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A transcript from our "**Coping with the New Section 16 Rules**" program held on September 18th is available at <http://www.realcorporatelawyer.com/CLE/CLE09-18-02Transcript.html>.

SEC I: Chairman Pitt Signals Major Changes to Shareholder Proposal Rule

In a speech today before the Council of Institutional Investors, Chairman Pitt noted that he has asked the Division of Corporation Finance to consider eliminating the "ordinary business" exclusion basis from the shareholder proposal rule. This basis - under Rule 14a-8(i)(7) - has been the most controversial basis under a very controversial rule.

This follows recent sentiment expressed by Chairman Pitt regarding the inclusion of a shareholder proposal regarding stock option expensing. Historically, this type of proposal has been permitted to be excluded by the Corp Fin staff - and an appeal is pending before the Commission on this matter (as discussed further [below](#)).

This also follows a recent rule petition that requests the SEC to revise the shareholder proposal rule to allow shareholders to elect directors through the proposal process. This petition seeks to revise the "election of directors" exclusion basis under Rule 14a-8(i)(8) to permit shareholders to nominate directors.

Chairman Pitt's speech before the Council of Institutional Investors is at <http://www.sec.gov/news/speech/spch582.htm>. The director election rule petition is at <http://www.sec.gov/rules/petitions/petn4-461.htm>.

SEC II: Filing Fee Rates to be Reduced

Once again, the SEC plans to reduce filing fee rates for 1933 Act and 1934 Act filings. When the SEC's fiscal year for 2003 starts on October 1, the SEC likely will be operating under a continuing resolution - under which filing fees remain at their current rates.

5 days after Congress acts to approve the SEC's regular appropriation, the fee rates for Section 6(b) of the Securities Act of 1933 and Sections 13(e) and 14(g) of the Securities Exchange Act of 1934 will be reduced from \$92.00 per million to \$80.90.

The SEC's Press Release (No. 2002-136) regarding these rate reductions is available at <http://www.sec.gov/news/press/2002-136.htm>.

SEC III: Mutual Fund Proposal to Disclose Voting Decisions and Policies

On September 20th, the SEC proposed rules that would require mutual funds to disclose their proxy voting decisions to shareholders twice a year - as well as require funds to file their proxy voting records with the SEC on EDGAR - and make them available to shareholders upon request within 3 days. In addition, the proposed rules would require funds to disclose the policies and procedures behind their votes.

The disclosure would consist of whether the funds cast their proxy votes - and if cast, whether those votes were "for" or "against" management. If a fund casts votes contrary to its voting policies or guidelines, the reasons behind casting these votes would have to be disclosed.

Currently, very few retail mutual funds disclose their proxy votes or policies to shareholders. In December 2000, the AFL-CIO sent a rule petition to the SEC urging rulemaking that would force mutual funds to disclose their policies and votes. More recently, larger funds have begun publicizing their guidelines. For example, in August 2002, Vanguard posted its proxy voting guidelines on its web site (it voted against 64% of the compensation proposals presented by companies in the first half of 2002!).

Separately, the SEC proposed rules that would require registered investment advisers to adopt proxy voting policies and procedures - and to disclose those policies and procedures to clients as well as explain how clients can obtain information about voting records. These proposed rules would not require advisers to file the records with the SEC or disclose how they voted on particular matters.

For both proposals, the comment period is 60 days.

The SEC's press release related to these actions is at <http://www.sec.gov/news/press/2002-139.htm>. The proposing releases are available at <http://www.sec.gov/rules/proposed/33-8131.htm> and <http://www.sec.gov/rules/proposed/ia-2059.htm>.

SEC IV: Enforcement Goes After Tyco Officers

In mid-September, the SEC filed civil fraud charges against 3 former top executives of Tyco International Ltd., including the former CEO, CFO and Chief Legal Officer. This action was brought at the same time a criminal action was brought by the Manhattan District Attorney.

Among other allegations, the SEC alleges that they failed to disclose multi-million dollar low interest and interest-free loans they took from the company, and in some cases, never repaid - and that they also sold shares of Tyco stock valued at millions of dollars while their self-dealing remained undisclosed. The SEC seeks a host of remedies, including disgorgement of profits and losses avoided on stock sales; repayment of loans with interest; and repayment of compensation received since the alleged fraudulent acts.

On September 17th, Tyco filed a Form 8-K with the details of these alleged fraudulent arrangements. This 8-K is at <http://www.sec.gov/Archives/edgar/data.htm>.

