

What Late SEC Filers Need to Know

Article contributed by:

Kevin C. Smith, Chadbourne & Parke LLP

In the wake of regulations implemented by the Securities and Exchange Commission under the Sarbanes-Oxley Act of 2002, including increased disclosure in periodic SEC reports (*e.g.*, Section 404 internal control assessment) and accelerated filing deadlines for those reports, as well as increased scrutiny from regulators, a number of public companies have missed their annual 10-K or quarterly 10-Q filing deadlines. Add to that the significant expansion of events that now trigger current reporting with the SEC on Form 8-K and the compressed 8-K filing deadline, and what was once a relatively rare occurrence for many public companies -- missing an SEC filing deadline -- has become a reality. If you are in the legal or finance department of a public company that finds itself missing an SEC filing deadline, these are some of the important issues that you need to be thinking about.

Notification to SEC of Inability to File on Time

If an annual report on Form 10-K or a quarterly report on Form 10-Q is not filed within the required time period, the issuer must file with the SEC within one business day of the due date for the report a Form 12b-25 (designated as an "NT 10-K" or "NT 10-Q" in the EDGAR filing system) disclosing its inability to file the report timely and the reason for the delay. If a Form 10-K or Form 10-Q cannot be filed timely, because the company is unable to file "without unreasonable effort or expense", the report will be deemed to be filed on the filing due date if the company timely files a Form 12b-25, and then files the report not later than the 15th calendar day (for a 10-K) or 5th calendar day (for a 10-Q) following the due date for the missed report.

Note that Rule 12b-25 filing extensions are not available for Form 8-K filings.

Violation of the Exchange Act; SEC Enforcement

The failure to file a required SEC report on time constitutes a violation of Section 13(a) of the Exchange Act and the SEC could institute an administrative proceeding against the late filer, among other things, seeking revocation of the company's registration under the Exchange Act. These proceedings by the SEC are uncommon and are typically aimed at recurring and egregious violations.

Disclosure Issues; Insider Trading Concerns

Companies listed on the NYSE or Nasdaq are generally required to issue a press release announcing the failure to file timely a periodic report. Late filers typically file a Form 8-K under Item 8.01 (Other Events) reporting the late filing by attaching a copy of the press release. In addition, companies that receive a notice of delisting or failure to satisfy a continued listing rule or standard must report the notice on Form 8-K under Item 3.01. As discussed below, the NYSE also strongly encourages companies to provide ongoing disclosure on the status of a delinquent annual filing to the market through press releases.

Companies that have previously relied on Form S-3 for shelf takedowns and that have become ineligible to utilize Form S-3 or to takedown from an existing effective Form S-3 should consider whether disclosure of this change in S-3 eligibility and ability to use an existing shelf registration should be included in future reports (*e.g.*, in the Liquidity and Capital Resources section of Management's Discussion & Analysis).

Of course, material information concerning the underlying reasons for a delinquent periodic report may raise disclosure issues under Rule 10b-5, the SEC rule that is interpreted to prohibit a person in possession of material nonpublic information about a company (including the company itself) from purchasing or selling that company's securities. If material nonpublic information concerning the reasons for a late SEC report is in the possession of the company or its officers and directors, company share repurchases and insider trading should be halted. Companies should also consider refraining from granting stock options during this period as the SEC staff has expressed serious concerns with the timing of option grants when material information concerning the company is not yet publicly disclosed.

Senior management and investor relations departments are likely to face ongoing questions regarding the issues underlying a delinquent periodic report as well as the timing of addressing those issues. It would be worth reminding those responding to such questions of the company's obligations under Regulation FD, which prohibits selective disclosure of material nonpublic information.

NYSE and Nasdaq Listing Requirements

Companies listed on the NYSE or Nasdaq face possible delisting if they become delinquent in their SEC filings.

NYSE

Applicable NYSE rules require companies to file annual reports on Form 10-K with the SEC in a timely manner or face possible delisting. The NYSE recently codified existing procedures for companies that fail to file timely their annual reports. Under these rules, the NYSE will notify a late filer of its delinquent status, and within five days of receiving the notice, the company must contact the NYSE to discuss the status of the annual report filing and issue a press release disclosing the status of the filing. If the company does not issue a press release, the NYSE itself will do so. The NYSE will also attach an ".LF" indicator to the company's ticker symbol.

