CORPORATE GOVERNANCE, ETHICAL CONDUCT AND PUBLIC DISCLOSURES IN THE POST-ENRON ERA ---- CHANGING THE WAY CORPORATE AMERICA OPERATES

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# TABLE OF CONTENTS

1. INTRODUCTION .................................................................................................................. 1
   1.1 Scope of Outline ........................................................................................................... 1
   1.2 Key Regulatory Reforms .......................................................................................... 1
   1.3 Role of Legal Counsel .............................................................................................. 2

2. CORPORATE GOVERNANCE UNDER THE POST-ENRON REGULATORY
   REFORMS ......................................................................................................................... 2
   2.1 Overview .................................................................................................................. 2
   2.2 Required Governance Guidelines ............................................................................. 3
   2.3 Required Director Independence ............................................................................... 5
   2.4 Required Executive Sessions of Non-Management Directors ................................. 7
   2.5 Required Board Committees .................................................................................. 8

3. OFFICER AND DIRECTOR RESPONSIBILITIES AND ACCOUNTABILITY
   UNDER THE POST-ENRON REGULATORY REFORMS .................................................. 9
   3.1 Overview .................................................................................................................. 9
   3.2 Executive Officer Accountability ............................................................................. 9
   3.3 Required CEO/CFO Certification of the Accuracy of 10-Qs and 10-Ks ................... 9
   3.4 Required CEO/CFO Certification of the Quality of Internal Controls ................. 9
   3.5 Required CEO Compliance Certification to NYSE .............................................. 10
   3.6 Required Management Assessment of Internal Controls ...................................... 10
   3.7 Required Maintenance and Assessment of Disclosure Controls ............................ 10
   3.8 Prohibition against Improperly Influencing The External Auditor ....................... 10
   3.9 Required Forfeiture of Bonus and Equity-Based Compensation .......................... 10
   3.10 Prohibition Against Insider Trading During Pension Plan Blackout Periods ....... 11
   3.11 Prohibition Against Loans to Executive Officers and Directors ......................... 11
   3.12 Required Stockholder Approval of All Equity Based Compensations ............... 11

4. CORPORATE ETHICS UNDER THE POST-ENRON REGULATORY REFORMS ... 11
   4.1 Code of Ethics Requirements ............................................................................... 11
   4.2 Whistle-Blower Requirements .............................................................................. 12

5. PUBLIC DISCLOSURE REQUIREMENTS UNDER THE POST-ENRON
   REGULATORY REFORMS ............................................................................................. 15
   5.1 Acceleration of Filing Deadlines for Form 10-Q and 10-K ..................................... 15
   5.2 Disclosure of Material Correcting Adjustments in Financial Statements ............. 16
   5.3 Disclosure of Material Off Balance Sheet Transactions ....................................... 16
   5.4 Non-GAAP Financial Disclosures ......................................................................... 16
   5.5 Real Time Disclosures ......................................................................................... 16
   5.6 Required Website Disclosures .............................................................................. 16

6. CONCLUSION ...................................................................................................................... 16
APPENDIX A
OUTLINE OF A NOMINATING/GOVERNANCE COMMITTEE CHARTER........................18

APPENDIX B
OUTLINE OF A COMPENSATION COMMITTEE CHARTER ...............................................20

APPENDIX C
OUTLINE OF A CODE OF ETHICS ...........................................................................................24
1. INTRODUCTION

1.1. Scope of Outline. In the aftermath of the recent failure of Enron and other major companies and the resulting loss of public confidence in the capital markets, the U.S. Congress conducted lengthy investigative hearings to determine the root causes of these problems. By the end of the hearings, major weaknesses had been identified in:

(i) corporate governance;

(ii) the accounting and external audit functions;

(iii) the public disclosure system;

(iv) corporate ethics; and

(v) the standards of conduct of key professionals in the capital markets.

To remedy these perceived weaknesses, Congress and the major stock exchanges quickly moved to fashion regulatory reforms that would strengthen the way corporate America operates. Other than for audit committee issues (which are covered in detail in a different outline prepared by the authors and entitled “The Ins and Outs of Audit Committees In The Post-Enron Era”), this outline discusses how these reforms impact (i) corporate governance, (ii) officer and director responsibilities and accountability, (iii) corporate ethics, and (iv) public disclosures. This outline does not address the impact of these reforms on foreign issuers.

1.2. Key Regulatory Reforms.

A. Sarbanes-Oxley Act Of 2002 (“SOA”). Signed into law by President Bush on July 30, 2002, the SOA is an extremely aggressive legislative effort to prevent future Enron-type problems even to the point of encroaching into areas that were once considered to be only within the purview of state corporation laws.

B. Securities And Exchange Commission (“SEC”) Rules And Regulations Implementing The Provisions Of The SOA. The SOA requires that the SEC adopt rules to implement several of its regulatory reforms. So far the SEC has finalized and adopted rules covering the following ten matters:

(i) CEO and CFO certifications;

(ii) Non-GAAP financial information;

(iii) Code of ethics for senior management;

(iv) “Audit Committee Financial Experts;”

(v) Insider trading during pension plan blackout periods;
(vi) Disclosure of material off-balance sheet transactions and contractual obligations;

(vii) Retention of audit records;

(viii) External auditor independence standards;

(ix) Standards of conduct for attorneys; and

(x) Expedited filing of Section 16 reports and Form 8-Ks containing earnings release information.

