is "out there," so the prospectus normally would need to be amended, by post-effective amendment, to add the new audit and other updated information; S-1 has no forward incorporation by reference.]

When the 10-K Precedes the Annual S-1 Amendment. The issuer files its 10-K by the end of March each year. What happens with the S-1 prospectus in April, *i.e.*, prior to the post-effective amendment being effected? [One might wonder why the issuer wouldn't just effect the S-1 post-effective amendment simultaneous with the 10-K filing. Actually, an issuer devoting its attention to meeting the 10-K deadline might not want to be in the position in late March of, in effect, dealing with Staff comments on its draft 10-K, as might happen in the post-effective amendment process. (Of course, our issuer here may find the Staff requesting amendment of the 10-K information in April, incident to its review of the S-1 post-effective amendment.)]

So, what happens to the offering in April? In the S-1 context, not only is the (March) 10-K not incorporated by reference (in April) but the 10-K filing doesn't automatically effect a post-effective S-1 amendment. The Staff says the analysis here, *i.e.*, of whether the old prospectus can be used in April, is the same "ongoing use" analysis. But, is there really room to justify using the old prospectus here?

One idea might be to attach the 10-K as a Rule 424 sticker to the (old) prospectus. But, the S-1 undertaking in S-K 512(a)(1)(ii) requires a post-effective amendment, not a new supplement, for a "fundamental change." Thus, the only way to use the old prospectus in April, while the post-effective amendment is being processed, is to get comfortable that the new audit and other updating in the March 10-K doesn't constitute a fundamental change; the Staff "can't imagine" that it wouldn't be. Thus, a supplement may work for anti-fraud concerns, but violate the undertaking (and, ultimately, Section 5).

Fundamental Change. The term "fundamental change" has not been defined by the SEC. Generally speaking, a fundamental change is something that is more than a material change, *i.e.*, *super* materiality. It can be either a single event or a cumulative result. We think of a fundamental change to be in the nature of a major change in an issuer's operations, such as a significant acquisition or disposition, or a change in the business or operations that would necessitate a restatement. We also understand the Staff's position to be that a quarterly financial statement, MD&A, etc. is not considered a fundamental change unless there is a significant departure from prior trends (see our November-December 1993 issue at pg 4). But here, we are looking at the annual financials.

The §10(a)(3) Deadline is Not April 30 the First Time Around Where a Registration Statement Becomes Effective After August 1

Assume an S-3 was effected in December 2006, and the (calendar year) issuer fails to file its 10-K for 2006 by the due date, or by April 30, 2007. Beginning on the 10-K delinquency date (*i.e.*, the day after the due date), the ongoing prospectus use/issuer call scenario applies. But here, the Section 10(a)(3) deadline isn't until September 2007 because, while the 2005 audited financials "in" the S-3 become 16 months old on April 30, it isn't yet nine months after the effective date. So, it's not until September that the S-3 may no longer be used.

Once the issuer timely files its 2006 Form 10-K, the next §10(a)(3) deadline is April 30, 2008. Thus, as a general rule, April 30 won't be the §10(a)(3) deadline (only) in the first year of S-3/S-8s that becomes effective after August 1.

WKSIs

The §10(a)(3) update also plays a role in ongoing WKSI status which, in turn, determines Form S-3ASR eligibility. If the WKSI does not make a separate §10(a)(3) update, *e.g.,* 10-K, post-effective amendment or a 424 prospectus filing, the 10-K due date becomes the WKSI determination date. Thus, the issuer ceases to be a WKSI if it misses the 10-K filing deadline. Additionally, if the issuer has a late 10-Q or (non-safe harbor) 8-K, WKSI status ceases on the filing of the 10-K (or the 10-K due date), for non-timeliness. (Until loss of eligibility, the WKSI is in ongoing use land.) When no longer a WKSI, the issuer would need to amend its S-3ASR on a form for which it is eligible.

A FEW PROXY SEASON ITEMS

Calculating the New Change-in-Control Benefit—Spread, Not FAS 123(R) Value

New S-K 402(j) essentially replaces the old 402(h)(2) disclosure of employment arrangements, and specifically requires quantification of post-employment benefits. With so much emphasis on 123(R) value in the December 22 SCT amendments (Rel. No. 33-8765), we began hearing questions whether 123(R) effects might be the basis for calculating the amount realizable upon acceleration of vesting of options and other equity awards in connection with a change-in-control. We think the appropriate measure here is still the intrinsic value (*i.e.,* spread) of the accelerated portion of an award (which normally would be a larger amount than the 123(R) accounting effect of acceleration—see the January-February 2007 issue of *The Corporate Executive* at pg 11).

