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**MEMORANDUM**

April 22, 2003

**TO:** Clients and Friends  
**FROM:** Graubard Miller  
**SUBJECT:** New SEC Rules relating to Codes of Ethics

As required by Section 406 of the Sarbanes-Oxley Act of 2002 (“Act”), the SEC has adopted rules relating to codes of ethics. The following is a description of these new rules.

**Disclosure Obligations**

The new rules require a company to disclose whether it has adopted a code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions (collectively, the “Covered Executives”). If a company has not adopted a code of ethics, it must explain why it has not done so.

**Definition of “Code of Ethics”**

The rules define the term “code of ethics” as written standards that are reasonably designed to deter wrongdoing and 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 reports and documents that a company files with, or submits to, the SEC and in other public communications made by the company;
- compliance with applicable governmental laws, rules and regulations;
- the prompt internal reporting to an appropriate person or persons identified in the code of violations of the code; and

- accountability for adherence to the code.

A company may have separate codes of ethics for different types of officers. Moreover, the required code of ethics items may be part of a broader code that addresses additional issues and applies to additional persons, such as all executive officers and directors of the company.<sup>1</sup>

### **Obligation to Publicly Publish Code**

A company must make its code of ethics publicly available using one of the following three methods:

- file a copy of the code of ethics as an exhibit to its annual report;
- post the code of ethics on its Internet website, provided however, that a company choosing this option must disclose its Internet address and intention to provide disclosure in this manner in its annual report;<sup>2</sup> and
- provide an undertaking in its annual report to provide a copy of its code of ethics to any person without charge upon request.

### **Disclosure of Amendments and Waivers**

Under new Item 10 to Form 8-K, a company will be required to disclose:

- any change to the company's code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions; and
- any grant of a waiver, including an implicit waiver, of a code of ethics requirement to a specified officer, the name of the person to whom the company granted the waiver and the date of the waiver.

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<sup>1</sup> On August 16, 2002, the New York Stock Exchange ("NYSE") submitted a proposal to the SEC that would require NYSE-listed companies to have a code of business conduct and ethics for directors, officers and employees similar to that under Section 406 of the Act. Any waiver of this NYSE-required code could be made only by the board of directors, or a committee of the board, and would have to be promptly disclosed to shareholders. While the NYSE proposal may yet undergo revisions before it becomes final, NYSE-listed companies should review codes of ethics with both SEC and NYSE requirements in mind. Nasdaq has filed an amended rule proposal that would require Nasdaq-listed companies to adopt a code of conduct applicable to all directors, officers and employees and to make the code of conduct publicly available. The code of conduct would have to meet the requirements of Section 406 of Sarbanes-Oxley Act and any rules issued by the SEC. Each code of conduct would require an enforcement mechanism that ensures enforcement of the code. The Nasdaq proposal also would provide that only the Board of Directors may approve any waivers of the code of ethics that are granted to executive officers or directors, and that any waivers be publicly disclosed to shareholders.

<sup>2</sup> Inclusion of the company's website address in the annual report will not, by itself, include or incorporate by reference the information on the company's website into the annual report, unless the company otherwise acts to incorporate the information by reference.

If a company elects to provide the required disclosure via Form 8-K, the Form 8-K must be filed with the SEC within five business days after the change or waiver.<sup>3</sup>

As an alternative to reporting this information on a Form 8-K, a company may post the relevant information on the company's website but only if the company had disclosed in its most recent annual report on Form 10-K or 10-KSB:

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

The instructions to the new rules state that companies do not need to disclose "technical, administrative or other non-substantive amendments" to its code of ethics. Moreover, the final rules define "waiver" as "the approval by the company of a material departure from a provision of the code of ethics" and "implicit waiver" as "the registrant's failure to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer."

### **Appointment of an Ombudsman for Violations**

The SEC has stated that companies should designate an appropriate person to receive and monitor reports of code violations or potential conflicts of interest. The SEC has not specified which person in a corporate structure should fill this role, but noted that the person (or office) should be identified in the code and such person should be of sufficient status within the company to engender respect for the code and should possess the necessary authority to deal with the persons subject to the code regardless of their status in the company. Each company will have to evaluate its own structure to determine who will be designated to fulfill such function.

### **Rules and Regulations Cites**

These new rules will be embodied in Item 406(c) of the Regulations S-K and S-B.

### **Effective Date**

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

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<sup>3</sup> In contrast to a domestic issuer, because foreign private issuers are not required to file current reports, they will not be required to promptly disclose any change to, or waiver from, the company's code of ethics for its Covered Executives. Instead, the foreign private issuer would be required to make such disclosure in its Exchange Act annual report. Nevertheless, the SEC "strongly encourages" foreign private issuers to make such prompt disclosure on a Form 6-K or on the company's website.

## **Additional Information**

If you have any questions, please call Brian Ross at (212) 818-8610 or Marci J. Frankenthaler at (212) 818-8892. We intend to provide updates to this memorandum and our previous memoranda regarding the implementation of the provisions of the Sarbanes-Oxley Act of 2002 as warranted at our website [www.graubard.com](http://www.graubard.com). When visiting our website for updates, please review the section entitled “Articles.”