C. Corporate Governance Reforms Through The Listing Requirements Of The Organized Securities Markets. The NYSE and NASDAQ also have proposed new governance requirements for listed companies that impact the function of audit committees. These proposals were submitted in the late summer and early fall of 2002 to the SEC for its review and approval. However, given its demanding schedule in meeting the SOA’s deadlines for adopting new rules and regulations, the SEC’s response to these proposed new listing requirements is not expected before the fall of 2003. Because the proposals of the NYSE and NASDAQ differ in many respects, we anticipate the SEC will consider how they can be best harmonized with each other and with the SEC’s own rules affecting corporate governance.

This outline includes the proposed New York Stock Exchange Listing Requirements (“NYSE Proposed Rules”) and the proposed The NASDAQ Stock Market Inc. Listing Requirements (“NASDAQ Proposed Rules”) relating to corporate governance (other than the audit committee), ethical conduct and public disclosures. If adopted in their current form, NYSE and NASDAQ listed companies will have two years to comply with the NYSE Proposed Rules (although shorter 6 and 12 month compliance deadlines apply to select provisions of the rule) and one year to comply with the NASDAQ Proposed Rules, respectively.

1.3. Role of Legal Counsel. The magnitude and speed of these regulatory reforms has created a great deal of anxiety amongst compliance-minded directors in boardrooms nationwide. Directors and management have turned to legal counsel to guide them through the maze of new regulatory reforms. The blizzard of new SEC rules and the proposed new listing requirements of the NYSE and NASDAQ has made the preparation of extensive presentations to boards on the SOA a challenge for legal counsel.

2. CORPORATE GOVERNANCE UNDER THE POST-ENRON REGULATORY REFORMS

2.1. Overview. Below is a discussion of the regulatory reforms (other than those involving the audit committee) designed to strengthen corporate governance in public companies. As you consider these reforms, a fundamental point to keep in mind is
that the primary goal of the SOA, the NYSE Proposed Rules and the NASDAQ Proposed Rules is to shift control and power away from company management (especially the CEO) to the independent directors. The influence and power of management and the non-independent directors has been intentionally diluted in the new regulatory scheme.

Under the reforms, the role and responsibilities of the independent directors have been substantially increased. Accordingly, the expectations of the capital markets and the regulators for independent directors have also increased. Today, independent directors are expected (i) to be more hands-on in overseeing management and company affairs and (ii) to spend more time than they have in the past in carrying out their duties.

Directors are asking numerous questions about how to handle these new regulatory reforms. With increased duties, will the independent directors be subject to greater risks of personal liability? Will boards be able to obtain qualified “independent” directors in view of the increased time demands and risks of liability? Should director fees be increased? Should members of audit committees be paid more than the other directors? It will probably be several years before we know the answers to these questions.

2.2. Required Governance Guidelines. Along with audit committee effectiveness, it is safe to say that the improvement to corporate governance is the major focus of the new reforms. Set forth below is a discussion of the key components of corporate governance addressed by the NYSE Proposed Rules and NASDAQ Proposed Rules.

A. SOA. There are no comparable requirements in the SOA regarding corporate governance except for the provisions of Section 301 of the SOA regarding the composition and duties of audit committees.

B. Listing Requirements. NYSE Proposed Rule 303A(9) would require listed companies to adopt governance guidelines. These guidelines are not intended to be “one size fits all” but would focus at a minimum on “key areas of universal importance.” Each listed company’s annual report would be required to state that its corporate governance guidelines (together with the charters of its most important committees and the company’s code of business conduct and ethics) be posted on its website and available in print to any stockholder who requests it. Although each company is expected to develop its own policies for corporate governance, the NYSE commentary to this proposed rule identifies seven topics that a company’s guidelines must address. The NASDAQ Proposed Rules provide little guidance on what should be included in a company’s governing principles. Below are some of the most common governance issues addressed by companies:
(1) **Board Composition And Performance.**

*Director Qualification Standards.* The qualifications for serving on a board of directors is the most basic governance policy to be included in the governing principles. Of course, the regulatory mandates regarding director “independence” (e.g. NYSE Proposed Rules 303A(1) and (2) and NASDAQ Proposed Rule discussed in Section 2.3 below) are the starting point for inclusion in a company’s qualification standards for directors.

**Observation:** Other kinds of director qualifications that companies often include in their governance guidelines are the following:

(i) *limitation on term of service;*

(ii) *age limitation on standing for re-election (e.g. 75 years);*

(iii) *limitation on the number of other public-company boards that a director can serve on;*

(iv) *limitation on serving on the audit committee of other public company boards; and*

(v) *resignation requirement in case of change of personal circumstances (e.g. change in principal work responsibility);*

(vi) *ability to devote time required for board service;*

(vii) *required stock ownership in the company.*

**Size Of Board.** Usually the number of board members is indicated by range (e.g. 10-15).

(2) **Director Responsibilities.** Governance guidelines typically set forth the basic responsibilities of directors in very general terms such as: “The board’s purpose is to build long-term value for the stockholders. The business of the company is to be managed by its officers under the oversight of the board. The board’s primary functions are to oversee management’s development of sound business plans and strategies, to select the chief executive offices and other senior officers, oversee management succession planning and ensure the company adheres to the highest standards of ethical conduct and complies with applicable laws and regulations.”