The SEC's press release related to this action is at <http://www.sec.gov/news/press/2002-135.htm>.

Accounting Standards: FASB and IASB Agree to Reach "Convergence"

In late September, the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") agreed to start eliminating the major differences between their rules. This is the first major step towards the creation of global

accounting standards - as the two groups cover companies in the U.S. and nearly 50 other countries.

As part of the goal to reach "convergence," the groups first will tackle major philosophical differences in their approaches to rule writing (i.e. rules-based in the U.S. versus principles-based elsewhere) - and also will conduct major rulemaking projects together. The tentative goal is to have the first set of uniform standards worked out by 2005 (which is the time by which European Union companies are required to adopt IASB standards).

For some time, the SEC has been considering whether to allow non-U.S. companies with securities listed on U.S. exchanges to follow IASB standards without having to reconcile the differences with U.S. rules (as is currently required). This consideration is now buttressed by Section 108(d) of the Sarbanes-Oxley Act - which requires the SEC to prepare a study of the feasibility of a principles-based accounting system for financial reporting in the United States. This study is due next summer.

The FASB's press release related to its agreement to "converge" is at <http://www.fasb.org/news/nr091702.shtml>.

Disclosure Practices and Procedures: What to Do Now

With the recent SEC rulemaking regarding CEO/CFO certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, companies now are required to develop and maintain a set of "disclosure controls and procedures" before CEOs and CFOs execute their certifications - and these officers must regularly evaluate and update these procedures.

It is not so clear what should be part of a set of "disclosure controls and procedures." The SEC's adopting release contains several statements about the topic - but nothing definitive as it provided flexibility for companies to devise the controls and procedures that best make sense for them.

These new "disclosure controls and procedures" relate to collecting information and timely providing it to senior management to allow them to determine whether disclosure should be made. This is broader than the set of controls and procedures that companies have been required to maintain for many years - "internal controls" that relate to financial reporting, as described in the AICPA Codification of Statements on Auditing Standards (AU § 319).

Companies should establish these new procedures as soon as possible - as CEOs and CFOs are required to evaluate these procedures during the 90 days prior to filing date each periodic report - and disclose the results of that evaluation in the reports. Although

each company has the flexibility to establish its own disclosure controls and procedures, the following should be considered as possible fixed components:

CEO/CFO Involvement - One fixed component should be the active involvement of the CEO and CFO in "kicking the tires." This should include making inquiries when necessary to anyone involved with the disclosure process - inside or outside the company. Each quarter, one or more meetings with the disclosure committee is crucial. Particular attention should be focused on the quality and timeliness of the company's internal controls and reporting systems, including any weaknesses that had been previously identified - and the adequacy of any changes taken to remedy those weaknesses.

Disclosure Committee - The disclosure committee should consist of the types of officers that the SEC has recommended - as well as those most responsible for internal controls. The committee should consider operating under some sort of charter that sets out its duties and responsibilities - as well as operating in a review and oversight role. This is as opposed to actually drafting the disclosures (but the actual draftspersons should all serve on the committee).

Drafting Sessions - Not common before Sarbane-Oxley, drafting sessions of the disclosure committee (perhaps with high-level minutes to document the process) may become routine. These sessions might include outside advisors - as well as employees not on the disclosure committee at the appropriate times when disclosure relating to their area of expertise is discussed.

Checklists - Checklists might be useful - but they should be vigorously updated each quarter as part of the CEO's and CFO's quarterly evaluation of the "disclosure controls and procedures." The checklist can list each disclosure item for a 10-Q or 10-K and the responsible party(ies) for the related disclosure. Beware of boilerplate checklists as they could lead to trouble. The lack of any changes over an extended period of time might indicate the lack of a rigorous evaluation. In addition to checklists, calendars may be useful to keep track of when particular actions have to be accomplished.

Documentation - Documentation of the entire process for each periodic report can be important - even though its labor-intensive. This may be useful in a dispute with the SEC or the plaintiff's bar. Ideally, a balance can be struck between adequately recording the process - and not providing a roadmap for future disclosure litigation.

Using Advisors - If not done as part of a drafting session, it may be useful to have outside advisors review one or more drafts of the disclosure prior to the disclosure committee's quarterly meeting with the CEO and CFO.

For practice pointers about CEO/CFO Certifications, see http://www.realcorporatelawyer.com/CEO_Certifications%202.html.

