NYSE TAKES ACTIONS ON CORPORATE GOVERNANCE REFORM

SEC ALERT REGARDING EXECUTIVE CERTIFICATION

New Developments Involving NYSE Corporate Governance Reform Proposals

On August 1, 2002, the New York Stock Exchange (the "NYSE") Board of Directors announced that it had approved new corporate governance reform proposals. These proposals supplement and clarify (after over 300 comment letters were received) the recommendations previously submitted on June 6, 2002 to the NYSE Board of Directors by the Corporate Accountability and Listing Standards Committee. The NYSE's proposals are intended to help restore investor confidence by increasing issuer accountability, integrity and transparency and are part of an ongoing effort of the government, the Securities and Exchange Commission ("SEC") and securities industry regulators to strengthen corporate governance rules.

The reform proposals will be forwarded to the SEC for final approval, and will be subject to a public comment period, prior to any amendments to the NYSE Listed Company Manual. For planning purposes, NYSE-listed companies should monitor in particular the proposed rules relating to board and board committee composition (including the exception for "controlled" companies), director independence clarifications, chief executive certification, governance procedures and shareholder approval for stock option plans.

New Developments Involving SEC Executive Certifications

As noted in our previous client memoranda, three separate types of executive certifications of companies' SEC filings are required under the recent legislative and regulatory corporate governance initiatives:

- *Section 906 Certifications.* Certifications of periodic reports required of the principal executive officers and principal financial officers of all reporting companies under Section 906 of the recently enacted Sarbanes-Oxley Act of 2002 (the "Act");
- *Section 302 Certifications.* Certifications of the information and financial statements included in periodic reports and an evaluation of internal financial controls and procedures pursuant to SEC regulations issued in June 2002 and, subsequently, under Section 302 of the Act; and
- *Major Company Certifications.* Certifications of prior SEC filings required of the principal executive officers and principal financial officers of approximately 1,000 public companies pursuant to a special order of the SEC, which certifications are generally due by August 14, 2002.

As further described below, on August 2, 2002, the SEC issued an alert announcing changes to its June 2002 rules regarding Section 302 certifications. **A footnote to this release confirmed our previous advice that Section 906 certifications became required upon the Act's enactment on July 30, 2002 and thus must be included with all quarterly and annual reports after that date.** Also, on August 2, the SEC proposed other rules mandating certifications by research analysts.

NYSE Proposed Rule Changes

The NYSE proposed rule changes would:

- subject to the exception for "controlled" companies (discussed below), require boards of listed companies to be comprised of a majority of independent directors, and provide guidance regarding determining director "independence;"
- subject to the exception for "controlled" companies, require listed companies to have a nominating committee and a compensation committee comprised solely of independent directors;
- require non-management directors to meet without management in regular executive sessions;
- require every listed company to have an internal audit function;
- require directors' compensation to be the sole remuneration from the listed company for audit committee members;
- require listed companies to adopt a code of business conduct and ethics and to promptly disclose any waivers of the code for directors or executive officers;
- require listed companies to publish codes of business conduct and ethics and key committee charters;
- require that shareholders of listed companies be given the opportunity to vote on stock-option plans, with certain exceptions;
- require listed foreign private issuers to disclose any significant ways in which their corporate governance practices differ from those otherwise mandated under the NYSE rules;
- require each listed company's CEO to certify annually that he or she is not aware of any violation by the company of the NYSE corporate governance standards;
- provide for the possibility for a NYSE public reprimand letter for violation of corporate governance standards in addition to the existing penalty of delisting; and
- recommend that every listed company establish an orientation program for new board members.

1. Board and Committee Independence; "Independence" Determination

The NYSE rules currently require audit committees to be comprised of three independent directors, but contain no requirement regarding the proportion of the entire board of directors that must be independent. Under the proposed rules, unless the company is a "controlled company," the majority of listed-company board members will be required to be independent. All currently listed companies will be required to reach majority-independence within two years. No director will qualify as "independent" unless the listed company's board of directors affirmatively determines that the director has no material relationship with the listed company. A board may adopt and disclose categorical standards to assist it in determining director independence, and may make a general disclosure if a director meets these standards. Any independence determination for a director who does not meet the standards must be specifically explained.