(3) **Board Operation and Structure.**

- Compensation
- Meetings
• Executive Sessions
• Performance Review
• Agenda Preparation
• Board Packages
• Frequency
• Selection of Chairman

(4) **Board Committees.**

• Selection
• Operations
• Responsibilities

(5) **Selection of Director Nominees.**

• Criteria
• Process

(6) **Director Orientation and Continuing Education.** A company’s policy toward providing continuing education to board members is generally covered in the guidelines. Certain companies, however, elect to provide specific and detailed guidelines in their committee charters. For example, Home Depot requires directors to periodically visit company stores, plants and other operating facilities.

(7) **Management Succession.** The guidelines should delineate how the board selects and reviews the chief executive officer and other key executive officers and its preparation and policies for management succession.

(8) **Annual Board Evaluations.** The guidelines should set forth the procedures by which the board of directors will annually conduct a self-evaluation of its own performance. Some boards use formal written surveys in carrying out self-evaluations. There is usually great debate in boardrooms to using such an instrument. The fear of many is that a survey will be “Plaintiff’s Exhibit 1” if litigation ensues.

2.3. **Required Director Independence.**

A. **SOA.** The only SOA requirement as to board member qualifications in Section 301 requires that all members of the audit committee be “independent” directors
which means that an audit committee member (i) cannot receive any compensation payments from the company except for board or board committee service and (ii) cannot be an “affiliated person” of the company or any of its subsidiaries.

B. Listing Requirements. Under Section 303.01(B)(2)(a) of the NYSE Listed Company Manual, all audit committee members must be independent. NYSE Proposed Rule 303A(1) would require that a majority of directors be independent. To be independent under NYSE Proposed Rule 303A(2), the company’s board of directors would be required to affirmatively determine that the director has “no material relationship” with the company (either directly or as a partner, with the company). In the case of a former employee, there is also a “cooling off” period of five years before that person can be considered to be independent. Additionally, to be considered “independent,” a person would not be able to receive any payments from the company other than director’s fees and regular benefits provided to directors. These fees may be paid in cash or company equity securities. The basis for a board determination that a director does not have a “material relationship” would have to be disclosed in the annual proxy statement. However, the NYSE Proposed Rules would allow for boards to adopt and disclose categorical standards for determining whether a director is independent.

Observation: Examples of how NYSE companies establish categorized standards are shown in the following definitions of independence:

(i) **Example 1.** An “independent” director is a person who: (i) has not been employed by the company in an executive capacity within the past five years; (ii) is not and is not affiliated with a company or firm that is an advisor or consultant to the company; (iii) is not affiliated with a significant customer or supplier of the company; (iv) has no personal services contract with the company; (v) is not affiliated with a tax-exempt entity that receives significant contributions from the company; (vi) is not a familial relative of any person described above; and (vii) is free of any other relationship which would interfere with the exercise of independent judgment.

(ii) **Example 2.** A director will not be considered “independent” if, within the preceding five years: (i) the director was employed by the company; (ii) an immediate family member of the director was employed by the company as an officer; (iii) the director was employed by or affiliated with the company’s independent auditor; (iv) an immediate family member of the director was employed by the company’s independent auditor as a partner, principal or manager; or (v) a company executive officer was on the compensation committee of the board of directors of a company that concurrently employed the company director or employed an immediate family member of the director as an officer.
(iii) **Example 3.** The following relationships will not be considered to be material relationships that would impair a director’s independence:

(a) if a director is an executive officer of another company that does business with XYZ and the annual sales to, or purchases from, XYZ are less than five percent of the annual revenues of the other company and

(b) if a director serves as an officer, director or trustee of a charitable organization, and the company’s discretionary charitable contributions to the organization are less than five percent of that organization’s total annual charitable receipts.

NASDAQ Proposed Rule 4200(A)(15) defines “independent director” to mean a person other than an officer or employee of the company or a subsidiary or any other person having a relationship which, in the opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. This Rule identifies five categories of people who would not be considered to be independent. For instance, two of the categories are (i) persons employed by the company or affiliate during the prior three years and (ii) persons affiliated with a non-profit organization to which the company made, or from which the company received, payments that exceed 5% of the recipient’s gross revenues or $200,000, whichever is more. NASDAQ Proposed Rule 4350(d)(2)(A) also would require that to be “independent” an audit committee member must (i) meet the criteria for independence set forth in Section 301 of the SOA and (ii) not own or control 20% or more of the company’s voting securities. NASDAQ Proposed Rule 4350(c)(1) requires that a majority of the board of directors be comprised of independent directors.

### 2.4. **Required Executive Sessions of Non-Management Directors**

A. **SOA.** No comparable requirement is in the SOA.

B. **Listing Requirements.** NYSE Proposed Rules 303A(3) would require non-management directors to hold regularly scheduled executive sessions without management. Non-management directors are those directors who are not officers. This requirement is intended to promote candid discussions among the non-management directors about issues that they might be reluctant to discuss in the presence of management. These meetings are intended to enhance communications among the non-management directors. The NASDAQ Proposed Rules contemplate that executive sessions will occur at least twice a year in conjunction with regularly scheduled board meetings.

The NYSE commentary to its rule provides that a director (“**Presiding Director**”) needs to be chosen to preside over these executive sessions and that the name of the Presiding Director be identified in the Company’s annual proxy statement. As an alternative, procedures for rotating the Presiding Director among the independent directors can be established (e.g., rotation among the board committee chairpersons). In any event, the company is required to disclose how a
person can contact the Presiding Director or the non-management directors as a group.

2.5. **Required Board Committees.**

A. **Audit Committee.** The SOA, the rules promulgated thereunder by the SEC and the proposed listing requirements of the NYSE and NASDAQ mandate the establishment of an audit committee. Because this topic is covered in the authors’ outline entitled “The Ins and Outs of Audit Committees in the Post-Enron Era,” audit committees will not be addressed in this outline.