Corporate Governance: "CGQ" Off and Running

Institutional Shareholder Services has launched its Corporate Governance Quotient

(known as "CGQ") and now has a few months of experience. To avoid the pejorative context created by use of schoolroom ("A" to "F") grades and credit ratings ("AAA" to junk), all CGQ ratings are relative and are reported on a percentile basis-from zero (low) to 100 (high).

Each company receives two CGQ ratings:

The first score shows how each company's corporate governance practices stack up against a relevant index-the S&P 500, the S&P (mid-cap) 400, S&P (small-cap) 600 or the remainder of the Russell 3000.

The second score compares the company against its industry peers-using S&P's 23 sector groupings.

For example, a company with an Index CGQ of 57 and an Industry CGQ of 63 outscores 57 percent of its market cap peers and 63 percent of its sector competitors. The two scores appear in a box in the top right hand corner of an ISS Proxy Analysis. A new table-typically on the second page of each analysis-provides details about the key factors that drove the ratings.

Seven core topics (and 51 sub-issues) comprise the CGQ rating:

1. board structure and composition,
2. charter and bylaw provisions,
3. laws of the state of incorporation,
4. executive and director compensation,
5. qualitative factors, including financial performance,
6. D&O stock ownership, and
7. director education.

ISS does not charge companies for being rated - as companies don't "sponsor" CGQ ratings. However, ISS tries to get companies to participate in the process in three ways:

visit the CGQ web site (<http://www.isscgq.com>) at any time to review the list of ratings criteria and submit data to ISS,

sign up at the CGQ web site for an e-mail Corporate Issuer Review - this affords companies with 3 business days to verify the information collected by ISS before the score is calculated and included on the proxy analysis, and

subscribe to a fee-based service that allows companies to learn how to improve their ratings - and to benchmark their corporate governance practices against a self-selected peer group.

Cashless Exercise Programs: Evolving Positions Amid Confusion

In an attempt to tackle the challenging interpretative issues that have arisen under Section 402 of the Sarbanes-Oxley Act, a group of executive compensation experts have been caucusing to find uniform positions. This effort has led to a number of law firms that have changed their positions about what is permissible under this provision.

For example, more law firms now believe all forms of cashless exercise programs are permissible (see the September 12th memo from [Sullivan & Cromwell](#)) - although they note that there still is some risk. This is a sea change from the first half of September when most firms were recommending that these programs be suspended until regulatory guidance was available.

For FAQs about Section 402, see <http://www.realcorporatelawyer.com/ProhibitedLoansFAQ.html>.

Section 16: Practice Pointers

The following are 10 practice pointers culled from our recent "Coping with the New Section 16 Rules" program (with a special thanks to **Keith Higgins** of **Ropes & Gray**) and other publications available in our SEC Reform Portal.

1. **Reconsider who is a Section 16 Insider** - This is a common recommendation that has gotten unfavorable media attention recently. In other words, companies might be wary of changes that appear to be spurred by tougher rules. On the other hand, it is always appropriate at the time of the preparation of the Form 10-K to consider carefully the roster of executive officers. Changes that are made in the interim - because there is a presumption that the list of executive officers are the same as the Section 16 insiders - may be viewed with some suspicion, unless objective events gave rise to the reclassification.
2. **Enforcement of Pre-clearance Procedures** - Shorter window periods is another common recommendation and a reversal of the general trend towards longer windows - or no windows at all - over the past decade. However, some practitioners argue they already are short enough. Probably the best way to handle the related concern is to ensure that there are pre-clearance procedures (not just pre-notification) - and that they are enforced!
3. **Manage Broker Relationships** - This is a dimension of compliance programs that now should play a central role. The first step is to let brokers know precisely what they will need to do to permit insiders to be in compliance with the new rules.

The company should have a form letter it sends to the broker - not for the broker's signature, but just to put the broker on notice. Regular reminders - including friendly telephone calls - can go a long way towards establishing a

healthy relationship. Maintaining a roster of brokers - along with their cell phone numbers - is just as important and should be available to all persons now tasked with Section 16 duties.

Some companies have approached brokers with instruction letters for their signature. These letters obligate the broker to communicate with company personnel before executing an insider's transaction. As could be expected, most brokers are not signing these letters - instead, the company is told that the broker's compliance department still is working on formulating a universal response. Until these responses are available, companies might want to wait before taking an adversarial position with a broker (with whom they will need to work closely with to file forms timely).