During the nine-month period after the filing due date, the NYSE will monitor the company and the status of the filing, including through contact with the company, until the annual report is filed. If the company fails to file the annual report within nine months after the filing due date, the NYSE may, in its sole discretion, allow the company's securities to be traded for up to an additional three-month trading period depending on the company's specific circumstances. If the NYSE determines that an additional trading period of up to three months is not appropriate, it will commence suspension and delisting procedures.

In determining whether an additional trading period of up to three months is appropriate, the NYSE will consider the likelihood that the overdue filing can be made during the additional period,

as well as the company's general financial status, based on information from a variety of sources, including the company, its audit committee, its outside auditors, the staff of the SEC and any other regulatory body. The NYSE strongly encourages companies to provide ongoing disclosure to the market on the status of the annual report filing through press releases, and will also take the frequency and detail of such information into account in determining whether an additional three-month trading period is appropriate.

NYSE rules also provide that at any time the NYSE deems it necessary or appropriate in the public interest or for the protection of investors, trading in any security can be suspended immediately, and application made to the SEC to delist the security.

Nasdaq

Under applicable Nasdaq rules, listed companies must comply with SEC filing requirements. Nasdaq-listed companies face delisting for missed quarterly 10-Q filings as well as for missed annual 10-K filings. If a listed company is delinquent in its annual or quarterly filing obligations, Nasdaq (unlike the NYSE) will issue without delay a delisting letter to the company, which will then have seven calendar days to request a hearing with the Nasdaq Hearing Panel. Nasdaq will also append a fifth character, "E," to the company's trading symbol until the company has fulfilled its filing obligations. Pending the outcome of the hearing, the company's securities generally will remain listed. In certain limited instances, trading in the securities may be halted during the pendency of the hearing process (*e.g.*, if the company has announced that its financial statements can no longer be relied upon).

Companies that receive a delisting letter from Nasdaq are required to issue a press release announcing the receipt of Nasdaq's letter and the basis therefor. Failure to issue the press release within seven calendar days of receipt of Nasdaq's letter will result in the implementation of a trading halt.

At a hearing before the Nasdaq Hearing Panel, companies facing delisting as a result of delinquent SEC filings are generally expected to provide an estimated date by which they will become current in all SEC filing obligations together with a schedule of actions to be completed by the company and its auditors. The company should describe any expected adjustments or restatements relating to the financial statements contained in prior filings. The company should also provide copies of all public disclosures pertinent to the filing delinquency or forthcoming restatements.

In July 2005, Nasdaq posted a new FAQ for listed companies that asks whether a Form 10-K satisfies Nasdaq's filing requirements if management has not completed its assessment of internal control over financial reporting or the auditor's related attestation report contains an opinion that is disclaimed because the auditor did not have time to complete its internal control work. Nasdaq's answer is that the Form 10-K would not satisfy Nasdaq's filing requirements, and the company would ordinarily be subject to being delisted.

However, Nasdaq acknowledges that during the first year of implementation of Section 404 of Sarbanes-Oxley, it has proven difficult for certain companies to complete their internal control assessment and file their 10-K without disclaimed opinions. As a result, after consultation with

the SEC staff, Nasdaq has determined that during calendar 2005, management's failure to complete its internal control assessment or an auditor's opinion that is disclaimed, based on a lack of time to complete internal control work, will not result in delisting, provided the company is taking all steps required by the SEC staff to address these issues.

Form S-3 and "WKSI" Eligibility

Form S-3 is a short-form registration statement that permits issuers to incorporate by reference to Exchange Act reports much of the information that would otherwise be required to be set forth in a long-form registration statement on Form S-1. Form S-3 is commonly used by seasoned issuers to put in place debt, equity or universal "shelf registrations" under which future securities offerings can be accomplished through "takedowns" from the shelf with relative speed. Among other eligibility requirements, in order to utilize Form S-3, issuers must have *timely* filed all required reports (including annual 10-Ks, quarterly 10-Qs and certain current 8-Ks) under the Exchange Act during the twelve calendar months and any portion of a month immediately before the filing of the registration statement.¹

Thus, if a company has missed a filing date for a Form 10-K or a Form 10-Q (and has not filed the report within the permitted 12b-25 grace period), absent a waiver from the SEC, it will not be eligible to file a Form S-3 registration statement until filings with the SEC have been timely made for a full year.²

Recognizing the hardship that could result from S-3 ineligibility caused by a missed 8-K filing, the SEC, when it adopted the new 8-K requirements in 2004, revised Form S-3 to provide that failure to file timely certain 8-K reports will not result in S-3 ineligibility. The Form 8-K reporting items covered by this exception are Items 1.01 (entry into a material definitive agreement), 1.02 (termination of a material definitive agreement), 2.03 (creation of a direct financial obligation or an obligation under an off-balance sheet arrangement of a registrant), 2.04 (triggering events that accelerate or increase a direct financial obligation under an off-balance sheet arrangement), 2.05 (costs associated with exit or disposal activities), 2.06 (material impairments) and 4.02(a) (non-reliance on previously issued financial statements or a restated audit report or completed interim review).