B. **Nominating/Governance Committee.**

(1) **SOA.** There is no comparable requirement in the SOA.

(2) **Listing Requirements.** NYSE Proposed Rule 303A(4) would require that each listed company (excluding controlled companies) establish a “nominating/corporate governance committee” composed entirely of “independent directors” (see Section 2.3 above). This committee is charged with overseeing the corporate governance of the company. The rule provides that the charter of the committee should set forth the committee’s purpose and its goals and responsibilities. In the case of the former, the rule requires that at minimum the committee’s purposes must be to identify persons qualified to serve as directors and to either (i) select the director nominees for election at the next annual meeting of stockholders or (ii) recommend to the board the selection of such nominees. The rule would also require that the committee be given the responsibility for developing and recommending to the board the governance principles of the company (see Section 2.2 above). The committee’s charter must also set forth the criteria for selecting directors and the manner in which the committee will oversee the evaluation of board and management performance. NASDAQ Proposed Rule 4350(c)(4) requires the nomination of a company’s directors to be determined by either a majority of the independent directors or a nominations committee comprised solely of independent directors, subject to certain limited exceptions. Appendix A hereto is an outline of the content of a typical charter of a nominating/governance committee of an NYSE listed company.

C. **Compensation Committee.** NYSE Proposed Rule 303A(5) would require listed companies to establish a compensation committee composed entirely of independent directors. The rule provides that at a minimum the purposes of the committee are to (i) discharge the board responsibilities in setting the compensation of company executives and (ii) produce an annual report on executive compensation for inclusion in the company’s proxy statement for its annual stockholders meeting in accordance with SEC rules and regulations. Further, the primary duties of the committee are to (i) review and approve the company’s goals and objectives with respect to the CEO’s compensation, (ii) evaluate the CEO’s performance against such goals and objectives and (iii) set the
CEO’s compensation based on that evaluation. Additionally, the committee is required to annually conduct a self-evaluation of its performance. NASDAQ Proposed Rule 4350(c)(3) requires the compensation of all of a company’s officers, including the CEO, to be determined by either a majority of the independent directors or a compensation committee comprised solely of independent directors, subject to certain limited exceptions. Appendix B hereto is an outline of the content of the charter of a compensation committee of an NYSE listed company.

3. OFFICER AND DIRECTOR RESPONSIBILITIES AND ACCOUNTABILITY UNDER THE POST-ENRON REGULATORY REFORMS

3.1. Overview. The new regulatory scheme is aimed at holding corporate management and directors accountable for the accuracy of corporate disclosures. In particular, the SOA has focused on the principal executive officer (“CEO”) and the principal financial officer (“CFO”) because they are directly responsible for the way a company operates, including compliance with applicable laws and regulations. Since the management is directly responsible for public disclosures, another major legislative objective of the SOA is to prevent officers and directors from enriching themselves through equity compensation gains resulting from fraudulent public disclosures.

EXECUTIVE OFFICER ACCOUNTABILITY

3.2. Required CEO/CFO Certification of the Accuracy of 10-Qs and 10-Ks. Section 302(1) through (3) of the SOA requires the CEO and CFO of public companies to certify the accuracy of annual reports on Form 10-K and quarterly reports on Form 10-Q. Securities Exchange Act of 1934 (“Exchange Act”) Rules 13a-14 and 15d-14 that implement Section 302 require that the CEO and CFO certify in such reports that: (i) the signing officers have reviewed the report; (ii) based on the officer’s knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made not misleading and (iii) based on such officer’s knowledge, the financial statements and other information included in the report fairly presents in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in the report.

3.3. Required CEO/CFO Certification of the Quality of Internal Controls. Section 302(4) requires the CEO and CFO to certify in such 10-Q and 10-K reports that they (i) are responsible for establishing and maintaining internal controls and procedures, and (ii) have designed such disclosure controls and procedures to ensure that material information relating to the company and its subsidiaries is made known to the CEO and CFO by others within those entities. SEC Rules 13a-15 and 15d-15 implement Section 302(4).

3.4. Required CEO/CFO Certification of the Quality of Disclosure Controls. Rules 13a-14 and 15d-14 require the CEO and CFO to certify in such 10-Q and 10-K reports
that they (i) have designed such disclosure controls and procedures to ensure that material information is made known to them on a timely basis, (ii) evaluated the effectiveness of the disclosure controls within 90 days prior to the filing date, and (iii) presented in the filing their conclusions about effectiveness of the disclosure controls. These duties are intertwined with their duties described in Section 3.3 and 3.7.

3.5. **Required CEO Compliance Certification to NYSE.** NYSE Proposed Rule 303A(12) would require the CEO of each listed company to annually certify to the NYSE that such person is not aware of any violation by the company of the NYSE corporate governance listing requirements. This certification must be disclosed by the company in its annual report to stockholders. There is no similar certification required by NASDAQ Proposed Rules.

3.6. **Required Management Assessment of Internal Controls.** Section 404(a) of the SOA mandates that each company’s Form 10-K shall contain an internal control report that (i) states the responsibility of management for establishing and maintaining adequate internal control systems and (ii) contains an assessment, at year-end, of the effectiveness of such controlling status. Section 404(b) requires the external auditor to attest to and report on management’s assessment of such internal control systems.

