

November 8, 2002

SEC Proposes Rules Regarding Use of Non-GAAP Financial Measures and Requiring Filing of Earnings Releases

The SEC has proposed new Regulation G under the Securities Exchange Act of 1934 and proposed amendments to Regulation S-K and Form 20-F that, if adopted as expected, will significantly impact the ways in which all SEC reporting companies (both U.S. and non-U.S.) disclose or otherwise release non-GAAP financial measures (whether such disclosure is made in writing, such as an SEC filing or a press release, made orally, such as during an investor conference call; or made electronically, such as a posting on a website).

- Proposed Regulation G generally would require such companies to include a presentation of the most comparable GAAP financial measure and a reconciliation of the disclosed non-GAAP financial measure to the most comparable GAAP financial measure.
- Proposed additional disclosure rules would apply to non-GAAP financial measures included in SEC filings by U.S. or non-U.S. reporting companies.

The SEC has also proposed to amend Form 8-K, to require that earnings releases or similar announcements containing financial information for completed fiscal periods be filed with the SEC.

I. Mandate of the Sarbanes-Oxley Act

The proposals regarding non-GAAP financial measures are intended to implement Section 401(b) of the Sarbanes-Oxley Act (the "Act"), which directs the SEC to adopt rules requiring that any public disclosure or release of non-GAAP financial measures by a company filing reports under Section 13(a) or 15(d) of the Exchange Act be presented in a manner that:

- does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading; and
- reconciles the non-GAAP financial measure presented with the financial condition and results of operations of the registrant under GAAP.

The proposed amendment to Form 8-K is viewed by the SEC as in keeping with Section 409 of the Act and the SEC's own initiatives to promote rapid and current (or "real time") public disclosure.

II. Regulation G

A. Required Disclosure When Non-GAAP Measures Are Presented

Proposed Regulation G would provide that whenever a reporting company, or person acting on its behalf, *publicly discloses* material information that includes a non-GAAP financial measure, the company must accompany that non-GAAP financial measure with:

- a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP; and
- a reconciliation (by schedule or other clearly understandable method), which shall be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed or released with the most comparable financial measure or measures calculated and presented in accordance with GAAP.

If a non-GAAP financial measure is made public orally, telephonically, by webcast or broadcast or by similar means, the required accompanying GAAP information and reconciliation may be provided on the registrant's website. The information would have to be posted by the time the non-GAAP financial measure is made public and the location of the website must be made public in the same presentation in which the non-GAAP financial measure is made public.

With regard to the quantitative reconciliation of non-GAAP financial measures that are forward-looking, a schedule or other presentation detailing the differences between the forward-looking non-GAAP financial measure and the appropriate forward-looking GAAP financial measure would be required. If the GAAP financial measure is not available on a forward-looking basis, the company must disclose that fact, explain why it is not available on a forward-looking basis and provide any reconciling information that is available without an unreasonable effort. The company must also identify any information that is unavailable and disclose its probable significance.

B. General Anti-fraud Provision

Regulation G would also provide that a reporting company, or a person acting on its behalf, shall not make public a non-GAAP financial measure that, taken together with the information accompanying that measure and any other accompanying discussion of that measure, contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure, in light of the circumstances under which it is presented, not misleading.

C. "GAAP" versus "Non-GAAP" Financial Measures

For purposes of Regulation G, a non-GAAP financial measure would be defined as a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

- excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements); or
- includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the comparable measure so calculated and presented.

The definition of non-GAAP financial measure is meant to capture all measures that have the effect of depicting either:

- a measure of performance that is different from that presented in the financial statements, such as income or loss before taxes, or net income or loss as calculated in accordance with GAAP; or
- a measure of liquidity that is different from cash flow or cash flow from operations computed in accordance with GAAP.

An example of a non-GAAP financial measure would be a measure of operating income that excludes one or more expense or revenue items that are identified as “non-recurring.” Another example would be EBITDA (earnings before interest, taxes, depreciation and amortization), which could be calculated using elements derived from GAAP financial presentations but, in any event, is not presented in accordance with GAAP.

However, non-GAAP financial measures would not include (and Regulation G would therefore permit without further disclosure):

- operating and other statistical measures (such as unit sales, numbers of employees, numbers of subscribers, or numbers of advertisers); and
- ratios or measures that are calculated using only:
 - financial measures calculated in accordance with GAAP; and
 - operating measures or other measures that are not non-GAAP financial measures.

Non-GAAP financial measures would also not include financial information that does not have the effect of providing numerical measures that are different from the comparable GAAP measure. Examples of measures to which Regulation G would not apply include:

- amounts of expected indebtedness, including contracted and anticipated amounts;
- amounts of repayments that have been planned or decided upon but not yet made;
- estimated revenues or expenses of a new product line, so long as such amounts were estimated as GAAP figures; and
- profit or loss and total assets for each segment required to be disclosed in accordance with GAAP.

