

SEC Adopts Final Rules Under Sections 306(a), 401(b), 406 and 407 of Sarbanes-Oxley

The SEC yesterday adopted final rules under Sections 306(a) (insider trading during pension blackout periods), 401(b) (disclosure of non-GAAP financial information), 406 (code of ethics), and 407 (audit committee financial experts). We have previously sent Securities Alerts that describe each of the proposed rules previously adopted by the Commission. These Securities Alerts are also available on our web site at www.ropesgray.com under “News & Events”. We have summarized below the major changes from the previously proposed rules that were discussed at today’s SEC open meeting. The text of the new, final rules has not yet been made available.

Disclosure Containing Non-GAAP Financial Information

Merger Disclosures. The new rules will not apply to any disclosure currently required by SEC rules for business combinations.

Foreign Private Issuers. For foreign private issuers, the new rules permit non-GAAP financial measures to be released in the US if already released in the issuer’s home country and exclude financial measures that are required by the issuer’s home country GAAP. GAAP is the primary GAAP of the foreign private issuer.

Financial Releases and Announcements Furnished to SEC on Form 8-K. The revised amendment to Form 8-K requires releases and announcements disclosing material non-public financial information about completed quarterly or annual fiscal periods to be “furnished” rather than “filed” with the Commission. Accordingly, these filings will not be subject to Section 18 liability under the Exchange Act and will not automatically become incorporated by reference into filings. In addition, these filings will not be subject to the more stringent requirements for filed documents. In order to avoid the filing of a transcript of information that is publicly disclosed orally, by web cast or by broadcast (or similar means) (i) the 8-K must be filed prior to such disclosure and the presentation must occur within 48 hours of filing on the 8-K, (ii) the presentation must be broadly accessible to the public, and (iii) information in the web cast must be posted on the company’s web site.

The new rules will take effect 60 days from the date of publication of the final rule in the Federal Register.

Audit Committee Financial Experts

Expanded Definition of Financial Expert. The designation of “financial expert” was renamed “audit committee financial expert” and the definition was broadened to include not only individuals who have direct experience preparing or auditing financial statements with issues comparable to those of the registrant, but also to include those who (i) actively supervise those individuals, (ii) have experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of financial statements, or (iii) have other relevant experience. In addition, the final rule will eliminate the proposed requirement that a person’s experience applying GAAP in connection with estimates, accruals and reserves be “generally comparable” to the estimates, accruals and reserves used in the issuer’s financial

statements. These changes were intended to include a broader class of people who still have the degree of financial expertise intended by the rules and by Sarbanes-Oxley.

Liability Safe Harbor. The Commission adopted a safe harbor to protect the audit committee financial expert by specifying that (a) he or she is not an expert for other purposes of the securities laws, most notably liability as an “expert” under Section 11 of the Securities Act, (b) the designation as an audit committee financial expert does not impart additional or higher responsibilities on such individual, and (c) the presence of an audit committee financial expert does not reduce the responsibilities of other members of the committee.

Effective Date and Transition Period. The new rule will take effect 30 days after publication of the final rule in the Federal Register. There will be a transition period such that these new disclosure requirements will only apply to reports covering fiscal years ending on or after July 15, 2003 (December 15, 2003 for small business issuers).

Code of Ethics

Avoidance of Conflicts Eliminated. The provision in the proposed rule requiring that a qualifying “code of ethics” include provisions designed to promote “avoidance of conflicts of interest, including disclosing to an appropriate person identified in the code of ethics of any material transaction or relationship that reasonably could be expected to give rise to such a conflict” has been eliminated. The SEC noted that provision requiring the “ethical handling of actual or apparent conflicts of interest” was sufficient so that a complete prohibition was not necessary or appropriate to comply with Sarbanes-Oxley’s requirement.

Web Site Posting of the Code, Changes in the Code and Waivers from the Code. Companies will be required to disclose changes in, or waivers from, their code of ethics within five business days (rather than two as previously proposed) by either (i) posting appropriate disclosure on their websites, in a location where an investor would typically look, or (ii) filing a Current Report on Form 8-K. Companies must make their code of ethics available to the public by either (i) filing it as an exhibit to the annual report, (ii) posting a copy on its website in a location where an investor would typically look, or (iii) upon written request, making copies available by mail.

Effective Date and Transition Period. The new rule will take effect 30 days after publication of the final rule in the Federal Register. There will be a transition period such that new annual report disclosure requirements will only apply to annual reports covering fiscal years ending on or after July 15, 2003.

Insider Trading During Pension Plan Blackout Periods (New Regulation BTR)

Elimination of the Irrebuttable Presumption that Securities Acquired in Connection with Employment or Service Come Out First. The final rules will provide an affirmative defense to the extent that the executive officer or director can trace the shares sold or otherwise transferred to securities acquired outside of the employment or service nexus, so long as the tracing methodology is consistent with current tax and all other disclosure and reporting requirements.

Profit Recovery Methodology. The proposed rules provided no guidance on how to calculate the profits recoverable in a private right of action. The final rules provide that the amount that can be recovered will be limited to the difference between the amount paid or received (during the blackout period) and the amount that would have been paid or received after the blackout period (based on an average of the closing price on

the three days immediately after the end of the blackout period). The SEC retains its authority to bring civil (as well as criminal) actions which it appears will not be subject to this cap.

Relief for Foreign Private Issuers. Under the final rules, a foreign private issuer will be deemed to have incurred a “blackout period” only if both of the following tests are satisfied for a period of more than three consecutive business days: (1) the ability of 50% or more of all U.S. individual account plan participants to trade in equity securities of the issuer under the plan is temporarily suspended; and (2) the blackout affects either (1) greater than 50,000 employees, or (2) greater than 15% of the issuer’s worldwide workforce. Under the proposed rules, the second prong of the test was that the blackout must affect more than 15% of all of the issuer’s individual account plan participants worldwide.

Additional Exempt Transactions. The list of transactions exempt from the prohibition of Section 306(a) has been expanded. In addition to all of the exemptions contained in the proposed rules, which will be retained, it appears that the following transactions will be exempt:

- Compensatory grants and awards of equity securities pursuant to programs under which grants and awards occur automatically;
- Exercises, conversions or terminations of certain derivative securities, which, by their terms, occur only on a fixed date, or are exercised, converted or terminated by a counter-party who is not subject to the influence of the director or executive officer;
- Acquisitions or dispositions of equity securities involving a bona fide gift or a transfer by will or the laws of descent and distribution;
- Acquisitions or dispositions of equity securities pursuant to a domestic relations order;
- Sales or other dispositions of equity securities compelled by the laws or other requirements of an applicable jurisdiction; and
- Acquisitions or dispositions of equity securities in connection with a merger, acquisition, divestiture or similar transaction occurring by operation of law.

Effective Date. These rules will become effective on January 26, 2003.

Contact Information

If you have any questions or would like to learn more about the proposal, please contact the lawyer who normally represents you.