3.7. **Required Maintenance and Assessment of Disclosure Controls.** Rules 13a-15 and 15d-15 require all companies that file reports under the Exchange Act to (i) maintain disclosure controls and procedures and (ii) within the 90-day period prior to the filing date of each report certified (as described in Section 3.3 and 3.4 supra) conduct an evaluation of the effectiveness of those controls with the participation of the company’s management, including the CEO and CFO.

3.8. **Prohibition Against Improperly Influencing The External Auditor.** Section 303 of the SOA makes it unlawful “for any officer or director of [a company] or any other person acting under the direction thereof, to take any action” to mislead the external auditor in the performance of its audit of the company’s financial statements for the purpose of rendering such financial statements materially misleading.

**Observation:** While most lawyers do not believe that SOA intended this result, the SEC proposed rule implementing Section 303 does not require intentional or knowing conduct on the part of the violator. Thus, this prohibition may be a trap for the unaware. After all, any discussions with an external auditor may affect the external auditing judgment with respect to its performance of an audit.

### OFFICER AND DIRECTOR CONFLICT RESTRICTIONS

3.9. **Required Forfeiture of Bonus and Equity-Based Compensation.** Under Section 304 of the SOA, if a company is required to restate its financial statements as a result of a material noncompliance, resulting from misconduct, with any financial reporting requirement of the federal securities laws, each of the CEO and CFO must repay the company (i) any bonus or incentive or equity-based compensation received by such
person during the 12-month period following the public disclosure of such information plus (ii) any profits realized by such person from the sale of securities of the company during such 12-month period.

**Observation:** The forfeiture requirement of Section 304 applies even in the absence of culpability on the part of the CEO or CFO with respect to the flawed disclosure that triggered the forfeiture.

3.10. **Prohibition Against Insider Trading During Pension Plan Blackout Periods.** Section 306 of SOA prohibits directors and executive officers from trading in any equity security of the company (other than an exempt security) during any pension plan blackout period if the equity security being traded was acquired by such person in connection with his or her service or employment as a director or executive officer. A blackout period is the time period during which a company prohibits plan participants and beneficiaries from trading the company’s equity securities in their plan account. The period must be for more than three days and must apply to at least 50% of the plan participants or beneficiaries under all individual account plans.

3.11. **Prohibition Against Loans to Executive Officers and Directors.** Section 402 of the SOA prohibits a public company from, directly or indirectly, extending or maintaining credit “in the form of a personal loan” (except for certain home loans and loans by brokers to employees in the ordinary course of business) to or for any director or executive officer. Loans outstanding at the time the SOA became effective are grandfathered so long as there is no material modification of any terms thereof.

3.12. **Required Stockholder Approval of All Equity Based Compensations.** NYSE Proposed Rule 303A(8) would require that all equity-compensation plans (except for inducement options, plans relating to mergers and acquisitions and tax qualified and excess benefit plans) be approved by the stockholders. This is designed to shift control over the granting of equity-based compensation plans to the stockholders and away from management.

4. **CORPORATE ETHICS UNDER THE POST-ENRON REGULATORY REFORMS**

4.1. **Code of Ethics Requirements.**

A. **SOA.** Section 406 of the SOA requires the SEC to issue rules requiring each public company (i) to disclose in its annual report whether it has a code of ethics applicable to the principal executive officer, principal financial officer, principal accounting officer or controller or person performing similar functions (collectively, the “senior officers”) and if not, why not and (ii) to disclose (within five business days on Form 8-K or its website) any change in such code of ethics and any waiver of such code of ethics with respect to any senior officer. A company will be required to make the code of ethics available to the stockholders by either (i) publishing it on the company website or (ii) including a copy in its annual report. Rather than have a separate code of conduct applicable only to
senior officers, companies may elect to make the ethical requirements for the senior officers a part of its code of conduct for all employees.

The SEC rules (Item 406 of Regulation S-K and Item 406 of Regulation S-B) implementing Section 406 define “code of ethics” as being standards reasonably designed to deter wrongdoing and to promote:

(i) honest and ethical conduct including ethical handling of actual or potential conflicts of interest between personal and professional relationships;

(ii) full, fair, accurate, timely and understandable disclosure in reports and documents filed with, or submitted to, the SEC and in other public communications made by the company;

(iii) compliance with applicable governmental laws, rules and regulations;

(iv) prompt internal reporting of code violations to an appropriate person or persons as identified in the code; and

(v) accountability for adherence to the code.

B. Listing Requirements. NYSE Proposed Rule 303A(10) would require listed companies to adopt a “code of business conduct and ethics” for officers, directors and employees. The rule would require each company to publicly disclose its code and to promptly disclose any waivers of its code with respect to officers and directors. Only the board or a board committee can grant a waiver for an officer or director. Although the content of a company’s code is to be determined by the company, the NYSE rules does identify the certain topics that would be required to be addressed in the code.

NASDAQ Proposed Rule 4350(m) would require that listed companies adopt a code of ethics that covers (i) conflicts of interest and (ii) compliance with laws, rules and regulations. The rule requires that a company’s code of ethics have enforcement provisions and that waivers for officers and directors may only be granted by the board or by a board committee on a “limited and qualified” basis.

Observation: While the topics covered by codes of ethics vary, the most commonly covered topics are shown in the outline of a code of ethics attached hereto as Appendix C.

4.2. “Whistle-Blower” Requirements.

