

SECURITIES UPDATE

SEC Proposes New Rules That Would Mandate Use of Interactive Data to Improve Financial Reporting

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The Securities and Exchange Commission has issued its proposing release on Interactive Data to Improve Financial Reporting. See Release Nos. 33-8924; 34-57896, <http://www.sec.gov/rules/proposed/2008/33-8924.pdf>. The proposed rules would require financial statement information to be filed in an interactive data format known as XBRL (short for extensible business reporting language), with the financial data “tagged” so that it is machine readable in a manner similar to bar codes. By individually labeling each number, this format allows for financial statement items to be searched on the Internet, downloaded into spreadsheets, reorganized in databases and otherwise used in analytical software. Comments on the proposed rules are due by August 1, 2008.

Mechanics of Compliance. Public companies would comply with the proposed XBRL rules by filing an additional exhibit that contains financial data in an interactive format when they file registration statements and reports with the SEC. The data to be tagged are the registrant’s financial statements, including the accompanying footnotes and any required financial statement schedules,

that are included in the registration statement or report filed with the SEC. The human readable financial data in this exhibit will be identical to the financial statements provided in traditional format filings, but in addition the exhibit will contain machine readable tags. Filers will need to use the most recent and appropriate tags from the list of tags released by XBRL U.S. or IASCF. Customized tags, called extensions, can be created for non-standard financial statement line items that are not included in the standard tags. There are also a limited number of other tags that will be used to identify the document and entity, such as form type, company name and public float. The SEC will make software available on its web site to view the interactive data.

When companies become subject to the new rule, in addition to filing the new exhibit with the SEC, they will be required to post the financial statements in interactive data format on their web sites on the same day they are filed, or required to be filed, with the SEC. Companies will *not* be able to satisfy this requirement by hyperlinking to documents available on the SEC’s web site.

Transition Schedule. The SEC envisions mandatory use of XBRL to be rolled out over three years:

- The first group of companies that would be required to prepare interactive financial data are domestic and foreign large accelerated issuers that use U.S. GAAP and have a worldwide public common equity float above \$5 billion as of the end of their most recently completed second fiscal quarter. As proposed, the rules would require these companies to comply for fiscal periods ending on or after December 15, 2008.
- The second group of companies that would be required to use XBRL are all of the other domestic and foreign large accelerated filers that use U.S. GAAP. These companies would have to comply beginning with fiscal periods ending on or after December 15, 2009.
- All remaining filers that use U.S. GAAP, including smaller reporting companies, and all foreign private issuers that prepare financial statements in accordance with IFRS as issued by the IASB would become subject to the XBRL rules for fiscal periods ending on or after December 15, 2010.

Forms Requiring Interactive Data. If the proposed rules are adopted, XBRL exhibits will be required for registration statements containing (as opposed to incorporating by reference) financial statements, annual reports on Forms 10-K or 20-F and quarterly reports on Form 10-Q. Registration statements that do not contain financial statements, such as those on Form S-3 or those filed by asset-backed issuers, would not be subject to the new exhibit requirements.

The current proposal does not contemplate the tagging of executive compensation data or other financial information at this time. However, the SEC has reserved that as a possibility to consider at a later time, which means that ultimately there may be tagging requirements associated with proxy statements. The proposed rules would not apply to Canadian issuers complying with the Multijurisdictional Disclosure System or to other foreign private issuers that prepare their financial statements in local GAAP and reconcile to U.S. GAAP.

Grace Periods and Exemptions. The first time that a company is required to file interactive data, the interactive data exhibit will be due within 30 days of the earlier of the due date or filing date of the related report or registration statement. This grace period would not apply to any other filings made during that year. There is also a transition rule for financial statement footnotes. Initially, these footnotes would be tagged individually as a block of text. However, once a company has been providing interactive tagging for one year, the filer would also have to tag the detailed disclosures within the footnotes and schedules. In a company's second year of required interactive filing, the company will have a similar 30-day grace period for the first interactive data exhibit that includes detailed tagging of footnotes and financial statement schedules.

In addition, there is a self-executing temporary hardship exemption. If a company experiences unanticipated technical difficulties that prevent the timely preparation and electronic submission of interactive data, this exemption would permit the filer to be deemed current for the purposes of incorpo-

ration by reference, short form registration eligibility and Rule 144 resales for a period of up to six business days. No staff or SEC action is needed, but if the company does not electronically submit the interactive data by the end of the period, the company will be deemed not current from the seventh business day forward until the missing data is submitted electronically. There is also a rule that permits a filer to apply in writing for a continuing hardship exemption if there is undue burden or expense to submit the information in electronic format. The continuing hardship exemption would require action by the SEC staff to become effective. In granting such an exemption, the staff may limit the exemption to a specific period.