4. **Filing on EDGAR** - As the SEC encourages - and will soon mandate - this obviously makes sense as it provides more time to prepare a form. The biggest challenges are obtaining EDGAR access codes for each insider (the company's codes can't be used) and ensuring that an insider's codes that were obtained for filings with another company are not cancelled by the SEC because you apply for codes for the same person. This can occur for insiders that serve on boards of other companies - and requires coordination between the two companies.

To determine whether an insider already has been issued EDGAR access codes, check the SEC's website at

<http://www.edgarcompany.sec.gov/servlet/CompanyDBSearch?page=main> - and enter the insider's last name in the "Company Name" field.

5. **Post Form 4s on Corporate Web Sites** - Also encouraged by the SEC - and will soon be mandated - this also ensures that the data is accurate (as compared to some third-party services that summarize data and make mistakes). The key here is not to post Form 4s selectively.
6. **Ensure More than One Person is the Section 16 Guru** - Powers of attorneys should be expanded to include at least 3 persons as attorneys-in-fact - and those persons should be the type that are not always traveling. Each of these persons should be kept up to speed on broker and plan administrator relationship developments, EDGAR access code problems, etc.
7. **Periodic Reminders to Insiders** - Of course, there still is a need to maintain a sound compliance program. Since the need for monthly reminders has dissipated as the Form 4 deadline is no longer fixed, companies should consider other dates to regularly send reminders - and orally remind directors and officers as often as possible (so you can be sure they hear you!).
8. **Coordinate with Plan Administrators and Rethink Plan Design** - As noted above, coordination with plan administrators is critical to ensure that Form 4s are filed timely - as the rule changes particularly impact certain plan transactions. Redesigning plans so that insiders don't have to file Form 4s frequently is a growing trend.
9. **Help Compensation Committee Determine the Proper Grant Date of Options** - Many practitioners are advising companies to change the ways that grants are communicated to optionees. Perhaps Section 16 insiders should be

told of their option awards promptly after the Compensation Committee decides to make the award. If so, perhaps all optionees should be informed of their awards at the same time to preserve employee morale.

As part of this, it might be wise to step back and ascertain when does the grant date truly occur. Date of board approval? What if the optionee has to sign the grant agreement? What if it's a one-sided award that doesn't require a signature? The best bet may be to prepare the Form 4s at the same time the material is prepared for the Compensation Committee's approval - then fill in the blanks after the committee meeting and file. The likelihood that an optionee refuses the award - possibly resulting in a cancellation - is fairly small.

10. **Let Insiders Know that More Corrections are Inevitable** - The bad news is that the new tight deadlines inevitably mean there will be more mistakes when preparing Form 4s. These mistakes require filing amendments to the incorrect forms. The good news is that the SEC believes that inadvertently incorrect forms still are not Item 405 reportable (only late forms are). Let insiders know that they should expect more incorrect filings - so they don't wonder about your competence when an amendment is filed.

A transcript of our "Coping with the New Section 16 Rules" program is at <http://www.realcorporatelawyer.com/CLE/CLE09-18-02Transcript.html>.

Stock Options: Excluded Shareholder Proposal on Expensing Appealed

In mid-July, the SEC staff issued a no-action letter allowing National Semiconductor Corporation to exclude a shareholder proposal regarding the board establishing a policy and practice of expensing the costs of future stock options issued to executives (2002 SEC No-Act. Lexis 651 (July 19, 2002)). The staff's response indicated that this proposal was excludable as "ordinary business" under Rule 14a-8(i)(7) - because it was a "choice of accounting methods." This staff response was consistent with six other requests filed during the past year.

The proponent, the United Brotherhood of Carpenters, filed an appeal with the Commission in late July. The Division of Corporation Finance and the Commission itself has not ruled on the appeal. In the meantime, additional groups have joined the proponent's cause by supporting the appeal, including The Calvert Group and Walden Asset Management.

As the issue of expensing options becomes more of a "significant policy issue," the likelihood of the SEC permitting the inclusion of these types of proposals grows. In fact, Chairman Pitt recently stated that he now supported the basis for the appeal. As part of their appeal, the shareholder groups' argue that the results of shareholder voting on this issue might be useful to the FASB as it studies the impact of stock expensing. Action on

the appeal is expected soon.