On the related subject of the new 402(j) disclosure of estimated severance benefits, it is a good idea to include in this disclosure that there may be a re-negotiation upon actual termination. Scott Spector, of Fenwick & West in Palo Alto, says the Wrigley proxy, dated February 13, 2007, is a good early example of exit disclosure (and of incentive compensation targets in the CD&A). (Mark Borges is analyzing new proxy statements these days on his Compensation Disclosure Blog on CompensationStandards.com, including the exit compensation disclosures of Eli Lilly and Merck.)

Currency Fluctuations

In converting to dollars compensation paid to an NEO in a foreign currency, the conversion should be calculated as of the date each payment was made (not as of the last day of the fiscal year), which should minimize dramatic swings in compensation from currency fluctuations (*e.g.,* increases if the dollar declines in relation to the foreign currency). Also, fluctuations in dollar compensation based on foreign currency swings would not be considered cash payments relating to an overseas assignment that would be excludable under Instruction 3 to Item 402(a)(3) in determining NEO status.

The Pledged-Share Disclosure in the Beneficial Ownership Table (Margin Accounts)

A change to the S-K 403 table requires disclosure by NEOs and directors of the number of shares pledged as collateral for indebtedness. Most executives these days end up holding their shares in a brokerage account, *e.g.,* a cash management account, where there may be a loan balance from time to time that technically is a margin loan secured by issuer shares and any other securities and assets in the account. Even though there may be substantial other assets in the account, the issuer stock technically can be sold out (first) in a margin sale.

The purpose of the new disclosure is to inform of circumstances that could have the potential to influence performance and decisions (see Rel. No. 33-8732A, August 29, 2006, at Section IV), as well as the possibility of a sudden change in control or sale of a significant block of issuer stock. [As our readers may recall, shares pledged by an affiliate may be freely sold by the pledgee without regard to Rule 144, so long as the shares have been held for two years by the pledgor and pledgee (combined); Rule 144 applies if less than two years, and no sales are permitted during the first year if the shares are "restricted securities" (which is unlikely, in that restricted securities normally aren't accepted as collateral). (See our January-February 1985 issue at pg 6.)]

Generic Disclosure?

Some issuers would like to avoid detailed footnote disclosure of the number of shares that each NEO and director may hold in a brokerage account (as opposed to pledged to a bank, etc. for a loan), citing (i) privacy concerns and (ii) that in most cases the information is meaningless/not material. Besides allowing executives to remove some or all of their issuer stock from a margin account, some issuers may (despite the express requirement to disclose the "number" of shares) utilize a generic footnote that some or all of the shares included in the table may be subject to margin accounts.

Five Percent Owners

The new pledge disclosure does not apply to 5% owners (who are otherwise covered in the 403 table). (The pledge of shares is reportable by 5% owners on Schedule 13D, but we suspect many do not comply with this requirement in the margin account context.) [The ABA had suggested in its May 15 comment letter on the proposing release that *hedging* of issuer stock also be disclosed in the 403 table, but instead the Commission indicated (at Section IV of the adopting release) that Section 16 reporting of hedging (see Model Forms 162 and 163 in Alan Dye's *Section 16 Forms and Filings Handbook* (2005)), together with the ability to address hedging in the CD&A (*e.g.*, the issuer's policy on hedging) should suffice. Here again, 13D should pick up any hedging by 5% owners.]

Grant Timing Policy—Blackout

Most issuers, we expect, are adopting some sort of grant timing policy, to be discussed in the CD&A. If the policy is intended to prevent "spring-loading" (*e.g.,* grants prior to the announcement of material information), and includes fixed grant dates, there needs to be enough leeway to impose a blackout when undisclosed material information (*e.g.,* a merger agreement) is pending. That raises the problem, however, of having to explain why, if and when a blackout is imposed. A blackout imposed on insider trading for similar reasons normally wouldn't be as visible as a *grant* blackout, which can affect many employees. Any grant timing policy should also provide leeway for new hires.