Consequences of Non-Compliance. If a company does not file its interactive data or post it on its web site when required, it will not be deemed current with its reporting obligations under the Securities Exchange Act of 1934, subject to the grace periods and exemptions referred to above. Therefore, such company would not be eligible to use short form registration statements such as Forms S-3, F-3 and S-8, or be able to elect to provide Form S-4 or F-4 information at a level prescribed by Form S-3 or F-3. Also, a company that fails to file or post its required interactive data will not be deemed to have available adequate current public information for the purposes of Rule 144 resales. However, in contrast to a late filing of a traditional format Exchange Act report, once the missing filing or posting of interactive data is made, the company will be restored to current and timely status, assuming that there is no other reason for the loss of such status.

Liability. Under the proposed rules, the interactive data that is viewable through the software available on the SEC's web site, to the extent that it is identical in all material respects to the corresponding portion of the traditional format filing, such as the financial statement numbers, would be subject to the same liability provisions of the federal securities laws as the corresponding data in the traditional format of the filing. In other words, the financial statement data itself should be the same in the XBRL exhibit as it is in the main text of the corresponding report or registration statement and, as such, would have the same liability under the federal securities laws.

The proposal would establish special liability exceptions for the data in the interactive file that is not the same as the data presented in the traditional format, such as machine readable tags, as opposed to human readable data. This type of data would be excluded from the officer certification requirements under Rules 13a-14 and 15d-14 under the Exchange Act. It would not be deemed filed for the purposes of Sections 11 and 12 of the Securities Act of 1933, Section 18 of the Exchange Act or Section 34(b) of the Investment Company Act of 1940, and, thus, would not be subject to liability under any of those sections. According to the Proposing Release, companies would be:

- protected from liability for failure to comply with the proposed tagging and related requirements if the interactive data either
 - met the requirements; or
 - failed to meet the requirements,

but the failure occurred despite the issuer's good faith and reasonable effort, and the issuer corrected the failure as soon as reasonably practicable after becoming aware of it.

The SEC has specifically preserved the potential for Rule 10b-5 liability for XBRL exhibits, stating in the Proposing Release:

None of the proposed liability-related provisions for interactive data submitted to the Commission, however, would affect the application of the anti-fraud provisions under the federal securities laws, whether the interactive data is submitted to the Commission or posted on an issuer's Web site.

The SEC expressly views the prospect of liability as a policing tool for interactive data. It said in the Proposing Release that, "[p]otential liability also helps ensure the accuracy and reliability of the data." Further, the SEC has identified the liability provisions of the federal securities laws as one of the factors that it envisions as furthering investor expectations of reliability and accuracy.

Rule Changes. The proposed XBRL rules provide for the amendment of a number of existing rules, as well as the adoption of several new ones. Proposed Rule 405 of Regulation S-T addresses the technical requirements for interactive data file submissions and postings, and proposed Rule 406 of Regulation S-T covers associated liability issues. The temporary hardship exception is proposed to be set forth in Rule 201(c) of Regulation S-T, with the continuing hardship exemption addressed in Rule 202 of Regulation S-T. Proposed Item 601(b)(101) of Regulation S-K sets forth the requirements of the interactive data file

exhibit. Corresponding changes are proposed in the rules that require current public information such as the rules governing registration statements on Forms S-3, F-3 and S-8 and Rule 144. Rules 13a-14 and 15d-14, governing certifications by the chief executive officer and the chief financial officer, would be modified to carve out interactive data files and XBRL-related documents.

Key Areas of Comment. The Proposing Release solicits comments for the staff to take into consideration when it prepares its final rule. Key areas of comment include:

- Whether it would be useful to extend the interactive financial data requirements to executive compensation disclosures and what burden that would place on reporting companies;
- Whether the proposed schedule for implementation is appropriate;
- Whether companies should be required to use interactive financial data in their initial public offerings;
- Whether adequate grace periods are provided;
- Whether to permit optional interactive data for financial disclosures that are not part of the current lists of tags for U.S. GAAP financial statement reporting and IFRS financial reporting, such as for management's discussion and analysis;
- Whether the rules should apply to Canadian issuers complying with the Multijurisdictional Disclosure System;
- Whether it is beneficial or burdensome to require both web site and EDGAR posting of the interactive data; and

- Whether the proposed balance between liability rules and the effort to promote reliable interactive data is optimal.

Practical Considerations.