What's Up Online: Mandatory Online Access to Periodic Reports

Beginning with Form 10-Ks for fiscal years ending on or after December 15, 2002, those companies that are "accelerated filers" (basically those companies that are Form S-3 eligible) are required to disclose whether they make their periodic and current reports available, free of charge, on their web sites "as soon as reasonably practicable" after these reports are filed with, or furnished to, the SEC.

When does this requirement really kick in - This new disclosure requirement covers the company's experience during the period covered by the report. However, for the 1st transition year, it covers the period since the effective date of the new rule amendments - which is November 15th. In other words, if a company has not provided adequate access to its reports by November 15th - it will have to disclose this fact in its next 10-K.

Where access should be made from - The SEC recognizes that these reports logically should be made accessible from IR web pages - not the home pages of the main corporate web sites.

What reports should be included - The SEC encourages companies to provide online access to all of their SEC filings - not just the periodic and current reports mandated under the new rules. The periodic and current reports should include all exhibits and supplemental schedules - but not reports incorporated by reference (although the SEC encourages this practice).

When access should be provided after filing - There is no absolute deadline stated in the final rule - contrary to what was proposed. However, in the adopting release, the SEC interpreted the "as soon as reasonably practicable" standard to mean that the report should be available - barring unforeseen circumstances - on the same day as filing. The SEC threatened to revisit this requirement if posting on the same day does not occur in most cases.

How long should reports be accessible - As for archiving practices, the SEC encourages companies to provide "continuous" online access to their reports - with a minimum of 12 months. If reports are archived for longer periods (as the SEC encourages), the SEC suggests that an "archive" label should be used.

How reports can be linked as part of "access" - The SEC allows companies to meet the new requirement by merely providing links to the reports - including linking to the reports on the SEC's web site or a third-party service. The caveat is that the reports should be made available through these links for the appropriate time frame - and linked access to the reports must be free of charge to the user. Links can go directly to the reports - or to a list of its reports. But links cannot go to the home page or general search page of the SEC or a third-party service.

Permissible formats for posted reports - If a company uses PDF or other formats that are not officially accepted by EDGAR (and this is the sole format used by

the company - as compared to it being in addition to an accepted format like HTML), this is okay - so long as all of the information in the reports remains retrievable.

Below are examples of different ways that companies are providing access to their SEC reports:

Use of HTML and Word - Microsoft - <http://www.microsoft.com/msft/sec.htm>

Use of PDF - Pfizer - <http://www.pfizer.com/pfizerinc/investing/secfilings.html>

Use of Third-Party Service - Coke - http://www.corporate-ir.net/ireye/ir_site.zhtml?ticker=KO&script=1901

Use of Pop-Up Disclaimer - Intel - http://www.intel.com/intel/finance/disclaim_edgar.htm

The SEC's adopting release mandating disclosure about access to disclosure online is at <http://www.sec.gov/rules/final/33-8128.htm#IID>.

Comings and Goings: Who's Doing What and Where

At the SEC, Ethiopis Tafara was named Acting Director of the Office of International Affairs. In addition, **Scott A. Taub** joined the SEC to serve as a co-Deputy Chief Accountant and **Jonathan Sokobin** was promoted to Deputy Chief Economist of the Office of Economic Analysis.

In Corp Fin, Kristina Schillinger Wyatt has left the Office of Chief Counsel to join Commissioner Roel Campos' office as one of his Counselors. With the departure of Commissioner Hunt, **Joe Babits** has rejoined the Corp Fin staff and is working on rulemaking and other projects.

Events Calendar

Upcoming events of interest include:

National Association of Stock Plan Professionals' "2002 Annual Conference," Las Vegas, September 29-October 2

Glasser's "Sarbanes-Oxley Act of 2002," New York City, October 2-3; San Francisco, October 28-29

Terry College of Business/NACD Directors' College's "2002 Directors' College," October 10-11, Atlanta

Cooley Godward's "[Executive Solutions to Sarbanes-Oxley](#)," Reston, Va. October

15

Glasser's "19th Annual M&A Institute," New York City, October 15
American Corporate Counsel Association's Annual Conference, Washington
D.C., October 20-23

Morrison & Foerster's "Living with Sarbanes-Oxley," Tysons Corner, VA
October 31 (see

<http://www.mofo.com/graphics/approvals/SarbanesOxleyDC/index.html>)

PLI's "34th Securities Law Institute," New York City, November 6-9 (also
available by videoconference in San Francisco or by webcast to your computer)

American Society of Corporate Secretaries "Issues Update," New York City,
November 21

Input, Please

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