Increased Incidence of Auditor Ratifications

ISS notes that 94% of last season's S&P 500 proxy statements included auditor ratification. Interestingly, when the election of directors becomes a "non-routine" matter next year (see our January-February 2007 issue at pg 2), auditor ratification will often be the sole routine matter, and uninstructed broker voting on auditor ratification will provide a source for quorum shares.

Nasdaq "Harmonizes" Its Independence Definition—Compensation, Not All Payments

As our readers may recall, Nasdaq issuers are required to meet the director independence requirements specified in Nasdaq Rule 4350, including (i) a majority of the board of directors must be independent, (ii) all members of the audit committee must be independent, (iii) executive officer compensation must be determined (or recommended to the board) by a compensation committee comprised solely of independent directors or by a majority of the independent directors, and (iv) nominees to the board must be selected or recommended by a majority of the independent directors or a nominating committee comprised solely of independent directors.

Nasdaq Rule 4200(a)(15) vests in the board of directors the determination whether a director is independent for the above purposes (a director may, however, be subject to the automatic disqualifiers in Rule 4350), providing that a director will be independent only if, in the opinion of the board, he or she does not have a relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. (The NYSE has a similar requirement, providing in NYSE Section 303A.02(a) that a director is independent only if the board makes an affirmative determination that the director has no material relationship with the issuer.)

Among Nasdaq's automatic disqualifiers is any relationship under which the director or any "family member" of the director (as defined in Rule 4200) received payments from the issuer in excess of $60,000 (proposed to be increased to $120,000 to match new S-K 404(a)—see Rel. No. 34-54797, November 20, 2006) during any 12-month period within the last three years (subject to a list of exceptions, including compensation for service on the issuer's board, dividends paid on issuer securities, benefits under a qualified plan or a non-qualified deferred compensation plan, payments on ordinary-course loans from a financial institution, banking transactions not disclosable under S-K Item 404(a), and personal loans not prohibited by SOX Section 402). (See Rule 4200(a)(15)(A).)

Compensation vs. Payments

When Nasdaq first adopted its definition of independence in 1999, a director was disqualified for receiving "compensation," not "payments," in excess of $60,000 (consistent with a recommendation in the 1999 report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees). Following Enron's collapse and the enactment of SOX, Nasdaq broadened this disqualifier in 2002 to cover any "payments." Since then, Nasdaq has encountered instances where non-compensatory payments to a director were not within the intended scope of the rule, and those instances led to additions to the list of exceptions from disqualification that appear in the rule.

Nasdaq apparently has continued to hear from its issuers regarding various types of payments that Nasdaq believes did not warrant mandatory disqualification. Rather than continue to add exceptions to the rule, Nasdaq last year applied to the SEC to amend its independence definition to go back to precluding (just) compensation, not all payments. See Rel. No. 34-54333 (August 18, 2006); the SEC approved the rule changes in Rel. No. 34-54583 (October 6, 2006).

NYSE Counterpart

The NYSE has a disqualifier similar to Nasdaq's, providing that a director is not independent if he or she has received more than $100,000 in "direct compensation" from the issuer during any 12-month period in the last three years. See NYSE Section 303A.02(b)(ii). Even there, issuers have been concerned that direct compensation might include too broad a range of payments. The NYSE has addressed this concern to some extent in Question 10 of its 2004 FAQs on Section 303A, which says that, in determining whether a director is disqualified under Section 303A.02(b)(ii), the issuer "must determine that there is or was an obligation for services by the director." This statement suggests that the NYSE views "compensation" as payment for personal or professional services, a conclusion borne out by other FAQs (in which the NYSE has taken the position that compensation does not include (i) payments made pursuant to a severance package or a non-compete arrangement, (ii) dividends or interest, or (iii) expense reimbursements). NYSE staff reviews relationships on a case-by-case basis, however, so it's best to consult with them in close or unusual cases.

Applicability of NYSE FAQs to Nasdaq Independence Rules. Nasdaq indicated in its application to the SEC that the rule change was intended to harmonize Nasdaq's rule with the NYSE's, so the FAQs building up at the NYSE may be useful to Nasdaq issuers in analyzing independence under Nasdaq's proposed new definition. Nasdaq's revised rule, however, specifies one form of payment that will be considered compensation regardless of how the NYSE interprets its rule: political contributions to the campaign of a director or a director's family member. (We don't know how the NYSE would handle this one.)