A. Employees. Section 806 of the SOA makes it unlawful for companies to take an adverse employment action against a employee who provides information, assists in an investigation, or participates in a proceeding regarding conduct which the employee reasonably believes to involve mail, wire, radio, television, bank or securities fraud, or that violates any rule or regulation of the SEC or any provision of Federal law relating to fraud against shareholders, when such information or
assistance is provided to a Federal agency, a member or committee of Congress, or a person with supervisory authority over the employee. An employee seeking relief under Section 806 must file a complaint with the U.S. Secretary of Labor within 90 days of the alleged violation. The employee making the complaint has the burden of establishing a prima facie case that the whistle-blowing action was a “contributing factor” to the adverse employment decision. However, no relief may be ordered if the employer demonstrates by “clear and convincing evidence” that the same adverse action would have taken place in the absence of the protected behavior. Remedies under Section 806 include reinstatement, back pay, attorney fees, litigation costs, and expert witness fees, but not punitive damages. Finally, the new federal whistle-blower protection statute does not preempt other federal and state whistle-blower statutes.

*Complaint Handling Procedures* – Under Section 301 of the SOA, the audit committee is required to establish procedures for handling whistle-blower complaints received by the company regarding accounting, internal controls or auditing matters (including confidential, anonymous submissions by employees).

The procedures for handling complaints concerning accounting, internal controls and auditing matters may be incorporated into a company’s code of ethics. Typically, the procedures relating to whistle-blower complaints on accounting-related problems will:

(i) Set forth statement about the company’s commitment to compliance with all applicable securities laws and regulations, accounting standards, accounting controls, and audit practices;

(ii) Encourage employees to inform the company of conduct amounting to a violation of the applicable standards in accordance with the procedures;

(iii) Describe prohibited conduct and provide specific examples relevant to the business;

(iv) Establish complaint procedures that employees can easily use including making anonymous complaints; and

(v) Provide assurances that there will be no retaliation for reporting suspected violations and that reports will remain confidential.

**B. Legal Counsel.** Section 307 of the SOA directs the SEC to adopt rules establishing minimum standards of conduct for attorneys practicing before the SEC. On January 29, 2003, the SEC adopted Rule 205. The rule provides that if (i) in appearing or practicing before the SEC in the representation of a company, (ii) an attorney becomes aware of evidence of a material violation by the company, the attorney must report the material violation “up the ladder” within the company starting with the chief legal officer (or if there is no chief legal officer, the chief executive officer) and, if an appropriate response is not received,
to the audit committee or another board consisting solely of independent directors (or if no such committee, to the full board). “Appearing or practicing” before the SEC is defined broadly. Likewise, the term “material violation” is defined to include securities law violations and breaches of fiduciary duty.

4.4 Securities Analysts Conduct Requirements. Section 501 of the SOA addresses the treatment of securities analysts by registered securities associations and national securities exchanges. Section 501 amends the Exchange Act by adding Section 15D “Securities Analysts and Research Reports.” The goal of Section 15D is to improve the objectivity of research and provide investors with more reliable information. No later than one year after the date of enactment of Section 15D, the SEC, or upon the authorization and direction of the SEC, a registered securities association or national securities exchange, must have adopted rules reasonably designed to (a) address conflicts of interest that may arise when securities analysts recommend equity securities in research reports and public appearances and (b) require securities analysts to disclose in public appearances, and broker-dealers to disclose in research reports, conflicts of interest that are known or should be known by the securities analyst or broker-dealer to exist at the time of the appearance or distribution of the report.

To satisfy the provisions of clause (a) the rules must include provisions that:

(i) restrict the prepublication clearance or approval of research reports by individuals employed by the broker-dealer who are engaged in investment banking activities, or persons not directly responsible for investment research, other than legal or compliance staff;

(ii) limit the supervision and compensatory evaluation of securities analysts to individuals employed by the broker-dealer who are not engaged in investment banking;

(iii) require that a broker-dealer and its employees who are involved with investment banking may not, directly or indirectly, retaliate against or threaten to retaliate against its securities analysts as a result of an unfavorable research report;

(iv) define periods during which broker-dealers who have participated or are to participate in a public offering as underwriters or dealers should not publish or distribute research reports relating to such securities or to the issuer of such securities; and

(v) establish appropriate informational partitions to ensure that securities analysts are separated from review, pressure or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision;
To satisfy the provisions of clause (b) the rules must require the following information to be disclosed:

(i) the extent to which the securities analyst has invested in the relevant issuer of the report or appearance;

(ii) whether any compensation has been received by the broker-dealer, any affiliate, including the securities analyst, from the relevant issuer (subject to certain exemptions as the SEC may determine appropriate);

(iii) whether the relevant issuer currently is or during the preceding year has been a client of the broker-dealer, and if so, stating the types of services provided to such issuer;

(iv) whether the securities analyst received compensation, with respect to a report, based upon the investment banking revenues; and

(v) any other disclosures or conflicts of interest that are material as the SEC determines appropriate.

These requirements have thus far been primarily addressed in NASD Rule 2711, amended NYSE Rule 472, and SEC Proposed Regulation AC.

5. PUBLIC DISCLOSURE REQUIREMENTS UNDER THE POST-ENRON REGULATORY REFORMS

5.1. Acceleration of Filing Deadlines for Form 10-Q and 10-K. Rule 12b-2, 13a-10 and 15d-10 accelerate the filing of quarterly and annual reports under the Exchange Act for U.S. reporting companies that possess a public float of at least $75 million, that have been subject to the Exchange Act’s reporting requirements for at least 12 months, and that have previously filed at least one annual report. The acceleration of filing deadlines for companies meeting these requirements will phase-in pursuant to the following three year schedule.

