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A legal update from Dechert's Corporate Finance Group

SEC Staff Updates its Regulation S-K Interpretations

Last month, the staff of the Securities and Exchange Commission's Division of Corporation Finance updated and replaced its existing guidance regarding Regulation S-K.[1] These compliance and disclosure interpretations (C&DIs) replace prior telephone interpretations and other C&DIs[2] with one comprehensive update that includes some additional interpretive guidance as well as some minor clarifications and corrections to existing guidance.

The following are some of the highlights of new guidance contained in the staff interpretation, presented in order of the applicable Regulation S-K item (references in parentheticals are to the particular question (Q) or interpretive response (IR)).

Item 103 – Legal Proceedings

The facts and circumstances of a proceeding against an officer which may require a company to indemnify such officer, and not the mere possibility of such indemnification, will determine if disclosure is necessary under Instruction 4 to Item 103 (Q 105.03).

Items 308 and 308T – Internal Control Over Financial Reporting

No internal control report is required in a Form 11-K report regarding a company's employee stock purchase plan (Q 115.01).

A non-accelerated filer's failure to provide management's report on internal control over financial reporting renders the annual report materially deficient. Therefore, the company's stockholders cannot rely on Rule 144, nor may the company file new Form S-8 registration statements, until the Form 10-K is amended to include this report. Moreover, even if the company amends its Form 10-K to include this report, the company will not be eligible to file new Form S-3 registration statements or use existing Form S-3 registration statements since the company would be current, but not timely, in its filings (Q 115.02).

Item 401 – Directors, Executive Officers, Promoters and Control Persons

Item 401(f)(1) requires disclosure regarding legal proceedings in foreign countries which are

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1 The new interpretations may be found at http://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm.

2 The new interpretations replace Regulation S-K and Regulation S-B interpretations in (i) the July 1997 Manual of Publicly Available Telephone Interpretations; (ii) the March 1999 Interim Supplement to the Manual of Publicly Available Telephone Interpretations; (iii) the November 2000 Current Issues and Rulemaking Projects Outline; (iv) the 2007 C&DIs on Items 201, 402, 403, 404, and 407; and (v) the March 2008 C&DIs on smaller reporting companies.

comparable to petitions under federal bankruptcy laws or state insolvency laws (Q 116.04).

Items 402 and 407 – Executive Compenstion and Corporate Governance

A company must disclose performance targets which are material in the context of the company's executive compensation program and the company may distinguish between qualitative/subjective performance goals and quantitative/objective performance goals. There is no requirement that a company provide quantitative targets for inherently subjective or qualitative assessments. Performance targets which are material may only be omitted if the disclosure would result in competitive harm to the company. A company must undertake a competitive harm analysis and reach a reasoned basis for concluding that disclosure would cause competitive harm in order to omit performance targets (Q 118.04).

Benchmarking disclosure is required if a company uses compensation data of other companies as a reference point, but not if the company merely considers a broad-based third-party survey for a more general purpose (Q 118.05).

A company's compensation committee disclosure should discuss any role a compensation consultant plays in determining executive or director compensation, whereas a consultant's material role in the company's compensation-setting practices and decisions should be discussed in the Compensation Discussion and Analysis (CD&A) (Q 118.06 and Q 133.08).

Compensation for all executive officers should be computed on the same basis for determining whether such executives are included in the Summary Compensation Table. Accordingly, the reversal of FAS 123R expenses for all executive officers should be considered in ranking the most highly compensated executive officers, even if any of such executive officers were not previously included in the Summary Compensation Table for prior years (Q 119.12).

Where the instructions to the Summary Compensation Table do not specifically limit footnote disclosure to the company's last fiscal year, footnote disclosure for prior years should only be included if it is material to an investor's understanding of the compensation reported for the company's last fiscal year (Q 119.114).

An instruction to the Summary Compensation Table requires the company to disclose valuation assumptions in connection with any stock or option award that was recognized in the most recent fiscal year. Generally, this can be accomplished by referencing the financial statements (or the associated footnotes) for the year in which each award was granted. It is not sufficient, however, to refer to financial statements for only the most recent fiscal year if awards granted in prior fiscal years were recognized during the most recent reporting year. For awards granted in the most recent fiscal year, this footnote disclosure may be satisfied by referring to the Grants of Plan-Based Awards Table if such assumptions are reported in that table (Q 119.15 and Q 119.16).

A cash retention bonus that is not a non-equity incentive plan award should not be reported in the Summary Compensation Table until the executive has satisfied the performance condition. However, such a bonus should be discussed in the CD&A for the year when the company agreed to pay such bonus and for subsequent years through the executive's satisfaction of the performance condition (Q 119.17).

Vesting information for awards reported in the Outstanding Equity Award at Fiscal Year-End Table may be provided by adding a grant date column to the table and disclosing the standard vesting schedule of such awards, provided that the company must disclose any vesting schedules which deviate from the standard schedule (Q 122.02).

The Nonqualified Deferred Compensation Plan Table must provide information on each plan on a plan-by-plan basis (Q 125.03). In addition, this table should include contributions credited to a so-called "excess plan" after the close of the current fiscal year if those contributions relate to an executive's qualified plan benefit for the current fiscal year (Q 125.04).