Director's Service as Interim Executive Officer

Nasdaq's independence definition also disqualifies any director who was employed by the issuer at any time during the past three years. (See Rule 4200(a)(15)(A).) The revised rule adds an exception for a director's service as an interim executive officer for less than one year. (This change, too, is a harmonizer; the commentary to NYSE Section 303A.02(b)(i) provides that service as an interim executive officer is not employment by the issuer that results in automatic disqualification.) Compensation to the interim officer also would not constitute disqualifying compensation under Nasdaq Rule 4200(a)(15)(B).

ISS's Director Independence Criteria Stricter Than SROs'—What Happens If ISS Criteria Not Met?

In its Corporate Governance Policy, updated November 15, 2006, ISS purposefully does not conform its director independence guidelines to the SRO definitions. They feel like there were there first, their purposes aren't necessarily the same as the SROs, and their standards are stricter. Moreover, they don't want to get involved with differences between the various SROs, or with changes and interpretations of those rules.

10A-3 Requirement. Rule 10A-3, derived from 1934 Act Section 10A(m)(1) (SOX Section 301), imposes stricter conflict standards on directors who are audit committee members. (See our March-April 2004 issue at pg 10.) Thus, even an indirect interest in a consulting, etc. fee can render an audit committee member non-independent.

Updating the Entire Amended Item When Filing a Form 10-K/A?

Rule 12b-15 provides that an amendment to a 1934 Act report must set forth "the complete text of each item as amended." So, for example, if an issuer files a Form 10-K/A to add a material legal proceeding that was extant at the date of the 10-K filing but was mistakenly omitted from Part I, Item 3 of the original filing, the issuer must restate Item 3 in its entirety, disclosing both the omitted proceeding and the proceedings originally disclosed.

A reader recently asked whether the amended item also must be updated through the date the amendment is filed, to pick up any developments that have occurred since the date of the original filing. The question here is whether the amendment speaks as of the date it is filed or, instead, as of the date of the original filing.

Our view is that a 10-K/A speaks as of the date of the original filing (not the FYE—see our September-October 1995 issue at pg 9), and that the issuer is not obligated to update the (entire) amended Item through the date of the amendment. In our example, therefore, the issuer would not need to review all of its pending

legal proceedings for the purpose of updating the status of any previously disclosed proceedings or adding any others that arose after the date of the original filing. Similarly, if the issuer files a 10-K/A to disclose (in Part III, Item 13) a related person transaction mistakenly omitted from the 10-K, the issuer would not need to recirculate the D&O questionnaire to flush out other transactions that occurred after the original filing, even though Item 404(a) requires disclosure through the "latest practicable date" (which would be the cut-off date in the original filing). [If the amended Item were updated to the date of the amendment, what then of other Items in the 10-K that might be affected by the updating, *e.g.,* MD&A?]

Issuers often say, in an explanatory note at the beginning of the 10-K/A, that the amendment is being filed to add or correct a particular disclosure, and that the remaining information in the amended Item speaks as of the date of the original filing. While this explanation is not necessary to avoid a "duty to update," we think issuers include it to, *e.g.,* limit the ability of a plaintiff's attorney to allege that investors reasonably believed that the Item (or even the entire 10-K) was updated through the date of the amendment.

Updating the Cover Page. Although the 10-K/A would speak as of the date of the original filing, issuers often choose to update identifying information on the cover page that has changed since the original filing (*e.g.,* to reflect a change in the issuer's name, address, telephone number or SEC file number). We suppose an issuer could also choose to update the other information on the cover page (*e.g.,* the number of shares outstanding, the value of the public float, whether the issuer is a WKSI, or whether the issuer has filed all required reports during the preceding 12 months), but we don't think the issuer has an obligation to do so, and we suspect that most issuers would rather not invest the time and energy (or otherwise create an overall impression of updating).

Practice Tip—Staff Looks At Analysts' Reports, Etc.

As part of its 1934 Act 10-K, etc. review process, the Staff often examines analysts' reports on the issuer, and even listens to analyst conference calls. The idea here is not a fishing expedition, but to better understand the issuer's financial issues, to glean the quality of extant analysis (which may be relevant to whether better disclosure by the issuer is needed), and to see whether questions that are raised by analysts, etc. are being addressed.