All other 8-K reporting items are not covered by this exception and the failure to file timely under any of the remaining items will result in a loss of S-3 eligibility for twelve months. Moreover, a company must be current in all of its Form 8-K filings, including those excepted from the timely filing requirement, at the actual time of a Form S-3 filing. Thus, a company must have filed the disclosure required by any of the excepted Form 8-K items on or before the date that it files a Form S-3 registration statement.

Utilizing an Existing Form S-3 Shelf Registration

A public company that is late in filing an SEC report may already have an effective Form S-3 shelf registration statement on file with the SEC. The SEC staff has indicated that an issuer that becomes ineligible to use Form S-3 may continue to use an existing effective Form S-3, so long as there is no need to update the shelf registration statement.

Under applicable SEC rules, issuers are required to update an effective Form S-3, among other things, for purposes of Section 10(a)(3) of the Securities Act (which requires periodic updating of information in a prospectus) or for "fundamental changes." For S-3 eligible issuers, under existing rules updating for these purposes may be accomplished by post-effective amendment or incorporation by reference to the issuer's Exchange Act reports, but not by means of a prospectus supplement or sticker. Material information not rising to the level of a "fundamental change" could, however, be disclosed through a prospectus supplement.³

At the time updating for purposes of Section 10(a)(3) or for a fundamental change is required, if the issuer is no longer eligible to use Form S-3 as a result of delinquent SEC reporting, it may not rely on incorporation by reference to the issuer's Exchange Act reports once they have actually been filed and, instead, must file a post-effective amendment on whatever form is available to the issuer at that time to update the shelf registration statement. For these delinquent issuers, only Form S-1 would be available for post-effective amendments to update the shelf registration statement. And the post-effective amendment would have to comply with all the requirements of Form S-1, including a complete prospectus meeting the S-1 requirements, and would be subject to SEC review.

For purposes of determining whether an existing shelf registration on Form S-3 can be used by a delinquent Exchange Act filer, a key question becomes whether information in a missed SEC report constitutes a "fundamental change." Missing information that would have been contained in a delinquent Form 10-K (including audited financials for the latest fiscal year) would seem clearly to constitute a "fundamental change", and information that would have been included in a missed 10-Q filing may well constitute a "fundamental change." The SEC staff has recognized the possibility that 10-Q information may not amount to a "fundamental change" by noting in a publicly available telephone interpretation that "the quarterly results set forth in Form 10-Q could be included in the registration statement by sticker rather than post-effective amendment, so long as such information does not constitute a fundamental change in the information set forth or included in the registration statement." Thus, an issuer that has been late in filing a Form 10-Q could take the position that it may continue to use an existing effective Form S-3 shelf registration statement on the grounds that information in the late Form 10-Q did not constitute a "fundamental change." However, even if an issuer concludes that information in the Form 10-Q does not constitute a "fundamental change" and therefore can be disclosed through a prospectus supplement, underwriters in a shelf takedown may be uncomfortable with that conclusion and resist proceeding with an offering until the delinquent report is filed and the issuer again becomes S-3 eligible (or utilizes Form S-1).

A delinquent filer faced with a year of S-3 ineligibility could file a new Form S-1 for shelf offerings once it becomes current in its Exchange Act reports. However, Form S-1 shelf registrations may not be practical as Form S-1 does not provide for incorporation by reference. Alternatively, the issuer could simply allow the effective Form S-3 to remain dormant until it is once again eligible to use Form S-3 and resume its use. There would be no duty to update the dormant S-3 so long as it is not being used.

Form S-8 is the short-form registration statement used by public companies to register securities offered to employees under company employee benefit plans. In order to use Form S-8, an issuer must have filed all reports with the SEC required to be filed during the preceding twelve months. Unlike Form S-3, there is no requirement that reports have been *timely* filed for the prior twelve months. Thus, if a company has missed a 10-K, 10-Q or 8-K filing deadline, the company may not register securities to be issued under a benefit plan on a Form S-8 until the missed report is filed. But there is no need to wait twelve months in order to once again be S-8 eligible.