Although the mandatory XBRL rules are not final, the SEC has signaled that it considers this to be a very important initiative. Therefore, it seems likely that the SEC will be issuing a final rule to make use of interactive financial data mandatory. And, there appears to be momentum to adopt the final rule in sufficient time to make it applicable beginning with the next annual reports on Form 10-K for the large companies that will be in the first group of companies required to comply.

To be ready, companies, particularly those that will fall in the first group of companies required to comply with the XBRL rules, should start formulating their method for compliance now, rather than waiting for the final rule. For example, decisions should be made as to whether the company plans to tag its data itself. If so, it should be looking into software options and making sure that it has employees trained to implement this task. If the company prefers to use an outside vendor, it should be selecting that vendor and satisfying itself that the vendor is adequately prepared for this task.

Even if a company is not in the first group that will be required to present financial data in interactive format, it is prudent to commence the preparations for the ultimate use of XBRL. If the rules are adopted as proposed, all filing companies using U.S. GAAP and foreign private issuers using IFSR will be required to comply in three years, and companies may choose to voluntarily comply

earlier. Making use of the extra lead time, by beginning consideration as to how best to accomplish the process of tagging data, should make ultimate compliance go more smoothly.

It will be important to identify early in the process whether the company will have any non-standard financial statement line items that are not included in the standard list of tags so that it will be able to create new tags that apply to such line items.

If a company chooses to outsource tagging, the company should identify and train persons within the organization to review what is produced. In the Proposing Release the SEC stated:

In the event a company relies upon a service provider to tag the company's financial statements, the company would want to carefully review the tagging done by the service provider in order to make sure that the tagged financial statements are accurate and consistent with the information the company presents in its traditional format filing.

Coming from the SEC, this should be taken as a very strong suggestion. Ultimately, the XBRL data is the reporting company's responsibility. The prospect of liability exists. There should be employees of the company who are responsible for the XBRL exhibits, whether or not the company does the entire filing in-house or outsources it.

Even though excluded from the officer certification requirements under Rules 13a-14 and 15d-14 under the Exchange Act, the interactive

data is subject to the internal control over financial reporting and disclosure controls and procedures requirements contained in Rules 13a-15 and 15d-15 under the Exchange Act. Reporting companies should consider whether any adjustments need to be made to their internal control over financial reporting or to the composition or procedures of their disclosure committee to reflect the proposed new XBRL rules. Reporting companies should determine how they are going to satisfy themselves from an internal control and disclosure control standpoint if they plan to retain a third party for data tagging. Also, the disclosure committee should be aware of how the company plans to implement the XBRL requirements and what steps are being taken to make sure that the company is prepared.

Companies should be advising those responsible for their web sites that there will be a requirement to post the interactive data on the company's web site on the same day that filings are made with the SEC.

Finally, the Proposing Release does not contemplate a requirement that companies obtain third party assurance for interactive data.

If you have any questions regarding the proposed mandatory use of interactive financial data, please contact any of the attorneys listed below or any other member of our Corporate & Securities group.

Edward S. Best
+1 312 701 7100
ebest@mayerbrown.com

Michael T. Blair
+1 312 701 7832
mblair@mayerbrown.com

James B. Carlson
+1 212 506 2515
jcarlson@mayerbrown.com

Robert E. Curley
+1 312 701 7306
rcurley@mayerbrown.com

Sterling M. Dorish
+1 212 506 2587
sdorish@mayerbrown.com

Eric J. Finseth
+1 650 331 2066
efinseth@mayerbrown.com

Marc H. Folladori
+1 713 238 2696
mfolladori@mayerbrown.com

Robert F. Gray
+1 713 546 0522
rgray@mayerbrown.com

Lawrence R. Hamilton
+1 312 701 7055
lhamilton@mayerbrown.com

Robert A. Helman
+1 312 701 7020
rhelman@mayerbrown.com

Michael L. Hermsen
+1 312 701 7960
mhermsen@mayerbrown.com

Philip J. Niehoff
+1 312 701 7843
pniehoff@mayerbrown.com

Elizabeth A. Raymond
+1 312 701 7322
eraymond@mayerbrown.com

Laura D. Richman
+1 312 701 7304
lrichman@mayerbrown.com

David A. Schuette
+1 312 701 7363
dschuette@mayerbrown.com

Jodi A. Simala
+1 312 701 7920
jsimala@mayerbrown.com

Frederick B. Thomas
+1 312 701 7035
fthomas@mayerbrown.com

Mark R. Uhryluk
+44 207 246 6217
muhryluk@mayerbrown.com

James R. Walther
+1 213 229 9597
jwalther@mayerbrown.com

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