NEW DEVELOPMENTS

Shareholder Proposal Update

David Lynn, who heads up Corp Fin's Chief Counsel's office, reported on the current shareholder proposal season at the Fall ABA Federal Securities Regulation meeting in DC in December. He says Ted Yu and Tamara Brightwell are the shareholder proposal point persons on the ground this year. The average response time for issuer no-action requests is the usual 40 days, but the earlier in the season (December to mid-January) the better.

Procedural Shibboleths

Lynn points out that Rule 14a-8(k) requests (but doesn't require) that the proponent supply the Staff with copies of its correspondence with the issuer. (The issuer generally provides this correspondence in any event.) Also, a "bring down" letter from a broker, etc., affirming that the proponent's 14a-8(b) share ownership requirement is still met, is not necessary; the proponent need only state an intention to continue to meet the ownership requirement through the date of the meeting. And, the Staff would prefer not to have the issuer attach to its request letter copies of relevant/cited 14a-8 no-action letters, which are readily available to the Staff (although 14a-8 letters are still not available on sec.gov) and just clog up the Commission's (paper) public reference file.

Don't Count on the (i)(3) Approach, i.e., False and Misleading

As we have discussed (see our January-February 2005 issue at pg 5), the Staff isn't enamored with issuer requests to exclude a proposal based on (i)(3). The Staff doesn't want to get into editing shareholder proposals. However, at least two (i)(3) requests have been granted recently, *i.e.,* Sara Lee Corp. (September 11, 2006) and Johnson & Johnson (January 31, 2007).

Majority Vote Proposals

Obviously, there will be many majority vote proposals this year (unless issuers take the opportunity to adopt, or propose to shareholders, their own majority vote provision that satisfies proponents); note that, by adopting a board-only approved bylaw, the board retains the ability to change things down the road. Several of last

year's proposals fudged the precatory/mandatory aspects, calling for adoption of a bylaw or charter amendment "if practicable." These proposals were excludable under 14a-8(i)(1), because a proposal can't mandate something that must be approved by the board (*e.g.*, a charter amendment). This year, there is expected to be a flood of mandatory majority vote bylaw proposals, especially where last year a precatory proposal passed and wasn't substantially implemented (in some states, the shareholders alone can adopt a bylaw, *e.g.,* DGCL Section 109(a)).

Last season, issuers tried to rely on the (i)(10) "substantially implemented" exclusion to fend off majority vote proposals where they had adopted the Pfizer-type plurality voting with tender of resignation in lieu of majority voting. That doesn't work.

Executive Compensation

AFSCME is ramping up its proposal for an advisory voting on the SCT. The approach here is an annual non-binding shareholder referendum on an issuer's compensation policies (*a la* ratifying the auditor), instead of going after individual directors. We understand this approach already has been utilized in, *e.g.,* the UK and Australia.

The Staff reports that shareholder proposals this year for advisory/precatory votes on executive compensation are of three types: approval of the SCT, approval of the CD&A, and vote whether compensation is too high, too low or about right. Issuer 14a-8 response to the latter is that it's not actually a proposal because it doesn't call for any action by the issuer but rather asks the shareholders to express their view regarding actions already taken; the Staff appears to have rejected this "defense" (see, *e.g.,* Capital One Financial Corp., February 7, 2007).

Option Grant Dating and Timing Proposals

While backdating may be a thing of the past, investor proposals affecting the *timing* of equity grants will be common this year, *e.g.,* calling for grant dates that are fixed in advance or during window periods, even for non-executives. Adoption of a grant timing policy would dovetail with the new S-K 402(b) requirement to describe in the CD&A any such policy for early grants.

At the time Lynn spoke, the Staff hadn't yet ruled on the excludability of this kind of proposal, but we would think they will end up allowing it as a type of compensation proposal (especially given the electricity surrounding option dating). ISS says it won't penalize past backdaters that "confess and correct."

