SEC Adopts Final Rules Regarding Code Of Ethics Disclosure
Under Section 406 of the Sarbanes-Oxley Act of 2002

February 2003

Introduction

On January 23, 2003, the SEC issued final rules under Section 406 of the Sarbanes-Oxley Act of 2002, requiring public companies to disclose (i) in their annual reports, whether they have adopted a code of ethics for their principal executive officer and senior financial officers and, if not, why not, and (ii) in a Form 8-K or on their public website, any amendment to or waiver of the code of ethics for the specified officers (see SEC Release No. 33-8177).

Time Frame for Compliance

Companies must comply with the disclosure requirements regarding adoption of a code of ethics in their annual reports for fiscal years ending on or after July 15, 2003. Companies must also comply with the disclosure requirements regarding amendments to or waivers of the code of ethics on or after the date on which they file their first annual report in which the code of ethics disclosure is required.

Disclosure Requirements Regarding Adoption of a Code of Ethics

The new rules (which are implemented by adding a new Item 406 to Regulations S-K and S-B, a new Item 16B to Form 20-F and a new Instruction B.(9) to Form 40-F) require public reporting companies to disclose:

• if the company has not adopted a code of ethics, the reasons it has not done so.

Note that, although Section 406 of the Sarbanes-Oxley Act focused on a code of ethics for a company’s senior financial officers, the new rules provide that the disclosure regarding the code of ethics will apply to its principal executive officer as well as senior financial officers.

All companies that are subject to the periodic reporting requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are subject to the disclosure requirements regarding the adoption of codes of ethics.

Public Availability of a Code of Ethics

In addition to requiring disclosure about the adoption of an ethics code, the new rules direct companies to make their codes of ethics publicly available by one of the following three alternative methods:

• as an exhibit to their annual report;

• on their public website (provided that a company choosing this option also must disclose its website address and intention to provide disclosure in this manner in its annual report); or

• by means of an undertaking in their annual report to provide a copy of the code of ethics to any person without charge upon request.

Elements of a Code of Ethics

The new rules define “code of ethics” to mean written standards that are reasonably designed to “deter wrongdoing” and to promote:
• **honest and ethical conduct**, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;

• **full, fair, accurate, timely and understandable disclosure** in the periodic reports required to be filed by the company;

• **compliance with** applicable governmental laws, rules and regulations;

• **prompt internal reporting** to the appropriate persons identified in the code of violations of the code; and

• accountability for adherence to the code.

The SEC’s definition expands the definition of a “code of ethics” from what is specified in Section 406 of the Sarbanes-Oxley Act to include the last two bullets above.

**Content of the Code of Ethics**

The new rules do not specify every detail that a company must address in its code of ethics or prescribe any specific language that the code of ethics must include. The rules also do not specify what procedures a company should develop, or the types of sanctions that a company should impose, to ensure compliance with its code of ethics. The SEC believes that ethics codes do, and should, vary from company to company and that decisions as to the specific provisions of the code, compliance procedures and disciplinary measures for ethical breaches are best left to each company.

The new rules allow companies to have separate codes of ethics for different types of officers. The required elements of a code of ethics for the specified officers may be part of a broader code that addresses additional issues and applies to additional persons.

The new rules do not require a company to adopt a code of ethics if it has not already done so, or amend its existing code of ethics if it already has one, but the rules require a company that does not have a code of ethics containing the required elements for the specified officers to explain why it does not have such a code. We expect, however, that most public companies will adopt a code of ethics for the specified officers containing the required elements.

**Location of Disclosure**

The new rules require companies to include the new disclosure in their annual reports on Forms 10-K and 10-KSB. The required disclosure will be made in Part III of such reports. Consequently, a company may incorporate this information by reference from its definitive proxy or information statement that involves an election of directors, if the company voluntarily chooses to include this information in its proxy or information statement and then files such statement with the SEC no later than 120 days after the end of the fiscal year covered by the Form 10-K or 10-KSB.

**Disclosure Regarding Amendments to, or Waivers of, the Code of Ethics**

The new rules add an item to the list of events that trigger a Form 8-K filing to require disclosure of the following:

• any amendment to a company’s code of ethics that applies to the specified officers; or

• any waiver of a provision of a code of ethics granted to a specified officer, including the name of the officer to whom the waiver was granted.

A “waiver” is defined by the SEC as the approval by the company of a material departure from a provision of the code of ethics. Technical, administrative or other non-substantive amendments to the code of ethics do not require disclosure.

If a company elects to provide the required disclosure on Form 8-K, the company must file the report within five business days after it amends the code or grants the waiver. Please note that the requirement to provide such disclosure within five
business days differs from recently proposed SEC rules, which would have required disclosure within two business days. The SEC has stated, however, that the five business day period will serve only as an “interim” deadline, and will consider whether to shorten the disclosure requirement to two business days when it more broadly addresses the Form 8-K proposals originally set forth in the SEC’s June 17, 2002 release (Release No. 33-8106).

As an alternative to providing the required disclosure on a Form 8-K, the new rules allow a company to use its own public website as a method for disseminating the disclosure about amendments to, or waivers of, its code of ethics. However, a company may take advantage of the website option only if it had previously disclosed in its most recently filed Form 10-K or 10-KSB:

- that it intends to disclose these events on its public website; and
- its public website address.

If a company elects to disclose this information on its website, it must do so within the same five-business day time period that the SEC requires for Form 8-K filings. In addition, the new rules require a company electing to provide website disclosure to make the disclosure available on its website for a period of at least 12 months after it initially posts the disclosure. After the 12-month posting period, the company must retain this disclosure for a period of not less than five years and make it available to the SEC upon request.

The SEC specified that only those waivers or amendments relating to the specified elements of the code of ethics and the specified officers must be disclosed. The SEC noted that this clarification is intended to allow and encourage companies to retain broad-based business codes without requiring companies to disclose amendments or waivers relating to matters other than the specified elements or involving persons (such as directors) other than the specified officers. In light of the requirement to disclose amendments and waivers of the code of ethics that is applicable to the specified officers, companies should discuss with counsel the pros and cons of single versus multiple codes of ethics.

**NYSE and Nasdaq Rules**

Both the NYSE and Nasdaq have submitted proposed rules to the SEC that include proposals requiring each listed company to maintain a code of ethics. Unlike the codes of ethics required by the new SEC rules, the proposed NYSE and Nasdaq codes of ethics would apply broadly to all directors, officers and employees of a company, not just to principal executive and senior financial officers. In addition, the proposed NYSE rules require that codes of ethics contain somewhat different elements than those specified by the SEC rules (although there is some overlap between the two sets of rules). By contrast, the proposed Nasdaq rules simply require codes of ethics to comply with the same elements of a code of ethics set forth in the SEC rules discussed above.

The SEC has not yet approved the NYSE and Nasdaq proposals, and therefore they are not yet effective. The NYSE has indicated that companies will be required to adopt a code of ethics within six months after SEC approval, and Nasdaq has stated that companies will be required to adopt a code of ethics as of the first annual stockholders meeting on or after January 1, 2004.

This memorandum is intended only as general information about the matters discussed, and should not be construed as legal advice. For more information about these matters, please contact your Wilson Sonsini Goodrich & Rosati partner.