<table>
<thead>
<tr>
<th>Year</th>
<th>10-K</th>
<th>10-Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>90 days</td>
<td>45 days</td>
</tr>
<tr>
<td>2</td>
<td>75 days</td>
<td>40 days</td>
</tr>
<tr>
<td>3 and after</td>
<td>60 days</td>
<td>35 days</td>
</tr>
</tbody>
</table>

The phase-in period will begin for accelerated filers with fiscal years ending on or after December 15, 2002.
5.2. Disclosure of Material Correcting Adjustments in Financial Statements. Section 401(a) of the SOA amends Section 12 of the Exchange Act to require that financial statements included in reports filed with the SEC reflect all material correcting adjustments that have been identified by the external auditor in accordance with GAAP and SEC rules.

5.3. Disclosure of Material Off Balance Sheet Transactions. Section 401(a) of the SOA directed the SEC to adopt rules requiring all 10-Qs and 10-Ks to disclose “all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and other relationships of the [company] with unconsolidated entities or other persons” that may have a “material current or future effect” on the company’s financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources or significant components of revenues or expenses.

5.4. Non-GAAP Financial Disclosures. Section 401(b) of the SOA directs the SEC to adopt rules as to how companies must present non-GAAP information so that it is not materially false or misleading. The new SEC rules implementing Section 401(b) define “non-GAAP financial measure” to be a numerical measure of a company’s historical or future financial performance, financial condition or cash flows that is not calculated and presented in accordance with GAAP. As part of the new rules, Regulation G imposes on a company that publicly discloses material information that includes a non-GAAP financial measure the duty to include in that disclosure the “most directly comparable” GAAP financial measure and a quantitative reconciliation to the GAAP financial measure.

5.5. Real Time Disclosures. Section 409 of the SOA amends Section 13 of the Exchange Act to require companies to publicly disclose on a “rapid and current” basis all material changes to their financial condition or operations as the Commission determines by rule to be necessary or useful for investor protection.

5.6. Required Website Disclosures. In amending Section 16(a) of the Exchange Act, the SOA requires electronic filing of change of beneficial ownership reports and website posting of such reports by both the Commission and the companies.

Under the NYSE Proposed Rule 303A(9), each listed company’s website must include corporate governance guidelines, the charters of its most important committees (including at least the audit compensation and nominating committees) and the company’s code of ethics. The company’s annual report must also state the availability of the above information on its website, and that the information is available in print to any investor who requests it.

NASDAQ Proposed Rules do not have any comparable requirement.

6. CONCLUSION

Obviously, the regulatory framework established by Congress through the SOA greatly expanded the reach of federal securities regulation into many areas not previously
addressed by federal securities law. Many questions still exist concerning how strictly the SEC, considering its staffing and budgetary constraints, will enforce the various provisions of the SOA once the post-Enron fervor has dissipated. In this era of uncertainty corporate counsel should continue to rigidly adhere to all rules and regulations promulgated by the SEC to enforce the SOA until the SEC offers more guidance regarding their specific enforcement intentions. Counsel must also remain cognizant of the rules governing NASDAQ and the NYSE and other securities exchanges as they evolve to meet the demands of the SOA. The potentially severe punishments that the SOA provides for noncompliance will require significant efforts by corporate counsel to ensure that their clients fulfill its unfamiliar and expansive requirements.
OUTLINE OF A NOMINATING/GOVERNANCE COMMITTEE CHARTER

1. **Statement of Purpose.**
   (i) Identify individuals qualified to become board members.
   (ii) Make recommendations to the Board regarding the nominees for director.
   (iii) Develop and recommend to the Board the company’s corporate governance policy.
   (iv) Take a leadership role in shaping the company’s corporate governance.
   (v) Review and make recommendations regarding the company’s policies related to public and social issues.

2. **Membership Composition.**
   (i) Number of members (including minimum number).
   (ii) Qualification
   (iii) Manner of appointment.
   (iv) Term of office.

3. **Meetings.**
   (i) Frequency.
   (ii) Keeping minutes.
   (iii) Quorum requirement.
   (iv) Action by unanimous written consent.

4. **Board and Committee Matters.**
   (i) Establish nominee criteria and qualifications.
   (ii) Search for and identify a pool of candidates.
   (iii) Right to retain a search firm in the committee’s sole discretion.
   (iv) Recommend to Board a slate of nominees for election or reelection.
   (v) Evaluate company’s director recruitment policy.
(vi) Review and make recommendations to Board regarding Board compensation and structure.

(vii) Review and make recommendations to Board regarding nature and duties of board’s committees.

(viii) Develop and oversee a director orientation and continuing education program.

(ix) Delegate authority and responsibilities to subcommittees as deemed proper.

5. Executive Officer Matters.

(i) Receive recommendations from the CEO regarding management succession.

(ii) Recommend to the Board a successor to the CEO when a vacancy occurs.

(iii) Recommend and review any personnel changes involving SEC reporting officers.

6. Corporate Governance Oversight.

(i) Review the company’s policies and programs in such areas as:

   • Code of ethics;
   • charitable contributions; and
   • director orientation and continuing education.

(ii) Meet or communicate with company constituents.

7. Reports and Assessments.

(i) Report from time to time to Board on Committee actions and fulfillment of Committee’s responsibilities

(ii) Make annual review and self-assessment of performance.

(iii) Develop and oversee and annual assessment of the full Board.
APPENDIX B

OUTLINE OF A COMPENSATION COMMITTEE CHARTER

1. **Statement of Purpose.**
   (i) Assist Board in its responsibility relating to fair and competitive compensation of key company employees.
   