Proxy Statement Access

We had initially expected that the Commission, at its December 13 meeting, might formally adopt a position permitting the excludability of proposals allowing shareholders to propose director nominees in management's proxy statement, under 14a-8(i)(8) (*i.e.,* relating to the election of directors), in that the essence of the Second Circuit's *AIG* decision (September 5, 2006) was not that these proposals must be includable but that the Commission hasn't articulated an exclusionary position. That didn't happen. Moreover, on January 22, the Staff took the same tack, taking a "no-response" position to H-P's request to exclude AFSCME's access proposal, essentially allowing access proposals to go forward (at least where the Second Circuit is involved). (AFSCME's proposal is included in H-P's proxy statement (undated, distributed on or about January 23, 2007).) Apparently, AFSCME doesn't believe that H-P's majority voting bylaw (which switches to plurality voting if a shareholder nominates a person for election, *i.e.,* a contested election) obviates the need for access.

Obviously, the Staff/Commission recognize that the current majority voting activity (*i.e.,* shareholder proposals, issuer adoptions, and state law amendments—see our January-February 2007 issue at pg 1) is but a part of the shareholder access end game, and that jumping into the fray now on an interim basis, essentially cutting off all access shareholder proposals this year, was not the way to go.

Other Binding Proposals

AFSCME seems to be leading the mandatory trend. It intends to propose, *e.g.,* embedding in bylaws the independent chair requirement, and reimbursement for expenses of a (successful) shareholder proposal.

Immediate "Appeal" to the Commission

At San Diego, Corp Fin Deputy Director Dunn reported that these days it has become standard practice for issuers to include, at the end of their request letter, a provision to the effect that the letter shall also serve as immediate appeal to the Commission if the Staff denies the request. No word from the Staff on whether this technique works.

Impact of the Staff's Recent Backdating Restatement Relief on 8-K Item 4.02 Reporting

Enforcement's backdating roster seems to be holding in the 130s (we recently saw "140"). We still wonder whether more issuers will come out of the closet by the end of the 10-K season. [We had wondered why so many law firms seem to be interested in backdating matters. The answer seems to be that virtually all issuers have been looking into it, and when it is found at an issuer multiple law firms become involved ($$$).]

In consequence of the accounting Staff's recent road map for avoiding multiple restatements, even in instances where traditional restatement analysis would call for restatement (see the Accounting and Financial Reporting page on Corp Fin's web page and our November-December 2006 issue at pg 10), there will be fewer restatements of financial statements on Forms 10-K/A and 10-Q/A (vs. current footnote disclosure), especially fewer multiple restatements going back many years. However, we don't think that obviates the need to file an 8-K Item 4.02 report.

Even where the 10-K amendment/disclosure recommended by the Staff doesn't involve any restatement, *e.g.*, where disclosure alone in the most recent 10-K (or, possibly, the upcoming 10-K) suffices, we think 4.02 would still be triggered, in that 4.02 speaks to no longer relying on extant financials, not to an intention to restate. (The 4.02 report itself could parse that the issuer may end up going the one-10-K restatement route (or none) vs. multiple restatements.)

We would think that all those issuers already in the 4.02 pipeline, who now may not file restatements in reliance on the Staff's relief, would already have crossed the 4.02 threshold before the Staff issued the relief. Issuers that are still in the process of investigating backdating, however, may soon end up facing a decision whether to file an Item 4.02 report. In any event, the issuer must consider its disclosure obligations/responsibilities/reputation.

Edgar's New Search Capability

The Commission recently announced that it has added a full-text search feature to its Edgar database, applicable to filings (including attachments) within the last four years. While similar capability has been available for some time via pay services, we are pleased to see that the SEC is trying to make its information freely accessible to all (although the pay services appear to still have the superior product; more on that below).

How it Works

Full-text searching of Edgar allows users to search for specific information/disclosure filed by a particular issuer. For example, if an investor wants to know whether ABC Co. has reported an options backdating investigation, that information is now ascertainable with a quick search rather than sifting through all of ABC's filings. The search capability also allows users to find information being filed by all companies on a particular topic, *e.g.*, backdating again, or bonus determinations for executives, which could help companies shape their disclosure (or even policy) with regard to the same items. The service is especially useful for counsel looking for comparables when drafting or negotiating contracts, *e.g.*, finding "hits" in Item 601(b)(10) material contract exhibits.