Executive X was the principal executive officer (PEO) of publicly-traded, consolidated parent and subsidiary companies. Executive Y was an executive officer of the publicly-traded parent company and the principal financial officer (PFO) of the public subsidiary. The parent company paid all of the salary payments to such officers who served both companies, even though such compensation was allocated between the two companies pursuant to intercompany accounting. The parent should include all of the PEO's compensation in the Summary Compensation Table and should include all of the other executive officer's compensation in determining whether such officer is includible in the

Summary Compensation Table. The subsidiary should report the respective percentage of the compensation allocated to its own books with respect to the PEO and PFO and each company's Summary Compensation Table should include footnote disclosure explaining the extent to which the same compensation is reported in both tables (IR 217.09).

Item 405 – Compliance With Section 16(a) of the Exchange Act

If a late Form 5 with respect to 2007 (which was due to be filed in February 2008) is disclosed in the 2007 Form 10-K and the proxy for the 2008 annual meeting, such disclosure does not need to be repeated in the 2008 Form 10-K or the proxy for the 2009 annual meeting (IR 231.01).

Item 507 – Selling Security Holders

A company may add or substitute selling shareholders to a registration statement by prospectus supplement (filed under Rule 424(b)(7)) if the company was eligible to rely on Rule 430B when the registration statement was originally filed. (IR 240.02).

Disclosure is required regarding the individual who owns a security account as well as the investment advisor who manages such accounts. This is required since both are viewed as security holders, given their shared power to vote and sell the securities held in the managed accounts (IR 240.03).

A resale registration statement which names several investment funds as selling security holders must name the individuals who have or share voting or investment power for each fund, regardless of whether such power is controlled by an investment committee consisting of a large number of individuals who each have a vote (IR 240.04).

Item 601 – Exhibits

A Form 10-Q's exhibit list only needs to list those exhibits actually filed as part of, or incorporated by reference into, the Form 10-Q (Q 146.03).

An agreement which was material when executed must be filed as an exhibit even if such agreement is no longer material to the company by the end of the reporting period during which the agreement was executed (Q 146.06).

Item 601(b)(31) certifications must be provided if the company is filing a special financial report on Form 10-K; however, paragraphs 4 and 5 of the certification may be omitted since the report will not contain Item 307 or 308 disclosures (Q 146.08).

An employee benefit plan under which registered securities will be issued should be filed as an exhibit to the applicable registration statement on Form S-8 (Q 146.10).

If a perquisite is separately identified and quantified in the company's proxy statement, then the written arrangement pursuant to which an executive officer receives such perquisite need not be filed as a "material contract" (Q 146.11).

If a company inadvertently omits part of the Section 302 certification in its first Form 10-K filing containing management's report on internal control over financial reporting, the company may file a Form 10-K/A which contains only the cover page, an explanatory note, the signature page, and paragraphs 1, 2, 4, and 5 of the Section 302 certification. However, if the same mistake is made the following year, the company will be required to file a Form 10-K/A with financial statements and full Item 9A disclosure (IR 246.13).

A company must file a corrected Section 302 certification accompanied by a full periodic report if (i) the wrong periodic report is identified in paragraph 1 of the certification; (ii) a conformed signature is omitted above the signature line at the end of the certification; (iii) there is no date on the certification; or (iv) the signors are neither the principal executive officer, principal financial officer, or persons performing equivalent functions (IR 246.14).

Item 701 – Recent Sales of Unregistered Securities

No disclosure is required regarding the anticipated use of proceeds. Disclosure is only required regarding actual expenditures (Q 147.01).

A company must provide use of proceeds disclosure in its first periodic report filed after the effective date of its first registration statement, even if the registration

statement covers a best-efforts offering that has not yet closed when the periodic report is filed (IR 247.02).

If a company registers shares for sale to the public and shares for issuance under employee benefit plans under the same initial public offering registration statement, use of proceeds disclosure is only required for the shares sold to the public (IR 247.04).

Item 703 – Purchases of Equity Securities by the Issuer and Affiliated Purchasers

No disclosure is required in connection with net option exercises; however, repurchase disclosure is necessary if shares are withheld in addition to the shares necessary to pay taxes or the exercise price. In addition, disclosure is necessary if the option exercise price is paid with company stock that the holder otherwise owns (Q 149.01).

No repurchase disclosure is required if a holder of restricted stock forfeits the stock upon failure to satisfy vesting conditions (Q 149.02).

If a company receives shares back from a vendor in a settlement of litigation, Item 703 disclosure is required regarding these shares (IR 249.01).

If an investor delivers a promissory note to a company to purchase stock from the company in a private placement and then the parties agree that, due to the investor's inability to repay the note, the investor will forfeit the stock in exchange for the cancellation of the note, the company must report the forfeiture of pledged stock as an issuer repurchase under Item 703 (IR 249.02).

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This staff update is a helpful, comprehensive compilation of prior and new staff guidance regarding Regulation S-K. We suggest that reporting companies review this guidance to ensure that they continue to satisfy their disclosure obligations.

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For more information, please contact one of the lawyers listed, the Dechert attorney with whom you regularly work, or visit our Corporate Finance page.

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