The proposed rules further narrow the definition of who will be considered to be "independent" by requiring a five-year "cooling off" period for (i) former employees of the listed company, (ii) former employees or affiliates of the listed company's independent auditor, (iii) former employees of any company whose compensation committee includes an officer of the listed company and (iv) immediate family members of the above.

2. Controlled Companies Exceptions

Under the proposed rules, a "controlled" company in which more than 50% of the voting power is held by an individual, company or group does not need to have a majority of independent directors on its board nor have nominating and compensation committees composed of independent directors. However, these companies must have a minimum three-person audit committee composed entirely of independent directors.

This "controlled" company exception has not as yet been adopted by either the Nasdaq Stock Market ("Nasdaq") or the American Stock Exchange ("AMEX"). Please refer to our memorandum dated July 29, 2002 regarding the recent Nasdaq and AMEX initiatives.

3. Stock Option Plans

Under the proposed rules, shareholders of a listed company must be given the opportunity to vote on all stock option plans, except employment-inducement options, options acquired through mergers and tax-qualified plans such as ESOPs and 401(k)s. In addition, brokers may vote customer shares on proposals for such plans only pursuant to customer instructions.

SEC Alert Regarding Section 302 Certifications

On August 2, 2002, the SEC announced changes to its previously proposed rules regarding executive certifications of their companies' annual and quarterly reports. These changes were necessitated by Section 302 of the recently enacted Sarbanes-Oxley Act of 2002 (the "Act"),

which directed the SEC to issue rules implementing this requirement to be effective by August 29, 2002. The SEC's alert advised that its previously proposed certification would be amended to conform to the requirements of the Act.

As described in our previous client memorandum of July 29, 2002, under Section 302 of the Act, CEOs and CFOs of public companies will each be required to personally certify in their companies' SEC quarterly and annual reports that they have reviewed the report and that, to their knowledge:

- the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading; and
- the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report.

The Section 302 certification also requires the executives to acknowledge their responsibility for and evaluation of the company's internal procedures and controls, including that they have disclosed to the company's auditors and audit committee:

- all significant deficiencies in the design or operation of these controls; and
- any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal controls.

Additionally, the form of certification must indicate whether or not there were any significant changes in internal controls subsequent to the date of the evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

While Section 302 of the Act requires the officers to make these certifications as to internal controls, it does not directly require controls. The SEC's proposed rules would continue to require a company filing these reports to maintain procedures to provide reasonable assurance that the company is able to collect, process and disclose the information (both financial and non-financial) required in periodic and current reports. In addition, the proposed rules would require a periodic review and evaluation of these procedures, and an annual evaluation would have to be presented to the company's principal executive officer and principal financial officer. They, in turn, would have to certify in the company's annual report that they have reviewed the results of this evaluation.

Significantly, *all* reporting companies, including foreign private issuers and Canadian issuers, will be required to make the Section 302 certification, unlike in the SEC's previous proposal.

The comment period with respect to the SEC's proposed rules was originally scheduled to terminate on August 19, 2002. In its alert, the SEC indicated that it would not extend the

comment period beyond this date in order to be able to meet the Act's deadline of August 29 for the effectiveness of final rules.

****

If you wish to obtain additional information regarding the foregoing, please contact John S. D'Alimonte (212-728-8212, jd'alimonte@willkie.com), Steven A. Seidman (212-728-8763, sseidman@willkie.com), Yaacov M. Gross (212-728-8225, ygross@willkie.com), Jeffrey S. Hochman (212-728-8592, jhochman@willkie.com), Frank Daniele (212-728-8216, fdaniele@willkie.com) or the partner who regularly works with you. Please let us know if we can assist you in remaining abreast of new corporate governance proposals and developing procedures to ensure compliance with any new rules that are enacted.

Willkie Farr & Gallagher is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000, and our facsimile number is (212) 728-8111. Our web site is located at www.willkie.com.

August 5, 2002