Examples of ratios and measures that would not be non-GAAP financial measures include sales per square foot (assuming that the sales figure was calculated in accordance with GAAP) or same store sales (again assuming the sales figures for the stores were calculated in accordance with GAAP). An example of a ratio that would be a non-GAAP financial measure would be a measure of operating margin where either the revenue component or the operating income component of the calculation, or both, were not calculated in accordance with GAAP.

D. Application to Business Combination Disclosure

Proposed Regulation G would apply to disclosures of non-GAAP projections or forecasts of results of business combination transactions (“post-transaction measures”) as well as non-GAAP financial measures that are used to calculate post-transaction measures. These might, for example, be filed with the SEC as information pursuant to the communications rules applicable to business combination transactions (e.g. Rule 14a-12 under the Exchange Act and Rule 165 under the Securities Act).

In the proposing release, the SEC solicited comments as to whether there should be an exception from certain of the requirements of Regulation G for post-transaction measures or other measures filed as information under the business combination rules. In addition, the SEC recognized that business combination communications often include brief statements regarding the potential benefits to be achieved by the business combination (e.g., synergies, valuations, dividend amounts, etc.) and asked if either instead of or in addition to the requirements of proposed Regulation G, the rules should specifically require the disclosure of any assumptions or bases underlying these measures.

E. Application to Foreign Private Issuers

For foreign private issuers whose primary financial statements are prepared in accordance with generally accepted accounting principles of a country other than the United States, references to “GAAP” in Regulation G would include the principles under which those primary financial statements are prepared.

Proposed Regulation G would not apply to a disclosure of a non-GAAP financial measure that is made by or on behalf of a foreign private issuer in circumstances similar to the existing exemptions for offshore press activities. The exception would apply if the following conditions are satisfied:

- the securities of the foreign private issuer are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States;
- the non-GAAP financial measure and the most comparable GAAP financial measure are not calculated and presented in accordance with generally accepted accounting principles in the United States; and
- the disclosure is made by or on behalf of the foreign private issuer outside the United States, or is included in a written communication that is released by or on behalf of the registrant only outside the United States.

This exception would apply notwithstanding the existence of one or all of the following circumstances:

- foreign or U.S. journalists or other third parties have access to the information, so long as the information is disclosed or released by or on behalf of the foreign private issuer only outside the United States;
- following its release or disclosure, the information appears on one or more web sites maintained by the foreign private issuer, so long as the web sites, taken together, are not available exclusively to, or targeted at, persons located in the United States; and/or
- following the disclosure or release of the information outside the United States, the information is included in a submission by the foreign private issuer to the SEC made under cover of a Form 6-K.

F. Consequences for Violations of Regulation G

A registrant's failure to include all of the information required to be included in a public announcement by Regulation G would not affect that registrant's form eligibility under the Securities Act or whether there is adequate current public information regarding the registrant for purposes of Securities Act Rule 144(c).

Section 3(b) of the Act provides that a violation of that Act or the SEC's rules thereunder shall be treated for all purposes as a violation of the Exchange Act. Therefore, if an issuer, or any person acting on its behalf, fails to comply with Regulation G, the issuer and/or the person acting on its behalf could be subject to a SEC enforcement action alleging a violation of Regulation G.

Regulation G would expressly provide that nothing in Regulation G shall affect any person's liability under Exchange Act Section 10(b) or Rule 10b-5 thereunder. Regulation G would also state that a person's compliance or non-compliance with the requirements of Regulation G would not affect that person's liability under Section 10(b) or Rule 10b-5. Nevertheless, the facts and circumstances surrounding a violation of Regulation G may give rise to a Rule 10b-5 violation if all the elements for a 10b-5 violation are present. In a prior release regarding the use of non-GAAP financial information, the SEC reminded companies that, under certain circumstances, non-GAAP financial measures could mislead investors if they obscure the company's GAAP results. Following that warning, the SEC brought an enforcement action against Trump Hotels & Casino Resorts, Inc., where it found the use of non-GAAP financial information to be materially misleading in violation of Section 10(b) and Rule 10b-5.

III. Changes to Regulation S-K and Form 20-F

A. Overview

The SEC has also proposed an amendment to Item 10 of Regulation S-K that would add a statement concerning the use of non-GAAP financial measures in filings made with the SEC. In addition, amendments to Form 20-F would incorporate Item 10 of Regulation S-K (as

proposed to be amended). These amendments would require registrants using non-GAAP financial measures *in filings with the SEC* to provide:

- a presentation, with equal or greater prominence, of the most directly comparable financial measure calculated and presented in accordance with GAAP;
- a quantitative reconciliation (by schedule or other clearly understandable method) of the differences between the non-GAAP financial measure disclosed with the most directly comparable measure or measures calculated and presented in accordance with GAAP;
- a statement disclosing the purposes for which the registrant's management uses the non-GAAP financial measure presented; and
- a statement describing the reasons why management believes such non-GAAP financial measures provide useful information to investors.