To access the search feature, click on "Search for Company Filings" on the SEC's home page and then click on "Full-Text Search." The search function is typical of other search engines, and intuitive. So, *e.g.*, users can list several words to search for documents in which any of those words appear, or can add quotation marks around a phrase and search only for that phrase. Searchers may also make use of the typical Boolean operators (*i.e.*, "and," "or," and "not") and wildcard symbols (*i.e.*, "*" and "?"). [As many of our readers know, the asterisk is used to search for any number of unspecified characters (from zero on up) and may be used at the beginning or end of a word. For example, a search for "sec*" would match "sec," "securities," "secured," etc. The question mark is used to specify a single wildcard character and can be used anywhere in a word, *e.g.*, a search for "a?sorb" would match "absorb" as well as "adsorb."]

A Few Thoughts/Suggestions

Based on our initial review, we have some thoughts and suggestions about the new tool:

Search Options. The "Advanced Search" feature allows searches of specific categories, *i.e.*, filing type; company name, CIK code or SIC code; as well as limiting the results to specified dates. While these help to narrow searches, we would like to see even more fields to enable users to quickly find the information they are looking for, including the state of incorporation, market cap, LAF/AF/SBI status, and an option to exclude amendments to the same document.

Search Results Display. The search result page displays "hits" by listing the date of the filing, the type of filing, the company name, and an excerpt from that filing. However, the excerpt does not always include the searched terms, forcing the user to click through to the filing to determine whether the hit is relevant or not. We would like to see the results page show the actual "hit" in the few lines of text that it displays so that the user knows whether to click on the filing to investigate further. Additionally, if there are several "hits" in one document, the search results on occasion display them in a bundle, which makes it difficult to ascertain the context of each hit. Some of the pay services collect all the hits from one filing and allow the user to see more

easily the context of each before having to click through to the document; we would like to see Edgar do this as well.

Once a user clicks on a particular filing, the search terms are not highlighted within the filing, so the user must find the location of the hit(s). Searching the terms this way will take longer than if the hits were highlighted throughout the document, or if the user were able to jump to each hit rather than scrolling through the (sometimes lengthy) text.

No Capability to Search Comment Letters/Correspondence. We are unclear as to which Edgar documents the search feature does not cover. We performed several test searches using both the Edgar tool and a pay service tool and it appears that comment letters are not part of the searchable database, which would be unfortunate (hopefully, that's in process).

Accuracy/Completeness. Going hand-in-hand with the uncertainty about which documents are searched, as with all search engines, we are unsure about the accuracy and completeness of the new Edgar search tool. For example, a search for "exxon capital exchange" from January 1 to November 30, 2006 generates just three hits using the Edgar tool, but seven hits using the pay service. But "option* backda*" for the month of November 2006 displays hits in 28 documents via Edgar and zero via a pay service (possibly, because November filings hadn't yet been indexed for searching).

Same-Day Filings Searchable. It appears that Edgar searches includes filings that are made on that same day. We like that filings are able to be indexed and available quickly, so that the latest information is available through the full text search.

No "Help" Screen. The SEC has not provided a "help" screen although, as we have said, the standard searching techniques it uses are intuitive and appear to work.

Search of Entire SEC Website. Currently, users are able to search the website generally (speeches, no-action letters, litigation releases, etc.), and also search Edgar. We would like to see these two search functions merged so that a user can find information about the topic they are searching in one fell swoop. Ultimately, we would also like to be able to word-search each area of sec.gov separately, *e.g.*, all posted no-action letters.

SEC Invites Suggestions

The SEC notes that it is still developing the Edgar search function and plans to enhance it based on user feedback. Comments and suggestions for improvement can be sent to textsearch@sec.gov.

Staff Posting of Comment Correspondence—Update

On the subject of the Staff's publication of correspondence relating to its review of 1934 Act reports, 1933 Act registration statements, etc., Corp Fin Director John White proudly reports that Edgar has finally been tweaked (or, is it twanged?) and is up and running to accommodate what, in effect, are filings *by* the Commission. (See our November-December 2005 issue at pg 4.) White notes that by late January almost 9,000 sets of review correspondence had been posted, compared to only 500 by last March.

Moreover, the system is getting down close to the 45-day (after completion of a review) minimum lag time for publication. Thus, it now behooves counsel to have in mind, when responding to comments, that responses (as well as further questions raised by responses) will soon see the light of day.

