

**“APPROVALS” PURSUANT TO CODES OF ETHICS MAY TRIGGER
DISCLOSURE REQUIREMENTS**

Under SEC regulations adopted pursuant to Section 406 of the Sarbanes-Oxley Act of 2002, a reporting company is required to disclose, commencing with its 2003 annual report, whether it has adopted a code of ethics that applies to its principal executive officer, principal financial officer and principal accounting officer or controller. The company is then required to report within five business days on a Form 8-K any amendments to, and waivers from, the code of ethics, relating to any of these officers. Alternatively, if the company has so stated in its most recent annual report, it may make the disclosure on its website in lieu of filing a Form 8-K.

Many codes of ethics contain approval processes whereby potentially problematic transactions or relationships may be permitted. For example, a code of ethics may prohibit investments in other businesses without the approval of the CEO and another executive officer. The question then becomes whether such an approval process expressly contemplated by the code constitutes an “approval by the company of a material departure from a provision of the code of ethics” (the definition of “waiver” under SEC regulations), triggering these disclosure requirements.

In informal discussions we have had with the SEC, the SEC indicated that they *would* view such an approval as a waiver. Apparently, the SEC is looking for current disclosure of any deviation from a general standard imposed under the code of ethics, rather than deviations from a corporate governance *process* established by the code.

Many practitioners were surprised by this SEC interpretation of what constitutes a “waiver.” Given the SEC’s conservative approach to this issue, companies should be cautioned against aggressive interpretations of the rules and regulations promulgated by the SEC in response to the Sarbanes-Oxley Act.

Commentary:

- In addition to these Sarbanes-Oxley and SEC code of ethics requirements, listed companies are further subject to similar but broader requirements imposed by the NYSE and NASDAQ. Unlike the Sarbanes-Oxley and SEC requirements, the NYSE and NASDAQ impose a substantive (as opposed to disclosure) requirement for a code of ethics that is somewhat broader in scope and extends to all officers, directors and employees. Similar disclosure is required for waivers for executive officers and directors. Although we have not consulted with the NYSE and NASDAQ on this issue, we believe that the NYSE and NASDAQ would likely take a view similar to that of the SEC.

- Note, however, that the NYSE and NASDAQ's substantive requirements further provide that such waivers may only be made by the board or a board committee; accordingly, the approval in our example above must be made by the board or board committee, at least for executive officers and directors.
- Ironically, requiring a company to formally disclose what it considers to be routine approvals for its executive officers and directors may lead it to narrow the restrictions imposed by its code of ethics, increase thresholds not subject to approval or remove certain transactions or relationships from coverage under its code entirely.
- Difficult disclosure issues may arise when a board or board committee may be required to "interpret" a general provision of a code of ethics. Depending on how general the language of the applicable provision of the code is and the nature of the issue presented, this interpretation may also constitute a waiver, triggering disclosure requirements. Additional specificity in a code of ethics, especially as to what is permitted, will help avoid these interpretative issues.
- Note also that the definition of waiver incorporates a materiality standard. So, for example, a one-time approval permitting an executive to keep a gift from a supplier that is a few dollars in excess of a permitted amount would not likely trigger a disclosure obligation.

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If you wish to obtain additional information regarding these code of ethics and other corporate governance requirements, please contact Serge Benchetrit, John S. D'Alimonte, Steven J. Gartner, Yaacov M. Gross, Jeffrey S. Hochman or the corporate partner with whom you regularly work.

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