In addition to these mandated disclosure requirements, Item 10 would be amended to prohibit the following:

- presenting a non-GAAP financial measure in a manner that would give it greater authority or prominence than the comparable GAAP financial measure or measures;
- excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures;
- adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur;
- presenting non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes;
- presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X;
- using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures; and
- presenting a non-GAAP per-share measure.

The requirement of Regulation G that the presentation of a non-GAAP financial measure, taken together with the information accompanying the measure and any other accompanying discussion, not contain a material misstatement or material omission necessary in order to make the presentation not misleading, in light of the circumstances in which the presentation is made, would also apply to disclosures in documents filed with the SEC.

The proposed requirements for filed information under amended Item 10 would be more extensive and detailed than those of proposed Regulation G. The additional

requirements would be generally consistent with the SEC staff's historical practice in situations where it has reviewed filings containing non-GAAP financial measures. In addition, the requirements for a GAAP presentation and for a reconciliation would be slightly more stringent than those set forth under Regulation G. In particular:

- in filings with the SEC, the presentation of the comparable GAAP financial measure must have equal or greater prominence;
- there would not be an "unreasonable effort" exception for forward-looking information to the requirement for a quantitative reconciliation between the non-GAAP financial measure and the comparable GAAP financial measure; and
- any non-GAAP financial measure presented must be accompanied by statements disclosing the purposes for which management uses the non-GAAP financial measure and why the registrant believes the non-GAAP financial measure would be useful to investors.

This last requirement is designed to ensure that companies are using non-GAAP financial measures that provide information that is important in analyzing and understanding the registrant. This requirement could be satisfied by including the statements in the most recent annual report filed with the SEC (or a more recent filing) and by updating those statements, as necessary, no later than the time of the filing. In the proposing release, the SEC indicated that the sole fact that the non-GAAP financial measure is used by or useful to analysts cannot be the sole support for management's statement as to why investors may find the non-GAAP financial measure useful. Rather, the justification for the use of the measure must be substantive, although it can be a justification that causes a measure to be used by or useful to analysts.

The definition of "non-GAAP financial measure" would be the same for purposes of Item 10 as for Regulation G.

B. Application for Business Combination Disclosure

As with Regulation G, in the case of business combinations, the proposed amendment to Item 10 would apply to "post-transaction measures" included in filings related to business combination transactions.

As with Regulation G, the proposing release seeks comment as to whether an exception from certain of the requirements for post-transaction measures or other measures filed as information under the business combination rules is appropriate, or whether such measures should be treated differently.

The SEC also sought comments as to whether it should specifically require the disclosure of assumptions or bases underlying announcements of potential benefits to be achieved by a business combination (e.g., synergies, valuations, dividend amounts).

C. Application to Foreign Private Issuers

Unlike Regulation G, there is no limited exception for disclosure of non-GAAP measures in SEC filings by foreign private issuers. The proposed requirements would apply to

filings on Form 20-F. However, a non-GAAP financial measure that would otherwise be prohibited would be permitted in a Form 20-F filing by a foreign private issuer if the measure was expressly permitted under the generally accepted accounting principles used in the issuer's primary financial statements and was included in the issuer's annual report or financial statements used in its home country jurisdiction or market.

The SEC did not propose to subject filers on Form 40-F under the Multi-Jurisdictional Disclosure System (MJDS) to the proposed Item 10 requirements because, under the philosophy of MJDS, which is currently applicable to certain Canadian issuers, the Canadian disclosure form requirements dictate required disclosure in filings with the SEC. However, *public disclosures* in the United States by these Canadian issuers, including filings with the SEC on Form 40-F, would be subject to proposed Regulation G.

IV. Proposed New Item 1.04 of Form 8-K

A. Proposed Filing Obligation

The SEC has also proposed to amend Form 8-K to add new Item 1.04 "Disclosure of Results of Operations and Financial Condition." New Item 1.04 would require U.S. reporting companies to file a Form 8-K within two business days of any public announcement or release disclosing material non-public information regarding a registrant's results of operations or financial condition for an annual or quarterly fiscal period that has ended. Foreign private issuers are not required to file 8-Ks and therefore would not be subject to this filing obligation.

Proposed Item 1.04 would require the registrant to identify briefly the announcement or release and file the announcement or release as an exhibit to the Form 8-K. According to the SEC's proposing release, the new disclosure requirements to be added to Item 10 of Regulation S-K would apply to a Form 8-K filed under proposed Item 1.04. It is our understanding from informal conversations with the SEC staff that they intend to apply the Item 10 requirements to 8-Ks filed under proposed item 1.04. As a result, an earnings release filed as an exhibit under the new filing rules must itself comply with all of the Item 10 requirements applicable to SEC filings.