No-Further-Comment Letters. The Staff is now regularly issuing letters advising issuers when its review is concluded. (That's when the 45 days should start.) And, these letters are included in the posting process. Counsel should ask for a no-further-comment letter when one has not been forthcoming. (Not asking, however, hoping that would delay the 45 days from starting, does not seem like a good idea, as the 45-day clock may be running nonetheless, and there could end up not being any letter in the public file signifying to the press, etc. that the subject issues have been resolved.)

Small Business Advisory Committee Recommendations—What Else is Happening?

We have discussed several of the Committee's non-§404 recommendations, in its report dated April 23, 2006. (See our May-June 2006 issue at pg 9.) Reading the tea leaves being sent out by senior Staff, we think Reg D reform (including easing up on the ban on general solicitation) is numero uno (which would also include an electronic Form D). Other capital raising recommendations include Nasdaq Capital Market (formerly, SmallCap) status and extending S-3 and Reg S-B to more companies.

Director Confidentiality—The Forgotten Issue in the H-P Board Saga

The recent public outcry over Hewlett-Packard's investigative methods in ferreting out the director(s) responsible for revealing confidential corporate information was not surprising given the invasiveness of some of those methods. But, we have a hard time dredging up much sympathy for any director who has clearly breached his or her confidentiality obligation to the company (and maybe Reg FD and even 10b-5). While we don't condone unlawful invasions of privacy, we think the press has overlooked the other side of this issue (presumably, the regulators haven't), possibly because the press is not interested in stemming the flow of information from confidential sources.

Deal Lawyers—Latest Issue Enclosed

The response to our new M&A practice practical print newsletter—*Deal Lawyers*—has been great. Enclosed, hot off the press, is the latest issue. As a loyal reader of *The Corporate Counsel*, you are able to take advantage of a special discount as a "thank you." We encourage you to take advantage of the no-risk trial to *Deal Lawyers* today. Call 925-685-5111 or use the no-risk form on DealLawyers.com.

Global Warming and the Impact on Corporate Law and Governance

On June 12th, learn how climate change will impact your daily practice during a full-day TacklingGlobalWarming.com webconference: "Tackling Global Warning: Challenges for Boards and their Advisors." As a "thank you" to our readers, this webconference will be provided on a complimentary basis and will provide guidance on, among other topics:

- The Board's Perspective: Strategic Opportunities and Fiduciary Duties
- Why You Need to Re-Examine Your D&O Insurance Policy
- The Investor's Perspective: What They Seek and Their Own Duties
- Disclosure Obligations under SEC and Other Regulatory Frameworks
- How (and Why) to Modify Your Contracts: Force Majeure and Much More
- Due Diligence Considerations When Doing Deals

The Latest Compensation Disclosures: A Proxy Season Post-Mortem, Part IV of our Crucial Web Conference: Wrapping up our 4-Part Web Conference providing the latest guidance on complying with the SEC's new executive compensation rules, tune in on June 20th to hear Mark Borges and Mike Kesner for a CompensationStandards.com webcast: "The Latest Compensation Disclosures: A Proxy Season Post-Mortem."

And then save the date for our October 9th Conference—"Tackling Your 2008 Compensation Disclosures: The 2nd Annual Proxy Disclosure Conference"—to be held in San Francisco and via nationwide video webconference. The agenda for this critical conference will be announced soon.

And More Timely Webcasts

Here is a list of upcoming webcasts on top topics:

- DealLawyers.com's webcast: "Deal Protection: The Latest Developments" (3/6)
- TheCorporateCounsel.net's webcast: "After McNulty: Changes in the Attorney-Client Privilege and Investigations" (3/8)
- The NASPP's webcast: "The IRS and Treasury Speak: Mid-Year Tax Update"—including the latest guidance on the new IRS 409A Regs (3/15)

October "Conference Week" in San Francisco: Save The Dates

October 9–12 will be a major Conference Week for our readers. On October 9, we will host the 2nd Annual Proxy Disclosure Conference: "Tackling Your 2008 Compensation Disclosures." On October 11, we will hold the "4th Annual Executive Compensation Conference." And, during the period from October 9–12, the NASPP Annual Conference will be taking place. As our colleagues will attest, the NASPP's Annual Conference has become 'a must' for counsel. So, we are holding all three conferences in one place—San Francisco—at the nicest time of the year. For more information, please go to Naspp.com.

JMB/MG

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