As is the case with Form S-3, applicable SEC rules require companies to update an effective Form S-8 for 10(a)(3) purposes and for "fundamental changes." And updating for these purposes is accomplished by incorporation by reference to the issuer's Exchange Act reports. If a Form 10-K or Form 10-Q filing is missed, and the incorporation by reference of the missed report would have otherwise satisfied a requirement to update the Form S-8 for 10(a)(3) purposes or for a "fundamental change," use of the existing Form S-8 should be suspended until the missed SEC report is filed.

Form S-4

Form S-4 is the form used by issuers to register securities issued in an exchange offer or as consideration in an acquisition. Form S-4 permits information with respect to the issuer to be incorporated by reference to the issuer's Exchange Act reports if the issuer meets the eligibility requirements for use of Form S-3. Otherwise, the required information regarding the issuer must be set out in the prospectus included in the S-4 registration statement.

If a late SEC filing results in S-3 ineligibility, another consequence will be the inability to incorporate Exchange Act reports into a Form S-4 registration statement until the issuer is again S-3 eligible (*i.e.*, after twelve months of current reporting).

Resales of Restricted or Control Securities Under Rule 144 Safe Harbor

Rule 144 under the Securities Act of 1933 provides a means for directors and officers of public companies and others to make unregistered public sales of restricted or control securities of the company without being deemed underwriters. Rule 144 eligibility is conditioned on satisfying several requirements including the availability of current public information about the company. Specifically, the company must have filed all reports required to be filed during the twelve months prior to the sale, other than Form 8-K reports (which the SEC decided to except from this requirement when it amended the 8-K rules in 2004).

A failure to file a required Form 10-K or Form 10-Q will result in the failure to satisfy the "current public information" requirement of Rule 144 and the inability of directors, officers and others to rely on the Rule 144 safe harbor until the late filing is actually made (at which time Rule 144 will become available immediately).

Indenture and Credit Agreement Covenants

Public company indentures and credit agreements often include an affirmative covenant to file timely SEC reports and/or to deliver copies of those reports to security holders and lenders or to

an agent or trustee on their behalf. Although the likelihood of a noteholder or lender delivering a notice of default solely as a result of a breach of a covenant to deliver SEC reports, absent a financial or other material covenant default, might seem small, it can happen. For example, in June 2005, Saks Inc., the department store owner, reported that it had received a notice of default from a hedge fund owning more than 25% of its convertible notes, with the notice claiming a breach of Saks' covenant to file required Exchange Act reports with the SEC and the trustee for the convertible notes.

Delinquent filers should review outstanding indentures and credit agreements to evaluate potential defaults. With regard to outstanding public debt, it may be useful to seek to determine if a substantial portion of the securities are held by a hedge fund or similar institution that might be more likely to call a technical default in an attempt to recover repayment at a premium over the price paid for the debt in the public marketplace.

Conclusion

If your company is delinquent in filing a report with the SEC, you need to be aware of the potential issues discussed above. The impact of a missed filing will vary depending on the nature of the missed report, the reasons underlying the delinquency and the company's anticipated timetable for ultimately making the required filing.

Kevin Smith is a partner in the corporate practice of Chadbourne & Parke LLP in New York. He represents public and private companies on a broad range of corporate and transactional matters, including mergers and acquisitions, joint ventures, dispositions, spin-offs, public and private securities offerings, and general corporate matters. Mr. Smith also regularly advises clients on corporate governance and Sarbanes-Oxley Act compliance matters.

¹ The SEC has adopted significant modifications to the securities offering and registration process under the Securities Act that become effective on December 1, 2005. One of the most important changes made by the new rules is the creation of a new category of issuers called "well-known seasoned issuers" (or WKSIs). WKSI status offers issuers a number of advantages under the new rules, including the ability to file automatically effective shelf registration statements. To qualify as a WKSI under the new rules, an issuer will, among other things, need to satisfy S-3 eligibility requirements. A detailed analysis of the possible consequences of late SEC filings on application of the new offering rules is beyond the scope of this article.

² Moreover, an issuer that otherwise qualifies as a WKSI under the new offering rules will lose its WKSI status.

³ Under the new SEC offering rules that become effective December 1, 2005, issuers will be permitted to update for "fundamental changes" through the filing of a prospectus supplement. The discussion that follows in this section will need to be re-visited once the new rules become effective and SEC interpretive guidance has been issued.