The proposal would not require any registrant to issue an earnings release or similar announcement. However, if a registrant issues such a release or announcement containing material non-public information regarding the registrant's results of operations or financial condition for an annual or quarterly fiscal period that has ended, it would trigger the new proposed filing requirement.

The requirement to file under Item 1.04 of Form 8-K would not apply to issuers that make these announcements and disclosures only in their quarterly reports filed with the SEC on Form 10-Q or their annual reports filed with the SEC on Form 10-K.

In a separate earlier release, the SEC proposed significant amendments to Form 8-K. While those proposals have not yet been adopted, the new Item 1.04 proposal is intended as a companion proposing release. The designation of the new item as Item 1.04 conforms to the new numbering system set out in the Form 8-K amendment proposal. For further information regarding these previously proposed amendments to Form 8-K, see our memorandum entitled

"SEC Proposes New Disclosure Rules for Current Reports on Form 8-K" which is available on our web site.

B. Treatment of Non-Written Disclosures

If non-public information is disclosed orally, telephonically, by webcast, broadcast, or similar means, Item 1.04 would *not* require the registrant to file a Form 8-K if:

- the disclosure initially occurs within 48 hours of a written release or announcement filed on Form 8-K pursuant to Item 1.04;
- the presentation is accessible to the public by dial-in conference call, webcast or similar technology;
- the financial and statistical information contained in the presentation is provided on the registrant's website, together with any information that would be required under proposed Regulation G; and
- the presentation was announced by a widely disseminated press release that included instructions as to when and how to access the presentation and the location on the registrant's website where the information would be available.

C. Repetition of Previously Disclosed Information

The filing requirement under proposed Item 1.04 of Form 8-K would be triggered by the disclosure of material non-public information regarding a completed fiscal year or quarter. Repetition of previously publicly disclosed information or release of the same information in a different form, for example in an interim or annual report to shareholders, would not trigger the proposed Item 1.04 requirement. This result would not change if the repeated information were accompanied by information that was not material, whether or not already public. However, release of additional or updated material non-public information regarding the registrant's results of operation or financial condition for a completed fiscal year or quarter would trigger an additional Item 1.04 filing.

D. Forward-Looking Statements

Proposed Item 1.04 of Form 8-K would apply only to publicly disclosed or released material non-public information concerning an annual or quarterly fiscal period that has ended. While such disclosure may also include forward-looking information, it is the material information about the completed fiscal period that triggers proposed Item 1.04. Accordingly, proposed Item 1.04 would not apply to public disclosure of earnings estimates for future or ongoing fiscal periods, unless those estimates are included in the public announcement or release of material non-public information regarding an annual or quarterly fiscal period that has ended.

In such a case, specifically identified forward-looking information could be furnished under proposed Form 8-K Item 6.01 (current Form 8-K Item 9) rather than filed under proposed Item 1.04. Information furnished under Item 6.01 should be included in the same Form 8-K that contains the historical material information filed pursuant to Item 1.04. Information furnished under Item 6.01 is not and would continue not to be subject to Section

18 of the Exchange Act, nor is it currently or would it be incorporated by reference into a registration statement, proxy statement or other report. The registrant would be required to identify the specific forward-looking statements it did not want to be considered filed.

E. Relationship with Regulation FD

Currently, announcements and releases disclosing material non-public information regarding results of operations or financial condition are subject to Regulation FD. Unlike disclosure made to satisfy Regulation FD, however, historical information filed under proposed Item 1.04 of Form 8-K always would be considered filed with the SEC for liability purposes. Further, a Form 8-K filed pursuant to Item 1.04 would satisfy an issuer's obligation under Regulation FD only if the Form 8-K were filed within the time frame required by Regulation FD.

Regulation FD could, of course, be satisfied by public disclosure other than through the filing of a Form 8-K meeting Regulation FD's requirements. In that case, a Form 8-K filed pursuant to Item 1.04 would be required to be filed within the Item 1.04 two-business day timeframe. Because the requirements of proposed Item 1.04 would be in addition to the requirements of Regulation FD, information furnished under existing Item 6.01 (current Item 9) of Form 8-K for the purpose of Regulation FD would not satisfy proposed Item 1.04 as it would not be considered filed with the SEC.

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The recommendations set forth herein are intended to be general in nature. This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Paul Weiss Securities Group, including:

Mark S. Bergman	(44 20) 7367-1601	John C. Kennedy	(212) 373-3025
Richard S. Borisoff	(212) 373-3153	Edwin S. Maynard	(212) 373-3034
Andrew J. Foley	(212) 373-3078	Raphael M. Russo	(212) 373-3309
Paul D. Ginsberg	(212) 373-3131		

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