   (ii) Assure that key employees (which should include at least the company’s SEC reporting officers) are compensated in a manner consistent with the compensation philosophy and strategy of the Board and in compliance with the requirements of regulatory bodies.
   
   (iii) Review and approve the company’s compensation philosophy and its compensation programs, plans, and awards.

   (iv) Administer company’s long and short term incentive plans and other stock-based plans.

   (v) Review and approve company’s general employee pension benefit plan and other benefit plans as needed.

2. **Membership Composition.**
   (i) Number of members (including minimum number).

   (ii) Qualifications:

   (iii) Manner of appointment.

   (iv) Term of office.

3. **Meetings.**
   (i) Frequency.

   (ii) Keeping minutes.

   (iii) Quorum requirement.

   (iv) Action by unanimous written consent.

4. **General Compensation Oversight.**
   (i) Review company’s executive compensation strategy and philosophy and consult with CEO regarding strategy’s effect on achievement of company goals.
(ii) Assure that total compensation paid to key employees is appropriate and consistent with company’s compensation philosophy.

(iii) Annually review market and industry data to assess company’s competitive position with respect to compensation.

(iv) Right to retain a compensation consultant in Committee’s sole discretion.

(v) Administer company’s incentive compensation or option plan and stock related plans through:

- approving option guidelines and size of grants;
- making grants;
- interpreting the plans;
- determining the rules and regulations relating to the plans;
- modifying or canceling existing grants and substituting new grants (with the consent of the grantees);
- designating employees eligible to participate in the plans; and
- imposing limitations, restrictions, and conditions upon any award as permitted under the applicable plan.

(vi) Monitor the proposed awards for conformance with any restrictions placed thereon by the Board and the shareholders and advise Board if any conflict exists.

(vii) Review with the CEO matters related to management succession.

(viii) Periodically review and make recommendations to the Board regarding the company’s stock ownership guidelines.

(ix) Delegate authority and responsibilities to subcommittees and deemed proper.

5. **Non-CEO Compensation Oversight**

(i) Review with the CEO the CEO’s recommendations for the compensation of other key employees

(ii) Annually review and make recommendations to the Board regarding the compensation made to the company’s key employees.

(iii) Annually review and make recommendations to the Board regarding the benefits and prerequisites made to the company’s key employees.

(iv) Review and make recommendations to the Board regarding agreements proposed to be entered into with the company’s key employees.
(v) Review and make recommendations to the Board regarding any deferred compensation arrangement proposed to be entered into with the company’s key employees.

(vi) Review and make appropriate recommendations to the Board regarding the competitiveness and appropriateness of compensation paid to executive officers of subsidiaries.

6. **CEO Compensation Oversight**

(i) Annually review and approve the compensation made to the CEO considering the following variables:

- company’s performance during good and bad economic cycles;
- relative shareholder returns;
- value of incentive awards to CEOs at comparable companies;
- proper balance between long and short term incentives;
- differences in compensation at various levels of company management; and
- achievement of the corporate goals and objectives that were reviewed and approved by the Committee the previous year.

(ii) Annually review and make recommendations to the Board regarding the benefits and prerequisites offered to the CEO.

(iii) Review and make recommendations to the Board regarding agreements proposed to be entered into with the CEO.

(iv) Review and make recommendations to the Board regarding any deferred compensation arrangement proposed to be entered into with the CEO.

(v) Approve in advance any salary adjustment for CEO and explain such adjustment in writing to the Board.

7. **Director Compensation Oversight.**

(i) Annually review and make recommendations to the Board regarding the compensation made to the company’s directors.

(ii) Monitor the amount of compensation proposed to be paid to any director, and its effect on director independence, for compliance with the company’s equity compensation plans.
8. *Reports and Assessments.*

(i) Report from time to time to Board on Committee actions and fulfillment of Committee’s responsibilities

(ii) Make annual review and self-assessment of performance.

(iii) Issue an annual report to Board regarding the propriety of the compensation arrangements and whether the compensation arrangements met their stated purpose and served the interests of the company.

(iv) Prepare an annual report as required by SEC rules and regulations and submit it to the Board for inclusion in the company’s proxy statement.
APPENDIX C

OUTLINE OF A CODE OF ETHICS

Legal Compliance

- Antitrust
- Anti-Kickback, Bribery
- Transacting International Business (Foreign Corporate Practices Act, etc.)
- Environmental
- Inside Information and Insider Trading
- Government Investigations

Customer and Supplier Relationships

- Bribes
- Gifts
- Entertainment
- Permissible Payments

Responsibilities To The Company

- Communications
- Conflicts of Interest
- Confidentiality of Information
- Corporate Opportunities
- Gifts, Entertainment and Favors
- Intellectual Property
- Protection and Proper Use of Company Assets
- Record Keeping and Retention
- Use of Internet, Technology, Email, etc.
• Use of Company Assets

**Employee Practices**

• Equal Employment Opportunity
• Health, Safety and Environment
• Substance Abuse
• Diversity
• Conduct in the Workplace/Harrassment
• Employment Records

**Political Activity**

• Political Contributions
• Lobbying

**Compliance With Code of Ethics (Whistle Blower Policy)**

• Ethical Responsibilities
• Duty to Report Violations
• Procedures for Reporting Violations
• Retribution Prohibited
• Guidance in Complying with Company Policies
• Disciplinary Action for Violations